May 12, 2003

Mr. Robert Esson
International Association of Insurance Supervisors
c/o Bank for International Settlements
CH-4002 Basel
Switzerland
Email: REsson@naic.org

Dear Mr. Esson,

Subject: Draft Issues Paper on Insurance Securitization

Further to my letter to you of December 5, 2002 forwarding the International Actuarial Association’s (IAA) draft comments on the Draft Issues Paper on Insurance Securitization, I am pleased to confirm that the IAA’s due process is now complete. The draft comments were approved by the Full Member associations for release as an IAA public statement, subject to certain revisions which are incorporated in the attached submission.

A copy of the final document is enclosed for your files.

Yours sincerely,

W. James MacGinnitie
President

Attachment

Jukka Rantala (Email: Jukka.Rantala@etk.fi)
Knut Hohlfeld (Email: Knut.Hohlfeld@bis.org)
Jane Lamb (Email: jane.lamb@bis.org)
A Commentary on the
DRAFT ISSUES PAPER ON INSURANCE SECURITIZATION
Released by the International Association of Insurance Supervisors: October 2002

International Actuarial Association
The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our Full Member actuarial associations exceed forty-five in number, and represent more than 95% of all actuaries practising around the world. The Full Member associations of the IAA are listed in an Appendix to this statement. 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.

Due Process
These comments have been prepared by two committees of the IAA, the members of which are listed below by name and association. These comments, which were circulated for approval to the Full Member associations of the IAA as part of our due process procedures, have been approved as a public statement of the IAA.

Members of the IAA Insurance Regulation Committee
Jukka Rantala
David Hartman
David Sandberg
Félix Arias Bergadà
Morris Chambers
Isagani de Castro
Nelson Emiliano Costa
Joubert Fereira
Rainer Führhaupter
K.S. Gopalakrishnan
Gyula Horvath
Thomas Karp
Jean-Michel Kupper
Won How Lo
Helge-Ivar Magnussen
Ibrahim Muhanna
Ryoichi Nakamura
Gennaro Olivieri
Ian Perera
Thierry Poincelin
Angus John Robertson
Norma Alicia Rosas
Simon Van Vuure
Robert E Wilcox

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Col. Legi d’Actuaris de Catalunya
Canadian Institute of Actuaries
Actuarial Society of the Philippines
Instituto Brasileiro de Actuária
Actuarial Society of South Africa
Deutsche Aktuarvereinigung e. V. (DAV)
Actuarial Society of India
Hungarian Actuarial Society
Institute of Actuaries of Australia
Association Royale des Actuaires Belges
Actuarial Institute of the Republic of China
Den Norske Aktuarforening
Cyprus Association of Actuaries, Lebanese Association of Actuaries
Institute of Actuaries of Japan
Istituto Italiano degli Attuari
New Zealand Society of Actuaries
Institut des Actuaires
Faculty of Actuaries
Colegio Nacional de Actuarios A.C.
Het Actuarieel Genootschap
Society of Actuaries; Conference of Consulting Actuaries
Members of the IAA Financial Risks Committee

David Kingston  Chairperson
Anthony Coleman    Vice-Chairperson
Jean Berthon    Institut des Actuaires
Leonardo Camozzato    Instituto Brasileiro de Atuária (IBA)
Paolo De Angelis    Istituto Italiano degli Attuari
Charles Hill    Canadian Institute of Actuaries
R Kannan    Actuarial Society of India
Christoph Krischanitz    Aktuarvereinigung Österreichs (AVÖ)
Janina Slawski    Actuarial Society of South Africa

The IAA appreciated the opportunity to respond to this paper at the draft stage. The issues surrounding “insurance-linked securitization” are of considerable interest to the actuarial profession as actuaries have been centrally involved in the technical development of many of the schemes described in the paper.

We support the development of securitization and other financing structures that can improve the efficiency of insurance systems, encourage innovation and in a competitive market can thus be expected to lower the costs of insurance. An effective regulatory framework will support this.

The Areas for Regulation
From the insurer’s viewpoint, insurance-linked securitization is a means of financing. To subsequent holders, including other insurers, the instrument is a security. We support the development of a framework of regulations to cover, among other things, the origination of the security, the value at which such a security may be held, the ways in which the security may be traded and the means by which policyholders are protected.

As the paper describes, insurance-linked securities have provided limited means for insurers to access markets traditionally reached through reinsurance. As the market for these securities continues to grow, insurers' risk management alternatives will expand beyond reinsurance. It would be useful to identify areas where regulations treat economically identical transactions in disparate fashion in order to avoid situations where regulation dictates the form rather than the substance of market activities. Clearly, the securitization of insurance risks should not relieve an insurer of the ultimate contractual liability to its policyholders.

Regulators in a number of territories have recently drawn attention to the scope for complex reinsurance transaction to cause a misunderstanding of balance sheets to the peril of investors and perhaps also policyholders (e.g. APRA’s comments in Australia concerning the failure of HIH). Full disclosure of insurance related securities in the accounts of all involved parties is essential for the operation of a healthy marketplace. All transactions of insurance related securities should be at arms length and standards should be developed for an appropriate disclosure of all such transactions, irrespective of their legal form.

Risk Pooling
A traditional approach to risk diversification has been the setting up of mutual risk pools, whereby several insurers agree to share their joint experience. Reinsurers have generally run
such pools. Insurance-linked securitization could provide the means to achieve such risk pooling more widely across financial markets. It would clearly be helpful if the regulatory framework recognized and facilitated this possibility.

Insurance-linked securitization should offer particular attractions to mutual insurers who are of course unable to raise additional capital from shareholders to finance growth. A marketable security can be constructed which provides for a loan to be raised with payment of interest and repayment on terms linked to the surplus emerging from a block of business and subordinated to the interests and ‘reasonable expectations’ of policyholders. National Provident Institution’s subordinated debt fund raising in the UK market in the early 1990’s is a well-known example to UK actuaries.

Paragraph 4 of the draft states that "Portfolio theory holds that the addition of uncorrelated risks to an investment portfolio reduces the overall risk of the portfolio." While it is true that when an uncorrelated risk is added to an existing investment portfolio that the risk of the new portfolio is less than the sum of the two separate risks before pooling, it is not true that the overall risk of the new portfolio is less than the overall risk of the old portfolio. It might be clearer to replace '...reduces the overall risk...' with '...enhances the risk-return characteristic...' and also '...diminish the overall risk...' with '...improves the risk-return characteristic...'.

**Closing Remarks**

As noted above, we believe this is an important area of development for the insurance industry and we are pleased to support the IAIS as it develops its regulatory framework.
FULL MEMBER ASSOCIATIONS OF THE IAA

Consejo Profesional de Ciencias Económicas de La Ciudad Autónoma de Buenos Aires (Argentina)
Institute of Actuaries of Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Association Royale des Actuaires Belges (Belgique)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Canadian Institute of Actuaries (Canada)
Cyprus Association of Actuaries (Cyprus)
Ceská Společnost Aktuárů (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Estonian Actuarial Society (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuaires (France)
Deutsche Aktuarvereinigung e. V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Hungarian Actuarial Society (Hungary)
Félag Islenskra Tryggingastaerdfræðinga (Iceland)
Actuarial Society of India (India)
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)
Lebanese Association of Actuaries (Lebanon)
Colegio Nacional de Actuarios A. C. (Mexico)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Actuarial Society of the Philippines (Philippines)
Polskie Stowarzyszenie Aktuarzy (Poland)
Instituto dos Actuários Portugueses (Portugal)
Academia de Actuarios de Puerto Rico (Puerto Rico)
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)
Actuarial Institute of the Republic of China (Taiwan R.O.C.)
Faculty of Actuaries (United Kingdom)
Institute of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
Society of Actuaries (United States)