Conference Call

LIFE RISK-BASED CAPITAL (E) WORKING GROUP
Friday, February 14, 2020
11:00 a.m. ET / 10:00 a.m. CT / 9:00 a.m. MT / 8:00 a.m. PT

ROLL CALL

Philip Barlow, Chair District of Columbia William Leung Missouri
Steve Ostlund Alabama Rhonda Ahrens Nebraska
Perry Kupferman California Seong-min Eom New Jersey
Deborah Batista Colorado Bill Carmello New York
Wanchin Chou Connecticut Andy Schallhorn Oklahoma
Gilbert Moreau Florida Mike Boerner Texas
Vincent Tsang Illinois Tomasz Serbinowski Utah
John Robinson Minnesota

AGENDA

1. Discuss Comment Letters Received on Proposal to Implement a Longevity Risk Charge—Philip Barlow (DC)
   - New York Attachment 1
   - American Academy of Actuaries Attachment 2
   - American Council of Life Insurers Attachment 3
   - Nationwide Attachment 4
   - Pacific Life Attachment 5
   - Principal Attachment 6
   - Sapiens Attachment 7

2. Discuss Next Steps for the Proposal—Philip Barlow (DC) Attachments 8 & 9

3. Consider Adoption of Proposed C-3 Instructional Changes and C-3 Guidance—Philip Barlow (DC)
   - Instructional Changes Attachment 10
   - Guidance Attachment 11

4. Discuss Treatment of Alien Affiliates—Philip Barlow (DC) Attachment 12

5. Discuss Any Other Matters Brought Before the Working Group—Philip Barlow (DC)

6. Adjournment
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We support the proposal, but we do not support the use of covariance for this RBC charge.

**William B. Carmello, Jr., FSA, MAAA**  
Chief Life Actuary

**New York State Department of Financial Services**  
One Commerce Plaza, Albany, NY 12257
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January 23, 2020

Mr. Philip Barlow  
Chair, Life Risk-Based Capital (E) Working Group  
National Association of Insurance Commissioners

Via email: Dave Fleming (dfleming@naic.org)

Re: Exposure of proposed longevity risk charge

Dear Philip,

On behalf of the Longevity Risk Task Force of the American Academy of Actuaries,¹ I am providing additional comments on the exposure of the longevity risk charge and risk-based capital (RBC) instructions update from the working group’s December 7, 2019, meeting. We want to reinforce our recommendation to add a longevity risk charge to the Life Risk-Based Capital formula (LRBC), and to express our support to include an explicit correlation factor less than 100% within the C-2 component.

The task force’s longevity factor recommendation was developed in line with the guidance from the Life Risk-Based Capital (E) Working Group to target a statistical safety level of 95th percentile associated with a longevity risk event that occurs over a 10-year period. The recommended longevity risk factors were calibrated to that target level. Given the close relationship between longevity risk (living longer than expected) and mortality risk (living shorter than expected), the Academy correlation recommendation (of -33%) was developed to maintain the 95th percentile capital target for the aggregate risk of uncertain future life span.

There are two different versions of the RBC worksheet and instructions included in the exposure. One includes a structure to allow for an explicit and transparent correlation between longevity and mortality risk with a correlation factor that can be specified. The second structure implicitly includes 100% correlation between longevity and mortality with no ability to adjust to a different correlation factor. We support the first structure that provides for an explicit correlation assumption and do not support the second, which keeps correlation implicit in the formula and restricted to a value of 100%.

Adding longevity risk and mortality risk with 100% correlation within LRBC would only represent a 95th percentile outcome for companies with concentrated exposure to either longevity

¹ The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
risk or mortality risk, while representing an outcome materially in excess of 95th percentile for companies with exposure to both longevity and mortality risks. Using a 100% correlation could reduce the usefulness of LRBC as a consistent tool to identify potentially weakly capitalized life insurers.

A 100% correlation assumption would express the view that an adverse longevity outcome where annuitants are living longer than expected would, with 100% certainty, occur concurrent with an equally adverse mortality outcome where insureds are dying sooner than expected. We do not believe this to be a plausible view of how longevity and mortality risk are related. Using a 100% correlation would result in a total C-2 amount that exceeds the 95th percentile objective.

While the task force understands that some regulators might not support a correlation assumption of -33% based on the concern that it may overstate the diversification between mortality risk and longevity risk, we believe that positive 100% correlation is unreasonable and inconsistent with the current RBC framework. The current framework clearly recognizes that the individual risk factors are not expected to all happen at the same time, and that is why a correlation adjustment across the various risk (C-0, C-1, etc.) is part of the current formula. We strongly believe that a similar approach should be applied for the longevity and mortality risk categories, because they are clearly not 100% correlated (and, in our view, are at least partially negatively correlated).

I shared a summary of the correlation recommendation and rationale on behalf of the Longevity Risk Task Force at the NAIC Summer 2019 National Meeting and would gladly share additional detail or address questions at a future call if that would be useful to the working group in moving forward toward implementation of longevity risk within Life Risk-Based Capital.

*****

Should you have any questions or comments regarding this letter, please contact Ian Trepanier, life policy analyst at the Academy (trepanier@actuary.org).

Sincerely,

Paul Navratil, MAAA, FSA
Chairperson, Longevity Risk Task Force
American Academy of Actuaries
February 7, 2020

Mr. Philip Barlow
Chair, NAIC Life Risk-Based Capital (E) Working Group (Life RBC)

Re: Longevity Risk Charge Proposal

Dear Philip:

The American Council of Life Insurers (ACLI)\(^1\) appreciates the opportunity to provide comments regarding the longevity risk charge proposal exposed for comment during the NAIC Fall Meeting. We appreciate all of the hard work of the American Academy of Actuaries Longevity Risk Task Force (Academy) to develop the factors and provide the rationale behind the assumptions and regulators’ thorough review of their work.

ACLI is supportive of the Academy recommendation regarding the longevity risk charge, contingent upon a reasonable correlation factor between the C-2 charges (mortality and longevity). We support both the recommendation on the factors themselves, as well as the recommended -33% covariance adjustment. We have the following comments regarding the exposure:

**A reasonable correlation adjustment is appropriate and necessary**

ACLI urges Life RBC to adopt the formula reflecting the correlation factor. As pointed out in our November 26\(^{th}\) letter, excluding the correlation factor in the RBC pages is equivalent to a +100% correlation. Given the generally inverse relationship between mortality and longevity risk, ACLI does not believe this to be a reasonable assumption. Such an additive view of the risks would overstate the capital needed for C-2 risks for companies with a balanced mix of mortality and longevity exposure. At the direction of the Longevity Risk (A/E) Subgroup, the Academy provided a recommendation of -33% for a correlation adjustment based on their analysis. We found their rationale for the -33% compelling, and as the Academy notes, it is in line with other jurisdictions (-25% for Canada and EU, -50% for Bermuda).

**Longevity Risk Charge should be paired with updated mortality factors**

ACLI recommends Life RBC delay implementation of the new longevity risk charge until the new mortality factors are adopted. This approach will allow the Longevity Risk Subgroup additional time to evaluate factors and methodology to include longevity reinsurance transactions. This approach would incorporate

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\(^1\) The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI’s member companies are dedicated to protecting consumers’ financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI’s 280 member companies represent 94 percent of industry assets in the United States.
all C-2 changes for yearend 2021 reporting, assuming the mortality factors are approved in a timely manner. In the absence of deferred implementation, we would recommend making the first reporting of the longevity factors informational only; this approach will allow regulators to assess the industry impact and the effect of the correlation factor.

We look forward to discussing our comments on a future call.

Sincerely,

[Signature]

cc Dave Fleming, NAIC
February 7, 2020

Mr. Philip Barlow
Chair, NAIC Life Risk Based Capital (E) Working Group (Life RBC)

Via email: Dave Fleming (dfleming@naic.org)

Re: RBC risk charge for longevity

Dear Philip,

Nationwide appreciates the opportunity to provide comments on the longevity risk charge proposal exposed for comment during the NAIC Fall Meeting. We appreciate the efforts of the American Academy of Actuaries Longevity Risk Task Force (LRTF) in developing the proposal and of the regulators in reviewing their work.

About Nationwide

Nationwide, a Fortune 100 company based in Columbus, Ohio, is one of the largest and strongest diversified insurance and financial services organizations in the United States. Nationwide is rated A+ by both A.M. Best and Standard & Poor's. An industry leader in driving customer-focused innovation, Nationwide provides a full range of insurance and financial services products including auto, business, homeowners, farm and life insurance; public and private sector retirement plans, annuities and mutual funds; excess & surplus, specialty and surety; pet, motorcycle and boat insurance.

Nationwide supports the version of the Longevity C-2 proposal outlined in the November 22, 2019 letter from LRTF to the Longevity Risk (A/E) Subgroup. This version of the proposal allows for appropriate consideration of the covariance between longevity and mortality risk. We believe the LRTF’s proposal of a -33% correlation factor is well-supported and within the realm of assumptions used by other jurisdictions. However, if Life RBC is inclined to add conservatism to this assumption, the LRTF proposal allows the flexibility to substitute a more conservative factor.

Nationwide does not support the proposal that does not include a covariance adjustment. This version effectively assumes tail risks with respect to mortality and longevity are 100% correlated. Such an assumption does not reasonably take account of the generally inverse relationship between the two risks and would significantly overstate the amount of capital required to cover tail events for companies with a balanced mix of these risks.

Based on material presented by LRTF to the 2019 Spring NAIC meeting, Nationwide’s understanding of the intended scope of the longevity risk charge is that it excludes living benefit guarantees associated with variable annuities, even after the account value has been exhausted, as these would be captured in C3 Phase 2 testing. While the exposed instructions do not explicitly include such benefits in scope,
Nationwide suggests that specifically excluding VA living benefit guarantees from the scope would be useful in clarifying the intention.

Thank you for your consideration.

Sincerely,

[Signature]

Frederick W. Slater, MAAA, FSA
Senior Technical Directory, Nationwide Financial
February 10, 2020

Filed Electronically

Philip Barlow
Chair, NAIC Life Risk-Based Capital (E) Working Group

Re: Longevity Risk Charge Proposal

Philip:

Thank you for the opportunity to provide comments on the longevity risk charge proposal that was exposed for comment at the NAIC Fall Meeting in Austin. Pacific Life joins the ACLI in commending the quality work of the American Academy of Actuaries and the Longevity Risk (A/E) Subgroup in developing and supporting appropriate and reasonable factors to implement a new risk charge for longevity. With the ACLI we also support the Academy factors as well as an appropriate covariance adjustment, which the Academy recommends at -33%.

We strongly agree with the ACLI recommendation to adopt the formula that reflects the correlation factor. In addition to the reasons the ACLI cites, keeping the formula in Life RBC allows regulators the flexibility to monitor and adjust the correlation should future experience justify such a change. While a risk factor for longevity is currently prudent and appropriate, there is recent evidence of slowing improvement and even dis-improvement in mortality trends. Locking in a +100% correlation does is not necessary or appropriate, as ACLI also suggests.

As always, I am available for further comments or discussion

Sincerely,

Art Panighetti

Cc: Rhonda Ahrens, Chair Longevity Risk Subgroup
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VIA EMAIL (philip.barlow@dc.gov)

February 5, 2020

Philip Barlow
Chair, NAIC Life Risk-Based Capital (E) Working Group
Associate Commissioner for Insurance
Department of Insurance, Securities and Banking
1050 First Street, NE, Suite 801
Washington, DC 20002

RE: Principal Life Insurance Company
    Academy Proposal for Risk-Based Capital for Longevity Risk

Dear Mr. Barlow,

This letter is written on behalf of Principal Life Insurance Company (Principal) to provide comments on the American Academy of Actuaries Longevity Risk Working Group’s (Academy) proposal to add a longevity component to the C-2 factor within the Life RBC formula. We appreciate this opportunity to comment on the proposal. Principal is a top five payout annuity provider within the U.S. industry, with over $25B of reserves. We believe that payout products serve a critical need to retirees, providing income protection for life.

Principal encourages the Working Group to adopt the Academy proposal to include Longevity Risk within the RBC formula, including the Academy’s recommended -33% correlation between the new longevity risk charge and the mortality risk charge. Reflecting longevity risk has the potential to make the RBC formula more risk sensitive and more useful to regulators, provided it is designed appropriately.

Under consideration are a range of scenarios for correlation between mortality and longevity risk, including the Academy’s -33% recommendation, a 0% correlation, and a 100% correlation, which is embedded in one of the options exposed. The Academy extensively analyzed the correlation component of their recommendation. Through this work, the Academy determined that 100% correlation was inappropriate.

Principal agrees with the Academy and views a 100% correlation factor as being critically flawed. The 100% correlation scenario provides no recognition or incentive for companies to create a naturally hedged book of business. Adopting this version of the exposure would be unsupported by theory, observable results, and would be contrary to the work done by the Academy. It would also lead to a distorted impact on the RBC results of companies that issue both life insurance and payout annuity business.
A 100% correlation implies simultaneous tail events occur on Life and Annuity blocks. This suggests a pandemic-like event only strikes life-insured participants while a critical life extending event only impacts a company's annuitants. This is statistically improbable and implausible. A tail event for either a longevity risk or a mortality risk event would not discriminate towards either the annuitant block or the life block, creating a natural hedge.

In conclusion, Principal supports the Academy's recommendation to include a charge for Longevity Risk in the RBC formula with a correlation factor of -33%. Thank you again for the opportunity to comment on the proposal.

Sincerely,

Sam Early, FSA, MAAA
Actuary
(515) 248-3104
eary.sam@principal.com

Michelle Rosel, FSA, MAAA
Actuary
(515) 878-6454
roel,michelle@principal.com

cc: Via Email (rhonda.ahrens@nebraska.gov)  
Rhonda Ahrens  
Chair, Longevity Risk (A/E) Subgroup

cc: Via Email (dfleming@naic.org)  
Dave Fleming  
National Association of Insurance Commissioners

cc: Via Email (mike.yanacheak@iid.iow.gov)  
Mike Yanacheak  
Iowa Insurance Division
Via email:

Mr. Philip Barlow
Chair, NAIC Life Risk-Based Capital (E) Working Group

Re: Exposure for incorporating Longevity Risk has an RBC charge the Life/Fraternal RBC formula

In attachment #1 of the exposure, the listed references in the Annual Statement Source column of the formula page are not formatted in the same manner as the rest of the formula. Statement references shown in this column are normally assumed to be for the General Accounts unless stated otherwise in the instructions or the line description. Additionally, the terms “blue book” and “green book” as references are not used anywhere else in the risk-based capital formula; not even on LR006 which specifically addresses Separate Accounts. The references in this column also indicate a “row” number. The correct term is “line.”

The line description for each of the four data lines already indicate if the general account or the separate account is being addressed. Therefore, it would seem logical that the reference listed in the Annual Statement Source column need only indicate the Exhibit, Column and Line number, although it might be a good idea to include a reference to the Separate Accounts in Line (4).

The following suggestion maintains the format normally used in the formula.

<table>
<thead>
<tr>
<th></th>
<th>General Account Life Contingent Annuity Reserves</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>General Account Life Contingent Annuity Reserves</td>
<td>Exhibit 5 Column 2 Line 0299999, in part‡</td>
</tr>
<tr>
<td>(2)</td>
<td>General Account Life Contingent Supplemental Contract Reserves</td>
<td>Exhibit 5 Column 2 Line 0399999, in part‡</td>
</tr>
<tr>
<td>(3)</td>
<td>General Account Life Contingent Miscellaneous Reserves</td>
<td>Exhibit 5 Column 2 Line 0799999, in part‡</td>
</tr>
<tr>
<td>(4)</td>
<td>Separate Account (SA) Life Contingent Annuity Reserves</td>
<td>S/A Exhibit 3 Column 2 Line 0299999, in part‡</td>
</tr>
<tr>
<td>(5)</td>
<td>Total Life Contingent Annuity Reserves</td>
<td>Lines (1) + (2) + (3) + (4)</td>
</tr>
</tbody>
</table>

Connie Jasper Woodroof
NAIC Liaison, Sapiens StatementPro

Sapiens
## Capital Adequacy (E) Task Force

### RBC Proposal Form

| [ ] Capital Adequacy (E) Task Force | [ ] Health RBC (E) Working Group | [ ] Life RBC (E) Working Group |
| [ ] Catastrophe Risk (E) Subgroup | [ ] Investment RBC (E) Working Group | [ ] Operational Risk (E) Subgroup |
| [ ] C3 Phase II/ AG43 (E/A) Subgroup | [ ] P/C RBC (E) Working Group | [ x ] Longevity Risk (A/E) Subgroup |

**DATE:** 6/6/19  
**CONTACT PERSON:** Dave Fleming  
**TELEPHONE:** 816-783-8121  
**EMAIL ADDRESS:** dfleming@naic.org  
**ON BEHALF OF:** Longevity Risk (A/E) Subgroup  
**NAME:** Rhonda Ahrens, Chair  
**TITLE:** Chief Actuary  
**AFFILIATION:** Nebraska Department of Insurance  
**ADDRESS:** 1135 M Street, Suite 300  
Lincoln, NE 68501-2089

<table>
<thead>
<tr>
<th>FOR NAIC USE ONLY</th>
<th><strong>IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED</strong></th>
</tr>
</thead>
</table>
| **DATE:** 6/6/19  | [ ] Health RBC Blanks  
[ ] Health RBC Instructions  
[ ] OTHER ____________________________ |
| **CONTACT PERSON:** Dave Fleming  
**TELEPHONE:** 816-783-8121  
**EMAIL ADDRESS:** dfleming@naic.org  
**ON BEHALF OF:** Longevity Risk (A/E) Subgroup  
**NAME:** Rhonda Ahrens, Chair  
**TITLE:** Chief Actuary  
**AFFILIATION:** Nebraska Department of Insurance  
**ADDRESS:** 1135 M Street, Suite 300  
Lincoln, NE 68501-2089 |
| **FOR NAIC USE ONLY** | **IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED** |
| **DATE:** 6/6/19  | [ ] Health RBC Blanks  
[ ] Health RBC Instructions  
[ ] OTHER ____________________________ |

### DESCRIPTION OF CHANGE(S)

This proposal creates a new schedule in the life and fraternal RBC formula along with the necessary instructions to incorporate a charge for longevity risk.

### REASON OR JUSTIFICATION FOR CHANGE **

The Longevity Risk (A/E) Subgroup was charged with providing recommendations for recognizing longevity risk in statutory reserves and/or RBC, as appropriate. This represents the Subgroup’s recommendation as it applies to RBC.

### Additional Staff Comments:

- 11-4-19: Proposal was exposed for comments (DBF)

**This section must be completed on all forms.**
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LONGEVITY RISK
LRtbd

Basis of Factors
The factors chosen represent surplus needed to provide for claims in excess of reserves resulting from increased policyholder longevity calibrated to a 95th percentile level. For the purpose of this calibration aggregate reserves were assumed to provide for an 85th percentile outcome.

Longevity risk was considered over the entire lifetime of the policies since these annuity policies are generally not subject to repricing. Calibration of longevity risk considered both trend risk based on uncertainty in future population mortality improvements, as well as level or volatility risk which derives from misestimation of current population mortality rates or random fluctuations. Trend risk applies equally to all populations whereas level and volatility risk factors decrease with larger portfolios consistent with the law of large numbers.

Statutory reserve was chosen as the exposure base as a consistent measure of the economic exposure to increased longevity. Factors were also scaled by reserve level since number of insured policyholders is a less accessible measure of company specific volatility risk. Factors provided are pre-tax and were developed assuming a 21% tax adjustment would be subsequently applied.

Specific Instructions for Application of the Formula
Annual statement reference is for the total life contingent reserve for the products in scope. The scope includes annuity products with life contingent payments where benefits are to be distributed in the form of an annuity. It does not include annuity products that are not life contingent, or deferred annuity products where the policyholder has a right but not an obligation to annuitize. Line (3) for General Account Life Contingent Miscellaneous reserves is included in the event there are any reserves for products in scope reported on Exhibit 5 line 0799999; it is not meant to include cash flow testing reserves reported on this line. Included in scope are:

- Single Premium Immediate Annuities (SPIA) and other payout annuities in pay status
- Deferred Payout Annuities which will enter annuity pay status in the future upon annuitization
- Structured Settlements for annuitants with any life contingent benefits
- Group Annuities, such as those associated with pension liabilities with both immediate and deferred benefits

{additional instructions would be required if Longevity Reinsurance product remains in scope – placeholder pending decision on scope}

The total reserve exposure is then further broken down by size as in a tax table. This breakdown will not appear on the RBC filing software or on the printed copy, as the application of factors to reserves is completed automatically. The calculation is as follows:

<table>
<thead>
<tr>
<th>Line (5)</th>
<th>Life Contingent Annuity Reserves</th>
<th>(1) Statement Value</th>
<th>Factor</th>
<th>(2) RBC Requirement</th>
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</thead>
<tbody>
<tr>
<td>First 250 Million</td>
<td></td>
<td></td>
<td>X 0.0171</td>
<td></td>
</tr>
<tr>
<td>Next 250 Million</td>
<td></td>
<td></td>
<td>X 0.0108</td>
<td></td>
</tr>
<tr>
<td>Next 500 Million</td>
<td></td>
<td></td>
<td>X 0.0095</td>
<td></td>
</tr>
<tr>
<td>Over 1,000 Million</td>
<td></td>
<td></td>
<td>X 0.0089</td>
<td></td>
</tr>
</tbody>
</table>

Total Life Contingent Annuity Reserves

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### Longevity Risk

<table>
<thead>
<tr>
<th>Life Contingent Annuity Reserves</th>
<th>Annual Statement Source</th>
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</thead>
<tbody>
<tr>
<td>(1) General Account Life Contingent Annuity Reserves</td>
<td>Blue Book Exhibit 5 column 2 row 02999999, in part ‡</td>
</tr>
<tr>
<td>(2) General Account Life Contingent Supplemental Contract Reserves</td>
<td>Blue Book Exhibit 5 column 2 row 03999999, in part ‡</td>
</tr>
<tr>
<td>(3) General Account Life Contingent Miscellaneous Reserves</td>
<td>Blue Book Exhibit 5 column 2 row 07999999, in part ‡</td>
</tr>
<tr>
<td>(4) Separate Account Life Contingent Annuity Reserves</td>
<td>Green Book Exhibit 3 column 2 row 02999999, in part ‡</td>
</tr>
<tr>
<td>(5) Total Life Contingent Annuity Reserves</td>
<td>Lines (1) + (2) + (3) + (4)</td>
</tr>
</tbody>
</table>

† The tiered calculation is illustrated in the Longevity Risk section of the risk-based capital instructions.
‡ Include only the portion of reserves for products in scope per the instructions

Denotes items that must be manually entered on the filing software.
<table>
<thead>
<tr>
<th>Source</th>
<th>RBC Amount</th>
<th>Tax Factor</th>
<th>RBC Tax Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>(134) Long-Term Care</td>
<td>LR019 Health Premiums Column (2) Line (28) + LR023 Long-Term Care Column (4) Line (7)</td>
<td>X 0.2100</td>
<td>=</td>
</tr>
<tr>
<td>(135) Life Insurance C-2 Risk</td>
<td>LR025 Life Insurance Column (2) Line (8)</td>
<td>X 0.2100</td>
<td>=</td>
</tr>
<tr>
<td>(136) Group Insurance C-2 Risk</td>
<td>LR025 Life Insurance Column (2) Lines (20) and (21)</td>
<td>X 0.2100</td>
<td>=</td>
</tr>
<tr>
<td>(136b) Longevity C-2 Risk</td>
<td>LRtbd Longevity Risk Column (2) Line (5)</td>
<td>X 0.2100</td>
<td>=</td>
</tr>
<tr>
<td>(137) Disability and Long-Term Care Health Claim Reserves</td>
<td>LR024 Health Claim Reserves Column (4) Line (9) + Line (15)</td>
<td>X 0.2100</td>
<td>=</td>
</tr>
<tr>
<td>(138) Premium Stabilization Credit</td>
<td>LR026 Premium Stabilization Reserves Column (2) Line (10)</td>
<td>X 0.0000</td>
<td>=</td>
</tr>
<tr>
<td>(139) Total C-2 Risk</td>
<td>Lines (133) + (134) + (135) + (136) + (136b) + (137) + (138)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(140) Interest Rate Risk</td>
<td>LR027 Interest Rate Risk Column (3) Line (36)</td>
<td>X 0.2100</td>
<td>=</td>
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<tr>
<td>(141) Health Credit Risk</td>
<td>LR028 Health Credit Risk Column (2) Line (7)</td>
<td>X 0.0000</td>
<td>=</td>
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<tr>
<td>(142) Market Risk</td>
<td>LR027 Interest Rate Risk Column (3) Line (37)</td>
<td>X 0.2100</td>
<td>=</td>
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<tr>
<td>(143) Business Risk</td>
<td>LR029 Business Risk Column (2) Line (40)</td>
<td>X 0.2100</td>
<td>=</td>
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<tr>
<td>(144) Health Administrative Expenses</td>
<td>LR029 Business Risk Column (2) Line (57)</td>
<td>X 0.0000</td>
<td>=</td>
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<tr>
<td>(145) Total Tax Effect</td>
<td>Lines (109) + (120) + (132) + (139) + (140) + (141) + (142) + (143) + (144)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### CALCULATION OF AUTHORIZED CONTROL LEVEL RISK-BASED CAPITAL (CONTINUED)

<table>
<thead>
<tr>
<th>Source</th>
<th>Requirement</th>
</tr>
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<tbody>
<tr>
<td>LR025 Life Insurance Column (2) Line (8)</td>
<td>(43) Individual and Industrial Life Insurance</td>
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<tr>
<td>LR025 Life Insurance Column (2) Lines (20) and (21)</td>
<td>(44) Group and Credit Life Insurance and FEGI/SGLI</td>
</tr>
<tr>
<td>LRtbd Longevity Risk Column (2) Line (5)</td>
<td>(44b) Longevity Risk</td>
</tr>
<tr>
<td>LR024 Health Claim Reserves Column (4) Line (18)</td>
<td>(45) Total Health Insurance</td>
</tr>
<tr>
<td>LR026 Premium Stabilization Reserves Column (2) Line (10)</td>
<td>(46) Premium Stabilization Reserve Credit</td>
</tr>
<tr>
<td>Sum of Lines (43) through (46)</td>
<td>(47) Total (C-2) - Pre-Tax</td>
</tr>
<tr>
<td>LR030 Calculation of Tax Effect for Life and Fraternal Risk-Based Capital Column (2) Line (139)</td>
<td>(48) (C-2) Tax Effect</td>
</tr>
<tr>
<td>Line (47) - Line (48)</td>
<td>(49) Net (C-2) - Post-Tax</td>
</tr>
</tbody>
</table>
November 22, 2019

Ms. Rhonda Ahrens
Chair, Longevity Risk (A/E) Subgroup
National Association of Insurance Commissioners

Via email: Dave Fleming (dfleming@naic.org)

Re: RBC Blank Implementation of Longevity C-2

Dear Rhonda,

On behalf of the Longevity Risk Task Force of the American Academy of Actuaries,¹ I am providing sample changes to risk-based capital (RBC) blanks to implement longevity C-2 factors to assist the Longevity Risk Subgroup.

Changes from the existing blanks are highlighted in yellow in the attached excel file.

• The LRtbd tab was previously provided to calculate the pre-tax longevity C-2 amount based on the factors proposed by the LRTF.
• Changes to LR030 include longevity risk in the calculation of tax effect for C-2.
• Changes to LR031 include longevity risk in the calculation of Net C-2 Post-Tax.

It was necessary to add new lines to LR030 and LR031 for longevity risk. This was done in this sample by adding lines numbered with “b.” It may be preferable in a final version to renumber the entire calculation so that longevity risk uses a uniquely numbered line.

Correlation between longevity and mortality is included in the formulas suggested for implementation. The formula includes a TBD Correlation Factor which can be inserted into the formula pending a decision by Life RBC on correlation.

At your request we have also included an alternative formula (provided to the right in the exhibit) that includes a Guardrail Factor that could be used to limit the reduction from correlation. We do not believe this Guardrail Factor is needed as part of the implementation of longevity C-2. If correlation is implemented with the Guardrail Factor, we recommend that it be

¹ The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
reviewed and phased out over time rather than become a permanent factor increasing the complexity of the RBC calculation.

*****

Should you have any questions or comments regarding this letter, please contact Ian Trepanier, life policy analyst at the Academy (trepanier@actuary.org).

Sincerely,

Paul Navratil, MAAA, FSA
Chairperson, Longevity Risk Task Force
American Academy of Actuaries
## Calculation of Tax Effect for Life and Fraternal Risk-Based Capital (Continued)

<table>
<thead>
<tr>
<th>Source</th>
<th>RBC Amount</th>
<th>Tax Factor</th>
<th>RBC Tax Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td>Confidential when Completed</td>
<td>Confidential when Completed</td>
<td>Confidential when Completed</td>
</tr>
</tbody>
</table>

| (134) | Long-Term Care | LR019 Health Premiums Column (2) Line (20) + LR023 Long-Term Care Column (4) Line (7) | X | 0.2100 | n |
| (135) | Life Insurance C-2 Risk | LR025 Life Insurance Column (2) Line (8) | X | 0.2100 | n |
| (136) | Group Insurance C-2 Risk | LR025 Life Insurance Column (2) Lines (20) and (21) | X | 0.2100 | n |
| (137) | Longevity C-2 Risk | LR03d Longevity Risk Column (2) Line (5) | X | 0.2100 | n |
| (138) | Disability and Long-Term Care Health Claim Reserves | LR024 Health Claim Reserves Column (4) Line (9) + Line (15) | X | 0.2100 | n |
| (139) | Premium Stabilization Credit | LR026 Premium Stabilization Reserves Column (2) Line (10) | X | 0.0000 | n |

### Alternative with Guardrail Factor:

\[
\text{Total C-2 Risk} = (L_{135}) + (L_{134}) + (L_{137}) + \sqrt{(L_{135})^2 + (L_{136b})^2 + 2 \times (TBD Correlation Factor) \times (L_{135}) \times (L_{136b})} \]

### Total Tax Effect

Lines (109) + (120) + (132) + (139) + (140) + (141) + (142) + (143) + (144)
<table>
<thead>
<tr>
<th>Company Name</th>
<th>Source</th>
<th>Confidential when Completed</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance Risk (C-2)</td>
<td>LR025 Life Insurance Column (2) Line (8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group and Credit Life Insurance and FEGISGLI</td>
<td>LR025 Life Insurance Column (2) Lines (20) and (21)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Longevity Risk</td>
<td>LRtbd Longevity Risk Column (2) Line (5)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Health Insurance</td>
<td>LR024 Health Claim Reserves Column (4) Line (18)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premium Stabilization Reserve Credit</td>
<td>LR026 Premium Stabilization Reserves Column (2) Line (10)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (C-2) - Pre-Tax</td>
<td>L(45) + L(46) + Square Root of [(L(43) + L(44))^2 + L(44b)^2 + 2 * (TBD Correlation Factor) * (L(43) + L(44)) * L(44b)]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (C-2) - Post-Tax</td>
<td>Line (47) - Line (48)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Rate Risk (C-3a)</td>
<td>LR027 Interest Rate Risk Column (3) Line (36)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Interest Rate Risk - Pre-Tax</td>
<td>LR030 Calculation of Tax Effect for Life and Fraternal Risk-Based Capital Column (2) Line (139)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Interest Rate Risk - Post-Tax</td>
<td>Line (50) - Line (51)</td>
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<tr>
<td>Health Credit Risk (C-3b)</td>
<td>LR028 Health Credit Risk Column (2) Line (7)</td>
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<tr>
<td>Total Health Credit Risk - Pre-Tax</td>
<td>LR030 Calculation of Tax Effect for Life and Fraternal Risk-Based Capital Column (2) Line (141)</td>
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<tr>
<td>Total Health Credit Risk - Post-Tax</td>
<td>Line (53) - Line (54)</td>
<td></td>
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<tr>
<td>Market Risk (C-3c)</td>
<td>LR027 Interest Rate Risk Column (3) Line (37)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Market Risk - Pre-Tax</td>
<td>LR030 Calculation of Tax Effect for Life and Fraternal Risk-Based Capital Column (2) Line (142)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Market Risk - Post-Tax</td>
<td>Line (56) - Line (57)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Overview

The amount reported on Line (35) and Line (37) is calculated using the 7-step process defined below. This calculation applies to all policies and contracts that have been valued following the requirements of AG-43 or VM-21. For contracts whose reserve was determined using the Alternative Methodology (VM-21 Section 7) see step 3 while all other contracts follow steps 1 and 2, then all contracts follow steps 4 - 7.

Step 1 CTE98: The first step is to determine CTE98 by applying the one of the two methodologies described in paragraph A below.

Step 2 C-3 RBC: using the formulas in paragraph B, determine the C-3 RBC amount based on the amount calculated in step (1). Floor this amount at $0.

Step 3 Determine the C-3 RBC using the Alternative Methodology for any business subject to that requirements as described in paragraph C.

Step 4 As described in paragraph D below, the C-3 RBC amount is the sum of the amounts determined in steps 2 and 3 above, but not less than zero. The Total Asset Requirement is the Reserve based on the requirements of VM-21 prior to the application of any phase-in, plus the C-3 RBC amount.

Step 5: For a company that has elected a Phase-in for reserves following VM-21 Section 2.B., the C-3 RBC amount is to be phased-in over the same time period following the requirements in paragraph E below.

Step 6 Apply the smoothing rules (if applicable) to the C-3 RBC amount in step (4) or (5) as applicable.

Step 7 Divide the amount from Step 4, 5, or 6 (as appropriate) by (1-enacted maximum federal corporate income tax rate). Split this amount into an interest rate risk portion and a market risk portion, as described in paragraph G.

The interest rate portion of the risk should be included in Line (35) and the market risk portion in Line (37).

The C-3 RBC is calculated as follows:

A. CTE (98) is calculated as follows: Except for policies and contracts subject to the Alternative Methodology (See C. below), apply the CTE methodology described in NAIC Valuation Manual VM-21 and calculate the CTE (98) as the numerical average of the 2 percent largest values of the Scenario Reserves, as defined by Section 4 of VM-21. In performing this calculation, the process and methods used to calculate the Scenario Reserves use the requirements of VM-21 and should be the same as used for the reserve calculations. The effect of Federal Income Tax should be handled following one of the following two methods

1. If using the Macro Tax Adjustment (MTA): The modeled cash flows will ignore the effect of Federal Income Tax. As a result, for each individual scenario, the numerical value of the scenario reserve used in this calculation should be identical to that for the same scenario in the Aggregate Reserve calculation under VM-21. Federal Income Tax is reflected later in the formula in paragraph B.1.

2. If using Specific Tax Recognition (STR): At the option of the company, CTE After-Tax (98) (CTEAT (98)) may be calculated using an approach in which the effect of Federal Income Tax is reflected in the projection of Accumulated Deficiencies, as defined in Section 4.A. of VM-21, when calculating the Scenario Reserve for each
scenario. To reflect the effect of Federal Income Tax, the company should find a reasonable and consistent basis for approximating the evolution of tax reserves in the projection, taking into account restrictions around the size of the tax reserves (e.g., that tax reserve must equal or exceed the cash surrender value for a given contract). The Accumulated Deficiency at the end of each projection year should also be discounted at a rate that reflects the projected after-tax discount rates in that year. In addition, the company should add the Tax Adjustment as described below to the calculated CTEAT (98) value.

3. A company that has elected to calculate CTEAT (98) using STR may not switch back to using MTA in the projection of Accumulated Deficiencies without prominently disclosing that change in the certification and supporting memorandum. The company should also disclose the methodology adopted, and the rationale for its adoption, in the documentation required by paragraph J below.

4. Application of the Tax Adjustment: Under the U.S. IRC, the tax reserve is defined. It can never exceed the statutory reserve nor be less than the cash surrender value. If a company is using STR and if the company’s actual tax reserves exceed the projected tax reserves at the beginning of the projection, a tax adjustment is required. The CTEAT (98) must be increased on an approximate basis to correct for the understatement of modeled tax expense. The additional taxable income at the time of claim will be realized over the projection and will be approximated using the duration to worst, i.e., the duration producing the lowest present value for each scenario. The method of developing the approximate tax adjustment is described below.

The increase to CTEAT (98) may be approximated as the corporate tax rate times f times the difference between the company’s actual tax reserves and projected tax reserves at the start of the projections. For this calculation, f is calculated as follows: For the scenarios reflected in calculating CTE (98), the scenario reserve is determined and its associated projection duration is tabulated. At each such duration, the ratio of the number of contracts in force (or covered lives for group contracts) to the number of contracts in force (or covered lives) at the start of the modeling projection is calculated. The average ratio is then calculated over all CTE (98) scenarios and f is one minus this average ratio. If the Alternative Method is used, f is approximated as 0.5.

B. Determination of RBC amount using stochastic modeling:

1. If using the MTA: Calculate the RBC Requirement by the following formula in which the statutory reserve is the actual reserve reported in the Annual Statement, in the second term – i.e., the difference between statutory reserves and tax reserves multiplied by the Federal Income Tax Rate – may not exceed the portion of the company’s non-admitted deferred tax assets attributable to the same portfolio of contracts to which VM-21 is applied in calculating statutory reserves:

$$25\% \times (CTE (98) + \text{Additional Standard Projection Amount} - \text{Statutory Reserve}) \times (1 - \text{Federal Income Tax Rate}) - (\text{Statutory Reserve} - \text{Tax Reserve}) \times \text{Federal Income Tax Rate}$$

2. If the company elects to use the STR: the C-3 RBC is determined by the following formula:

$$25\% \times (\text{CTEAT (98)} + \text{Additional Standard Projection Amount} - \text{Statutory Reserve})$$

The Additional Standard Projection Amount is calculated using the methodology outlined in Section 6 of VM-21.

C. Determination of C-3 RBC using Alternative Methodology: This calculation applies to all policies and contracts that have been valued following the requirements of AG-43 or VM-21, for which the reserve was determined using the Alternative Methodology (VM-21 Section 7). The C-3 RBC amount is determined by applying the methodology as defined in Appendix 2 to these instructions.
D. The C-3 RBC amount is the sum of the amounts determined in paragraphs B and C above, but not less than zero. The TAR is defined as the Reserve determined according to VM-21 plus the C-3 RBC amount. All values are prior to any consideration of Phase-in allowances for either reserve or C-3 RBC, or any C-3 RBC smoothing allowance. The RBC values are post-tax.

E. Phase in: A company that has elected to phase-in the effect of the new reserve requirements following VM-21 Section 2.B. shall phase in the effect on C-3 RBC over the same time period, using the following steps:

1. Begin with the C-3 RBC amount from step 7 for Dec. 31, 2019 LR027 Line (37) instructions for all business within the scope of the Variable Annuities modeling requirements as of 12/31/19. Add to this any voluntary reserves which were subtracted from TAR when the C-3 RBC amount reported for 2019 was determined. Also add to this the amount of C-3 RBC computed in the same manner as the 2019 value for any reinsurance ceded that is expected to be recaptured in 2020 and in the scope of the Variable Annuities modeling requirements. This amount is 2019 RBC

2. Determine the C-3 RBC amount as of 12/31/19 using paragraphs A, B, C, and D for the same inforce business as in 1. Exclude any voluntary reserves in these calculations. Labeled as 2019 RBC New.

3. Determine the phase-in amount (PIA) as the excess of 2019RBC New over 2019RBC

4. For 12/31/2020, compute the C-3 RBC following paragraphs A – D above, then subtract PIA times (2/3)

5. For 12/31/2021, compute the C-3 RBC following paragraphs A – D above, then subtract PIA times (1/3)

Guidance Note: For a company that has adopted a Phase-in for reserves longer than 3 years, adjust the above formula to reflect the actual period with uniform amortization amounts during that period.

Guidance Note: An adjustment is made for voluntary reserves. Voluntary reserve means any reserve that is not required by AG-43, VM-21 and/or a state in which the company is doing business and was subtracted from TAR in 2019 to determine the RBC.

F. Smoothing of C-3 RBC amount

A company should decide whether or not to smooth the C-3 RBC calculated in paragraph D or E above to determine the amount in Line (37). For any business reinsured under a coinsurance agreement that complies with all applicable reinsurance reserve credit “transfer of risk” requirements, the ceding company shall reduce the reserve in proportion to the business ceded while the assuming company shall use a reserve consistent with the business assumed.

A company may choose to smooth the C-3 RBC calculated in paragraph D or E above. A company is required to get approval from its domestic regulator prior to changing its decision about smoothing from the prior year. In addition, a company that has elected to smooth the risk-based capital is required to get approval from its domestic regulator prior to smoothing if it has experienced a material change in its Clearly Defined Hedging Strategy from the prior year. For this purpose, a company’s Clearly Defined Hedging Strategy is considered to have experienced a material change if any of the items outlined in VM-21 Section 1.D.2 in the current year differs from that in the prior year.

To implement smoothing, use the following steps. If a company does not qualify to smooth or a decision has been made not to smooth, go to paragraph G.

1. Determine the C-3 RBC amount calculated in paragraph D or E above

2. Determine the aggregate reserve for the contracts covered by the Variable Annuity Stochastic modeling requirements.

3. Determine the ratio of the C-3 RBC / reserve for current year.

4. Determine the C-3 RBC as actually reported for the prior year Lines (35) plus (37) and adjust that amount to a post-tax amount by multiplying by (1- enacted maximum federal corporate income tax rate). Restate the amount to remove the effect of any voluntary reserves held in prior years that materially differ in amount from the voluntary reserves held in the current year.

5. Determine the aggregate reserve for the contracts in scope of these requirements for the prior year-end. Restate the aggregate reserve to remove any voluntary reserves held for the prior year-end that materially differ in amount from the voluntary reserves held as of the current year-end.

6. Determine the ratio of the C-3 RBC / reserve for prior year.

7. Determine a ratio as 0.4*(6) plus 0.6*(3) {40% prior year ratio and 60% current year ratio}.
8. Determine the risk-based capital for current year as the product of (7) and (2) \{adjust (2) to be actual 12/31 reserve\}.

G. The amount determined in paragraphs D., E., or F. above for the contracts shall be divided by (1-enacted maximum federal corporate income tax rate) to arrive at a pre-tax amount. This pre-tax amount shall be split into a component for interest rate risk and a component for market risk. Neither component may be less than zero. The provision for the interest rate risk, if any, is to be reported in Line (35). The market risk component is reported in Line (37).

The amount reported in Line (37) is to be combined with the C-1cs component for covariance purposes.

H. The way grouping (of funds and of contracts), sampling, number of scenarios, and simplification methods are handled is the responsibility of the company. However, all these methods are subject to Actuarial Standards of Practice, supporting documentation and justification, and should be identical to those used in calculating the company’s statutory reserves following VM-21.

I. Certification of the work done to set the C-3 RBC amount for Variable Annuities and Similar products are the same as are required for reserves as part of VM-31. The certification should specify that the actuary is not opining on the adequacy of the company's surplus or its future financial condition.

The certification(s) should be submitted by hard copy with any state requiring an RBC hard copy.

J. An actuarial memorandum should be constructed documenting the methodology and assumptions upon which the required capital for the variable annuities and similar products is determined. Since the starting point for the C-3 RBC calculation is the cash flow modeling used for the reserves, the documentation requirements for reserves (VM-31) should be followed for the C-3 RBC. The reserve report may be incorporated by reference, with this C-3 RBC memorandum focused on identifying differences and items unique to the C-3 RBC process, or at the company's option, the documentation of C-3 RBC may be merged into the VA Report with the differences for C-3 RBC discussed in a separate section of the Memorandum as outlined in VM-31.

These differences that would need to be identified either in the RBC Actuarial Memorandum or the VA Report will typically include:

* the basis for considering federal income tax,
* whether or not smoothing was applied, and the effect of that smoothing,
* whether or not a phase in was used, and the impact on the reported values,
* If the company elects to calculate CTEAT (98) using STR whereby the effect of Federal Income Tax is reflected in the projection of Accumulated Deficiencies, the company should still disclose in the memorandum the Total Asset Requirement and C-3 RBC that would be obtained if the company had elected to use the MTA method.

* Documentation of the alternative methodology calculations, if applicable, and

* Documentation of how the C-3 RBC values were allocated to the interest and market risk components.

This actuarial memorandum will be confidential and available to regulators upon request.
The lines on the alternative calculations page will not be required for 2019 or later.

The total of all annual statement reserves representing exposure to C–3 risk on Line (36) should equal the following:

Exhibit 5, Column 2, Line 0199999
– Page 2, Column 3, Line 6
+ Exhibit 5, Column 2, Line 0299999
+ Exhibit 5, Column 2, Line 0399999
+ Exhibit 7, Column 1, Line 14
+ Separate Accounts Page 3, Column 3, Line 1 plus Line 2 after deducting (a) funds in unitized separate accounts with no underlying guaranteed minimum return and no unreinsured guaranteed living benefits; (b) non-indexed separate accounts that are not cash flow tested with guarantees less than 4 percent; (c) non-cash-flow-tested experience rated pension reserves/liabilities; and (d) guaranteed indexed separate accounts using a Class II investment strategy.
– Non policyholder reserves reported on Exhibit 7
+ Exhibit 5, Column 2, Line 0799997
+ Schedule S, Part 1, Section 1, Column 12
– Schedule S, Part 3, Section 1, Column 14
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During the Life Risk-Based Capital (E) Working Group’s discussion at the Fall National Meeting, an issue was raised with respect to voluntary reserves and smoothing that may impact those companies that choose to early adopt for 2019. To highlight and address this issue, the Working Group exposed proposed modifications to the 2020 RBC instructions for comment. Additionally, as indicated, the Working Group is also now exposing the following recommendation for 2019 reporting for comment:

For insurers that meet the following three criteria:

1. Are early adopting the revised methodology for variable annuity reserves and C-3 RBC;
2. Held voluntary reserves in 2018 and intend to reduce or eliminate voluntary reserves in 2019;
3. Are currently smoothing or intend to request permission to smooth for 2019;

It is recommended those insurers do not smooth for 2019. Those insurers may then choose to begin smoothing in 2020. The smoothing instructions have been proposed to be revised for 2020 and the impact of the change will be a discontinuity in the C-3 RBC amount between 2019 and 2020 for those companies meeting the criteria identified above. A change in smoothing does require approval from the state of domicile.
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June 24, 2010

Mr. Louis Felice  
Chair, NAIC Capital Adequacy Task Force  
New York State Insurance Department  
25 Beaver Street  
New York, NY 10004

Re: Risk Based Capital Treatment of Foreign Life Insurance Subsidiaries

Dear Mr. Felice:

Following up on our earlier discussion, we are requesting a change in the RBC Instructions to address the anomalous and distortive impact of foreign life insurance subsidiaries on the RBC ratio. I am referring to the fact that the contribution to the parent company’s risk based capital for “Affiliated Alien Life Insurers - All Others”, as they are referred to in the RBC Instructions, is the entire statutory carrying value of such foreign companies.

The illogical effect of this requirement is that, for a company with even an average RBC ratio, an increase in the foreign insurance company’s carrying value reduces that company’s RBC ratio. The higher the parent company’s RBC ratio the more pronounced this impact becomes. The result is that the RBC ratios of companies, like New York Life, that have significant foreign insurance operations, are significantly understated in comparison to similar companies whose U.S. operating insurance companies do not have foreign subsidiaries.

For the most part, this anomaly only affects mutual life insurers. This is because most stock life insurers that have foreign life insurance affiliates have a structure in which these affiliates are owned by a non-insurance holding company rather than by a U.S. life insurance company. As a result, the capital of the foreign affiliates is not taken into account in calculating the U.S. operating life insurer’s RBC ratio.

We would like to propose a change that would achieve parity between mutual and stock companies and more accurately reflect the financial condition of the parent of any foreign insurance subsidiaries. We recommend that RBC be revised so that the foreign insurance affiliate’s statutory carrying value is excluded from both total adjusted capital (the numerator) and RBC (the denominator) of the RBC ratio. We believe this change could be implemented by making the following revisions to the RBC Instructions (references are to the 2009 Instructions):
1. On page 67, add the following at the end of the section titled “Calculation of Authorized Control Level Risk-Based Capital”: “In recognition of the exclusion of the carrying value of Affiliated Alien Life Insurers - All Others from TAC, the carrying value of these entities is also to be excluded from the calculation of C-0 risk based capital.”

2. On page 67, in the section titled “Calculation of Total Adjusted Capital” in the first sentence of the last paragraph on the page, make the following change: “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 of the parent for purposes of computing TAC.”

3. On page 76, revise the section under the heading “Alien Insurance Affiliates – Other”, to read as follows:

“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. 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. 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.”

We ask that the NAIC Capital Adequacy Task Force consider this proposal either on its own or by referral to the Life Insurance Risk Based Capital Working Group. We hope you agree that it is important to eliminate this anomalous situation and therefore we ask that this change be implemented for the 2010 reporting year. Please let us know if you need additional information or if we can assist in your review in any way.

Thank you.

Sincerely,

Joel M. Steinberg
Senior Vice President and Chief Actuary
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.
Subsidary 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 of the parent 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.
Holding Company Value in Excess of Indirectly Owned Insurance Affiliates
The pre-tax risk-based capital charge for the parent insurer preparing the calculation is a 30 percent charge against the holding company value in excess of the indirectly owned insurance affiliates as calculated in the prior example.

Report information in the appropriate columns of the worksheet, omitting those columns that do not apply (Column (3) – NAIC Company Code and Column (4) affiliate’s risk-based capital). Subsidiaries reported in this section will be assigned an affiliate code of “7” for Holding Company Value in Excess of Indirectly Owned Insurance Affiliates.

The total of Indirectly Owned Insurers (life and property and casualty) plus the amount of Holding Company Value in Excess of Indirectly Owned Insurance Affiliates should equal Schedule D, Part 6, Section 1, Line 0699999 for the reporting of preferred stock and Schedule D, Part 6, Section 1, Line 1599999 for common stock.

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, 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. 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.”