

Life Risk-Based Capital Operational Risk Charge Consideration

American Academy of Actuaries Life Operational Risk Work Group

The American Academy of Actuaries' (Academy) Life Operational Risk (OR) Work Group has been discussing, analyzing, and thinking through the proposed change to Life Risk Based Capital (LRBC) the NAIC has exposed. As part of our analysis, we have created illustrative examples that flesh out the LRBC calculations for sample companies.

In these examples, we analyzed whether there might be the unintended consequence of double-counting parts of LRBC in situations in which:

- i) A parent company cedes business to a subsidiary, or
- ii) A subsidiary writes business directly, and rolls up into a parent

We have also come to understand, through conversations with Lou Felice and in listening to the NAIC's Operational Risk Subgroup calls, that, in the exposed LRBC proposal:

- i) The C0 factor assumed by a parent will not include the Basic OR charge of the subsidiary, and
- ii) The basic OR calculation of the parent will also, therefore, not include the Basic OR charge of the subsidiary

We believe that such treatment prevents double counting of LRBC for the large majority of cases we analyzed in our illustrative examples, and we continue to be very appreciative of the NAIC's patience and ongoing consideration of any of our comments. However, as illustrated in the next slide, there is still potential for double counting in a situation when a subsidiary writes business directly, and rolls up into a parent. To address this, we'd simply recommend making the following minor adjustment:

- i) Include the C4 charge of a subsidiary when calculating the C4 offset in determining the basic OR charge (see next slide)



Life Risk-Based Capital Operational Risk Charge Consideration

American Academy of Actuaries Life Operational Risk Work Group

Proposed approach for addressing OR when sub writes direct business							
		<u>All Business retained in Parent</u>	<u>Parent and Subsidiary both write direct business (assumed 50/50 split)</u>		<u>Revised OR Approach</u>		
			Parent	Sub	Parent	Sub	
C1		600.0	300.0	300.0	300.0	300.0	300.0
C2		60.0	30.0	30.0	30.0	30.0	30.0
C3		200.0	100.0	100.0	100.0	100.0	100.0
C4		20.0	10.0	10.0	10.0	10.0	10.0
C0 = CAL of sub excluding OR of sub		-	411.1	-	411.1	-	-
Prelim CAL		822.2	822.2	411.1	822.2	411.1	411.1
OR before C4 offset = 3% of Prelim CAL		24.7	24.7	12.3	24.7	12.3	12.3
C4 Offset		20.0	10.0	10.0	20.0	10.0	10.0
OR after C4 offset		4.7	14.7	2.3	4.7	2.3	2.3
Final CAL		826.9	836.9	413.5	826.9	413.5	413.5
* Include the C4 charge of the sub when calculating the C4 offset in the parent.							

Because the C4 offset is only 10, the final OR charge increases by 10

When we include the C4 of the subsidiary in the offset calculation, the final total CAL is not impacted by corporate structure

