AMERICAN ACADEMY of ACTUARIES

July 26, 2006

Committee on Financial Risks
International Actuarial Association
Via email to: davidk@acuvest.ie

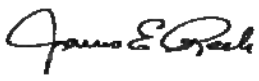
To Committee on Financial Risks,

Re: AAA comments on the IAIS Draft Supervisory Standard and Issues paper on Asset Liability Management

The American Academy of Actuaries'[1] Risk Management and Solvency Committee (RMSC) has completed a review of the May 31 drafts of the IAIS ALM Papers and prepared the attached comments in the format requested by the IAIS. It is our hope that these comments will be considered for incorporation into the IAA's comment to the IAIS.

Once again, on behalf of the American Academy of Actuaries' Risk Management and Solvency Committee, I wish to thank you for the opportunity to comment. Should you have any questions or need further information on our comments, please feel free to contact us through Tina Getachew at getachew@actuary.org or at (202) 223-8196.

Sincerely,



James E. Rech
Chairperson, AAA RMSC

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

Members and Observers Comments on IAIS Draft Papers

1) *Supervisory Standard on Asset Liability Management (ver 31 May 06*)

2) Issues Paper Asset Liability Management (ver 31 May 06)

(Comments due by 26 July 2006)

Paragraph reference	Comment
	1)*Supervisory Standard on Asset Liability Management*
8	"The key to ALM is to have the right balance between assets and liabilities…" This sentence is not clear, the paper might be proposing that the assets are suitable to the liabilities written, or assets/liabilities have appropriate characteristics.
8	Where it says "to forecast asset and liability cash flows using observable market data and appropriate financial models", the use of observable market data, where available, is advisable only for economic assumptions. For actuarial assumptions (mortality, claim runoff, etc.) they should only be used when sufficiently credible company-specific data is not available.
9	The first sentence is not relevant to this paper.
10	Contrary to the second sentence of this paragraph, ALM for certain property/casualty short-tail products do not require a close liaison between product design/pricing/valuation/marketing/IT and the investment functions. Perhaps this sentence could start off with the phrase "Except for certain products with short durations, appropriate ALM …"
13	The second sentence should say "ALM takes into consideration" rather than "ALM models", if it is intended to incorporate both life and non-life, scenario-based stress-testing as opposed to full probabilistic modelling should be included.
Req II	This requirement to use a model to project "cash flows for a range of plausible scenarios" seems to contradict paragraph 2. For an insurer that writes mostly short-tail lines, why should a model be built to produce a range of plausible scenarios, when simple scenario analysis can produce all that is needed for the company's ALM.
Req III	Editorial – change "likely" to "may likely," or change "These are likely to include:" to "These may include:"
15	We are unclear as to what the word "their" refers to in the first sentence of the first bullet? Many liability flows are not interest rate sensitive. Recommendation – change "their" to "any possible" or "the"
16	This definition of underwriting risk seems to ignore reserving risk (i.e., the risk that unpaid claim liabilities will runoff differently than estimated). This can be a significant risk for non-life insurers with long-tail claim liabilities, and is appears to be ignored by this paper. Is this in the scope of this paper?
17	This paragraph makes little sense from the non-life perspective, as when a non-life contract proves onerous the impact is on claim liabilities. The management actions listed do little to help out with this situation, and the reinsurance option mentioned may qualify as retroactive reinsurance (which is usually very limited). While there is no harm in requiring consideration of "the impact of inflation on future claims" for ALM, it is not always necessary. For short-tail non-life contracts, this is a pricing issue and not an ALM issue. For long-tail claim liabilities, the inflation subject of most concern is generally social (e.g., changing views by society and court decisions as to compensability and liability) rather than a type of CPI inflation.
25 / Req VIII	As Solvency II moves toward explicitly recognizing diversification mandates, it should be mandatory that an ALM strategy be examined at least at the local entity level, if not on a group-wide basis.
27	This section associates the technique used with the measure that management is to use in planning. That is, for more adequate capitalized companies a different measure can be used than for thinly capitalized companies. That is true; but the technique to be used to obtain the measure will generally be the same, i.e. cash-flow analysis.
38	It may be difficult for an insurer to accurately measure its ALM exposure so that changes can be implemented on a "day-to-day" basis – month-to-month is probably the most that can be expected. However, this doesn't imply that measurement tools cannot be applied more frequently than monthly even if ALM is not actually measured daily or weekly. Investments, for example, need guidance to buy assets daily.

40	In order for the Supervisory Authority to be able to review the ALM process results and to be able to obtain an independent opinion of the validity of the process and the results obtained, extensive documentation is required. Either this section should be strengthened, by detailing the type of documentation required, or the Asset Liability Management Issues Paper should include a section on documentation.
	2) Issues Paper- Asset Liability Management
12i.	The first sentence in the first bullet should be changed so that it says, "… departments *may* have an important stake …" The current wording says that such departments have an important stake, but this is not true for many non-life companies. The second bullet also has little relevance to non-life.
31	The paragraph talks about "matching assets", but this is a misnomer. The concern should be "asset/liability management", whereby the asset flows should be managed to within a certain tolerance of the expected liability flows. Given the uncertainty in the liability flows, such flows cannot be totally "matched". The last sentence should be clarified as to what type of inflation is being referenced. Where the inflation risk is "social inflation", there are no indexed assets currently available. In the U.S. for lifetime Workers' Compensation medical benefits, there is some risk of medical inflation, but there are also no indexed assets for that inflation currently available. (There are also no indexed assets for benefit utilization, which is also a major risk with regard to lifetime Workers' Compensation medical benefits.) In short, inflation is too broad a term to use without a qualifier.
35-58	Paragraphs 35 through 58 are largely theoretical. Their applicability to an in-force block of business is limited. The practical method of testing is cash flow testing. The paper provides no description of the process. For example, why all the different definitions of duration? Which ones are preferable, if any?
56/57	The holding period for VaR calculations also typically represents the length of time until a company can defease or exit the position/situation that caused the risk. Hence, it is a less than useful measure for risk exposures that take a long time to exit. It should also be noted that the probability distribution used to calculate the VaR should represent the future risk, but the calculation is frequently based on the volatility of a past period that did not include all the risks (e.g., systemic) faced in the future. Tail VaR calculations should also include consideration of such systemic risks that may not be adequately reflected in a past experience period.
58	There should be some discussion of the liquidity time horizon when discussing liquidity needs. That topic may not belong here, but it belongs somewhere in the paper. For example, a company may determine that it needs $X in one month liquidity, $Y in three month liquidity, and $Z in six month liquidity.
59	The first sentence in this paragraph should discuss management of the expected asset cash flows relative to the expected liability cash flows, not the exact match. The later paragraphs in this section discuss how the uncertainty in the liability flows makes exact matching impossible. The focus should be on cash flow management, not matching. Transparency of management's strategy, where they have taken risks, is critical. For example, either matching or mismatching strategies could be allowed depending on the specific risk appetite of management.
60	With regard to non-life cash flow needs, it is probably better to discuss large claims in general, rather than catastrophe claims. Since large catastrophes typically take a while in payouts. Consequently, it can be a long time for an investment manager dealing with day-to-day cash flows. Much more uncertainty comes from more-than-expected payouts for large cases (such as a large adverse verdict) or for an overall product line (for example, if the predicted loss ratio for a line is off by 5 to 10% of premium).
75	The wording of this paragraph should include the owning of insufficient assets along with the failure to liquidize assets in the definition of liquidity risk. As such, the definition should be made clearer. In general, all assets can be converted to cash immediately, but not always at a fair and reasonable value. Hence, liquidity risk is either the inability to meet cash needs without the inopportune sale of an illiquid asset, or the inability to sell a normally liquid asset when the need arises due to a temporary market disruption.
76	The phrase "Such factors often impact both assets and liabilities simultaneously" is generally not true for non-life. It could be fixed by saying instead "For some products, such factors may impact both …"
86	Editorial – change "maybe" to "may be".
89	Editorial – In the second sentence, should "elements the risk" be replaced with "elements of the risk"?

96	Derivatives and other liquid market instruments are an effective way to manage the risk inherent in insurance policies (explicit / implicit interest rate guarantees, equity market guarantees, etc.) Any "regulatory disincentives against the hedging program" of the company must be flexible enough to allow for the full use of capital market instruments to hedge against risks.
98	In the 5th sentence in this paragraph is a list of "examples" of those non-life product lines with year-to-year variation in claims experience. But the list is so extensive that it is hard to find a non-life product line that is not covered by the list. The example would be more effective if it included fewer product lines.
111	The paper should mention that corporate-wide ALM strategies should be aware of restrictions on movement of funds across legal entities.
ALM risk definition	This risk is defined relative to the best estimate asset flows and best estimate liability flows. As such, it seems to exclude the risk that the expected asset flows won't match the actual liability flows. Shouldn't that risk also be part of the ALM strategy?
Underwriting risk definition	This definition seems to exclude reserving risk. If so, where is that risk addressed? Should it be addressed here?