



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

30 September, 2013

Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

fsb@bis.org

Dear Sir/Madam,

Re: FSB Consultative Document on Principles for an Effective Risk Appetite Framework

We appreciate the opportunity to comment on the *FSB Consultative Document on Principles for an Effective Risk Appetite Framework*. I am pleased to transmit, on behalf of the International Actuarial Association (IAA), our comments and recommendations.

These comments have been prepared by the Insurance Regulations Committee in consultation with the Enterprise and Financial Risk Committee of the IAA. If, upon reading these comments, you identify any points that you wish to discuss or obtain further insight regarding them, please do not hesitate to contact the Chairperson of the Insurance Regulations Committee, care of the [IAA Secretariat](#). The IAA will be pleased to develop these ideas further with you.

Yours sincerely,

Kurt Wolfsdorf
President

Attachment: IAA comments

**Comments by the International Actuarial Association on the Consultative Document on
PRINCIPLES FOR AN EFFECTIVE RISK APPETITE FRAMEWORK released by the Financial
Stability Board on 17 July 2013**

International Actuarial Association and its Due Process

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our sixty-four Full Member actuarial associations, listed in [Appendix A](#) to this statement, represent more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact on the areas of expertise of actuaries.

The IAA is pleased to be given the opportunity to provide input to the Financial Stability Board on its consultative document. These comments have been prepared by the Insurance Regulation Committee in consultation with the Enterprise and Financial Risk Committee, the members of which are listed in [Appendix B](#) to this statement. It has also been subject to the due process required for it to constitute a formal view of the IAA, and will be posted to the IAA’s official web site.

General Comments

We think the paper needs to convey more explicitly the totally dynamic nature of risk capacity and risk profile. It would only make sense for risk appetite to also be highly dynamic. A dynamic, variable situation is the norm; the static situation is a rarity.

The regulatory system has not differentiated between firms with effective risk management programs that are linked to a risk appetite framework and those with ineffective risk management entertainment systems that look like risk management systems but that have no, or minimal impact on decisions and actions. Distinguishing between those two types of programs needs to be a primary goal of this effort.

It should also be realized that there are risks that get ignored, precisely because they are not quantifiable or have a lot of uncertainty as to their actual frequency. Unless a risk appetite framework is also linked to an emerging risk process, limits that were set (and acted upon) may still not prevent failure due to risks not yet quantified.

Comments on each article

II. Key Definitions

The definition of Risk Capacity on page 2 is not relevant to most insurance company situations. It defines capacity in terms of only "regulatory capital" and liquidity needs. An insurer, for example, operating in the U.S. is subject to capital requirements applied by regulators, rating agencies and an internal view of risk. The most common operative constraint in the U.S. is usually rating agency requirements (i.e., the capital required to achieve or maintain a certain financial strength rating), not regulatory requirements.

The definition of Risk Limits states that such limits are based on "forward looking assumptions". But forward looking assumptions are not part of a limit as to the maximum exposure a company may want to have from a single insured. For example, the maximum policy limit an insurer may want to sell for a single property (for property insurance) may be \$10 million, regardless of any forward looking assumptions.

III. Principles

1. Risk appetite framework

In the discussion of what an effective RAF should do, item f says that an increase in one risk limit should be counterbalanced by the reduction in another risk limit, or by an allocation of an excess in a risk limit. This ignores the possibility of expanding the firm's risk capacity so as to accommodate the increased risk limit. The discussion in item f should allow for numerous management actions to accommodate an increase in a risk limit.

2. Risk appetite statement

The document repeatedly discusses risk limits in terms of the "allocation of the firms' aggregate risk appetite statement". This does not translate well to the general insurance business. For example, we may have a risk appetite statement that strives for a certain rating and perceived financial strength even in times of stress. An insurer's risk limit may include a maximum amount at risk from any single insured or counterparty, and no new mass tort exposure. Such limits are extremely important for insurers, serving the purpose of limiting concentrations of risk exposure that would negate the entire purpose of risk pooling that is fundamental to insurance. But it is not clear that this is an "allocation" of the aggregate risk appetite. It is consistent with the risk appetite but not necessarily an allocation. The FSB's document needs to focus more on consistency with the risk appetite and less on allocation concepts.

3. Risk limits

In this section it says that risk limits should be "frequency-based". What does this mean, relative to the maximum amount at risk from a single insured?

4. Roles and responsibilities

If applied to an insurance company (especially a general insurance company), the list of officers in the first paragraph of section 4 should include the chief underwriting officer. Implementation of the RAF cannot be done without that person's contribution. (This position should also be added to the discussion later in this section.) In general, the paper should probably refer to functions rather than to positions, as the structure of these functions may vary across financial institutions.

Some of the functions assigned to "internal audit" in this paper are beyond the expertise of some internal audit departments, but are sometimes handled by other control mechanisms set up by and within a company. Is it intended that the reference to "internal audit" in this paper is to a generic control function

(that may be made up of several pieces within a company), and not necessarily to a single department? For example, some companies distinguish the internal audit control function as one that ensures that controls set in place are being followed. They then define the company ERM control responsibility as one that assess if the appropriate risk controls have been established. Since the focus of this exposure is on whether a risk appetite framework is appropriate, there may be a need to look to the ERM control functions as more relevant than those of the traditional internal audit function.

We are not sure how item 4.2.j applies to some of the risk limits that exist for general insurance, as it seems to bring the insurance supervisor/regulator into operational issues that may not have immediate solvency consequences. For example, a policy may have been written with an excessive policy limit, but could be mitigated through the purchase of reinsurance. Should/would an insurance supervisor be notified immediately of such an event, if by itself it does not threaten solvency and can be mitigated in a relatively short period? (It probably depends on how one defines "serious" in the discussion of "serious breaches of risk limits". Perhaps the term "serious" should be defined here, or another term used instead.)

Instead of bringing the regulator into that process, it would be much more valuable for the regulator to be told regularly of how the appetite, tolerance and limits had, or did not have, an impact on company decisions. A risk appetite statement and associated limits that does not have an actual impact on company decisions and actions is of no value. It is in fact the management actions in relation to the limits that serve as the most appropriate signal of an appropriate and operational risk control function.

It should be noted that within the insurance industry when there is no explicit CRO role the function is typically performed by an actuary who is advising on setting the company risk appetite and risk limits. Please refer to the IAA paper on *The Role of the Actuary*, June 2013.

http://www.actuaries.org/index.cfm?lang=EN&DSP=ABOUT&ACT=ABOUT_ACTUARIES

Appendix A

Full Member Organizations - 64

Caribbean Actuarial Association
Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires (Argentina)
Actuaries Institute Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Institut des Actuaire en Belgique (Belgique)
Aktuarsko Drustvo U Bosni I Hercegovini (Bosnia and Herzegovina)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Bulgarian Actuarial Society (Bulgaria)
Canadian Institute of Actuaries/Institut Canadien des Actuaire (Canada)
China Association of Actuaries (China)
Actuarial Institute of Chinese Taipei (Chinese Taipei)
Asociación Colombiana de Actuarios (Colombia)
Institut des Actuaire de Côte d'Ivoire (Côte D'Ivoire)
Hrvatsko Aktuarsko Drustvo (Croatia)
Cyprus Association of Actuaries (Cyprus)
Česká Společnost Aktuárů (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Eesti Aktuaaride Liit (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuaire (France)
Deutsche Aktuarvereinigung e. V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Magyar Aktuárius Társaság (Hungary)
Félag Islenskra Tryggingastærðfræðinga (Iceland)
Institute of Actuaries of India (India)
Persatuan Aktuaris Indonesia (Indonesia)
Society of Actuaries in Ireland (Ireland)
Israel Association of Actuaries (Israel)
Istituto Italiano degli Attuari (Italy)
Institute of Actuaries of Japan (Japan)
Japanese Society of Certified Pension Actuaries (Japan)
The Actuarial Society of Kenya (Kenya)
Latvijas Aktuaru Asociācija (Latvia)
Lebanese Association of Actuaries (Lebanon)
Lietuvos Aktuariju Draugija (Lithuania)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A. C. (Mexico)
Association Marocaine des Actuaire (Morocco)
Het Actuarieel Genootschap (Netherlands)

New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Pakistan Society of Actuaries (Pakistan)
Actuarial Society of the Philippines (Philippines)
Polskie Stowarzyszenie Aktuariuszy (Poland)
Instituto dos Actuários Portugueses (Portugal)
Russian Guild of Actuaries (Russia)
Udruzenje Aktuara Srbije (Serbia)
Singapore Actuarial Society (Singapore)
Slovenska Spolocnost Aktuarov (Slovakia)
Slovensko Aktuarsko Drustvo (Slovenia)
Actuarial Society of South Africa (South Africa)
Col.legi d'Actuaris de Catalunya (Spain)
Instituto de Actuarios Españoles (Spain)
Svenska Aktuarieföreningen (Sweden)
Association Suisse des Actuaires (Switzerland)
Society of Actuaries of Thailand (Thailand)
Institute and Faculty of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Professionals & Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
Society of Actuaries (United States)

Appendix B

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