

**Member and Observer Comments on IAIS Draft Paper
Draft Guidance paper on the use of internal models by insurers
(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	An important aspect of a model prior to use for regulatory capital purposes is that the model be seasoned. An internal model should be evaluated for a few years prior to placing too much reliance on such a model. This concept should likely appear in the section under Key Feature 8 regarding approval of the use of the model.	
USA NAIC	3, Key Features 5 & 8, 40, 44	We recommend that the term "robust" be defined in the context of this paper.	
USA NAIC	4,32	Items 4 and 32 mention at the end of each paragraph expectations of production for 2008/09 by the IAA and the IAIS. Is it really appropriate to insert these work plans and specific timetables into a guidance paper? What if these deadlines are not achieved? At least these sections of the paper would then become obsolete. Consideration should be given to deleting the specifics of future work plans here and elsewhere from guidance papers unless achievement of these work plans is obviously necessary for the continued relevance of the paper.	
USA NAIC	12	The tone, if not the words in item 12, may come across as a bit simplistically presumptuous. Arriving at that point where the use of internal models is appropriate is more than simply needing "time to develop a greater understanding" within supervisory environments of lesser sophistication. There are fundamental prerequisites such as appropriate structures of corporate governance, and a legal system supportive of management accountabilities and effective supervisory enforcement. The competency and accountability of auditing, accounting and actuarial professionals must also be of sufficient measure. The demands of affording due process can be very taxing within "sophisticated jurisdictions".	
USA NAIC	13	Editorial: add "of" in "complexity of its business"	
USA NAIC	23	Since the internal model does not necessarily identify risks, perhaps modify the first two sentences: "As identified in the <i>Guidance paper on enterprise risk management for solvency purposes</i> an ERM framework should identify all reasonably foreseeable and relevant material risks that affect the insurer's business. The internal model should address those identified risks and assess the impact of those risks on its business given the possible situations that could occur."	
USA NAIC	28	Recommend adding, "A supervisory regime might also explicitly	

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

		identify some characteristics of the model (e.g. a series of stochastically generated interest rates, equity scenarios, fixed or required assumptions) which would aid comparability amongst insurers.	
USA NAIC	29	With the sentence about the 99.5% VaR, add that the target is a BB company. The 99.5% would differ if a regime chose a different company rating as the target.	
USA NAIC	40	Another sentence should be added to say, "New data may also not be of substantial use when testing the accuracy of internal modelling for items that require a long-term view of experience, such as testing the predictions of cash flows for catastrophic events.	
USA NAIC	46	We believe the paper on internal models should be independent of the particular accounting structure. Therefore, the last sentence of paragraph 46 should be deleted.	
USA NAIC	53	Suggest adding "When there is reliance on a module developed by an external vendor, the reliance should be documented, along with explanation of the appropriateness of the use of the external module."	
USA NAIC	55	In the last sentence change "require" to "need"	
USA NAIC	58	Suggest saying "In general only material changes to the model (such as...) or to the risks faced by the insurer should require it to be reassessed by the supervisor.	
USA NAIC	60	Suggest moving the last sentence to paragraph 18.	
USA NAIC	Key Feature 9, 62	The statement that "it is essential that supervisors are able to understand fully the insurers' internal models and be able to appraise their quality" is EXTREMELY important. The sobering reality is that most supervisors don't currently have the expertise, either on staff or within their consulting budgets, to do this. The IAIS might consider providing additional commentary or advice on how supervisors can develop this expertise. Just as we recommended that a model be "seasoned" before being used for regulatory capital purposes, so should a supervisor become "seasoned" in understanding and analyzing internal models before passing judgment on them.	
USA NAIC	63	This paragraph belongs in the Capital paper rather than in the internal models paper.	