American Academy of Actuaries
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October 29, 2018

Mr. Stephen Wiest
Chair, Operational Risk (E) Subgroup
National Association of Insurance Commissioners ("NAIC")

Re: Commentary on the Exposed Life Risk-Based Capital ("LRBC") Growth Charge Proposal

Mr. Wiest,

The Operational Risk ("OR") Work Group of the American Academy of Actuaries'[1] Life Practice Council offers the following comments as a follow-up to our previous letters and discussions surrounding a growth component to be potentially incorporated into the LRBC framework (an operational risk growth charge, or "growth charge"). We are pleased to respond to the growth charge proposal exposed by the Operational Risk Subgroup in a memorandum dated August 20, 2018, by providing our brief commentary. In addition, the Operational Risk Subgroup exposed a document for comment on that same date entitled, "Collecting Operational Risk Data;" we will provide brief commentary on that document herein as well.

Response to the August 20, 2018 Operational Subgroup Memorandum: Alternative Approach for Growth Risk Treatment in Life Risk-Based Capital – Enhanced Add-On Approach

- The OR Work Group, in its comment letter dated June 6, 2018, stated that a growth charge is not needed in the LRBC framework and detailed the reasons. We believe that these points should continue to be considered in growth risk charge discussions. Should the NAIC move forward with an explicit LRBC charge for growth, we recommend that it be based on some characteristics of growth (for example, X percent increase in reserves year-over-year), rather than being just a general 1.5 percent further increase in RBC applied to all companies.

- As the NAIC Subgroup and Working Groups continue to evaluate the need for a growth risk charge before any proposal is adopted and we would be happy to present the points expressed in our letter.

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

- We additionally note the strong possibility of unintended consequences with respect to the exposed approach (e.g., scenarios where the charge actually decreases when companies have periods of high growth).

<u>Response to the August 20, 2018 Operational Risk Subgroup Document: Collecting Operational Risk Data</u>

There has been an ongoing discussion of the concept of an operational risk loss database, which would be prospectively maintained by the NAIC. In response to the document exposed, we provide the following key considerations:

  - We do believe that assembling and maintaining an Operational Risk Loss Database is sound in concept and a good thing to develop.

  - We note that there has been considerable effort under various regulatory paradigms as well as independent firms such as ORX and ORIC to identify, define, measure, and interpret OR loss data, which could be considered if the NAIC was to endeavor to create an OR database.

  - We'd also note that the discussions of operational risk stresses, including past losses and expected losses, included in ORSA reports for most organizations lay out useful OR loss information, which could be considered if the NAIC was to endeavor to create an OR database.

  - We believe that creating an OR database would be challenging, and that its effectiveness depends on properly identifying, defining, measuring, and interpreting the OR loss data[DJN1].

  - Finally, we'd note that the credibility, consistency, and meaning of OR loss data collected should all be carefully evaluated in advance of pursuing any type of regulatory change action.

<u>Conclusion</u>

We continue to believe that there is not a need for a separate growth charge in LRBC. The longer duration nature of the life business, the fact that the current LRBC factors already implicitly address growth, and the other, much more effective tools which regulators have at their disposal to address growth, all support this view.

We also believe that creating an OR loss database would be a useful, but very challenging undertaking, and that it is of paramount importance to evaluate the credibility, consistency, and applicability of that data before pursuing any regulatory change action with respect to operational risk.

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Thank you for the opportunity to comment. If you have any questions or would like to further discuss these comments, please contact Ian Trepanier (trepanier@actuary.org), life policy analyst at the American Academy of Actuaries.

Sincerely,

Brian O'Neill, MAAA, FSA, CFA, CERA,
Chairperson, Operational Risk Work Group
American Academy of Actuaries

Cc: Lou Felice, Solvency and Capital Policy Advisor, NAIC
Philip Barlow, Chair, NAIC Life RBC Working Group