

Draft: 10/28/21

Property and Casualty Risk-Based Capital (E) Working Group
Virtual Meeting (*in lieu of meeting at the 2021 Fall National Meeting*)
October 25, 2021

The Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met Oct. 25, 2021. The following Working Group members participated: Tom Botsko, Chair, and Dale Bruggeman (OH); Wanchin Chou, Susan Andrews, and Qing He (CT); Nicole Altieri Crockett (FL); Judy Mottar (IL); Leatrice Geckler (NM); Halina Smosna (NY); Will Davis (SC); Rebecca Armon, Miriam Fisk, and Monica Avila (TX).

1. Adopted its Summer National Meeting Minutes

Mr. Botsko said the Working Group met July 22 in lieu of the Summer National Meeting and took the following action: 1) adopted its June 9 and April 27 minutes, which included the following action: a) adopted proposal 2021-05-P (Underwriting Risk Line 1 Factors); b) adopted proposal 2021-08-P (P/C Bond Factors and Instructions); c) adopted proposal 2021-03-P (Credit Risk Instruction Modification); d) forwarded the response to the Restructuring Mechanisms (E) Subgroup; and e) heard a presentation on property/casualty (P/C) risk-based capital (RBC) underwriting risk factors from the American Academy of Actuaries (Academy); 2) adopted the report of the Catastrophe Risk (E) Subgroup, which included the following action: a) adopted its June 1 and April 26 minutes; b) adopted its 2021 working agenda items; c) received an update from its Catastrophe Model Technical Review Ad Hoc Group and; and d) heard a presentation from AIR Worldwide on its wildfire model; 3) adopted the 2021 P/C RBC Newsletter; 4) discussed 2020 P/C RBC statistics; 5) discussed its 2021 working agenda items; and 6) heard a presentation on a P/C RBC underwriting risk project from the Academy.

Mr. Chou made a motion, seconded by Ms. Mottar, to adopt the Working Group's July 22 minutes (*see NAIC Proceedings – Summer 2021, Capital Adequacy (E) Task Force, Attachment Five*). The motion passed unanimously.

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

Mr. Chou said the Subgroup met Sept. 28 and took the following action: 1) discussed its 2021 working agenda; 2) heard a presentation from Karen Clark & Company (KCC) regarding the KCC U.S. wildfire reference model; and 3) discussed the possibility of allowing additional third-party models or adjustments to the Vendor Models. He also stated that the Subgroup is finishing up the technical review with Risk Management Solutions (RMS) on the wildfire model and working on impact analysis with three wildfire modelers—AIR, KCC, and RMS. He said the Subgroup expects that the wildfire risk structure will be ready for discussion in December. He also indicated that the KCC hurricane models have been reviewed and verified by the Florida Commission. Most of the Subgroup members agreed that KCC seems to qualify under the same standards as the other modeling firms have for hurricane and earthquake.

Mr. Chou also provided an overview of the Subgroup's Oct. 27 meeting in lieu of the Fall National Meeting, which included the following action: 1) adopted its Sept. 28 minutes; 2) discussed the possibility of allowing third-party models calculate the catastrophe model losses; 3) considered exposure of proposal 2021-15-CR (Adding KCC Model); 4) heard an update from the Catastrophe Model Technical Review Ad Hoc Group; 5) heard a presentation from RMS regarding its Wildfire High Definition (HD) Model; and 5) discussed the impact analysis on different third-party commercial wildfire models.

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

3. Exposed a Draft Recommendation to the Restructuring Mechanism (E) Subgroup

Mr. Botsko said the Runoff Ad Hoc Group met Oct. 13 to continue discussing the best course of treatment of runoff companies. He stated that the drafted recommendation indicated that a run-off company should include the following characteristics: 1) no renewing of policies for at least 12 months; 2) no new direct or assumed business; and 3) no additional runoff blocks of business. Mr. Botsko also said the ad hoc group agrees with the international treatment of runoff companies, which is handled through the Analysis and Exam Teams. In addition, the ad hoc group recommended that the Working Group adjust the instruction to better reflect the unique runoff characteristics, such as removing: 1) the trend test from the RBC calculation; 2) the charge for premium growth; and 3) Rcat from the RBC formula. Lastly, Mr. Botsko stated that this recommendation letter will be shared

with the Health Risk-Based Capital (E) Working Group and the Life Risk-Based Capital (E) Working Group for further consideration.

The Working Group agreed to expose the recommendation to the Restructuring Mechanism (E) Subgroup for a 30-day public comment period ending Nov. 24.

4. Exposed Proposal 2021-14-P (R3 Factor Adjustment)

Mr. Botsko said when the reinsurance recoverable credit risk charge was implemented in 2018, a load of operational risk was embedded in the R3 charge. Currently, the operational risk is separately addressed in the RBC as a stand-alone capital add-on; it results with duplication of the operational risk charge on the reinsurance recoverable component. He stated that this proposal intends to eliminate the double-counting effect of the operational risk charge on the component. He said NAIC staff performed an analysis to determine the impact on the RBC action levels by reducing the 2% reinsurance recoverable RBC charge for all reinsurance designation equivalents (Attachment Six-xx). The result indicated that the impact is insignificant, as only three companies with Total Adjusted Capital (TAC) between zero to 75 million will change the RBC results from action level to no action.

The Working Group agreed to expose proposal 2021-14-P (R3 Factor Adjustment) for a 30-day public comment period ending Nov. 24.

5. Heard Updates on a P/C RBC Underwriting Risk Project from the Academy

David Traugott (Academy) provided a status on the recommended adjustments to the formulas for premium and reserve risk to reflect the impact of interest rates. He stated that this project is still a work in progress status; the results may change based on further review by the Academy Property and Casualty Risk-Based Capital Committee. He also stated that this presentation relates to premium risk only; an analysis of reserve risk is underway. During the presentation, he provided a brief overview of: 1) background of the Investment Income Adjustments (IIAs); 2) interest rate history 3) payment patterns; 4) risk charge versus interest rate; and 5) analysis of present value calibration. He also stated that the next steps in the Committee work plan include: 1) further examining the line-by-line risk charges to assess the extent to which the general approach described in the presentation is applicable by line; 2) applying the present value analysis to the RBC data for the short-tail lines; and 3) applying the same type of analysis to reserve risk.

Mr. Botsko said he appreciates 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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