AMERICAN ACADEMY *of* ACTUARIES

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January 30, 2015

Mark Birdsall
Chair, NAIC Life Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners

Dear Mark:

The American Academy of Actuaries[1] Life Capital Adequacy Committee (LCAC) appreciates the opportunity to comment on the National Association of Insurance Commissioners Life Risk Based Capital (E) Working Group (LRBCWG) exposures released for comment through January 30 (i.e., 2014 33-L Qualified, 2014 34-L Other Securities, 2014 35a-L Shortfall (Cushion), 2014 35b-L Shortfall (Cushion)).

For purposes of our commentary we organized these exposures into one of two categories:

1. Defining RBC consequence for AG48 Asset Deficiency: 2014 33-L Qualified, 2014 35a-L Shortfall (Cushion), 2014 35b-L Shortfall (Cushion)
2. Establishing RBC factors, where none exist today: 2014 34-L Other Securities

AG48 Asset Deficiency

While LCAC opposes the prescription of a qualified Actuarial Opinion via Actuarial Guideline XLVIII (AG48), we support the exposure 2014 33-L Qualified that would eliminate the RBC impact of a qualified opinion due solely to the requirements of AG48 and thus avoid additional capital requirements on products outside the scope of AG48.

Two alternatives were exposed to create an RBC consequence when an unresolved AG48 primary asset requirement deficiency exists. The first alternative would deduct the deficiency from Total Adjusted Capital (TAC). The second would add this deficiency to Authorized Control Level (ACL). Assuming that 2014 33-L Qualified is adopted, we prefer that the deficiency be recognized by adjusting TAC and thus support adoption of 2014 35a-L Shortfall (Cushion). Reducing TAC by the amount of the primary asset deficiency recognizes the AG48 shortfall dollar for dollar, and reduces the RBC ratio. Adjusting ACL would be more punitive on the RBC ratio as this adjustment would have a leveraging effect since typically most companies hold capital that is several multiples of ACL. Further, we believe that any adjustments to RBC should be risk-based and aligned with the objective of identifying weakly capitalized companies.

[1] 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.

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Establishing New RBC Factors

Generally speaking, we believe that C1 charges for assets/securities involved with policies/transactions subject to AG48 should be the same as for those with similar risks in the RBC formula. In other words, we do not see any additional investment risks for those assets/securities associated with AG48 transactions. Therefore, we agree that existing RBC factors should be used where available and that new charges should only be created to address gaps in current factors. However, we have several concerns with the 2014 34-L Other Securities exposure:

1. Introductory language for Section 1 should more clearly state (a) Scope is assets/securities involved with policies/transactions subject to AG48 and (b) Intent is to establish factors for assets that are not addressed elsewhere in the RBC formula.

2. Section 1 is for assuming entities that report or file RBC. Therefore, we do not see the need to include anything other than "other assets" in this section. Specifically, Section 1 need only include “Assets Backing Other Security: Admissible Per SSAP No. 4” and “Assets Backing Other Security: Not Admissible Per SSAP No. 4.” We suggest that the LRBCWG remove assets addressed elsewhere in the RBC formula from this section or help us better understand why this is necessary.

3. Language in footnote of Section 1 could be clarified. We suggest language such as “C1 charge is based on the Bond factor for the financing provider’s financial strength rating if available; if not available, base the C1 charge on the issuer’s credit rating. If neither financial strength rating nor issuer credit rating is available for the financing provider, then the rating should be provided by the Commissioner.”

   We also note that some instruments (e.g., LOCs) are rated by NRSROs. We suggest the use of the instrument’s rating rather than the rating of the financing provider. The rating would take into consideration the specific characteristics of the instrument and would be a better predictor of the instrument’s credit loss, as compared to the rating of the financing provider. If the instrument is not rated, then the C1 charge could be based on the hierarchy described above: financial strength rating, commissioner assigned.

4. We do not see the need for a C1 factor on policy loans because policy loans are essentially secured. Repayment of policy loans is assured via the contract between the policyholder and the insurer.

5. We suggest that line [59] be amended to read Affiliate **or Parental** Guarantees.

6. Section 2 applies in the situation where the assuming entity does not report or file RBC. We think that a full listing of primary and other assets would be required for the ceding company to complete sections 2. Additional information may be required for other components of RBC to be developed (e.g., C2, C3, C4). However further comment is not possible until Section 2 is exposed or the LRBCWG’s intent is better understood.

7. For both sections it is not clear how the exposures will be aggregated with or incorporated

into the RBC in aggregate. We believe it makes sense for the Section 1 results to be part of C1 and flow through the covariance calculation.

The LCAC is available to answer your questions and continue a dialogue with the LRBCWG regarding this proposal. If you have any questions or would like to discuss this letter in more detail, please contact Brian Widuch, the Academy's life policy analyst (widuch@actuary.org; 202-223-8196).

Sincerely,

Jeffrey Johnson, MAAA, FSA
Chairperson
Life Capital Adequacy Committee
American Academy of Actuaries