



AMERICAN ACADEMY of ACTUARIES

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May 19, 2015

Ms. Elaine Wieche
Chair, Investment Risk Based Capital (E) Working Group
c/o Ed Toy, Director, Capital Markets Bureau
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Asset Risk Factors for Health RBC Formula

Dear Ms. Wieche,

On behalf of the American Academy of Actuaries' Health Solvency Work Group (HSWG),¹ I would like to provide the National Association of Insurance Commissioners (NAIC) with an update on the evaluation of the asset risk factors for the health risk-based capital (HRBC) formula. After some preliminary review and discussion, the HSWG will provide a recommendation of the bond factors used in the Health RBC formula.

The HSWG recognizes the following approaches could be employed in the review of the bond factors:

- Maintain the current bond factors and provide the rationale for the status quo;
- Accept the recommendation of the Academy's Life C1 Work Group regarding bond factors without modification; or
- Leverage the modeling work completed by the Academy's Life C1 Work Group, but update the modeling for known differences between health and life business.

The HSWG recommends that we move forward with the last option. This will provide for a consistent basis of the bond factor development between health and life while recognizing and accounting for differences in the underlying characteristics of the business. The HSWG will analyze and develop a set of bond factors for all rating classes, but we anticipate following the same structure for bond classes as being recommended by the Life C1 Work Group. The most critical differences between health and life business and the supporting liabilities that will need to be evaluated include:

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.

- The HSWG will need to discuss the implications of most health business having materially shorter liabilities and how this may influence the selected time horizon in determining the default rates in the model.
- It is important to note that statutory policy reserves for life insurance include some provision for expected credit losses given a default. Therefore, the life C-1 bond model reflects an offset for the expected loss included in statutory policy reserves. The health bond model would need to remove the effect of this offset.
- Finally, the health bond model would need to recognize the pre-tax basis of the Health RBC factors.

The Life C1 Work Group is targeting completion of their model validation process in early summer. Once that process is completed, the HSWG will review the model and documentation to assess the necessary changes to make the model appropriate for HRBC. We anticipate completing this review and revising the model by the end of the fourth quarter. Preliminary proposed factors could be presented to the NAIC by the end of the first quarter of 2016.

Currently the bond, preferred stock, and hybrid securities utilize the same risk factors in the HRBC formula. Therefore, any changes made to the bond factors also will be applied to preferred stock and hybrid securities.

The HSWG recognizes that not all asset risk factors are addressed by this update. However, we wanted to limit this initial scope in order to ensure progress is made. Other asset factors can be evaluated in the future.

The HSWG appreciates the opportunity to provide an update to the NAIC on this important endeavor to evaluate and update, as appropriate, the various assets factors for the HRBC formula. Should you have any questions, do not hesitate to contact Tim Mahony, state health policy analyst at 202.223.8196, or Mahony@actuary.org.

Sincerely,

Tim Deno, MAAA, FSA
Chairperson, Health Solvency Work Group
American Academy of Actuaries