To: Risk-Focused Surveillance (E) Working Group

From: Richard Piazza (LA), Chair, Casualty Actuarial and Statistical (C) Task Force

Date: May 29, 2014

Re: Comments on modifications to the NAIC Financial Condition Examiners and Financial Analysis Handbooks

Thank you for the opportunity to comment on the proposed modifications to the NAIC Financial Condition Examiners and Financial Analysis Handbooks. In general, the Casualty Actuarial and Statistical (C) Task Force is comfortable with the direction taken in these documents, especially in the context of the underlying regulator philosophy on enterprise risk management conveyed in these documents (i.e., two-way learning through frequent dialog including in-person meetings, non-prescriptive approach, emphasis on ownership, etc.).

With respect to the potential role of the actuary as part of the team participating in the ORSA review process, we believe that the actuary can make a significant contribution in, but not limited to, the following areas:

- For life insurers, compare the assumptions the company used in its risk analysis with the assumptions used in its asset adequacy analysis. There should be a level of consistency in the company’s view of its key risks;
- For all insurers, compare the statutory Total Asset Requirement (“TAR”; statutory reserves plus Company Action Level RBC) with the company’s estimates of its target capital needs. The statutory TAR represents a key measure of the company’s ability to meet possible future adverse experience and forms a barrier against removing needed capital from the company. While RBC represents minimum capital, the relationship between minimum capital and target capital should make sense to the regulator; and
- To the extent a company calculates economic or best estimate reserves in its analysis, the actuary can calculate statutory margins that could be tracked over time. A large portion of the future statutory profits of the company are embedded in the statutory margins. These statutory margins will vary by line of business and, depending on the lines of business, by era of statutory reserve requirements.

Following is a general comment pertaining to both the Financial Condition Examiners and Financial Analysis Handbooks:

- We believe that the context of long-term versus short-term liabilities, products and guarantees is relevant and should be captured. It applies to the work of actuaries, examiners and analysts. The approach to the evaluation of an ORSA might differ, for example, between life/annuity products with long-term guarantees (and, in the extreme, no (or limited) flexibility in changing premiums) and short-term products (property, automobile, etc.). Potential risk outcomes where the duration is shorter may have “more tolerance” in evaluation than for longer liabilities in view of the time horizon. In other words, we might be more tolerant of an assumption we felt was aggressive for short-term products than for long-term products.
Following are a few specific comments pertaining to both the Financial Condition Examiners and Financial Analysis Handbooks:

- Clarification of the term “far-sighted scenarios” is needed. This term is first referenced on the bottom of page five when describing the Insurers’ Risk Management Framework, Risk Culture and Governance, Managed Practices. The Subgroup reasons this may be a reference to a tail scenario, however, further clarification would be helpful.

- In the Description of the Insurers’ Risk Management Framework: Risk Culture and Governance section, a clearer contrast of Leadership Practices and Managed Practices would be helpful. The Subgroup contemplated as to how the description of “leadership practices” is a better structure than “managed practices.”

- In the Insurer’s Assessment of Risk Exposure section, we recommend more emphasis on forward-looking, prospective, and emerging risks.

- Also in the Insurer’s Assessment of Risk Exposure section, more specific guidance for the examiner on stress testing may be helpful. For example, add possible time frames and event probabilities, (e.g., is stress testing a 1-in-100 year event sufficient, or should a higher event horizon be considered?).

- Regarding the outcomes of stress testing, the Handbook may want to instruct the examiner to consider prior years’ stress test. There may be value from comparing assumptions/financial outcomes of recent prior years’ stress tests. For example, how different are the stress scenarios and risk parameter assumptions this time around from prior year(s) and why? Or, how different are the financial outcomes and why?

- It may also be helpful to capture additional information during the analyst’s review (e.g. significant changes in the product lines, processes, calculation methodologies and assumptions, key economic capital outcomes, risk appetite, tolerances, risk mitigation, management personnel over the period since the prior ORSA and reasons for the change) as found somewhere in the submissions to the regulators. While the documents do suggest this, it may be preferable to be more specific.

If you have any questions, please contact Nikki Hall (shall@naic.org), NAIC staff.