

**Member and Observer Comments on IAIS Draft Paper
Draft Guidance paper on capital requirements
(Comments due by 30 August 2007)**

Name	Paragraph reference	Comment ¹	Resolution
USA NAIC International Solvency and Accounting Working Group (hereafter "USA NAIC")	Over-all	Once again, we compliment the authors on drafting this guidance paper, noting that this was not an easy task, and thank you for all of your hard work.	
USA NAIC	Over-all	<p>Regarding the proposal to create three types of papers called standards, guidance papers, and application guidance:</p> <ul style="list-style-type: none"> • We note that the plan would be to take the key features out of the guidance papers, and with cohesive wording, then create the standards papers. We advise that the standards will need to have sufficient qualifications and explanation to be an acceptable product. • We suggest that the guidance papers and standards, and ideally even the application guidance, should be finalized and produced at the same time. This would be similar to how accounting standards are released with the implementation guidance and basis for conclusions attached to the standards. We have some worries that as we further discuss the standards over the next year and as work develops from an actuarial viewpoint over the next year, that we would find additional information that need to be covered within the guidance papers and re-modifying the guidance paper after a short time seems inappropriate. 	
USA NAIC	Over-all	<p>While the internal models and ERM guidance papers seem to have been on a little more solid footing, the capital paper has significantly evolved over time, and we suggest needs some further development. The capital paper is one of utmost importance, as one of the keys and backbone of our solvency structure, and we would suggest that an additional formal exposure would be appropriate after changes are made in Sydney. We should make sure to have sufficient due process and exposure of the paper. In addition, our fellow regulators in our jurisdiction want sufficient time to formally review and openly discuss the document after modification is made based upon this first round of formal comments and after discussion in Sydney.</p> <p>Within our attached comments we expand upon some areas we believe need to be developed further within this paper. While we believe it appropriate to move some of the discussion about capital resources to the asset and liability valuation papers, we believe some issues must be handled in these papers that do not relate to asset and</p>	

¹ Please provide comments of a more critical nature on scope and content, together with alternate drafting suggestions

		liability valuation, yet are of significant importance in the solvency structure.	
USA NAIC	5	In addition to preconditions determining the specifics of supervision, we note that policy also drives this. For example, where the different ladders of supervision should be established is a basis of policy rather than preconditions. An editorial issue: change 8 to 7 for the # of key principles.	
USA NAIC	11-13	Moving aspects related to capital resources into the asset/liability paper is appropriate. However, we note that there are some capital issues that are not related to assets/liabilities and need to be developed within this paper. We should consider whether the following issues (and likely more) fit within an asset/liability or a capital paper: subordinated debt and its treatment/valuation in the equity accounts for purposes of a company's compliance with regulatory capital requirements, Tier 2 capital, the ability to call contingent capital, restrictions on dividends, additional quality issues of capital items in regard to preferred (particularly cumulative preferred), and mandatory distributions of preferred stock. Within this discussion, the symmetry between holders and those who owe on the debt should be discussed, especially regarding whether we have issues with the values differing between these parties.	
USA NAIC	14	Do we really need the "should" regarding the development of group level capital requirements? There are other approaches to group supervision in addition to group-wide capital requirements. Why not settle on the statement in the last sentence to avoid biases toward one approach? The future work can then study this.	
USA NAIC	15	Shareholders only have a responsibility to ensure that there is adequate capital if they are owners and control the company. Regulators should not be mentioned in this same sentence. Regulators establish requirements so that the companies can ensure there is enough capital, but regulators accept a certain amount of failure in the industry and know that our requirements are not going to always catch fraud and other circumstances such that full obligations to policyholders will be met -- although that is always a target. We recommend saying regulators "should aim to ensure..." Also recommend changing "significant" to "significantly adverse": "...Capital serves to reduce the likelihood of failure due to significantly adverse losses..."	
USA NAIC	17	Add "(ORSA)" after the phrase since the acronym is used later in paragraph 34. While the acronym currently appears in a footnote, it should appear in the text since it is later used in the text. We also wonder whether it would be an appropriate use of time and financial resources for a financially solid company to calculate the costs of winding up. Perhaps a trigger should be established prior to that calculation needing to be performed.	
USA NAIC	24	Footnote: recommend changing "immediate future" to define the amount or range of time.	
USA NAIC	25	We suggest using the term "regulatory impairment" versus "regulatory insolvency". The use of the word "insolvency", even though defined differently, still leads one to think about a legal finding that has major implications on creditors' rights.	

USA NAIC	33	6 th Bullet: change “legislative” to “legal” to include aspects that could be derived from court cases.	
USA NAIC	37	This paragraph should also allow the option that PCR and MCR might be calculated by two different models, without necessarily using similar methods and approaches (although they should be consistent). Since the MCR needs to be established as a non-arguable calculation for legal purposes, there might be a need to be formulaic or deterministic calculation for the MCR, while the PCR might be driven more by internal models and be more stochastic.	
USA NAIC	Key Feature 5	We question whether this should be a regulatory requirement or an insurer’s “best practice”.	
USA NAIC	43	“...the supervisor should have the flexibility to increase vary the regulatory capital requirement calculated by the standard approach...” Shouldn’t a supervisor be allowed to reduce (compared to the amount of capital calculated by the standard approach) the regulatory capital requirement of an insurer with a low risk profile?	
USA NAIC	46	We want an insurer to be able to meet their liabilities but we do not need them to demonstrate that they can continue in business.	
USA NAIC	48	We agree that the solvency regime’s level of safety should be transparent and that the level of safety should not need to be in a prescribed format. It should be allowable for a regime to establish some regulatory capital levels calibrated to a certain representation of the marketplace. For example, the PCR could be established such that a certain percentage of companies, based on levels of capital held in the industry, would fall below the PCR. Those companies would then be required to take the first steps of developing company action plans to address their higher risk or lower capital situation. It is too prescriptive to state that the solvency regime should identify a risk measure and time horizon as that implies particular methodologies and does not allow for circumstances where stochastic modelling is not always appropriate or where sophisticated methodologies are not needed or cost-beneficial. In addition, mandatory control levels will need to be set at non-arguable levels so that regulators can take control of a company without lengthy court battles. This may only be achievable by methods that allow for less manipulation, such as formulaic methods. While these methods should still be tailored to the risks of each company, we should allow a range of methods to achieve the overall principle of having a required and transparent level of safety.	
USA NAIC	56	In the chart, the size of the risk margin block is increased as the current estimate increases after the shock. Is this an expected result, and if so, should we note that in the text?	
USA NAIC	56 Figure 2	The technical provisions bar should be labelled “technical provisions (and other liabilities)” as it correctly is in Figure 1.	