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February 14, 2020

Mr. Tom Botsko
Chair, Capital Adequacy (E) Task Force
National Association of Insurance Commissioners (NAIC)
Via email to: Jane Barr, NAIC Staff (JBarr@naic.org)

RE: RBC Proposal 2019-16-1—Incorporate 20 designations for bonds

Dear Tom,

On behalf of the C-1 Work Group (C1WG) of the American Academy of Actuaries,[1] we appreciate the opportunity to provide comments on the Capital Adequacy (E) Task Force (CADTF) proposal to expand the number of bond factors in the Life Risk-Based Capital (LRBC) formula. We support the expansion of the bond designations to better capture the credit risk within an insurer's portfolio. Generally, we recommend the expansion to a 20-factor structure for any asset type that currently utilizes a six-factor structure.

This expansion also facilitates the calculation of LRBC based on the C-1 bond factors recommended by the C1WG. Expanding to the 20 designations would eliminate the large jumps in the LRBC factors between NAIC bond designations.

The exposure does not expand the number of C-1 factors for all asset types that currently utilize a six-factor calculation structure for C-1 and retains the current six-factor calculation. The LRBC C-1 calculation for bonds and preferred stock reported on Schedule D relies on a security's designation, primarily assigned by a Nationally Recognized Statistical Rating Organization (NRSRO) with certain exemptions. Generally, NRSROs base their assigned rating on a Global Ratings Process, where risk differences are theoretically neutralized and result in equivalent ratings. In the Global Ratings Processes, different asset types with similar credit loss characteristics will receive equivalent ratings. The C1WG's analysis that support an expansion from six to 20 factors recognizes this anticipated equivalence in the Global Ratings Process. The C1WG supports the consistent application of C1 RBC factors for assets subject to the Global Ratings Process. We see no reason to simplify the C1 calculation, especially in light of the electronic data feeds that underlie the LRBC calculation.

[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.

To expand on the point above, the exposure does not expand the designations for unaffiliated preferred stock (LR005, lines 1-6), Surplus and Capital Notes (LR008) or Derivative Instruments (LR017, lines 16-23). The methodologies used by NRSROs for assigning ratings for preferred stock and surplus/capital notes are similar to the methodologies used for bonds; therefore, using the same C-1 factors is appropriate. Derivatives are used to hedge the credit risk of an insurer's bond portfolio. As such, it would be logical to align the number of designations for the bonds and derivatives.

The exposure would delete the lines for the C-1 calculation for hybrid securities. We assume the reason for this proposed deletion is to simplify the LRBC spreadsheet, rather than to change the required capital for hybrid securities. It would be useful to note the reason for this deletion (e.g., hybrids are included in the Bond Asset Valuation Reserve (AVR) Component, and therefore, included in LR002, lines for Long-term Bonds).

The exposure is not expanding the number of factors for Separate Accounts with Guarantees or Synthetic Guaranteed Investment Contracts (GICs) (LR006). The Separate Accounts that utilize fixed income assets can hold identical assets to those in the General Account. Similarly, Synthetic GICs, which provide guarantees to trusts held external to life insurance companies, also utilize fixed income assets. The C1WG recommends the expansion to the 20-factor structure for Separate Accounts with Guarantees (LR006, line 1 Indexed Class I Strategies and lines 2-3) and Synthetic GICs (LR006, line 8). We note that this calculation for Separate Account Guarantees originates from company records and is not explicitly detailed in the LRBC Instructions; however, we believe that it should be understood that companies performing this calculation will replace the six-factor structure with the 20-factor structure for that purpose.

Expanding to the 20-factor designation structure for all asset types that currently use the six-factor structure is an important step to improving the calculation of required capital. We understand that the AVR blank will be modified to support the expansion of the 20 factors. We support adoption of the AVR and LRBC changes at the same time.

Thank you for your consideration of our comments. Please contact Nancy Bennett (bennett@actuary.org) with any questions.

Sincerely,

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Co-chairperson, C-1 Work Group
American Academy of Actuaries

Jerry Holman, MAAA, FSA, CFA
Co-chairperson, C-1Work Group
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Copy: Kevin Fry, Chair, NAIC Investment Risk-Based Capital (E) Work Group