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AMERICAN ACADEMY *of* ACTUARIES

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May 12, 2014

Via email to: [eyeung@naic.org](mailto:eyeung@naic.org)

Nicole Elliott  
Chair, Property/Casualty Risk-Based Capital (E) Working Group

David Altmaier  
Interim Chair, Catastrophe Risk (E) Subgroup

c/o Eva Yeung, Senior Insurance Reporting Analyst  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

Re: Reinsurance Association of America Proposal

Dear Nicole and David:

The Property/Casualty (P/C) Risk-Based Capital (RBC) Committee of the American Academy of Actuaries<sup>1</sup> is pleased to provide comments on the Reinsurance Association of America's (RAA) March 21, 2014 updated proposal, "Proposed Reinsurance Credit Risk Charge for R3, R6 & R7."<sup>2</sup>

The committee is gratified that its prior comments have been generally well-received by the RAA and that much of the committee's input is reflected in the RAA's updated recommendations.

The committee's comments below are intended to offer general support for the RAA's R3 recommendations, along with specific input that can be used to further adjust the determination of the RBC R3 load. We view the current movement to reform RBC as one step in an ongoing process.

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<sup>1</sup> The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

<sup>2</sup> The committee is particularly indebted to the following individuals for their work in drafting this response: Saeeda Behbahany, Joe Cofield, and Robert Eramo.

1. We agree with elimination of the uniform 10 percent RBC load for R3 risk. In addition to the elimination of uniformity of the RBC load, the application of 10-year S&P historical default rates are a significant improvement.
2. The margin for other risk of three percent is warranted, but further research should be done on this factor.
3. The stress load of 120 percent seems reasonable but probably needs further research to quantify properly.
4. The R3 determination for the ceding company should be adjusted for reinsurer funds payable and funds held by the ceding company. In Exhibit 1, it appears as though the heading of item 12 should read, "R3 Charge for Collateralized Amounts (Item 10 x Item 11)," and the associated total should be \$5,162,097, yielding a total ratio R3 charge of 4.72 percent. Thus the statement on page 2 that "collateral can never reduce the factor below 5 percent" appears not to be correct.
5. The committee has some reservations about not incentivizing the posting of collateral of highly rated reinsurers. Effective regulation on the matter will encourage the free arbitration of collateral agreements between the insurer and reinsurer.
6. There is no formal statement in the RAA updated proposal concerning quality of collateral. For collateral to be recognized in the reduction of the RBC R3 charge, the collateral must be credit-worthy.
7. In the matrix of the reinsurer equivalent rating group, rating group six ("Vulnerable") was determined with a 15 percent load and an additional three percent for other than credit risk in R3. The 15 percent results in the industry average being close to the industry average R3 of about 10 percent in Exhibit 3. Currently, all reinsurers with one agency rating or no agency ratings are in group six. The RAA update proposes applying a default to only the group six reinsurers that have no rating. In this scenario, reinsurers in group six will suffer a significant increase in their associated RBC R3 charge to their insurer customers. This situation may lead many of those unrated reinsurers to transfer large amounts of collateral to their reinsureds. For this reason, the NAIC may want to temper the 10 percent overall starting point for R3 RBC to avoid penalizing group 6 reinsurers.
8. For an R3 load associated with R6 and R7, reinsurance recoverable amounts in predominately property losses are short term in nature. The credit ratings of reinsurers used in the RAA study reflect an overall mix of short-term and long-term obligations. There is inherently less risk in shorter-term obligations, and that should be reflected in RBC R3 for property catastrophe. The

proposed RAA rate of 4.8 percent in Exhibit 3 is likely too high to reflect accurately the risks associated with property reinsurance.

Our comments are not intended to delay the NAIC's implementation of an RBC revision; we believe that periodic revisions of the NAIC's RBC framework are useful as part of an ongoing process. If you have any questions, please feel free to contact Lauren Pachman, the Academy's casualty policy analyst, at [pachman@actuary.org](mailto:pachman@actuary.org).

Sincerely,

Thomas S. McIntyre, FCAS, MAAA, CERA  
Chairperson, P/C Risk-Based Capital Committee  
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