

Draft Pending Adoption

Attachment Five
Capital Adequacy (E) Task Force
07/28/21

Draft: 07/26/21

Property and Casualty Risk-Based Capital (E) Working Group Virtual Meeting (*in lieu of meeting at the 2021 Summer National Meeting*) July 22, 2021

The Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met July 22, 2021. The following Working Group members participated: Tom Botsko, Chair (OH); Wanchin Chou (CT); Robert Ridenour (FL); Judy Mottar (IL); Anna Krylova (NM); Halina Smosna (NY); Miriam Fisk (TX); and Randy Milquet (WI).

1) Adopted its June 9 and April 27 Minutes

Mr. Botsko said the Working Group met June 9 and April 27 and took the following action: 1) adopted proposal 2021-05-P (Underwriting Risk Line 1 Factors); 2) adopted proposal 2021-08-P (P/C Bond Factors and Instructions); 3) adopted proposal 2021-03-P (Credit Risk Instruction Modification); 4) forwarded the response to the Restructuring Mechanisms (E) Subgroup; and 5) heard a presentation on property/casualty (P/C) risk-based capital (RBC) underwriting risk factors from the American Academy of Actuaries (Academy).

Mr. Chou made a motion, seconded by Mr. Milquet, to adopt the Working Group June 9 (Attachment Five-A) and April 27 minutes (Attachment Five-B). The motion passed unanimously.

2. Adopted the Report of the Catastrophe Risk (E) Subgroup

Mr. Chou said the Subgroup met July 15 (Attachment Five-C) and took the following action: 1) adopted its June 1 and April 26 minutes, which included the following action: a) exposed and forwarded the response to a request for proposed changes to the P/C RBC catastrophe component; b) heard an update from its Catastrophe Model Technical Review Ad Hoc Group; and c) discussed the possibility of allowing additional third-party models or adjustments to the vendor models; 2) adopted its 2021 working agenda items; 3) received an update from its Catastrophe Model Technical Review Ad Hoc Group and 4) heard a presentation from AIR Worldwide on the wildfire model.

Mr. Chou made a motion, seconded by Ms. Smosna, to adopt the report of the Catastrophe Risk (E) Subgroup. The motion passed unanimously.

3. Adopted the 2021 P/C RBC Newsletter

Mr. Botsko said each year, NAIC staff incorporate all adopted current year proposals into the current year (RBC) formula. The 2021 changes have been incorporated into the P/C RBC newsletter.

Mr. Chou made a motion, seconded by Mr. Milquet, to adopt the 2021 P/C RBC newsletter (Attachment Five-D). The motion passed unanimously.

4. Discussed 2020 P/C RBC Statistics

Mr. Botsko said the results of the 2020 P/C RBC report compiled by NAIC staff were fairly consistent with prior years. There were 24 companies that triggered the trend test; only 1.7% of the total companies fell under the 200% RBC ratio, which is slightly less than the historical failing percentage of around 2.3%. Overall, the asset risk has slightly increased over time.

The Working Group unanimously approved the 2020 P/C RBC statistics to be posted to the Working Group's web page.

5. Discussed its 2021 Working Agenda

Mr. Botsko summarized the changes to the Working Group's 2021 working agenda, which included the following substantial changes: 1) changing the completion date of the "evaluate the possibility of allowing additional third-party models or adjustments to the vendor models to calculate the cat model losses," "evaluate if changes should be made to the P/C formula to better assess companies in runoff," "evaluate the underwriting risk line 1 factors in the P/C formula," and "evaluate R3

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adjustment for operational risk charge” items; and 2) deleting the “consider eliminating the different treatment of uncollateralized reinsurance recoverable from authorized versus unauthorized, unrated reinsurers” and “remove the embedded 3% operational risk component contained in the reinsurance contingent credit risk factor of Rcat” items from the working agenda.

Mr. Chou made a motion, seconded by Mr. Milquet, to adopt the Working Group’s 2021 working agenda. The motion passed unanimously.

6. Heard Updates on P/C RBC Underwriting Risk Projects from the Academy

David Traugott (Academy) provided a status on different projects being conducted by the Academy that all related to calibrating various components of the premium risk and reserve risk in the P/C RBC formula. He said all the Academy projects are described in three different reports. The first report, which was distributed during the Spring National Meeting provided indicated premium and reserve risk line 4 factors based on an analysis of data through 2017. Mr. Traugott also said the second report, which will be shared with the Working Group by the end of 2021, related to updating the investment income adjustment factors (IIAs) in the RBC formula line 7 and line 8 for premium risk and reserve risk, respectively. As many of the line 4 factors are decreasing, Mr. Traugott said the Academy recommended the Working Group consider implementing the line 4 factors along with updated investment income adjustment factors to offset the decreases. Lastly, Mr. Traugott stated that the concentration factors for the underwriting premium and reserve risks have not been reviewed since the RBC formula was first implemented. The Academy planned to provide the last report, which is related to updating these factors during the first half of 2022. Furthermore, Mr. Traugott said there are two additional analyses requested by the Working Group, which are related to catastrophe adjustment factors and industry average development/loss ratios. Scott Williamson (Reinsurance Association of America—RAA) thanked the Academy for the improvements made to the calibration methodology for the R4 and R5 line 4 factors. Those improvements resolved the concerns RAA raised several years ago about the prior methodology. Mr. Williamson said the results from the recent update of the factors underscore that the improvements are working, as evidenced by the decreased volatility in the indicated change by line. He also asked the Academy to continue working to prevent double counting of CAT losses between underwriting risk and Rcat. With respect to proposed changes to the investment income adjustment factors, he recommended that the Academy consider using the discount method, corporate bond index yield curve segment rates, and payment patterns that are now prescribed for tax loss reserve discounting under the federal Tax Cuts and Jobs Act. He said these rates better approximate the industry’s investment yield and bond portfolio duration. Ralph Blanchard (Travelers) advised the Academy that the preliminary estimate of losses from Property Claims Services (PCS) may not be the same as the final estimate of losses. Mr. Traugott anticipated that the Academy will complete the review before mid-2022.

Mr. Botsko said he appreciates what all the Academy does for the Working Group. He said the Working Group will provide the needed support to ensure the projects are completed in time.

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

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