

## **CAPITAL ADEQUACY (E) TASK FORCE**

Capital Adequacy (E) Task Force Oct. 19, 2010, Minutes

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Capital Adequacy (E) Task Force  
Orlando, FL  
October 19, 2010

The Capital Adequacy (E) Task Force met in Orlando, FL, Oct. 19, 2010. The following Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Gennet Purcell, Vice Chair, represented by Philip Barlow (DC); Jim L. Ridling represented by Richard Ford (AL); Steve Poizner represented by Ron Dahlquist and Perry Kupferman (CA); Thomas R. Sullivan represented by Richard Marcks (CT); Karen Weldin Stewart represented by Al Franz (DE); Kevin M. McCarty represented by Al Willis and Kerry Krantz (FL); John P. Camacho represented by John Carlos (GU); Glenn Wilson represented by Blaine Shepherd (MN); Brett J. Barratt represented by William McCune (NV); Mary Jo Hudson represented by Dale Bruggeman (OH); Robert L. Pratter represented by Steve Johnson (PA); Scott H. Richardson represented by Leslie Jones (SC); Neal T. Gooch represented by Jake Garn (UT); Mike Kreidler represented by Patrick McNaughton (WA); and Sean Dilweg represented by Peter Medley (WI). Also participating were: Alan Seeley (NM); and Anne Kelly (NY).

1. Receive the Report of the Property Risk-Based Capital (E) Working Group

Ms. Kelly said the Property Risk-Based Capital (E) Working Group had asked the American Academy of Actuaries (AAA) to review the underlying methodology for calculating the underwriting risk for the reinsurance lines of business. She said it was agreed that the AAA would provide regular updates on the project to provide greater transparency. The Working Group will address an issue regarding run-off companies. The run-off companies can trigger the risk-based capital (RBC) growth charge, which was intended for companies with expanding business. Mr. Medley made a motion to adopt the report of the Property Risk-Based Capital (E) Working Group (Attachment One). Mr. Ford seconded the motion. The motion passed unanimously.

2. Adopt the Report of the Health Risk-Based Capital (E) Working Group

Mr. McNaughton said the Health Risk-Based Capital (E) Working Group had released for comment an annual statement blanks proposal to clarify the annual statement instructions for the classification of certain health receivables. He said this was in response to the anticipated impact on RBC of federal health care reform. He said further discussion would be needed regarding the health RBC covariance formula. He said the Working Group was looking for feedback from the AAA regarding industry concentration and the impact of health care reform. Mr. McNaughton made a motion to adopt the report of the Health Risk-Based Capital (E) Working Group (Attachment Two). Mr. Ford seconded the motion. The motion passed unanimously.

3. Adopt the Report of the Life Risk-Based Capital (E) Working Group

Mr. Barlow said an update had been received from the American Council of Life Insurers (ACLI) regarding the commercial mortgage loan proposal. A Life Risk-Based Capital (E) Working Group conference call would be scheduled to finalize the modeling assumptions and methodology. He said it was unlikely the mortgage loan project would be completed for year-end 2011 life RBC, but would probably be completed for year-end 2012 life RBC. He said the Working Group had released for a 30-day comment period a proposal for derivatives risk mitigation and made a referral to the Statutory Accounting Principles (E) Working Group. The Working Group would attempt to address all outstanding issues for C-3 Phase 3 prior to the 2011 Spring National Meeting.

Mr. Barlow said the Working Group had adopted a life RBC proposal from New York Life regarding non-U.S. affiliates. He said the Working Group had discussed changing the life RBC trend test percentage from 250% to 300%. While the Working Group did not disagree with the proposal, the numbers of companies did not appear to be significant enough to justify a change on its own. The proposal will be revisited if another change in the model law was being considered. He said it had been discussed that the Working Group would be coordinating and receiving updates regarding issues that affected life reserves and capital, replacing the Capital Adequacy (E) Task Force/Life and Health Actuarial Task Force Joint Subgroup. Finally, the Working Group had decided that the Working Group chair would draft a comment letter regarding the final AAA deferred tax asset report. Mr. Barlow made a motion to adopt the report of the Life Risk-Based Capital (E) Working Group (Attachment Three). Mr. Marcks seconded the motion. The motion passed unanimously.

4. Release for Comment a Model Law Request Form Related to the Life RBC Trend Test

Mr. Johnson said he did not agree with the conclusion of the Life Risk-Based Capital (E) Working Group regarding the life RBC trend test. He said it was not the number of companies identified but who the companies were. He said the calculation

would be catching companies who really should have a capital plan. In addition, he said the *Risk-Based Capital (RBC) for Health Organizations Model Act* (#315) was being changed to implement a trend test.

Mr. Felice said he agreed that the real issue was whether to require that jurisdictions make the change. He said the change to the health RBC formula would be an upgrade in the 34 or so jurisdictions had already adopted the model act. The life RBC model had already been implemented in more than 50 jurisdictions. He said changes as a result of the Solvency Modernization Initiative (SMI) might also change the model act. Mr. Johnson said he thought the SMI changes would be further down the road. He said regulators should continue to show progress in updating the RBC calculations.

Mr. Barlow said he thought the life RBC was effectively doing the job intended. He said he did not think the trend test proposal would materially improve the quality of the RBC. He said there were other areas of the RBC calculation where time would be better spent addressing those issues rather than this one. Mr. Johnson said he did not think a lot of time would be needed for the proposal. He said he did not also think it would be a big deal for the states to update their RBC statutes.

Mr. Johnson made a motion to have NAIC staff draft language to change the life trend test percentage from 250% to 300% for a comment period of 30 days and then have a conference call of the Task Force to address sending a model law request to the Financial Condition (E) Committee. Mr. Medley seconded the motion. The motion passed. Mr. Barlow opposed the motion.

#### 5. Discuss the Final AAA Deferred Tax Assets Report

Mr. Felice said the Task Force had released the final AAA deferred tax asset report for a 30-day comment period during its Oct. 6 Task Force conference call. He encouraged comments on the proposal to be submitted.

#### 6. Receive the Update from the C-3 Phase 2 Results (E) Subgroup

Mr. Barlow said the C-3 Phase 2 Results (E) Subgroup had agreed to review the work Oliver Wyman was doing, along with taking a broader look at the C-3 Phase 2 calculation. He said the Subgroup anticipated having several upcoming conference calls, including some open calls. Mr. Shepherd made a motion to receive the report of the C-3 Phase 2 Results (E) Subgroup. Mr. Ford seconded the motion. The motion passed unanimously.

#### 7. Adopt the 2011 Proposed Task Force Charges

Mr. Felice asked if there were any additions or changes needed to the Task Force's 2011 Proposed Charges. Mr. Medley asked whether fraternal should be added to the RBC business types specified in the first charge regarding RBC formula refinements. Mr. Felice agreed. Mr. Medley made a motion to adopt the 2011 Proposed Charges (Attachment Four) with a change to include fraternal RBC in the first charge. Mr. Shepherd seconded the motion. The motion passed unanimously.

#### 8. Receive the Update from the Solvency Modernization Initiative RBC (E) Subgroup

Mr. Seeley said the Solvency Modernization Initiative RBC (E) Subgroup held a meeting Oct. 17. During the meeting, a presentation was made by the Bermuda Monetary Authority regarding the recently completed Bermuda Solvency Capital Requirement. Bermuda had gone into details about the calibration, time horizon, stress testing, etc. He said the Subgroup's detailed work plan was discussed and several items were added. A letter was sent to the AAA and a response was received back indicating a willingness to assist in a number of ways. The AAA felt it would more of a regulator responsibility to determine calibrations targets. Mr. Seeley said there were two potential courses of action for determining calibration. First would be to look at different common calibration targets for other jurisdictions. A second approach would be to use internal models of large insurers to look at the calibration of the current RBC formula. He said the Subgroup would need a few conference calls before the Spring National Meeting to continue its work.

Mr. Felice said he agreed that there were a number of decision points on how to move forward. He said it did not matter to him whether a top-down approach was used for calibration or whether a segmented improvement of individual risk categories and then later looking at the calculation as a whole. He asked the Task Force to consider which approach might be best. He said the Task Force should provide as much guidance as possible to the Subgroup. Mr. Ford made a motion to receive the report of the Solvency Modernization Initiative RBC (E) Subgroup (Attachment Five). Mr. Marcks seconded the motion. The motion passed unanimously.

9. Receive the Referral from the Rating Agency (E) Working Group

Mr. Felice said the Rating Agency (E) Working Group had made a number of recommendations to different groups. He said four items had been referred to the Task Force to review. He said the second item regarding a comprehensive review of the RBC formula, including greater granularity and risk analysis is currently being reviewed by the Solvency Modernization Initiative RBC (E) Subgroup. The fourth item regarding the asset valuation reserve would probably be assigned to the Life Risk-Based Capital (E) Working Group, in consultation with the Invested Asset (E) Working Group. Mr. Felice asked the Task Force to review the working agenda between now and the end of November. Consideration would need to be given whether the items should be added to the Task Force's working agenda. Mr. Felice asked NAIC staff to redistribute the working agenda for review by the Task Force after adding those items. A fuller discussion would be held in a conference call when the working agenda was addressed. Mr. Franz made a motion to receive the referral of the Rating Agency (E) Working Group. Mr. Ford seconded the motion. The motion passed unanimously.

10. Discuss Fraternal RBC

Mr. Felice said not a lot of progress had been made regarding fraternal RBC due to other priorities. He said NAIC staff should draft the changes needed to the fraternal RBC formula as soon as possible. Mr. Johnson said he no longer thought a model act for fraternal RBC was necessary. He said the states that wanted to bring in fraternal companies should use their life RBC statute to do so. He said there were not enough states with domiciled fraternal companies to justify a separate model act. He said work needed to continue to maintain the fraternal RBC formula. Mr. Felice agreed that the Task Force needed to give the states a tool to use to take regulatory action. He said a number of the states were moving along with their own statutes and a limited number of states had already implemented statutes.

Mr. Shepherd said he had discussions with a fraternal actuary regarding parts of the fraternal RBC formula that should be reviewed including tax factors and fraternal expenses. He thought it was important that the Task Force move forward with reviewing the fraternal RBC formula. Mr. Felice asked Mr. Shepherd and any other interested regulators to work with NAIC staff on addressing changes needed to the fraternal RBC formula.

11. Adopt Interim Minutes

Mr. Johnson made a motion to adopt the Oct. 6 (Attachment Six), Sept. 30 (Attachment Seven) and Sept. 9 (Attachment Eight) Task Force conference call minutes. Mr. Ford seconded the motion. The motion passed unanimously.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

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Draft: 10/13/10

Property Risk-Based Capital (E) Working Group  
Conference Call  
September 23, 2010

The Property Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Sept. 23, 2010. The following Working Group members participated: Anne Kelly, Chair (NY); Ron Dahlquist (CA); Richard Marcks (CT); David Altmeyer (FL); Dale Bruggeman and Mary Miller (OH); Nicole Elliott (TX); and Peter Medley (WI). Also participating were: Steve Johnson (PA); Will Davis (SC); and Dennis Julnes (WA).

1. Update from Catastrophe Risk (E) Subgroup

Mr. Dahlquist said there was no update to report for the Catastrophe Risk (E) Subgroup since the last conference call. He stated that, in June, Mr. Seeley contacted the rating agencies to obtain the needed information on the current state of industry data quality in the catastrophe modeling area. No response was received. Mr. Dahlquist said it is necessary to develop a work plan to deal with this issue. A conference call will be set up to continue addressing the outstanding issues for this project.

2. Discuss Referral from Capital Adequacy (E) Task Force and Review Appropriate Methodology and Data Filtering for Calculating Reserve and Premium Charges for Reinsurance

Ms. Kelly said the Reinsurance Association of America (RAA) gave a presentation at the Capital Adequacy (E) Task Force meeting during the Summer National Meeting concerning the increases to the underwriting risk factors approved by the Property Risk-Based Capital (E) Working Group in May. Data filtering appeared to be one reason for causing the increase. Dan Swanson (NAIC) informed the Working Group that Mr. Johnson made a motion to add a working agenda item for the Property Risk-Based Capital (E) Working Group to review the methodology for allocating the underwriting risk reserve and premium factors for various lines of business. Alex Krutov (American Academy of Actuaries—AAA) said that the AAA has started reviewing the methodology, and input from interested parties is welcomed. Ms. Kelly noted that the RAA had asked for greater transparency, and she recommended that the AAA give status reports the Working Group during its conference calls. Scott Williamson (RAA) said he believed that these status updates will address those concerns from the RAA.

3. Updates from the Solvency Modernization Initiative RBC (E) Subgroup

John Tittle (NAIC) said that the Solvency Modernization Initiative RBC (E) Subgroup is working to finalize a detailed work plan for discussion and adoption at the Fall National Meeting. He stated that introduction of catastrophe and property/casualty interest rate risk charge would be the key concern for the Subgroup at this time. He expressed that the Working Group has until Nov. 30 to document reasons for excluding and including risks that are missing.

4. Discuss the Impact of the Growth Charge to Run-off Companies

Ms. Kelly said the growth charge was designed to account for risk associated with excess premium growth due to an increase in exposure. She noted that a run-off company with significant audit premium could trigger the charge. Ms. Kelly said that, because this additional premium was not due to an increase in exposure, an exemption could reasonably be granted for such a company due to the nature of the additional premium. Mr. Dahlquist agreed, and said he anticipated that examiners would want to review the situation if a company in run-off regularly had enough audit premiums to warrant a growth charge exemption. Ms. Kelly said this issue will be further discussed in an upcoming conference call.

Having no further business, the Property Risk-Based Capital (E) Working Group adjourned.

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Health Risk-Based Capital (E) Working Group  
Conference Call  
September 16, 2010

The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Sept. 16, 2010. The following Working Group members participated: Dennis Julnes, Chair, and Patrick McNaughton (WA); Sheila Travis and Steve Ostlund (AL); Julia Philips (MN); Lou Felice (NY); and Jo Beth Stephenson (TX). Also participating were: Richard Tan (FL); Alesia Pierce (IL); Mary Pesce and Frank Cipriani (NJ); Allen Seeley (NM); and Richard Hinkel (WI).

1. Update from the AAA Health Care Receivables Factors Work Group

Kevin Russell (American Academy of Actuaries—AAA) indicated that there were significant inconsistencies in the way health care receivables are reported on the RBC formula. He said that a substantial number of insurers were reporting government-based insured plan premiums with other health care receivables instead of in premium. Mr. Julnes stated that this misreporting issue produced a significant distortion on other health care receivables data in the health RBC formula. He said a proposal has been drafted to provide a more definitive annual statement instruction to ensure that the industry will report correctly in the future. Upon a motion by Mr. Ostlund, seconded by Mr. Felice, the Working Group voted unanimously to expose the proposal for comment.

2. Discuss Federal Health Care Reform Impact on Risk-Based Capital

Mr. Felice said that the Supplemental Healthcare Exhibit forms and instructions were formally adopted by the Financial Condition (E) Committee in July. He also stated that the Health Reform Solvency Impact (E) Subgroup will keep addressing any potential issues related to the forms until the scheduled upcoming filing date in April 2011. Mr. Felice said he anticipated that any future changes will not impact the 2010 reporting, because the rate rebate will not take effect until Jan. 1, 2011. Ms. Philips stated that a conference call has been scheduled with the U.S. Department of Health and Human Services (HHS) to discuss the high increase on the guaranteed-issue child rates and the cost of the preventive care issues. Mr. Ostlund said the identification and resolution of various issues have been finalized. He said he anticipated that the Executive (EX) Committee/Plenary will address both of these items during the Fall National Meeting. In terms of RBC, Mr. Ostlund recommended that reviewing the insurance risk would be a good starting point for the change of the pricing and insurance models.

3. Discuss the Health RBC Covariance Recalculation

Mr. Julnes said that a report distributed earlier indicated that changing the covariance formula will not significantly affect the number of insurers that fall into any action level. Donna Novak (NovaRest, representing AAA) said he believed that underwriting risk during the health RBC formula was one of the major reasons for the result. She said she thought that analyzing companies using the result of no covariance would be another alternative to study the effect of the covariance adjustment. Karl Madrecki (Blue Cross and Blue Shield Association, representing AAA) said it would not be an easy task to recalculate the H0 component in the model. However, setting the H0 component to zero would be another option to help determine the impact to the companies. James Braue (UnitedHealth Group) said he was concerned that the covariance adjustment in the health RBC formula will impact other RBC formulas. Mr. Julnes stated that because the Solvency Modernization Initiative RBC (E) Subgroup also is reviewing the covariance and calibration of the model across all business types, any findings from all parties would be welcome.

Mr. Julnes stated that it seemed to him the industry concentration has never been addressed in the RBC formulas. Mr. Ostlund agreed, stating that he believed feedback from the AAA would be necessary, because this would be an important issue on the health care reform evaluation.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.

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Draft: 10/26/10

Life Risk-Based Capital (E) Working Group  
Orlando, FL  
October 19, 2010

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Orlando, FL, Oct. 19, 2010. The following Working Group members participated: Philip Barlow, Chair (DC); Steven Ostlund (AL); Perry Kupferman (CA); Blaine Shepherd (MN); Lou Felice (NY); and Mike Boerner (TX). Also participating was: Alan Seeley (NM).

1. Discuss the American Council of Life Insurers Long-Term Proposal for Commercial Mortgage Loans

Mr. Barlow said that since the Summer National Meeting, the Working Group had established a subgroup to work on the modeling for commercial mortgage loans. He said if the Working Group wanted to implement for year-end 2011, a proposal would need to be adopted by the end of the year. He said that based on where the process stood now, he thought it might carry over to year-end 2012 life RBC.

John Bruins (American Council of Life Insurers—ACLI) said the subgroup appointed in September had been working to address issues, but there were one or two questions that still needed to be resolved. He said the ACLI still needed to finalize a contract with the modeler. He said he was hopeful the modeling could start in another week or two. He said some of the issues worked through were how to address what percentile to use, volatility, national versus regional data, etc. He said work was being done on developing RBC instructions.

Mr. Felice said New York was supportive of moving forward with the proposal but wanted to make sure they were comfortable with the use of debt service coverage and loan-to-value ratios. Mr. Barlow said since there was very little likelihood of completing a proposal for year-end 2011, it seemed like the Working Group should have a conference call to approve the modeling parameters once they were finalized so all of the issues were covered in the modeling work.

Mr. Felice said since the current calculation would not sunset for 2011, the Working Group would not need to take any action if the proposal was not completed for year-end 2011. Mr. Barlow said if it was still thought a calculation could be completed for year-end 2011 then the Working Group could take that issue up on the conference call. Mr. Seeley said the Solvency Modernization RBC (E) Subgroup of the Capital Adequacy (E) Task Force was currently in the process of determining specific calibration targets. He asked if this might be an opportunity to determine a calibration. Mr. Bruins said the initial proposal had at least been following what had been intended as being the original calibration.

2. Release for Comment the ACLI Derivatives Risk Mitigation Proposal

Mr. Barlow said that at the Summer National Meeting, the Working Group had released for comment the proposal with both the basic and intermediate hedges. He said the ACLI was asked to work with New York to resolve concerns they had. Walter Givler (Northwestern Mutual Life, representing ACLI) said the ACLI had agreed at the Summer National Meeting to address the New York concerns. He said a number of calls had been held with New York. He said the issue had been narrowed down to a concern about an accounting mismatch between the hedged asset and the derivative. He said as the bond decreases in value the credit default swap increases. Since the fair market value is often used for the derivative accounting, the value of the derivative increases and the value of the bond stays the same unless it is written down.

Mr. Givler said two different views on how to address the issue had been distributed for the meeting. He said the New York view was that the total adjusted capital should be adjusted for the difference between the carrying value of the bond and the credit default swap versus the liquidation value of both. He said the ACLI view was that the issue was an accounting mismatch and a referral should be made to the Statutory Accounting Principles (E) Working Group. Mr. Felice said the fundamental difference in the views was that New York wanted to see a modification made to total adjusted capital. Mr. Barlow said it appeared there was uniform agreement that there was a mismatch and just different procedures for moving forward. Mr. Ostlund suggested making the New York adjustment to total adjusted capital until a response was received from the Statutory Accounting Principles (E) Working Group.

Mr. Givler said the ACLI was concerned about the potential for unintended consequences for the adjustment. He asked that time be given to consider the language so any concerns could be addressed. Mr. Barlow said that could potentially delay year-end 2011 life RBC implementation. Mr. Givler said he hoped the issue could be resolved by the end of the year. Mr.

Felice suggested releasing the language for comment and also making a referral at the same time. Mr. Ostlund made a motion to release the proposal for a final comment period of 30 days, including the language for the New York proposal. Mr. Boerner seconded, and the motion passed unanimously. Mr. Felice made a motion for NAIC staff to draft a referral and send it to the Statutory Accounting Principles (E) Working Group. Mr. Shepherd seconded, and the motion passed unanimously.

3. Discuss the C-3 Phase 3 Proposal

Mr. Barlow said the Working Group had requested a joint conference call of the Life and Health Actuarial Task Force and the Capital Adequacy (E) Task Force. In that call it had been decided that the Working Group should continue to work on the C-3 Phase 3 proposal. He said the work would be done keeping an eye toward coordination with the Life and Health Actuarial Task Force. He asked NAIC staff to put together a list of current outstanding issues and distribute it to the interested parties. He said between now and the Spring National Meeting, the Working Group would address the outstanding issues. Mr. Ostlund made a motion for staff to draft a memo of the outstanding issues. Mr. Felice seconded, and the motion was unanimously adopted.

4. Adopt a New York Life Proposal for Non-U.S. Life Affiliates

Mr. Barlow said the non-U.S. affiliates proposal from New York Life had been released for comment, with a specific request for comments regarding the implementation date, and no comments were received. The proposal would be for year-end 2011 adoption, as the 2010 life RBC instructions had already been adopted. Mr. Ostlund made a motion to adopt the New York Life non-U.S. affiliates proposal for year-end 2011 (Attachment Three-A). Mr. Shepherd seconded, and the motion passed unanimously.

5. Discuss the Life Risk-Based Capital Trend Test

Mr. Barlow said the trend test issue had been addressed earlier by the Working Group. While the Working Group did not have significant issues with the proposal, it did not seem to be a material enough change to adopt on a stand-alone basis. The next time the model law was changed, the trend test change could be included as well. Mr. Barlow said NAIC staff had been asked to provide more recent data. He said it appeared to still be a fairly minimal number of companies. Mr. Felice said he did not have the opportunity to look at the results, but Steve Johnson (PA) had indicated that the companies impacted were weakly capitalized companies.

Mr. Shepherd asked about the issue of consistency with the other RBC formulas. Mr. Barlow said it had been agreed there were valid reasons for the RBC formulas to be different. He agreed that consistency was good, but even if the RBC percentage was consistent, the trend tests would still not be calculated differently. Mr. Felice asked whether the position of the Working Group was that it agreed with the proposal but would only recommend making a change to the model act if another change was being made. Mr. Barlow said the Working Group did not disagree with the change but would still need to review the change if another change was being made to the model act.

6. Discuss Any Other Matters

Mr. Barlow asked if any Working Group members were interested in drafting comments to the American Academy of Actuaries deferred tax assets final report that had been released for comment by the Capital Adequacy (E) Task Force. Mr. Ostlund and Mr. Shepherd indicated that they would support looking at the proposal. Mr. Barlow said he would draft comments and distribute them to the Working Group.

Mr. Barlow said the C-3 Phase 2 Results (E) Subgroup of the Capital Adequacy (E) Task Force had restarted. He said they would be delving into the Oliver Wyman results and intended to have additional calls, some of which would be open. He said a lot of the issues the Subgroup would be working on would be parallel to Working Group issues.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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## CALCULATION OF AUTHORIZED CONTROL LEVEL RISK-BASED CAPITAL

LR029

### *Basis of Factors*

The purpose of the formula is to estimate the risk-based capital levels required to manage losses that can be caused by a series of catastrophic financial events. However, it is remote that all such losses will occur simultaneously. The covariance adjustment states that the combined effect of the C-1o, C-1cs, C-2 and C-3 and a portion of the C-4 risks are not equal to their sum but are equal to the square root calculation described below. It is statistically assumed that the C-1o risk and a portion of the C-3 risk are correlated, while the C-1cs risk, the C-2 risk, the balance of the C-3 risk and a portion of the C-4 risk are independent of both. The split of the C-3 and C-4 risks allows for general consistency with the health RBC formula. This assumption provides a reasonable approximation of the capital requirements needed at any particular level of losses.

Authorized Control Level Risk-Based Capital is 50 percent of the sum of the C-0 plus the C-4a risk-based capital and the square root of the sum of the C-1o and C-3a risk-based capital squared, the C-1cs risk-based capital squared, the C-2 risk-based capital squared, the C-3b risk-based capital squared and the C-4b risk-based capital squared.

Mandatory Control Level Risk-Based Capital is 70 percent of Authorized Control Level Risk-Based Capital.

### *Specific Instructions for Application of the Formula*

All amounts reflected for the calculation of Authorized Control Level Risk-Based Capital will be calculated automatically by the software.

In recognition of the exclusion of the carrying value of Affiliated Alien Life Insurers - All Others from Total Adjusted Capital, the carrying value of these entities is also to be excluded from the calculation of C-O risk based capital.

## CALCULATION OF TOTAL ADJUSTED CAPITAL

(Including Total Adjusted Capital Tax Sensitivity Test)

LR031

### *Basis of Factors*

In determining the C-1 risk factors, availability of the AVR and voluntary investment reserves to absorb specific losses was not assumed. Therefore, the AVR is counted as capital for the purposes of the formula although it represents a liability and is not usable against general contingencies. Voluntary investment reserves were eliminated from Total Adjusted Capital for the 1997 risk-based capital formula.

The annual statement provision for future dividends can provide a general cushion against potentially adverse future experience. As a reflection of this possible cushion, 50 percent of the annual statement dividend liability is included. However, when a block is reinsured, such credit to Total Adjusted Capital will not be allowed to either company unless the company has total control over the dividend decision and the full benefit of a change in the dividend scale flows to the company. A factor of 25 percent of the dividend liability is used in sensitivity testing.

8/17/2010

Subsidiary amounts other than the carrying value of Affiliated Alien Life Insurers - All Others, are included as appropriate recognizing that this surplus is included within the surplus of the parent. The carrying value of Affiliated Alien Life Insurers - All Others should be excluded from the surplus for purposes of computing Total Adjusted Capital. Property and casualty subsidiaries should subtract all non-tabular discount from surplus to arrive at the adjusted surplus figure. This adjustment to surplus was phased in over a five-year period by subtracting 20 percent of the non-tabular discount the first year and an additional 20 percent each year thereafter. Beginning with the 1998 risk-based capital formula, the adjustment to surplus is 100 percent. The same adjustment is made to the surplus of a life company having ownership of a property and casualty subsidiary.

The laws of certain states allow insurers to issue a form of capital instrument called a "capital note." A credit is allowed to Total Adjusted Capital for a capital note that satisfies all of the following conditions:

1. In a liquidation, the capital note ranks with surplus notes and is subordinate to the claims of policyholders, claimants and general creditors.
2. The form and content of the capital note was approved by the commissioner of the insurer's state of domicile.
3. At the time of issuance of the capital note, the aggregate principal amount did not exceed 25 percent of the Total Adjusted Capital (including the aggregate principal amount of outstanding capital and surplus notes) as of the end of the immediately preceding calendar year less the aggregate principal amount of outstanding capital and surplus notes.
4. The term of the capital note is not less than five years.
5. At the time of issuance of the capital note:
  - a) The total principal amount of capital notes maturing in any one year did not exceed 5 percent of Total Adjusted Capital (measured at the time of issuance); and
  - b) The total principal amount of capital notes maturing in any three-year period did not exceed 12 percent of Total Adjusted Capital (measured at the time of issuance).
6. Payment of interest, dividend or principal of the capital note is deferred if it would have caused:
  - a) The insurer's Total Adjusted Capital to drop below its Company Action Level Risk-Based Capital; or
  - b) The insurer's Total Adjusted Capital to drop below 125 percent of its Company Action Level Risk-Based Capital, and there is a negative trend on the Trend Test.However, upon request by the insurer, the commissioner of the insurer's state of domicile may approve such payment if, in the commissioner's judgment, the financial condition of the insurer warrants it.
7. The commissioner of the insurer's state of domicile may halt all payments on the capital note if the insurer's Total Adjusted Capital drops below three times the principal amount of the capital and surplus notes the insurer has outstanding.
8. The capital note is treated as a liability in the computation of statutory surplus.
9. The insurer issuing the capital note is obligated to supply to the commissioner of the insurer's state of domicile an informational filing in a manner approved by the commissioner at the same time the insurer files its annual statement, and at such other times as the commissioner determines necessary. The filing shall include and be based on the following guidelines:
  - a) The filing shall display the financial results of the criteria used to determine whether payments on the insurer's capital notes need be approved by the commissioner or may be halted by the commissioner. Further, it shall specifically identify those results that either necessitate commissioner approval of the payment or give the commissioner the option to halt payment.
  - b) The insurer shall notify the Commissioner for informational purposes of each forthcoming payment under a capital note not less than ten business days prior to the date of payment, nor more than 30 business days prior to the date of payment.
  - c) Whenever an insurer declares its intention to exercise the option to call or redeem a capital note prior to the scheduled maturity, the Commissioner shall be notified within five business days following the declaration, and not less than 10 business days prior to the declared redemption date. The 10-day period should be measured from the date of the commissioner's receipt of the notice.The credit for a capital note is reduced as the note approaches maturity (as calculated on LR030 Capital Notes before Limitation). The aggregate credit for capital notes is limited so that the total amount of capital and surplus notes included in Total Adjusted Capital is not more than one-third of Total Adjusted Capital.

8/17/2010

**AFFILIATED INVESTMENTS**  
 LR037, LR038 and LR039



Detail Eliminated to Conserve Space

Alien Insurance Affiliates – Canadian Life

Canadian regulatory authorities have in place a Minimum Continuing Capital and Surplus Requirement (MCCSR) for Canadian life insurance companies. In addition to the MCCSR formula, Canadian regulators have the authority to adjust the capital requirements upward for companies where deemed appropriate. For purposes of the U.S. formula, MCCSR times percent of ownership is used to establish the risk-based capital requirement for Canadian life subsidiaries. If the MCCSR has been adjusted by regulatory authorities, this adjusted MCCSR is to be used. Canadian property and casualty companies will continue to be reported in the Alien Insurance Affiliates – Other section.

Report the Canadian life insurer name, alien insurer identification number, the book/adjusted carrying value of common and preferred stock and the total outstanding value of common and preferred stock. Companies reported in this section will be assigned an affiliate code of “8” for Canadian life insurers.

Alien Insurance Affiliates – Other

For purposes of this formula, the risk-based capital of each alien insurance affiliate is ~~the annual statement carrying value of the reporting company’s interest in the affiliate multiplied by 100 percent zero~~. Report information for any non-U.S. insurance affiliate, both life (except for Canadian life insurers) and property and casualty.

For each affiliate, report the name, and alien insurer identification number.<sup>5</sup> For purposes of this formula, the statement value of common and preferred stock and the total outstanding value of common and preferred stock for alien insurance affiliates should be entered as zero. ~~the statement value of common and preferred stock and the total outstanding value of common and preferred stock~~. Companies reported in this section will be assigned an affiliate code of “9” for alien insurers.

~~The total of all alien insurance affiliates (Canadian life and other) should equal the amounts reported in Schedule D, Part 6, Section 1, Line 0599999 and Line 1499999.~~

Investment in Upstream Affiliate (Parent)

The pre-tax risk-based capital for an investment in an upstream parent is 0.300 times the carrying value of the common and preferred stock regardless of whether that upstream parent is subject to risk-based capital. Report the appropriate information from Schedule D, Part 6, Section 1, Lines 0199999 and 1099999 in Columns (1) through (6). The affiliate code for an upstream parent is “10.”

8/17/2010

## 2011 PROPOSED CHARGES

Draft: 10/19/10

### CAPITAL ADEQUACY (E) TASK FORCE

The mission of the Capital Adequacy (E) Task Force is to evaluate and recommend appropriate refinements to capital requirements for all types of insurers.

#### Ongoing Support of NAIC Programs, Products or Services:

1. Evaluate refinements to the existing NAIC risk-based capital (RBC) formulas implemented in 2010. Forward final version of the structure of the 2011 life, P&C, health and fraternal RBC formulas to the Financial Condition (E) Committee by June 2011.—*Essential*
2. Consider proposals for structural changes to the RBC formulas (including proposals related to the NAIC Solvency Modernization Initiative) submitted by the working groups/subgroups. Proposed structural changes to the 2012 formulas that are received by the 2011 Fall National Meeting will be considered for adoption by the Task Force, and adopted changes will be forwarded to the Financial Condition (E) Committee by March 2012.—*Essential*
3. Review the effectiveness of the NAIC's RBC policies and procedures as they affect the accuracy, audit ability, timeliness of reporting access to RBC results and comparability between the RBC formulas. Report on data-quality problems in the 2010 RBC filings at the summer and fall meetings.—*Essential*
4. Monitor changes in accounting and reporting requirements resulting from the adoption and continuing maintenance of the revised *Accounting Practices and Procedures Manual* to ensure that model laws, publications, formulas, analysis tools, etc., supported by the Task Force continue to meet regulatory objectives.—*Essential*
5. Evaluate emerging "risk" issues for referral to the RBC working groups/subgroups for certain issues involving more than one RBC formula. Monitor emerging and existing risks relative to their consistent or divergent treatment in the three RBC formulas.—*Essential*
6. Conduct a regulatory review of the 2008, 2009 and 2010 RBC filings (and associated company records) in order to assess the impact resulting from implementation of the principle-based changes to the life RBC formula. Monitor implementation and impact of the adopted changes, as well as provide responses to the Principles-Based Reserving (EX) Working Group, regarding how the proposed expansion to the principle-based reserving approach affects all of the RBC formulas. Also develop and review disclosure-documentation and governance protocols to be used by regulators and companies.—*Essential*
7. Upon notice that a security has been placed under regulatory review, the chair of Capital Adequacy (E) Task Force, or his or her representative, will be deemed a member of the Invested Asset (E) Working Group of the Valuation of Securities (E) Task Force. The chair, or his or her representative, is charged with contributing the perspective and expertise of the regulatory group to the development of NAIC regulatory guidance for the security under review.—*Essential*

#### *Sponsors for 2011 Charges* (Except as noted, I support all charges)


Staff Support: Dan Swanson

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Draft: 10/29/10

Solvency Modernization RBC (E) Subgroup  
Orlando, FL  
October 17, 2010

The Solvency Modernization Initiative RBC (E) Subgroup of the Capital Adequacy (E) Task Force met in Orlando, FL, Oct. 17, 2010. The following Subgroup members participated: Alan Seeley, Chair (NM); Richard Ford (AL); Ron Dahlquist (CA); Lou Felice (NY); and Patrick McNaughton (WA). Also participating were: Richard Marcks (CT); Philip Barlow (DC); Kerry Krantz (FL); and Larry Bruning (KS).

1. Received Presentation from the Bermuda Monetary Authority

Craig Swan and Roger Scott (Bermuda Monetary Authority) gave a presentation regarding the recently developed Bermuda Solvency Capital Requirement calculation. Mr. Swan said the project began in 2006 and Bermuda had worked with PricewaterhouseCoopers to calibrate the model. Bermuda data had been used for the modeling, and the risk measure was chosen to be consistent with other world-class standards.

Mr. Swan said value at risk (VaR) and tail value at risk (TVaR) had been reviewed and TVaR was chosen. A one-in-250-year loss standard was chosen, with a one-year time horizon. For catastrophe risk, catastrophe models are used to estimate the probable maximum loss. Stress testing is done inside and outside the models, with the majority done outside to help verify the modeling results. An operational risk charge is assigned according to the quality of the risk management and governance. He said peer group benchmarking of results is done to identify outliers. He said potential recalibration of the calculation would be reviewed every three to five years.

Mr. Swan said that each company would identify its own material risks according to the Bermuda Own Risk and Solvency Assessment (ORSA). He said Bermuda was introducing a catastrophe risk return. The concentration risk of the company would be disclosed, along with which switches are turned on and off, for the catastrophe models. He said it would also be disclosed which risks are not modeled or where the data was deficient in the modeling. Mr. Swan said that stress-testing investments were stressed for duration, interest rate changes and changes in fair market value. Stress tests also were conducted for underwriting losses for windstorms, earthquakes, etc. A stress test also was done for a rating agency downgrade of the company rating of two classes for liquidity issues.

Mr. Barlow asked who did the modeling work. Mr. Swan said the company did the modeling work and regulators performed analysis of the modeling. Mr. Barlow asked who did the stress testing. Mr. Swan said regulators did the stress testing. Mr. Bruning asked what would happen when a company fell below the minimum capital requirement. Mr. Swan said the Bermuda Monetary Authority would have the ability to withdraw the insurance license of the company to write new business or to restrict dividends. Mr. Bruning asked what would happen in a wind-down situation. Mr. Swan said that Bermuda's registrar of companies would wind down the company, not the Bermuda Monetary Authority. Mr. Bruning asked whether there was a guaranty fund. Mr. Swan said there was not a guaranty fund, so it was important to identify companies with problems as early as possible.

Mr. Marcks asked about confidentiality of the capital results. Mr. Swan said there was a roadmap of disclosures that were in the process of being implemented. He said that, at the moment, only class 4 companies are required to disclose capital requirements in the general purpose financial statements. Over the next few years, more companies will be required to disclose capital requirements. Mr. McNaughton asked whether metrics were used to score or rate corporate governance. Mr. Swan said Bermuda uses a company self-assessment of corporate governance, with four potential levels based on the company's measurement and implementation. He said the various levels determined what companies disclosed. Mr. Seeley said that, as Bermuda was primarily a property/casualty jurisdiction, whether a life model had been developed. Mr. Swan said a life model was just been released for 2011 implementation. Mr. Seeley asked if a longer than one-year time horizon had been used for life. Mr. Swan indicated a one-year time horizon had been used for life, as well.

Alex Krutov (Navigation Advisors) said a TVaR standard had been chosen, and asked how it had been calibrated. Mr. Swan explained that a one-in-250-year loss level had been chosen. The modeled results had given a 99.5% TVaR level. He said the minimum capital requirement was calculated on a different basis. Mr. Krutov asked whether the regulator was required or allowed to take action on the company. Mr. Swan said action was allowed.

## 2. Discuss the Subgroup's Draft Work Plan

Mr. Seeley said the Solvency Modernization Initiative (EX) Task Force had asked that risk-based capital (RBC) be enhanced to reflect diversification, risk mitigation and missing risks, in addition to calibrating the RBC to a safety level and time horizon. Mr. Seeley said he would like feedback on items that needed to be added, deleted or combined for the detailed work plan. Mr. Felice said he would like to see what projects were already in progress. He said he did not want resources expended on projects that did not meet the ultimate goal. Mr. Dahlquist said the calibration of the underwriting risk was not included for property/casualty insurance. He said there should also be an item for the overall calibration. Mr. Seeley agreed. He said another item that should be added was the definition of intervention levels. He said the current levels should be changed to something with a better theoretical underpinning. Mr. Felice said one item not of the list was the position on modeling.

Ralph Blanchard (Travelers) said resources could either be spent to quantify the existing risk level or improve the current risk charges to find what level recreates the current level of capital. Mr. Seeley said one way to determine current calibration of the RBC would be to use the internal models of large U.S. companies, although this approach did have some shortcomings. Art Panighetti (Northwestern Mutual Life, representing the American Academy of Actuaries—AAA) said the AAA had found some shortcomings with the approach, but said it would likely be the easiest way to determine the current calibration. Mr. Bruning said one important item to consider in determining the total calibration is the impact of the guaranty fund association, when the United States is being compared to other solvency regimes. Mr. Dahlquist said a higher calibration standard might be needed without the guaranty fund backstop. Mr. Seeley said one item to consider was what extreme event might wipe out the guaranty fund. Mr. Barlow said one thing that might be looked at was some kind of uniform standards for guaranty funds.

Mr. Seeley said that a letter was sent to the AAA Sept. 15, and the AAA had responded back. Mr. Krutov said some fundamental questions still needed to be answered. He said it first needed to be decided what risk measure and time horizon would be used in order to calibrate. Nancy Bennett (AAA) said it would be useful to document which assumptions are being made such as the accounting method and calibration. She asked what the overall objective was what was trying to be accomplished by the end of 2012. Mr. Seeley said the NAIC wanted to have a version of RBC reasonably calibrated to a risk measure that satisfies International Association of Insurance Supervisors (IAIS) standards. He said a reasonable attempt to calibrate the formula would need to be made. Mr. Krutov asked if the primary goal was to keep the current framework. Mr. Felice said that, as a whole, the existing framework was working, even though it was not perfect. He noted that the target was solvency modernization, and RBC was just a piece of that.

Having no further business, the Solvency Modernization Initiative RBC (E) Subgroup adjourned.

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Draft: 10/14/10

Capital Adequacy (E) Task Force  
Conference Call  
October 6, 2010

The Capital Adequacy (E) Task Force met via conference call Oct. 6, 2010. The following Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Gennet Purcell, Vice Chair, represented by Philip Barlow (DC); Jim L. Ridling represented by Richard Ford and Charles Angell (AL); Thomas R. Sullivan represented by Richard Marcks (CT); Kevin M. McCarty represented by Al Willis, Kerry Krantz and Richard Tan (FL); Glenn Wilson represented by Blaine Shepherd (MN); Brett J. Barratt represented by William McCune and Annette James (NV); Mary Jo Hudson represented by Dale Bruggeman (OH); Robert L. Pratter represented by Steve Johnson (PA); Neal T. Gooch represented by Jake Garn (UT); and Mike Kreidler represented by Dennis Julnes and Patrick McNaughton (WA).

1. Release for Comment the American Academy of Actuaries Final Deferred Tax Asset Report

Mr. Felice asked for a summary of the final report from the American Academy of Actuaries (AAA) regarding deferred tax assets (DTA). Mark Verheyen (CNA Insurance, representing the AAA) said the overall framework was consistent with the June AAA report. He said the issue of the RBC level at which a floor should apply was revisited. A second level of risk-based capital (RBC) charges had been added for RBC ratios between 300% and 500%. This change had been done after reviewing rating agency metrics. Mr. Verheyen said there was a disconnect between Life and Property/Casualty RBC ratios. The Life RBC ratios were higher for a comparable rating agency rating. He said the AAA decided to have the percentages on a consistent basis.

Mr. Bruggeman asked about the assumption 1% RBC charge for a full deferred tax asset (DTA) and a 0% charge for a limited DTA. Mr. Verheyen said capping the admissibility of the DTA was felt to be an implicit RBC charge. Mr. Felice asked whether the AAA report was stating that capping the DTA eliminated the risk of recoverability. Mr. Verheyen said that was correct. He said the 1% RBC charge was comparable to a class 1 bond charge, and the 5% was comparable to a class 3 bond. Below a 300% RBC ratio, the charge increased significantly.

Mr. Bruggeman asked about the covered DTA amount. Mr. Verheyen said the AAA was differentiating between past taxes paid and DTA's dependence on future earnings. He said the RBC charge was just on the covered DTA and not the non-covered. He said the DTA on past taxes paid was felt to be recoverable even in an insolvency. Mr. Felice pointed out that the RBC formula would need to be changed to capture both the covered and non-covered portions. He asked whether it was readily discernable what portion was covered versus uncovered. Mr. Verheyen said the AAA was not able to assess the order of magnitude of DTA amounts related to past earnings versus future earnings from the data currently available. Mr. Bruggeman said a disclosure was added for year-end 2010 and that data would be available then. Mr. Felice said the Task Force would want to make sure that the data was available and verifiable.

Mr. Bruggeman said the DTA amounts would not all be capped. He said the cap would only apply to the expectation of future taxable income. Mr. Felice said the RBC charge would only be on the capped portion. John Tittle (NAIC) said there was a third element to the DTA admission calculation that was not capped at all for the deferred tax liability (DTL) offset, which might not be addressed by the proposed RBC charge. Mr. Bruggeman felt it was indirectly included in the RBC charge. Mr. Felice asked if the DTL would reduce the net DTA. Mr. Bruggeman said there were circumstances where a timing mismatch could occur where the DTL reverses. Mr. Tittle mentioned that scheduling of tax items was included in the AAA report and was not currently required in the SSAP No. 10R guidance, which might be an issue. Mr. Felice said the Task Force would need to keep up with any changes made to the accounting treatment for the effect on the RBC treatment.

Mr. Felice asked what happened between 200% and 300% RBC ratios. Mr. Verheyen said the RBC charge would increase linearly in order to avoid having a cliff where the RBC charge would suddenly increase. Mr. Felice asked whether there were tax implications for Life RBC. Art Panighetti (Northwestern Mutual Life, representing the AAA) said he was not sure whether there were any implications. Mr. Felice said the Task Force would want to have a level playing field among the different business types.

Mr. Julnes asked why the progression was at the 200% to 300% level rather than some other level, such as 300% to 400%. Mr. Verheyen said the 300% level had been chosen to be consistent with SSAP No. 10R for Property/Casualty companies. He said the levels had also been re-evaluated based on rating agency metrics. He said there was some conservatism in the calculation because the DTA was not included in Total Adjusted Capital.

Mr. Ford made a motion to release the American Academy of Actuaries Deferred Tax Asset Report for a comment period of 30 days. Mr. Marcks seconded the motion. The motion passed unanimously.

## 2. Discuss a Referral Received Regarding the Financial Sector Assessment Program Recommendations

Mr. Felice said a referral to the Task Force had been received regarding three issues as a result of the Financial Sector Assessment Program recommendations. He said he thought the Task Force's Solvency Modernization Initiative RBC Subgroup had held discussions regarding establishing a safety level for capital requirements.

Mr. Felice said the multiple gearing issue was probably more of a holding company issue where the parent issued debt for a capital infusion to the subsidiary. He said he would ask for clarification from the Solvency Modernization Initiative (EX) Task Force on the issue. Mr. Johnson said he agreed that it was a holding company issue. Under the ring fence approach in the U.S., he did not see it as a concern. He said it might be a concern at the group level, but the equity would not leave the insurance company once it was received. Mr. Felice said the issue was wrapped in a larger issue regarding group capital requirements.

Mr. Felice said the stress testing issue was already on the Task Force working agenda. He said the Task Force's Solvency Modernization Initiative RBC Subgroup had also discussed the issue. He said he would report to the Solvency Modernization Initiative (EX) Task Force that the Capital Adequacy (E) Task Force was looking at the safety level and the stress testing issues, and the multiple gearing issue was not ready to be discussed yet.

## 3. Memorandum Regarding Financial Regulation Standards and Accreditation (F) Committee Referral

Mr. Felice said a referral had been received from the Financial Regulation Standards and Accreditation (F) Committee to consider what portions of the *Risk-Based Capital for Health Organizations Model Act* (#315) should be identified as significant elements for accreditation purposes. The current *Risk-Based Capital for Insurers Model Act* (#312) is currently an accreditation standard and most major sections of model #312 had been selected as being significant elements. He said a memorandum had been drafted to send to the Financial Regulation Standards and Accreditation (F) Committee based on the significant elements for model #312.

Mr. Johnson made a motion to send the memorandum (Attachment Six-A) to the Financial Regulation Standards and Accreditation (F) Committee. Mr. Julnes seconded the motion. The motion passed unanimously.

## 4. Any Other Matters

Mr. Felice said the Life and Health Actuarial Task Force had asked whether the Capital Adequacy (E) Task Force's C-3 Phase 2 Results Subgroup preliminary recommendations would be released for comment along with the recommendations from Oliver Wyman. He said he did not see a problem with releasing the recommendations, but wanted to leave the issue open until he had a chance to discuss it with Al Sekac (TX).

Mr. Felice said that NAIC staff had run a report regarding Life RBC trend test data. He said the issue would be discussed at the Life Risk-Based Capital (E) Working Group meeting at the Fall National Meeting. Mr. Johnson said that though changing the trend test percentage from 250% to 300% does not bring in a lot of new companies, it did bring in companies that should be reviewed. In addition, going to 300% would make Life consistent with the other RBC business types. He said he saw no reason not to make the change. States would need to implement the change, but it would be years before the change would be needed for accreditation purposes. Mr. Felice asked that the Life Risk-Based Capital (E) Working Group look at the proposal from a reasonableness standpoint and look at whether it would want to release the proposal for comment.

Having no further business, the Capital Adequacy (E) Task Force adjourned.





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MEMORANDUM

**TO:** Superintendent Joseph Torti, III  
Financial Regulation Standards and Accreditation (F) Committee

**FROM:** Lou Felice, Chair  
Capital Adequacy (E) Task Force

**DATE:** October 6, 2010

**RE:** Significant Elements for the *Risk-Based Capital for Health Organizations Model Act* (#315)

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At the Aug. 14 meeting of the Financial Regulation Standards and Accreditation (F) Committee, Superintendent Torti requested that the Capital Adequacy (E) Task Force provide guidance regarding the items in the *Risk-Based Capital for Health Organizations Model Act* (#315) that should be identified as significant elements for accreditation purposes. These would be the key provisions of the model that should be specifically required for accreditation. These provisions would not apply to single-state and other entities that are exempted from application of the risk-based capital (RBC) model act.

Below are the significant elements for accreditation identified by the Capital Adequacy (E) Task Force, based on the significant elements already identified for the *Risk-Based Capital for Insurers Model Act* (#312):

- Definitions similar to those in Section 1.
- Provisions to RBC Reports similar to Section 2.
- Definitions of Company Action Level Event and processes regarding such similar to Section 3.
- Definitions of Regulatory Action Level Event and processes regarding such similar to Section 4.
- Definitions of Authorized Control Level Event and processes regarding such similar to Section 5.
- Definitions of Mandatory Control Level Event and processes regarding such similar to Section 6.
- Provisions for Hearings similar to those in Section 7.
- Confidentiality and Prohibition on Announcement provisions similar to those in Section 8.
- Supplemental provisions similar to Section 9.
- Provisions for foreign insurers similar to Section 10.
- Severability provisions similar to Section 12.
- Notice provisions similar to Section 13.

Any questions regarding the significant elements may be directed to me at 212-480-5061 or to Dan Swanson (NAIC) at 816-783-8412.

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<b>SECURITIES VALUATION OFFICE</b>	48 Wall Street, 6th Floor	New York, NY 10005-2906	p   212 398 9000	f   212 382 4207

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Draft: 10/13/10

Capital Adequacy (E) Task Force and  
Life and Health Actuarial Task Force  
Joint Conference Call  
September 30, 2010

A joint conference call between the Capital Adequacy (E) Task Force and the Life and Health Actuarial Task Force was held Sept. 30, 2010. The following Capital Adequacy Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Gennet Purcell, Vice Chair, represented by Philip Barlow (DC); Jim L. Ridling represented by Richard Ford (AL); Steve Poizner represented by Perry Kupferman (CA); Thomas R. Sullivan represented by Jim Jakielo (CT); Karen Weldin Stewart represented by Linda Sizemore (DE); Kevin M. McCarty represented by Al Willis, Kerry Krantz and Dan Keating (FL); John P. Camacho represented by John Carlos (GU); Glenn Wilson represented by Blaine Shepherd (MN); Brett J. Barratt represented by Annette James (NV), Mary Jo Hudson represented by Pete Weber (OH); Neal T. Gooch represented by Jake Garn (UT); and Mike Kreidler represented by Dennis Julnes and Shirazali Jetha (WA).

The following Life and Health Actuarial Task Force members participated: Sandy Praeger, Chair, represented by Larry Bruning (KS); Scott H. Richardson, Vice Chair, represented by Leslie Jones (SC); Linda S. Hall represented by Katie Campbell (AK); Jim L. Ridling represented by Richard Ford (AL); Steve Poizner represented by Perry Kupferman (CA); Thomas R. Sullivan represented by Jim Jakielo (CT); Kevin M. McCarty represented by Dan Keating, Kerry Krantz and Al Willis (FL); Glenn Wilson represented by Blaine Shepherd (MN); John M. Huff represented by David Hippen (MO); James J. Wrynn, represented by Fred Andersen, Bill Carmello and Dennis Lauzon (NY); Mary Jo Hudson represented by Pete Weber (OH); Mike Geeslin represented by Mike Boerner and Jo Beth Stephenson (TX); and Neal T. Gooch represented by Jake Garn (UT).

1. Discuss Addressing Joint Capital and Reserve Issues

Mr. Felice said the C-3 Phase 2 Results Subgroup had worked on C-3 Phase 2. Since not much progress had been made on coordination with reserves, his recommendation was to have the C-3 Phase 2 Results Subgroup to continue their work on C-3 Phase 2. He said the Capital Adequacy Task Force had several items on the working agenda for the Capital Adequacy (E) Task Force (CATF)/ Life and Health Actuarial Task Force (LHATF) Joint Subgroup and he wanted to consider whether those items still applied and how they would be addressed.

Mr. Felice asked what the status was for the C-3 Phase 2 Results Subgroup. Mr. Andersen said a set of proposals from Oliver Wyman had been presented for both reserves and capital along with some other proposals. He said the proposals were highly technical and the Subgroup was currently trying to gain an understanding of the proposals. Once the proposals were understood, then a recommendation could be sent to LHATF and CATF. Mr. Carmello said the C-3 Phase 2 Results Subgroup also had a prior list of issues as well as the Oliver Wyman issues. Mr. Andersen said the prior list of issues would be reviewed to see whether new items needed to be added.

Mr. Felice said the issue was that since the issues applied to both reserves and capital there needed to be a mechanism to address both. Mr. Andersen recommended that since most of the issues related to both capital and reserves, to have LHATF address them. He said LHATF had more time available through conference calls and at national meetings to address the issues and for the most part the same regulators were on both groups. Some coordination could be done with the Life Risk-Based Capital (E) Working Group with issues that were capital specific going through that group.

Mr. Felice said it was important for capital and reserves to move forward on a parallel track even if the majority of the work was done by LHATF. He said there needed to be a process for receiving updates on the work. Mr. Barlow agreed with Mr. Andersen's suggestion that LHATF address the issues. He said it was difficult to get focus on capital issues over reserve issues. He also agreed that some process was needed to better coordinate the work.

Mr. Felice said there needed to be a briefing from LHATF at every National Meeting if there was not a CATF/LHATF Joint Subgroup to coordinate. Mr. Bruning did not have a problem with LHATF taking the lead on issues that applied to both reserves and capital. But, he said that items that relate directly to capital should be dealt with by the Life Risk-Based Capital Working Group. Mr. Felice asked whether the Life Risk-Based Capital Working group could assume the role of the CATF/LHATF Joint Subgroup. Mr. Barlow said the Life Risk-Based Capital Working Group could probably do that. But, he said there needed to be a process for the Working Group to provide input on issues that affected capital while LHATF was

working on them if it was needed. Mr. Felice said the issues that related to both capital and reserves could be added to the Life Risk-Based Capital Working Group working agenda. He said an item would be added to the CATF meeting agenda to assign the CATF/LHATF Joint Subgroup items.

John Bruins (American Council of Life Insurers–ACLI) said the C-3 Phase 2 Results Subgroup had been meeting on a regulator-only basis which was understandable since they were reviewing confidential data. He asked whether it was appropriate whether that group continued on a regulator-only basis. Mr. Barlow said the Subgroup had followed the normal NAIC requirements on open calls. Mr. Felice agreed that the calls should be open when confidential data was not being discussed.

Mr. Bruning said time had been scheduled at the Fall National Meeting for another presentation from Oliver Wyman. The Oliver Wyman recommendations might be released for comment. He asked whether the C-3 Phase 2 Results Subgroup report might also be released for comment at the same time. Mr. Felice said he was fine with that as long as it was all right with the C-3 Phase 2 Results Subgroup. He said perhaps it could be discussed by the Subgroup in a conference call before the Fall National Meeting.

Mr. Barlow said one of the reasons for the conference call was whether the LHATF work should slow down the C-3 Phase 3 proposal. Mr. Felice said the Life Risk-Based Capital Working Group could go ahead with vetting the proposal. The Working Group would need to make sure to coordinate with LHATF if there was not going to be a CATF/LHATF Joint Subgroup.

## 2. Discuss CATF/LHATF Joint Subgroup Working Agenda Items

Mr. Felice said there were several items on the working agenda for the CATF/LHATF Joint Subgroup that would need to be reassigned if there was not going to be reassigned. Mr. Felice said the items regarding capital and reserves coordination and the scenario generator could be assigned to the Life Risk-Based Capital (E) Working Group. He asked whether there was any need CATF needed to look at actuarial qualifications. Mr. Bruning said he thought the issue was probably related to the peer review process which was rejected by LHATF and could probably be taken off the list.

Mr. Barlow said the item regarding working agenda item for stress testing could be moved to the Capital Adequacy Task Force's Solvency Modernization Initiative RBC Subgroup. Mr. Felice said he would need to discuss it with the chair of the Solvency Modernization Initiative RBC Subgroup. Mr. Felice said the item regarding risks and calibration was clearly going to be addressed by the Solvency Modernization Initiative RBC Subgroup. He said to let him know if there were any issues on the reserve side that needed to be coordinated. Otherwise, the item would be assigned to the Solvency Modernization Initiative RBC Subgroup.

Having no further business, the Capital Adequacy (E) Task Force and the Life and Health Actuarial Task Force adjourned.

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Draft: 10/15/10

Capital Adequacy (E) Task Force  
Statutory Accounting Principles (E) Working Group  
Joint Conference Call  
September 9, 2010

The Capital Adequacy (E) Task Force and Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force held a joint conference call Sept. 9, 2010. The following Capital Adequacy (E) Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Gennet Purcell, Vice Chair, represented by Clark Simcock (DC); Jim L. Ridling represented by Steve Ostlund and Sheila Travis (AL); Steve Poizner represented by Kim Hudson and Louis Quan (CA); Thomas R. Sullivan represented by Kathy Belfi and Elaine Weiche (CT); Karen Weldin Stewart represented by Linda Sizemore (DE); Kevin M. McCarty represented by Al Willis and Patrick Craig (FL); Glenn Wilson represented by Blaine Shepherd (MN); Brett J. Barratt represented by Annette James (NV); Mary Jo Hudson represented by Dale Bruggeman (OH); Neal T. Gooch represented by Jake Garn (UT); Mike Kreidler represented by Dennis Julnes and Patrick McNaughton (WA); and Sean Dilweg represented by Peter Medley (WI).

The following Statutory Accounting Principles (E) Working Group members participated: Joseph Fritsch, Chair (NY); Jim Armstrong, Vice Chair (IA); Kim Hudson and Louis Quan (CA); Jim Hanson (IL); Stewart Guerin (LA); Judy Weaver (MI); Tom Burke (NH); Dennis Fernez and Dennis Lauzon (NY); Dale Bruggeman (OH); Mike Boerner (TX); Doug Stolte and David Smith (VA); and Peter Medley (WI).

1. American Academy of Actuaries – Potential Risk-Based Capital Charges for Deferred Tax Assets

Mr. Felice said the Capital Adequacy (E) Task Force was expecting a final report from the American Academy of Actuaries (AAA) on potential RBC charges for deferred tax assets. He advised that last year, a 5% Life RBC charge outside of the covariance was adopted. The Task Force had requested the AAA to review and determine an appropriate charge across the RBC formulas for Deferred Tax Assets (DTAs). The AAA is conducting research and providing recommendations for the Task Force to consider. A preliminary report from the AAA was received in June, with a final report due Sept. 15. The preliminary report was exposed for comment and no comments were received. The purpose of this conference call is to discuss the current draft of the AAA report before finalization.

Tom Herget (Risk Lighthouse LLC representing the AAA) stated that the updated report will include four more aspects within the Special Considerations section on page 16 of the report. The AAA's opinion regarding the 300% authorized control level (ACL) as discussed on page 18 was revised. Art Panighetti (Northwestern Mutual Life representing AAA) noted that the effect of tax-sharing agreements on deferred tax admissibility is different for generally accepted accounting principles (GAAP) and statutory accounting principles (SAP). He advised that a company is limited to the amount actually paid to its parent company and the amount they can reasonably expect to recover through the tax-sharing agreement with the parent company. The AAA feels this is conservative, as it is a double limit, and a company can not assume they will get more from the parent than the reasonable standard would allow. Looking forward, the ability to recover departs from GAAP in that it is to be done on a separate company basis. A company cannot assume there are benefits from reporting on a consolidated basis. The AAA also feels that this is conservative, thus they concluded that they have no concerns regarding tax-sharing arrangements. This conclusion will be in Section 8A of the final report.

Bob Meilander (Northwestern Mutual Life representing AAA) addressed the relationship of RBC tax adjustments and RBC on DTAs, including whether tax credits should be allowed for weak companies. He clarified that this was specific to the tax credits in the RBC formula, and not the DTA arrangement. He felt that this issue was out of the scope related to DTAs because it relates to the broader RBC formula. He also noted that it would require significant changes to the RBC formula because currently only the life formula has tax offsets. Mr. Lauzon commented that the DTA credit and tax credit on C-1 asset losses are competing for the same gains to justify those credits.

Mark Verheyen (CNA representing AAA) addressed the value of a DTA in a sale. He advised that the AAA tried to bifurcate the value of a DTA in a sale to a couple of components. With regards to net operating losses and capital losses, he advised that the IRS has strict rules to prevent trafficking in DTAs by imposing limits on a company's ability to monetize the DTAs. With regards to loss reserve discounting, he noted that aspects would occur post-acquisition.

Mr. Meilander addressed whether there were any special considerations due to the unique circumstances of fraternal. He advised that since fraternal did not pay taxes, they will not have DTAs, and therefore, do not need special consideration.

Mr. Verheyen discussed the factor development being updated in the report pertaining to the appropriate charge in accordance with the nature of the risk. In the original AAA report, the charge was tied to an NAIC Class 1 bond, similar to the credit risk on a bond. At 300% of authorized control level (ACL), it was concluded that a more appropriate comparison would be achieved with an NAIC Class 3 bond. Further updates from the draft report include comparing a 500% authorized control level RBC percentage to an NAIC class 1 bond factor, and for those below the 300% authorized control level RBC, continue with a gradual increase in the RBC factor until a full charge-off of the deferred tax asset is done for the RBC calculation. Mr. Bruggeman asked whether the 500% RBC level was related to a rating agency level of capital. Mr. Verheyen commented that there is a difference between life and property and casualty companies at what ACL level the larger companies typically fall. Mr. Meilander stated he had a conversation with a rating agency representative who indicated that the 500% level was appropriate for NAIC Class 1, at least for life companies. He noted that the AAA is recommending this level for all company types.

Mr. Medley stated that most companies file through a holding company and the AAA preliminary report does not seem to fully address the risk of insurer's not receiving tax assets in the event of the holding company's failure. Mr. Panighetti stated that the refund amount the insurance company can recognize has to be reasonably expected to be received, and in such instances, it cannot reasonably expect to receive the refund. Another limit is the amount that was actually paid to the parent. Mr. Bruggeman indicated that this issue may relate more to a current receivable rather than a deferred tax asset. Mr. Lauzon inquired about the risk for situations when an insurer that filed on a consolidated basis has run into trouble and are looking for gains to offset losses. It was noted that such situations should be addressed through the tax-sharing agreement.

Mr. Felice indicated that one basic issue is the way the factors interact with RBC levels. One difference in the accounting, is that admission is on or off. DTA admission is geared to an RBC level akin to what would reasonably be expected to need regulatory intervention. The RBC charge is based on an imputed credit-risk value that a rating agency might give. He cautioned about the potential use of RBC results that are above the minimum action levels as the RBC was not intended for that purpose. Mr. Bruggeman indicated that from the accounting perspective, paragraph 10b of *SSAP No. 10R—Income Taxes* (SSAP No. 10R) it is a forward looking step. He advised that in situations where there are projections there is more risk. He advised that the current guidance in SSAP No. 10R will likely change, noting that it is intended for there to be some level of break points in the updated accounting guidance, but that there needs to be a balance in the accounting and the RBC.

Mr. Felice asked whether the AAA had looked at movement in RBC as opposed to RBC levels specifically (i.e., as RBC trends down, charges go up). Mr. Herget stated this was not considered. Mr. Felice indicated there could also be a look-back approach for RBC movement. Mr. Herget indicated the AAA would discuss the movement in RBC during their next call.

Mr. Felice advised that statutory accounting treatment creates a damper on the potential for risk. The charge to the AAA was to look at the risk from a global perspective, to look at any possibility from no statutory adjustment to what it is now. He stated that he would like to get more information on the DTA accounting treatment as a surrogate RBC charge. The preliminary report indicates that the accounting treatment increases volatility. Mr. Verheyen stated that the AAA reviewed admitted and nonadmitted DTA components for property and life companies. It is clear that the nonadmitted DTA increases significantly as the RBC ratios decrease. He said it is difficult to bifurcate how much is related to a valuation allowance and how much is due to the impact of other restrictions within SSAP No. 10R. He advised that Appendix 2 of the report shows how much of DTAs are nonadmitted currently and what that implies as a charge. Mr. Fritsch inquired if this is based on the limitation of admissibility only or if it takes into account not insurers being unable to realize the full amount. Mr. Meilander responded that it is both. The AAA took the RBC ratio result for the industry as a whole, took the average DTAs and average admitted DTAs, calculated as if the entire amount was admitted, then calculated the charge to get back to the same RBC level. Thus, the calculation included the impact of the valuation allowance and the limits themselves.

Mr. Felice said that as capital decreases, which essentially lowers the RBC ratio, the effect of a nonadmitted asset grows in terms of the overall impact on the financial condition of a company. Mr. Verheyen said the AAA report indicated that this is shown for all statement types. Mr. Stolte commented that the DTA Subgroup of the Statutory Accounting Practices Working Group is also waiting on the AAA report. Before RBC changes are made, the Task Force remember that changes could also still occur to SSAP No. 10R.

Mr. Fritsch inquired what the actual RBC percentages would be based on under the AAA report. Mr. Verheyen responded that the current property and casualty RBC charge inside the covariance was 5%, which reflects approximately 0.8 percent after covariance. The proposed charge would be outside the covariance and range from a 1% charge at a 500% RBC level up to 5% at a 300% RBC level. The percentage ramps down so that at or below a 200% RBC percentage, there would be a 100% RBC charge. Mr. Felice confirmed that the RBC percentages were without DTAs.

Mr. Felice advised that once the final report was received, the Task Force will try to have a conference call before the Fall National Meeting. If changes need to be made to the RBC formulas, they will need to be completed by the end of December. He noted that the Task Force would have more time for instructional or factor changes for 2011.

Having no further business, the Capital Adequacy (E) Task Force and the Statutory Accounting Principles (E) Working Group adjourned.

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