American Academy of Actuaries

July 24, 2025

Director Judith French (OH), Co-Chair
Commissioner Nathan Houdek (WI), Co-Chair
Risk-Based Capital Model Governance (EX) Task Force
National Association of Insurance Commissioners

Re: Request for comments on proposed preliminary Risk-Based Capital principles and questions

Dear Director French and Commissioner Houdek:

On behalf Life Practice Council (LPC), Health Practice Council (HPC), Casualty Practice Council (CPC), and Risk Management and Financial Reporting Council (RMFRC) of the American Academy of Actuaries (Academy),[1],we appreciate the opportunity to offer the following comments to the Risk-Based Capital (RBC) Model Governance (EX) Task Force (Task Force) on the principles and questions outlined in the request for comments on the proposed preliminary RBC principles and questions. These comments reflect the actuarial perspectives and expertise of our volunteers across the health, life, property/casualty, and financial reporting and risk management lines of business.

Questions that the principles and broader framework should be used for guidance:

1. *When should a particular risk be addressed in the RBC model?*

   When it is a material industry risk.

2. *What level and type of data and analysis are needed to support the setting of capital factors?*

   We encourage the use of sound actuarial practices to estimate risk and the associated charges for that risk, guided by applicable actuarial standards of practice. This may involve the use of credible historical data on loss distributions, which can be used to estimate losses at a defined confidence level. It may also involve fitting less robust data into a distribution to estimate those losses. In addition, anticipated impacts of changes in the risk since the data period are also important to consider. The exact data and analysis will depend on the individual risk and the data available. We encourage as much consistency of approach as possible while still considering how the risk manifests as well as the credibility and reliability of data.

3. *How should new and emerging risks and asset types be treated if a capital framework has not yet been developed for them?*

   We believe the same actuarially sound approaches should be used for new and emerging risks. In other words, they should be assessed appropriately and added to the capital framework once a sound capital approach is developed. If there is a desire to capture emerging risks generally, which may not be incorporated into RBC quickly, a general margin approach on top of the developed factors could be considered.

[1] The American Academy of Actuaries is a 20,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For 60 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.

4. *What level of statistical safety is to be targeted by the model or, if not, a single target, and how should such tailored safety targets be determined?*

   We believe that the regulatory community should determine the desired safety level. Such a target should be consistent across companies and risks, consider diversification across risks, and appropriately capture tail risks, which may mean that at least some risks require a conditional tail expectation rather than a point estimate to capture "fat tails."

5. *When should the calibration of risks to capital factors be re-evaluated?*

   We recommend a periodic reevaluation, such as every 10 years.

6. *How should the RBC calculations define and structure governance over model risk, including model development, documentation standards, validation, ongoing monitoring, and change management?*

   We recommend leveraging the model risk governance frameworks that are currently available, which includes Actuarial Standard of Practice No. 56, *Modeling* (ASOP 56).

7. *To what extent should RBC calculations align with Statutory Accounting Principles (SAP)? If alignment is pursued, how should the framework account for, say, valuation differences between directly held assets and securitized exposures, and how might these differences influence investment behavior or regulatory arbitrage?*

   Aligning the calculations with amounts in the Statutory Statements creates auditability, which is a desirable characteristic. However, we recognize that there may be risks that require going beyond Statutory Statement values and factors in order to capture the risk well. An example of this includes incorporating risks for variable annuities, as we have today with C3 Phase 2. However, that tradeoff should be carefully considered. If there are accounting issues that drive significant regulatory arbitrage due to the capital charges, it is possible that an alternative method for determining capital would be needed. It is also possible that the underlying accounting requirements should be reconsidered.

8. *How should reserves, valuation adjustments, or offsets (e.g., taxes or discounting) be considered?*

   Capital should cover risks beyond those already accounted for in the starting balance sheet. For example, if reserves are set at one standard deviation beyond the mean, then capital would be from one standard deviation to whatever the desired confidence level (i.e. no double counting). Diversification should be considered.

9. *How should existing principles (e.g., the American Academy of Actuaries' Principles for Structured Securities RBC), which regulators have endorsed, fit into the principles?*

   In general, RBC should be designed so that it does not violate existing principles. In the event there is a conflict between having the RBC fit into RBC principles versus having it not violate existing principles, then both sets of principles may need to be reevaluated.

10. *How should interaction/co-dependence of factors (e.g., C-1/C-3 and RBC Covariance) be recognized and treated?*

    Risk diversification should be considered. However, we suggest balancing the approach to diversification with ease of understanding and auditability.

In addition to the responses to the proposed questions above, we offer the following comments on the proposed preliminary RBC principles.

<u>Proposed preliminary RBC principles, applied by company type</u>:

1. *Use of RBC calculations.* Since RBC principles cannot necessarily dictate what RBC calculations are

used for, we recommend the following revisions:

1. **Use of RBC calculations.** RBC is intended to be used as a regulatory tool ~~only~~ to identify potentially weakly capitalized companies. RBC provides regulators with legal permission and/or requirements to intervene at various RBC levels.

   1.A.ii. **RBC calculations should secondarily acknowledge their impact on product availability that meets consumer needs.** In considering the appropriate safety level for RBC, the balance between protecting solvency and maintaining affordable insurance products should be considered. -RBC charges should be sufficiently granular to recognize material differences in risk~~, particularly when they may materially affect insurer decisions that impact meeting consumer needs~~.

   1.~~a~~A.iv. **Identified risk.** Where identifiable, RBC should include all industry risks that may be material to solvency. In the event one of these risks is excluded (i.e., it is hard to quantify the risk), that should be documented. ~~charges should reflect measurable differences in risks that can impact solvency. The risks captured or not captured within RBC calculations should be identified. Adjustments should offset material risks that are captured in multiple calculations.~~

   1.B. **Insurance groups and global competitiveness.** While RBC calculations are designed to identify potentially weakly capitalized companies, ~~they should be acknowledged as a component~~they should be developed with the goal of having them acknowledged as a component of assessing capital adequacy for insurance groups, including those active internationally.

2. **Objectivity.** RBC charges should be objective and measured at a consistent statistical safety level. RBC charges should reflect the risk exposure they are intended to measure, capturing differences in their risk distributions, with appropriate considerations for concentration, diversification, and tail risks. ~~They should recognize differences in accounting, reserving requirements, and other offsets (e.g., taxes or discounting) and consider overall business practices and their treatment within the framework (e.g., hedging strategies)~~RBC charges should reflect the risk of impairment to the entity's statutory surplus. While accounting values may be used in the calculation for simplicity and auditability, the RBC framework should aim to produce RBC amounts that are consistent across risks based on the desired safety level and should not be inappropriately skewed due to accounting differences.

   While we agree that RBC should not dis-incentivize good risk-management practices, we do not necessarily believe that RBC should consider overall business practices and their treatment within the framework. Different safety levels may be suitable for different risk charges in some cases, such as for risks with substantially different time horizons. Note that currently Rcat, which focuses on natural catastrophes, is calibrated to the 100-year return period since insurers typically know their ultimate losses fairly accurately within a year of the event. -R4 and R5, on the other hand, are calibrated to the nine- or 10-year return period, due to the longer horizon.

3. **Consistency with Statutory Accounting.** RBC charges should be derived from values reported in the statutory annual statement.

Given that in some cases it will not be possible to get an appropriate risk charge using the annual statement values, we suggest this addition to allow for alternatives in those cases.

4. **Emerging Risks.**

We suggest further clarifying what is meant by “industry segment exposure.”

5. **Changes to RBC calculations**.

We agree with this principle and reiterate our support for a transparent, collaborative process.

5. B. ***Equal Capital for Equal Risk.***

The current P&C RBC formula has examples which seem to conflict with the concept of equal capital for equal risk. Our understanding is that when P&C RBC was introduced, it was observed that larger insurers generally had lower risk than smaller insurers (per dollar of premium, for a given line of business). Despite that observation, the NAIC decided not to stratify P&C RBC charges for reserve risk and premium risk by insurer size/volume, to avoid making it more onerous for smaller insurers to operate.

6. **Governance.** ~~Components of~~ RBC calculations should adhere to Model Governance Standards that provide processes for model development, documentation standards, validation, ongoing monitoring, and change management. The calculations should be understandable and auditable by regulators. ~~This ensures that future adjustments align with guiding principles and supporting guidelines.~~

We recommend the deletion of the final sentence, as having understandable calculations will not necessarily ensure that future adjustments align with the principles. We propose ASOP No. 56 as a good resource for setting up model governance standards. Further, we believe that the principles should state that the NAIC serves as the repository for RBC data.

We would welcome the opportunity to discuss these comments and remain committed to continuing public dialogue and collaborative efforts as the Task Force continues its work. If you have any questions or would like to discuss these comments further, please contact Katie Dzurec, Public Policy Outreach (State) Director (dzurec@actuary.org).

Sincerely,

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