CAPITAL ADEQUACY (E) TASK FORCE

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Memorandum Regarding NAIC Designations for Schedule D, Part 2 – Section 2 – Common Stocks (Attachment Twelve)
Memorandum Regarding Foreign Mutual Funds (Attachment Thirteen)
The Capital Adequacy (E) Task Force met in Austin, Texas Dec. 8, 2019. The following Task Force members participated: David Altmaier, Chair (FL); Todd E. Kiser, Vice Chair, represented by Dan Applegarth (UT); Lori K. Wing-Heier represented by Michael Ricker (AK); Jim L. Ridling represented by Sheila Travis (AL); Andrew N. Mais represented by Wachin Chou (CT); Stephen C. Taylor represented by Philip Barlow (DC); Trinidad Navarro represented by Ryllyn Brown (DE); Doug Ommen represented by Mike Yanachek (IA); Robert H. Muriel represented by Kevin Fry and Vincent Tsang (IL); Vicki Schmidt represented by Tish Becker (KS); Steve Kelley represented by Kathleen Orth (MN); Chlora Lindley-Myers represented by Shannon Schmoeger (MO); Mike Causey represented by Jackie Obusek (NC); Marlene Caride (NJ); John G. Franchini represented by Anna Krylova (NM); Barbara D. Richardson represented by Stephanie McGee (NV); Jillian Froment represented by Tom Botsko and Dale Bruggeman (OH); Glen Mulready represented by Eli Snowbarger (OK); Elizabeth Kelleher Dwyer represented by John Tudino (RI); Kent Sullivan represented by Mike Boerner (TX); Mike Kreidler represented by Patrick McNaughton (WA); and Mark Afable represented by Randy Milquet (WI).

1. **Adopted its Oct. 8 Minutes**

   The Task Force met Oct. 8 and took the following action: 1) adopted its Sept. 18 minutes, which was an e-vote to adopt its 2020 proposed charges; and 2) exposed its referrals: 1) NAIC Designations for Schedule D, Part 2-Section 2; 2) Mutual Funds; 3) Comprehensive Funds; and 4) Supplemental Investment Risk Interrogatories (SIRI).

   Ms. Orth made a motion, seconded by Mr. Botsko, to adopt the Task Force’s Oct. 8 minutes (Attachment One). The motion passed unanimously.

2. **Adopted its Working Group Reports**

   Mr. Barlow mentioned an addition to the Life Risk-Based Capital (E) Working Group’s summary report to include phase-in and spreading of variable annuity reserves capital.

   Mr. Milquet made a motion, seconded by Ms. Obusek, to adopt the reports of the: Health Risk-Based Capital (E) Working Group, including its July 17 minutes (Attachment Two); Life Risk-Based Capital (E) Working Group (Attachment Three); and Property and Casualty Risk-Based Capital (E) Working Group (Attachment Four). The motion passed.

3. **Adopted its Working Agenda**

   Mr. McNaughton said the completion dates for stop loss insurance, health care receivables and the health test ad hoc group were extended to better reflect the expected completion of each of these projects. The referral letter to the Task Force on guaranty funds, long-term care (LTC) and health maintenance organizations (HMOs) and the review of LTC and long-term disability under the H2 component were removed from the agenda. The Health Risk-Based Capital (E) Working Group completed the memorandum on the LTC and guaranty funds and referred it to the Task Force, and the Working Group determined that due to materiality, the item on LTC and long-term disability would be removed and, if needed, can be reassessed in the future.

   Mr. Botsko summarized the changes to the to the 2020 Property and Casualty Risk-Based Capital (E) Working Group working agenda: 1) removed “evaluate the proposed changes from the Investment Risk-Based Capital (E) Working Group related to bond changes in the property/casualty (P/C) formula” in the new items section; and 2) added “evaluate the possibility of using the NAIC as a centralized location for reinsurer designations” and “evaluate the possibility of allowing additional third-party models to calculate the cat model losses” in the carry-over items and new items sections, respectively.

   Mr. Botsko said that the Affiliated Investment Ad Hoc Group has continued its bi-weekly conference call since the Summer National Meeting and met in person on Dec. 6. The Ad Hoc Group has finalized the Directly Owned Subsidiary instructions for all three forms. It also has made progress on the Indirect Owned Subsidiary and Alien Subsidiary instructions. The Ad Hoc Group will continue to move forward with the remaining instructions over the next few months. Mr. Botsko said that he plans to present the Direct and Indirect instructions to the respective working groups and the Task Force by the 2020 Spring National Meeting.
Draft Pending Adoption

Mr. Botsko made a motion, seconded by Mr. Boerner, to adopt its Working Agenda (Attachment Five). The motion passed.

4. Received an LTC/Guaranty Fund Memorandum

Mr. McNaughton summarized a referral from the Task Force regarding adopted amendments to the Life and Health Insurance Guaranty Association Model Act (#520) and to determine if changes were warranted to the health RBC formula. The health RBC formula currently includes a 0.5% charge on all premiums that are subject to a guaranty fund assessment.

Mr. McNaughton added that through their analysis: 1) that while some states have not yet adopted the model law changes, once adopted, a majority of the states will allow for a premium tax or corporate tax offset, or the ability to impose a minimal surcharge to help offset the assessment; 2) at a maximum, HMOs would incur a charge of 2% (depending upon each state’s guaranty fund law) and if they were unable to pay or meet this obligation, they could request a waiver from the guaranty fund of some or all of the assessment; and 3) given the differences and complexities between states in the regulation and taxation of HMOs and that the risk-based capital (RBC) formula is a generic formula, the goal of which is to be applied as uniformly as possible and not at such a granular level, it would be difficult to incorporate such changes into the formula that could address all the different scenarios needed to provide a different charge, offset or credit to such a distinct population in such diverse regulatory environments.

Mr. McNaughton said based on these findings, the Working Group does not recommend any changes to the health RBC (Attachment Six).

6. Adopted the Proposal of the Property and Casualty Risk-Based Capital (E) Working Group

a. Proposal 2019-11-P (Clarification to Instructions Regarding Lloyd’s of London) and the 2019 Reporting Guideline (Attachment Seven)

Mr. Botsko said upon review of 2018 Annual Statement Schedule F, Part 3 filings, it was observed that many filers reported reinsurance recoverable amounts due from Lloyd’s of London syndicates as NAIC 6 – unrated; therefore, they are subject to the highest R3 charge. He stated that the purpose of this proposal is to clarify that the reinsurance recoverable from individual syndicates of Lloyd’s of London that are covered under the Lloyd’s Central Fund may use the lowest financial strength group rating received from an approved rating agency. He said that because the deadline for the change of the 2019 RBC instructions has passed, a guideline for 2019 RBC reporting will be posted to the Working Group’s web page pending the proposal’s adoption by the Working Group. He also stated that the Working Group received no comments during the exposure period.

b. Proposal 2019-12-P (Remove PR038 Adjustment for Reinsurance Penalty) (Attachment Eight)

Mr. Botsko said that because the computation of the RBC charge for reinsurance recoverable amounts has been moved to the Annual Statement Schedule F, Part 3 in 2018 reporting, the adjustment for reinsurance penalty for affiliates applicable to Schedule F in PR038 is no longer needed. He stated that the purpose of this proposal is to eliminate the adjustment for reinsurance penalty for affiliates applicable to Schedule F section in PR038. Mr. Botsko also said the Working Group received no comments during the exposure period.


Mr. Botsko said in order to avoid double-counting the catastrophe losses in the RBC formula, the U.S. and non-U.S. catastrophe event lists provide a routine annual update for those catastrophe events that should be excluded from the R5 calculation. He stated that the Subgroup exposed the list during its Nov. 8 conference call; no comments were received during the exposure period. Mr. Botsko also indicated that any additional events that occur between Nov. 1 and Dec. 31 will be exposed during the first week of January. The Subgroup will either schedule a conference call or conduct an e-vote to adopt the updated list after the Committee assignment meeting.

Mr. Botsko made a motion, seconded by Mr. Chou, to adopt the proposals of the Property and Casualty Risk-Based Capital Working Group. The motion passed.

7. Adopted the RBC Preamble

Commissioner Altmaier said that the purpose of the RBC preamble (Attachment Ten) is to provide some history and background on the RBC as a reference when reviewing the numerous referrals and proposals that pass to the Capital Adequacy
Commissioner Altmaier said that he received a comment that indicates there are some states that are allowing insurers’ permitted practices to adjust their RBC outside the accounting permitted practices to their financial statement. The wording in the preamble states that permitted practices are not allowed, and the Task Force was not aware that this was allowed by any state.

Ms. Brown said that if permitted practices are allowed, there should be some type of disclosure of the permitted practice and why it is allowed. She added that it is not a good idea to allow permitted practices in the RBC, which would be a disadvantage of companies that are following the rules. Mr. Barlow said that he has heard there are permitted practices in RBC, which he believes there should not be because of the significant solvency to the insurance company. Mr. Bruggeman said that RBC is a tool used to monitor solvency, and when a company’s RBC falls into various action levels that may require monitoring, adjusting those numbers will skew their results. He added that permitted practices are allowed in the financial statement and that is where they belong, not by adjusting the RBC numerator. Mr. Fry said that there may be state laws that allow for a permitted practice in RBC. Mr. McNaughton said that this tool is a cornerstone to solvency regulation and because the Risk-Based Capital (RBC) for Insurers Model Act (#312 and #315) is an accreditation standard, if this is allowed, there could be some regulatory arbitrage.

Commissioner Altmaier said that the paragraph in question would be paragraph 10 of Attachment 11, which states: “RBC instructions, RBC reports and adjusted report(s) are intended solely for use by the commissioner/state in monitoring the solvency of insurers and the need for possible corrective action with respect to insurers and are considered confidential. All domestic insurers are required to file an RBC report unless exempt by the Commissioner. There are no state permitted practices to modify the RBC formula, and all insurers are required to abide by the RBC instructions.” He said adoption would eliminate that state’s authority to allow permitted practices. Mr. Fry suggested that the Task Force table this adoption. Lou Felice (NAIC) said that RBC should not allow for permitted practices to the dominator, which would change the RBC formula and factors. The nominator could be an accounting permitted practice, or a state permitted practice that flows into RBC. Mr. Yanacheak said he is in favor of moving forward with the current wording today. Commissioner Altmaier said that if adopted, the Task Force could look into the states that are allowing a permitted practice and if the numerator or dominator is being adjusted.

Mr. Yanacheak made a motion, seconded by Mr. Barlow, to adopt the RBC preamble. The motion passed.

8. **Heard Comments on Exposed Referrals**

Commissioner Altmaier said that the Task Force has received numerous referrals regarding investments that could affect the RBC formula. Three referrals were exposed for a 30-day public comment period ending Nov. 8, and the Task Force requested that the following questions be considered: a) if changes to the RBC formula were appropriate; b) if so, what was the best way for the Task Force to move forward; and c) what resources should the Task Force consider for research and analysis of these investments.

a. **Comprehensive Fund Referral (Attachment Twelve and Attachment Thirteen)**

Nancy Bennett (American Academy of Actuaries—Academy) said that the risk in a single bond is not the same as the risk associated with comprehensive bonds. She added that using speculative risk analysis (default rate and credit experience) to rate bond funds may reduce the capital requirement for fund investments below state insurance regulators’ state statistical level. Ms. Bennett said that the Academy recommends further analysis so that similar treatment does not undermind the RBC calculation.

Josh Bean, representing the American Council of Life Insurers (ACLI) and North American Securities Valuation Association (NASVA), said they encourage the Task Force to continue discussion on the bond. He said they preferred stock focused on fund structures’ risk profile and to determine a risk-based factor appropriate for this investment portfolio. Mr. Bean said that these funds offer insurance companies access to diversification and solid risk adjusted returns, as well as liquidity and cash flows well suited to insurers asset/liability matching needs.

Chris Anderson (Anderson Insights—AI) said that for regulatory purposes, open end funds (which include exchange-traded funds [ETFs]) should not be treated like closed-end funds (actual bonds) and could encourage insurers to invest in assets with low C-1 factors for various reasons; 1) they do not have the same predictability and periodicity of cash flows of actual bonds; 2) they have indeterminate, not fixed, lives; 3) they do not offer promises of cash flows that insurers can use to provide their...
Projected future liability needs, and due to time constraints, they will end on item 4) they are not subject to credit analysis because there is no party to be evaluated making specific promises concerning the amounts of future cash flows. He asked that the Task Force determine whether it is appropriate to assign the same risk factor for these funds as if they were a bond or preferred stock.

Commissioner Altmaier said the comment letter from Everest is included in the materials.

Erinn King (Payden & Rygel) said that Payden & Rygel is in support of assigning bond factors for fixed income designation for all bond and preferred stock funds, and ETFs, both private and public, regardless of which schedule they are reported on in the annual statement that are determined/designated by the Securities Valuation Office (SVO). She added that funds allow smaller insurers to achieve better pricing economies of scale and diversification of investment risk than many can find purchasing individual securities, but the RBC charges are inconsistent across the formulas.

Kelly Sweppenhiser (Vanguard) focused on two important points from Vanguard’s research: 1) there is 1/10 of 1% of bond mutual funds that apply for designations, so there is minimal impact to RBC; and 2) if bond funds were afforded bond-like treatment in RBC, that amount would slowly increase, and a small subset of U.S. Securities and Exchange Commission (SEC)-registered bonds would be submitted for designation.

b. Structured Notes Referral

Mr. Bean stressed that the RBC should exclude non-admitted structured notes from receiving an RBC charge. The RBC rules for P/C companies refer to the net book/adjusted carrying values (net of a non-admit amount) when calculating RBC charges. This is inconsistent with the treatment in the life RBC formula (reducing statutory capital and surplus by 100% of the net book/adjusted carrying value of the asset), and the gross asset (before reducing it for non-admitted) has an RBC charge associated with it. Mr. Bean said that should an insurer receive a permitted practice to admit structured notes as “other derivatives,” the ACLI and NASVA recommend the RBC rules associated with derivatives on Schedule DB be modified to treat such instruments like equity securities.

Commissioner Altmaier asked the Task Force members to consider the comments heard today so when the Task Force reconvenes, a determination can be made on how to move forward.

10. Discussed Any Other Matters

Commissioner Altmaier thanked Mr. McNaughton for his years of service as chair of the Health Risk-Based Capital (E) Working Group, as well as for his expertise and diligence with the health formula. Commissioner Altmaier expressed admiration for Mr. McNaughton receiving the Robert Dineen Award for Outstanding Service and Contribution and said he looks forward to seeing him participate in a non-regulatory capacity.

Having no further business, the Capital Adequacy (E) Task Force adjourned.
The Capital Adequacy (E) Task Force met via conference call Oct. 8, 2019. The following Task Force members participated: David Altmaier, Chair (FL); Todd E. Kiser, Vice Chair, represented by Jake Garn (UT); Ricardo Lara represented by Perry Kupferman (CA); Andrew N. Mais represented by Wanchin Chou (CT); Stephen C. Taylor represented by Philip Barlow (DC); Doug Ommen represented by Mike Yanacheak (IA); Robert H. Muriel represented by Kevin Fry (IL); Vicki Schmidt represented by Tish Becker (KS); Chlora Lindley-Myers (MO); Marlene Caride represented by Diana Sherman (NJ); John G. Franchini represented by Anna Krylova (NM); Jillian Froment represented by Dale Bruggeman (OH); Glen Mulready represented by Joel Sander (OK); Elizabeth Kelleher Dwyer represented by Jack Broccoli (RI); Kent Sullivan represented by Jim Everett (NY); Mike Kreidler represented by Randy Milquet (WA); and Mark Afable represented by Randy Milquet (WI). Also participating was Jim Everett (NY).

1. **Adopted its Sept. 18 Minutes**

Director Lindley-Myers made a motion, seconded by Mr. Bruggeman, to adopt the Task Force’s Sept. 18 minutes (Attachment One) and 2020 proposed charges (see NAIC Proceedings – Fall 2019, Financial Condition (E) Committee Attachment One-A). The motion passed unanimously.

2. **Exposed its Referrals**

Commissioner Altmaier said the Task Force has received numerous referrals dating back to August 2018. The referrals relate to investments and various other groups under the Financial Condition (E) Committee, such as the Statutory Accounting Principles (E) Working Group and the Valuation of Securities (E) Task Force. The referrals indicate that some changes to the way certain investments are treated either from an accounting standpoint or an investment standpoint which may or may not result in necessary changes to the risk-based capital (RBC). Due to the volume of referrals, it is apparent that some can be grouped together, and the purpose of this call is to discuss a pathway forward. Items 2a through 2e, which correspond to attachments 2–6, are open for questions or discussion today. These items will be exposed for a 30-day public comment period ending Nov. 8 to receive input on how to approach each one of the referrals.

Commissioner Altmaier added that this is an opportunity for interested stakeholders to provide feedback to the Capital Adequacy (E) Task Force members on how these referrals could help state insurance regulators identify insurance companies that might have issues from a capital standpoint and how the RBC formula can be more efficient to meet that goal by updating investment risk factors within the formula.

a. **NAIC Designations for Schedule D, Part 2-Section 2 – Common Stocks** – Mr. Fry said the Valuation of Securities (E) Task Force did look at this and item C – Comprehensive Funds, which are somewhat related, and he said the framework already allows for this investment through the Statement of Statutory Accounting Principles (SSAP) No. 26R—Other Admitted Assets; but was written a long time ago, and these investments are allowed on Schedule D Part 1 and are given the same factor as bonds. He added that in the life and fraternal RBC, these funds are reported on Schedule BA and are given the same bond treatment. He believes that these funds should be given a designation similar to bonds instead of a factor similar to common stock, which is a fixed flat factor charge of 15% for property/casualty (P/C) and health. He added that re-evaluating the funds would be a lengthy process and a quicker way of updating would be to treat it like a bond.

Commissioner Altmaier added that some of these referrals are similar to each other; although listed separately on the agenda, they can be lumped into one comment letter to the Capital Adequacy (E) Task Force. Mr. Barlow added that the investments should be evaluated first to determine the appropriate charge, and he disagrees that just giving them the bond factor is wrong. He added, especially when the sole purpose of this referral is to change the RBC factor, he disagrees with changing the factor firsts and then evaluating what it should be later. He stressed that the analysis to determine the appropriate risk charge should be done first, and he stated that it is very clear that the proposal’s objective is to change the RBC charge. He asked for clarification on the exposure and whether these referrals will apply to all RBC formulas. Commissioner Altmaier said for now, they will remain at the Task Force level; after the comments are reviewed, the Task Force will determine the appropriate direction, whether that will be to refer them to
all RBC working groups for further review or not. He added that if any of the proposal moves beyond this exposure period, there will be other opportunities for further discussion on methodology and what changes should occur in the formulas.

b. Mutual Funds – Commissioner Altmaier pointed out that this referral was received some time ago and was also directed to the Valuation of Securities (E) Task Force. Julie Gann (NAIC) said the Statutory Accounting Principle (E) Working Group already adopted this change based on feedback received during its exposure period and determined that it was previously included in SSAP No. 30R—Unaffiliated Common Stock and inadvertently excluded mutual funds reported on the common stock schedule. She added that a referral to the Blanks (E) Working Group to include designations for mutual funds and include them in the top 10 exposures based on diversified and non-diversified funds. Hearing no comments, the Capital Adequacy (E) Task Force will consider this referral complete.

c. Comprehensive Funds – Commissioner Altmaier said both of these referrals came from the Valuation of Securities (E) Task Force regarding funds that predominately hold bonds. Charles Therriault (NAIC) said the Securities Valuation Office (SVO) is charged with evaluating credit risk and assigning a designation based on that risk by looking into the required payments within the investment and what the source of those payments are (e.g., for a typical corporate bond, the source of those payments are the operating business entity whose financial statements are reviewed and analyzed along with the bond’s legal agreement, and an opinion is formed based on the likelihood that the contractual payments will be met; that opinion is provided by assigning a designation). Funds are a portfolio of individual bonds, and the portfolio is the source of those payments. For example, if an investor holds 10 bonds directly, those 10 bonds would be exposed to a credit risk; therefore, the fund would be exposed to the same level of credit risk, assuming they all have the same market value change and credit events. The substance of the risk has not changed, just the legal form. The weighted average ratings factor (WARF) is applied to each underlying investment and reflects the relative risk of each of the delineations and credit risk A bonds with an A+ rating would get a factor of roughly 100. If compared to another bond with a rating of B+, it would get a factor of 50, 858 times the level of risk; and through the application of these rating factors to the underlying investments they are aggregated up to essentially become an aggregate fund, the risk level, which is why there is a lot of comfort in terms of the analysis process and how NAIC designations are assigned to this portfolio. Analysis would be difficult based on the number of different classes of investment included in a fund. Mr. Everett said the first thing to consider is how many mutual funds and exchange-traded funds (ETFs) are being reported on Schedule D Part 2 Section 2. Back in the time when ETFs were first given bond treatment, there were only two or three funds. Currently, these funds are receiving a 15% charge, same as common stock for the health and P/C RBC. It would be helpful to know what the growth rate is and what amount is being talked about. There are definitely more funds today, and if the market is much larger and the percentage of funds are at an increase, then it would seem that the best place to catch hold of it, if dealing with credit default risk and averaging ratings as opposed to averaging percentages of default, it would be helpful to capture that information on a separate schedule. Mr. Everett reiterated that it is important to understand the trend before factors are changed and its impact to RBC. Commissioner Altmaier agreed and asked that NAIC staff provide any analysis already collected on these funds. Mr. Barlow said it would also be helpful to find out where in the schedule these funds are currently reported; assuming that the volume is significant, there might be some benefit in either creating a specific schedule or an identifier to put all these funds together. He added that in a lot of cases, companies are misreporting and examiners have missed things or are not quite sure where they should be reported. If a separate schedule for these funds were added, only then could the real exposure be seen and the different funds and individual investments be differentiated. Commissioner Altmaier said the Capital Adequacy (E) Task Force would welcome any feedback from the interested stakeholders on the referral or on any of the comments from the state insurance regulators’ discussion, these should be included in comments during the 30-day public comment period.

d. Supplemental Investment Risk Interrogatories (SIRI) – Ms. Gann explained that this was exposed at the Summer National Meeting, and the Statutory Accounting Principles (E) Working Group will discuss comments received during the Fall National Meeting. Pending comments, this proposal may not be finalized at that time. Her summary stated that if an equity exposure is diversified, open-end diversified funds would not necessarily have to be looked into to identify all exposures for aggregation. However, if a closed end fund is not diversified or an open-end fund is not diversified, then the exposure would need to be looked through to identify what the exposures are, and it would need to aggregate those with other individual exposures. Essentially, it is preventing the inclusion of a fund environment to prevent identifying key exposures for an insurance entity. It was referred over simply because a comment was received that there could potentially be an RBC impact for this with in regard to concentration risk. Commissioner Altmaier said this referral will be moved to the top of the list, exposed for a 30-day public comment period and specifically,
and he asked that any comments regarding its impact to RBC that the Capital Adequacy (E) Task Force should provide to the Working Group be provided within.

e. Structured Notes – Commissioner Altmaier said this referral specified specific revisions to the Statutory Accounting Principles SSAP No. 2R—Cash, Drafts, and Short-term Investments, SSAP No. 26R—Bonds; SSAP No. 43R—Loan-Backed and Structured Securities and SSAP No. 86—Derivatives that affect structure notes, and revisions were adopted with a Dec. 31, 2019, effective date. The Capital Adequacy (E) Task Force will expose this referral for a 30-day public comment period to receive any feedback or objections to the changes.

Commissioner Altmaier reiterated that the referral for mutual funds is considered completed, the SIRI referral is open for comments by the Statutory Accounting Principles (E) Working Group, and they will allow the Capital Adequacy (E) Task Force until mid-November to provide comments. The common stocks, comprehensive funds, and structured notes referrals will be exposed for a 30-day public comment period asking specifically if these referrals affect RBC, what resources should be used to analyze the investments, and how the analysis should be done.

3. Discussed Working Agenda

Commissioner Altmaier said the only updates to the working agenda will be to prioritize the referrals as a 3- low priority during the exposure period.

Having no further business, the Capital Adequacy (E) Task Force adjourned.
The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Austin, TX, Dec. 8, 2019. The following Working Group members participated: Patrick McNaughton, Chair, and Steve Drutz (WA); Steve Ostlund (AL); Eric Unger (CO); Wanchin Chou (CT); Carolyn Morgan (FL); Tish Becker (KS); Rhonda Ahrens (NE); Tom Dudek (NY); Kimberly Rankin (PA); and Mike Boerner (TX). Also participating was: Tom Botsko (OH); and Andrew Schallhorn (OK).

1. **Adopted its October 21 and Sept. 9 Minutes**

The Working Group met Oct. 21 and Sept. 9. During these meetings, the Working Group took the following action: 1) expose the health test language proposal to the Life Risk-Based Capital (E) Working Group and the Health Risk-Based Capital (E) Working Group for a 30-day public comment period ending Nov. 20; 2) discuss the field testing in relation to the proposed changes to the health test; 3) refer the long-term care (LTC) health maintenance organization (HMO) guaranty fund memorandum to the Capital Adequacy (E) Task Force; 4) receive comments and rejected proposal 2019-04-H for health care receivables and agreed to continue to look into the matter; 5) receive comments on the excessive growth charge and the health bond structure; 6) discussed the managed care credit; and 7) receive an update on the Health Test Ad Hoc Group.

The Working Group also met Oct. 10 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings.

Mr. Ostlund made a motion, seconded by Mr. Chou, to adopt the Working Group’s Oct. 21 (Attachment Two-A) and Sept. 9 (Attachment Two-B) minutes. The motion passed.

2. **Discussed the Draft Health Bond Structure**

Mr. McNaughton said that over the last couple of years, the Working Group has discussed the proposed recommendations from the American Academy of Actuaries (Academy) on the bond factors. During that time period, the Working Group exposed the Academy’s report “An Update to the Property & Casualty and Health Risk-Based Capital Bond Factors: Report to the NAIC Investment Risk-Based Capital (E) Working Group, Health Risk-Based Capital (E) Working Group, and Property and Casualty Risk-Based Capital (E) Working Group” and a draft of the proposed structure changes (Attachment Two-C). The Working Group received comments from UnitedHealth Group and America’s Health Insurance Plans (AHIP) in which they raised concerns regarding the inclusion of investment income, factors for the Aaa and AA1 bonds, and the bond portfolio adjustment included in the factors for speculative grade bonds. The Working Group asked the Academy to review these comments and provide its feedback.

Mr. McNaughton summarized the comments received from UnitedHealth on the investment income (Attachment Two-D). He said that in the Academy’s response (Attachment Two-E), it was noted that the property/casualty formula used investment income in the development of the underwriting risk and considered it to be redundant to include it in the development of the bond factors. The Academy also noted that it was unclear if investment income was used in the development of the underwriting risk in the health formula and indicated that updating the factors to include the investment income would require a number of considerations and assumptions to accommodate the impact.

Mr. McNaughton said that NAIC reviewed past minutes for the Working Group and did not find any discussion that investment income was considered in the development of the underwriting portion of the health risk-based capital (RBC) formula. He said investment income does not seem to be of significant relevance due to the need to hold liquid assets to cover short-term liabilities and that while health insurers may not pay dividends to policyholders, it is not uncommon for larger profitable health insurers to pay dividends to stockholders from earnings, which would include investment income.

Mr. Ostlund asked the significance of including or not including it in the factor development. Crystal Brown (NAIC) said it is her understanding that the Academy would have to go back into the data and update the model for a number of considerations and assumptions to incorporate or identify the impact of the investment income into the factors. Mr. Ostlund said it seems that the Working Group is expending a lot of time on something that may not have much of an impact. Mr. McNaughton agreed...
and said that RBC is a regulator-only tool and that making changes to the formula that do not have a material impact may not be in the best interest of the Working Group.

Donna Novak (Novarest Consulting) said she was one of the actuaries who worked with the Academy on the development of the original health RBC formula. She said she did the modeling for the underwriting risk and does not remember including investment income; it was based all on the claims.

Mr. McNaughton said that UnitedHealth also commented on the proposed factors of Aaa and Aa1 bonds. He indicated that those bonds are less risky than the Aa2 bonds and recommended that a lower factor should be applied to these types of bonds. UnitedHealth suggested factors of 0.03% and 0.07% as opposed to the proposed factor of 0.1% from the Academy. Mr. McNaughton noted that the Academy responded that the factor of 0.1% for Aaa, AA1 and Aa2 bonds was recommended for reasons of conservatism. He said that the Academy noted that in considering a minimum risk factor, it also took into consideration the risk charge associated to the cash. He said that the Academy noted that if cash had a risk charge, then bonds should have a charge at least as great and that there could be other risks outside of the modeled risk of misuse or loss that should also be taken into consideration. Mr. McNaughton said that from a solvency and conservatism perspective, he recommended that the Working Group consider retaining the factor of 0.1% for the Aaa and AA1 bonds.

Mr. McNaughton said that AHIP (Attachment Two-F) expressed concerns with the recommended Academy factors that included the bond portfolio adjustment for the speculative grade bonds. In its letter, AHIP noted that it could find no basis for the assumption that the statistical fluctuation based on the portfolio size from the default/no-default variation is appropriate for any presumed variation by portfolio size due to market value fluctuations.

Mr. McNaughton said that it is important to note that from a consistency basis, the health formula is deviating from the treatment of the bond portfolio adjustment used in the life and P/C formulas by incorporating the bond portfolio adjustment into the factor itself. He said it is also important to remember that the life and P/C formulas do not differentiate between investment grade and speculative grade bonds when calculating the bond portfolio adjustment. Therefore, excluding the bond portfolio adjustment from the speculative bond factors would be an additional inconsistency incorporated into the health formula.

Mr. McNaughton said that through additional discussions with the Academy, it indicated that the data was not split between investment grade and speculative grade bonds when the factors were developed. Therefore, the Academy would have to go back and re-evaluate the data, which could result in a significant amount of effort. The Academy indicated that by removing the bond portfolio adjustment from the speculative grade bond factors, it could increase the investment grade bond factors. Mr. Chou suggested caution in moving forward with any changes to the factors.

Mr. McNaughton said that a conference call will be scheduled the week of Dec. 16 for the Working Group to address this item further with the Academy and determine how to move forward.

3. Received an Update on the Health Test Ad Hoc Group and Discussed Comments Received on the Health Test Language Proposal

Mr. McNaughton said the ad hoc group was formed to look at the health test and the impact it had on the results received for health premiums written in the US. The Working Group exposed the initial draft of the health test language proposal (Attachment Two-G) during its Oct. 21 conference call, and one comment letter was received from the American Council of Life Insurers (ACLI).

Steve Clayburn (ACLI) summarized the ACLI’s comments (Attachment Two-H). He said the review of the exposure with the ACLI’s members raised some practical implications because reducing the premium threshold from 95% to 90% could cause some companies to move from blank to blank each year. He suggested that the test be strengthened to make it a two-way test and suggested that the premium threshold be characterized as a threshold rather than a passing/failing test.

Mr. McNaughton said that the ad hoc group is aware of the possible burden on industry and the concern of having to move back and forth across blanks. He said that there could be some changes to the language to move towards a threshold approach and to give states greater discretion in working with their domestic companies when those thresholds are triggered. He said the main purpose is to identify what kind of business that company is writing.
Mr. McNaughton said that the ad hoc group met Nov. 8 via conference call to discuss the exposure of the health test language and the possibility of field testing. He said that they continue to evaluate enhancements to the health test language based on comments received and ongoing feedback.

Mr. McNaughton said that the ad hoc group will continue to evaluate how to move forward with field testing. However, a review of data found approximately 40 companies that have moved from the life blank to the health blank in the last 10 years, and this could be used as a starting point to evaluate the potential impact of moving from one blank to another. Mr. McNaughton said that the comments received will be referred to the ad hoc group for further consideration.

4. Exposed the Health Care Receivable Guidance

Mr. McNaughton said the Working Group rejected proposal 2019-04-H for health care receivables during its Oct. 21 conference call. He said the Working Group agreed to draft guidance on the reporting of the health care receivables within the annual statement filing and provide an explanation of how this data will be used in the development and re-evaluation of the health care receivable factors in the health RBC formula. He asked industry and states to consider providing examples or concerns that they have encountered in completing the Exhibit 3, Exhibit 3A and U&I Part 2B that could be incorporated into the guidance.

Hearing no objections, the Working exposed the Health Care Receivable Guidance proposal for a 30-day public comment period ending Jan. 7, 2020.

5. Adopted Updates to its 2020 Working Agenda

Ms. Brown said the health RBC working agenda was revised to update the priority of item 22 to a 3 and the expected completion date to 2023; item 23 and item 24 were updated to change the expected completion dates to the 2023 and 2022, respectively; and item 25 and item 26 were removed. Item 25 was removed because the response memorandum was completed and referred to the Capital Adequacy (E) Task Force, and Item 26 was removed due to premium amounts reported and the limited number of health entities that write long-term care (LTC) and long-term disability.

Mr. Chou asked for further clarification on the reason for the change to the expected completion of the health test ad hoc group. Ms. Brown explained that the group is moving forward in a two-phase approach: 1) review of the health test language; and 2) review of the annual statement blank to consider changes to schedules or supplements. Mr. McNaughton said that due to deadlines in which to make changes in the various groups, it will likely be closer to 2022 for implementation.

Mr. Ostlund made a motion, seconded by Mr. Chou, to adopt the updates to the 2020 health RBC working agenda. The motion passed.

6. Received an Update on the Excessive Growth Charge Ad Hoc Group

Mr. Drutz said the Excessive Growth Charge ad hoc group is moving forward with the referral from the Operational Risk (E) Subgroup and is considering possible changes.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.
Health Risk-Based Capital (E) Working Group
Conference Call
October 21, 2019

The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Oct. 21, 2019. The following Working Group members participated: Patrick McNaughton, Chair, and Steve Drutz (WA); Steve Ostlund (AL); Eric Unger and Rolf Kaumann (CO); Wanchin Chou (CT); Carolyn Morgan and Gilbert Moreau (FL); Tish Becker (KS); Kristi Bohn (MN); Michael Muldoon (NE); Christine Graiton (NY); and Aaron Hodges and Mike Boerner (TX).

1. Oct. 10 Regulator-Only Conference Call

The Working Group met Oct. 10 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings to: 1) hear a recap of the Health Care Receivable Project from the American Academy of Actuaries (Academy) as it relates to the misreporting of health care receivables; and 2) discuss the Health Care Receivables proposal.

2. Exposed a Health Test Proposal

Mr. McNaughton said the Health Test Ad Hoc Group was developed by the Working Group to look at the health test language in the annual statement instructions due to the significant amount of health business that is reported on the life blank. The ad hoc group began its work in 2018 and agreed to approach the review in two phases. The first phase was to look specifically at the health test language as it is in the annual statement instructions. The second phase is to review the life and health annual statement blanks and identify changes or supplemental schedules that can be incorporated into each of these annual statement blanks.

Mr. McNaughton said the ad hoc group has completed the initial draft of the health test language blanks proposal, and the language was significantly modified to remove the following components of the test: 1) reserve ratio; 2) entity is licensed and actively issuing and/or renewing business in five states or less; 3) at least 75% of the entity’s current year premiums are written in the domiciliary state; and 4) the values for the premium and reserve ratios equal 100% in both the reporting and prior year. The premium ratio was also changed in the proposal; currently, the premium ratio must equal or exceed 95% of premiums. The proposal lowers the premium ratio to 90%. Mr. McNaughton said this change alone will transition a significant amount of the health business currently being reported on the life blank over to be filed on the health blank. He said changes were made to the section labeled as “Variances from following these instructions,” in an effort to create dialogue and discussion with the entity’s state insurance regulator should the entity fall below the 90% premium ratio. He said the ad hoc group discussed this in detail and felt that it did not want to create a scenario where an entity may be required to move back and forth between blanks if they fell below 90%. The language, as it is drafted, will allow the entity to discuss business changes with the domestic regulator and allow for flexibility if business writings change.

Hearing no objections, the Working Group exposed the draft proposal to the Health Risk-Based Capital (E) Working Group and Life Risk-Based Capital (E) Working Group for a 30-day public comment period ending Nov. 20, 2019.

3. Discussed the Field Testing of the Health Test

Mr. McNaughton said that in conjunction with the initial exposure of the health test language, the ad hoc group is moving forward with a possible field test exercise. The purpose of this field testing is two-fold: 1) it could assist in identifying changes needed to the health test language, as well as identifying possible changes to the annual statement blanks that will be reviewed as part of Phase 2; and 2) it will allow state insurance regulators to identify the potential risk-based capital (RBC) impact on an entity that has been reporting on the life blank; and if the entity passes the health test, it would then be required to report on the health blank. The field testing will be strictly voluntary, and a confidentiality agreement would be drafted between the company and the NAIC indicating that this information would be used only for this project. The field-testing memo outlines this approach.
Mr. McNaughton said the ad hoc group would like to move forward with the project as outlined and reach out to those companies who would meet the proposed 90% premium ratio requirement to see if they would be willing to volunteer. The goal is to have field testing complete by the end of the year if possible, and it would be based on the 2018 annual statement filing.

Hearing no objections, the ad hoc group will move forward with the field test.

4. **Discussed the Referral of Long-Term Care HMO Guaranty Fund Memo to the Capital Adequacy (E) Task Force**

Mr. McNaughton said the Working Group previously received a request from the Capital Adequacy (E) Task Force to review the referral letter regarding adopted amendments to the *Life and Health Insurance Guaranty Association Model Act* (#520) and determine if changes were warranted to the health RBC formula. The referral outlined significant amendments to Model #520, including: 1) broadening the assessment base for long-term care insurance (LTCI) insolventcies to include both life and health insurers and splitting the assessment equally between the life and health insurers; 2) clarifying the guaranty associations’ coverage of LTCI; and 3) including health maintenance organizations (HMOs) as members of the guaranty association, similar to other health insurers.

Mr. McNaughton said the Working Group exposed a response letter during its May 13 conference call that addressed the items noted in the referral letter. Currently, the guaranty fund assessment risk charge under the H4-Business Risk component is 0.5%, and it is applied to direct earned premiums (as reported in Schedule T) in any state in which the reporting entity is subject to guaranty fund assessments. He said based on the current instructions and reporting, there do not appear to be any modifications needed to the Health RBC formula as a result of this change at this time. He noted that there were no comments received on the original exposure of the letter; however, the Working Group was asked by other state insurance regulators to perform additional analysis on the consideration of those HMOs that do not pay premium taxes and would not have a method to recoup those assessments other than through premium increases. He said he and NAIC staff further reviewed the changes to Model #520 and the potential impact it could have on the Health RBC formula with respect to HMOs. Based on the additional analysis of data specific to the application of guaranty fund laws in each state, we continue to believe that no changes to the formula are needed at this time. Through the additional analysis performed, it was found that: 1) while some states have not yet adopted the model law changes, once adopted, a majority of the states will allow for a premium tax or corporate tax offset, or the ability to impose a minimal surcharge to help offset the assessment; 2) at a maximum, HMOs would incur a charge of 2% (depending upon each state’s guaranty fund law), and if they were unable to pay or meet this obligation, they could request a waiver from the guaranty fund of some or all of the assessment (currently, this is a fairly frequent practice); and 3) given the differences and complexities between states in the regulation and taxation of HMOs, and that the RBC formula is a generic formula, the goal of which is to be applied as uniformly as possible and not at such a granular level, it would be difficult to incorporate such changes into the formula that could address all the different scenarios needed to provide a different charge, offset or credit to such a distinct population in such diverse regulatory environments.

Mr. Kaumann made a motion, seconded by Mr. Ostlund, to refer the Long-Term Care HMO Guaranty Fund Memo to the Capital Adequacy (E) Task Force. The motion passed unanimously.

5. **Discussed Proposal 2019-04-H**

Mr. McNaughton said the health care receivable proposal was developed due to misreporting problems identified by the Academy in their review of the data for the health care receivable factor development. The proposal was designed to apply an additional charge for receivable amounts that were accrued in the prior year, but not recovered in the current year. The recommendation was to implement the proposal on an informational-only basis for 2020 and 2021 with full implementation in 2022. The Working Group exposed the proposal on two separate occasions with comments received from America’s Health Plans (AHIP) and UnitedHealth Group (UHG). Mr. McNaughton said the original intent of the proposal was to encourage companies to report the health care receivables correctly within the annual statement blank.

Mr. McNaughton proposed an alternative option for moving forward with the health care receivable factor review. He suggested that the Working Group: 1) reject proposal 2019-04-H; and 2) draft guidance on the problems encountered with the reporting of the health care receivable data in the annual statement. He said the Working Group can work with the trades, the Academy and companies to identify the reporting concerns. Through these avenues, the Working Group can then draft guidance for reporting health care receivables in Underwriting & Investment Exhibit, Part 2b, Exhibit 3, and Exhibit 3a. The guidance includes an explanation of how the data reported in these exhibits will be used in the development of the revised health care receivable factors, beginning with data year 2020–2022. Included in the guidance could be scenarios of items encountered and
how to correct those. This guidance could then be posted on the Health RBC webpage and sent to companies’ financial and RBC contacts.

Mr. Ostlund made a motion, seconded by Mr. Boerner, to reject proposal 2019-04-H. The motion passed unanimously.

Mr. McNaughton said the Working Group will continue to move to look at the health care receivable factors, but in a different manner.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.
The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Sept. 9, 2019. The following Working Group members participated: Patrick McNaughton, Chair, David Hippen and Steve Drutz (WA); Steve Ostlund (AL); Wanchin Chou (CT); Carolyn Morgan (FL); Tish Becker (KS); Kristi Bohn (MN); Lindsay Crawford and Michael Muldoon (NE); Annette James (NV); Christine Gralton (NY); Kimberly Rankin (PA); and Mike Boerner (TX).

1. **Received Comments on Proposal 2019-04-H**

   Mr. McNaughton said that the health care receivable proposal 2019-04-H (Attachment Two-B1 was re-exposed to include instructions from the Working Group’s July 17 conference call for a 30-day public comment period. Comment letters were received from UnitedHealth Group (Attachment Two-B2) and America’s Health Insurance Plans (AHIP) (Attachment Two-B3).

   Jim Braue (UnitedHealth Group) summarized UnitedHealth Group’s comment letter. UnitedHealth Group suggested: 1) changes to the mathematical structure of the formula; 2) a review of the asymmetry; 3) exclusion of remaining receivables; 4) lack of proportionality; and 5) limitation of one-year of history. He said that UnitedHealth Group thinks it is important the proposal be in as final a form as possible before being implemented on even an informational-only basis. This will provide more useful information in how the proposal would work in practice and how it will affect companies going forward. He said that it may be beneficial to delay moving the proposal forward for a year in order to ensure that it is correct. Mr. Braue said that UnitedHealth Group has suggested an alternative formula and provided an example.

   Kevin Russell (American Academy of Actuaries—Academy) said the issue of proportionality makes sense and while it adds some complexity to the formula, it could readily be accomplished. He said that the proportionality change could have a limit on the impact that any change would have on this year’s factor and that this may be a reason for not looking back a full three years but instead just looking back one or two years. He said all the suggestions are something that could be incorporated into the proposed changes.

   The Working Group agreed to take the recommendations under advisement and to continue to review the proposal and discuss on a future conference call.

2. **Received Comments on the Excessive Growth Charge**

   Mr. McNaughton said the Working Group received the excessive growth charge referral letter (Attachment Two-B4) from the Operational (E) Risk Subgroup and established an ad hoc group at the Spring National Meeting. Prior to the ad hoc group meeting, the Working Group exposed the referral letter and will use comments received in evaluating how to move forward with the excessive growth charge. Comment letters were received from AHIP (Attachment Two-B5) and UnitedHealth Group.

   Mr. Braue summarized UnitedHealth Group’s comment letter (Attachment Two-B6) and agreed that there should be a review of the charge. However, he noted that charges are typically updated as a result of new experience or due to enhancements in the models used to produce them. However, this is not the case for the excessive growth charge. He said that the excessive growth charge as it exists today was more judgmentally based, and the rationale for changing it should be based on a review of: 1) if it has been working adequately in the past; 2) if there have been issues; 3) if it has failed to reflect actual problems that have occurred; or 4) if it has resulted false positives.

   Mr. McNaughton said that based on the referral letter and comments received, the ad hoc group will focus on the key elements outlined in the letter and identify if the charge should be revised or kept as it is. He said the group may consider if the risk is appropriately accounted for and if not, the group may need to look at how to describe and quantify the risk along with the parameters that should be considered. He said the first conference call will be set up for late September or early October.

3. **Received Comments on Health Bond Structure**
Mr. McNaughton said the Working Group exposed the draft structure and instructions for the 20 designations for NAIC bonds and recommended factors during its June 24 conference call. Comment letters were received from AHIP (Attachment Two-F) and UnitedHealth Group.

Mr. Braue summarized UnitedHealth Group’s comment letter (Attachment Two-D) on the bond structure proposal. He suggested that the factors used for miscellaneous fixed income assets and unaffiliated preferred stock that were based on the original bond factors be updated to reflect these changes suggested for bonds. He said this would not preclude any future studies’ independent factors for these asset types. He said UnitedHealth Group has some continuing concerns related to the factors for investment income, investment grade bond factors and speculative grade bonds.

Tim Deno (Academy) summarized the Academy’s response letter (Attachment Two-E). He said that through the Joint P&C/Health Bond Factors Analysis Work Group, the Academy identified that the property/casualty (P/C) risk-based capital (RBC) formula does include a portion of investment income in the underwriting risk. It is not clear if investment income is currently included in the underwriting risk portion of the health RBC formula.

Mr. Deno said that a minimum factor was set for the investment grade bonds because there is a minimum risk charge for cash. He said an appropriate relationship between the investment grade bond factors and cash factor should be considered.

Mr. Deno said that the life and P/C formulas include speculative grade bonds in the bond size adjustment, and for consistency purposes, speculative grade bonds were included in health. He said when the factors were developed, the data did not distinguish between the number of issuers on investment grade and speculative grade bonds, and if they were split, the data would have to be re-evaluated. He said that by doing this, in theory, the investment grade bond factors would raise some while speculative grade bond factors would go down slightly because of the volume that is there. He said a review of what assumptions are driving conservatism versus what assumptions are driving aggressiveness may need to be reviewed and to make sure that the Working Group is comfortable with these assumptions.

Crystal Brown (NAIC) said that the focus of the proposal at this time will be to update only the bond factors, with the recognition that there are other asset types whose factors were based on the original bond factors that will need to be looked at separately from the bonds. Ms. Brown said language could be added to the instructions for these other asset types indicating that the current factors were based on the original bond factors.

The Working Group asked NAIC staff to research through historical minutes to try to identify if investment income is currently included in the health formula. The Working Group will also research the inclusion of speculative grade bonds in the bond portfolio adjustment.

4. Discussed MCC

Mr. McNaughton said a question was brought to the Working Group in December 2018 pertaining to the execution of a risk-sharing contract with providers, which shifted paid claims from “Category 1 – Payments Made According to Contractual Arrangements” to “Category 2 – Payments Made Subject to Withholds or Bonuses That Are Otherwise Managed Care Category 1,” specifically when the change is modeled. There does not appear to be much of a benefit or change in credit when shifting from Category 1 to Category 2b. Mr. McNaughton said this resulted in a broader question: What was the original intent of the formula? Was it that the formula would yield the same managed care credit (MCC) (e.g., a 15% result) under Category 1 and 2B, even though the underlying arrangements are subject to different MCCs on their own? Or should a company get an additional credit under 2B compared to a 15% result under 1?

Mr. McNaughton said NAIC staff have reviewed the past minutes of the Health Risk-Based Capital (E) Working Group and found the original instructions. The instructions direct that the maximum credit for Category 2 withhold arrangements was 25% based upon a calculation that determines the ratio of withholds returned/bonuses paid to providers during the year prior to the reporting year to total withholds/bonuses during such year and then applies that ratio to the average provider withhold rate for the same prior year. If the underlying payment arrangement would otherwise fall under Category 1, and the MCC credit calculated under this category is less than 15%, the managed care organization (MCO) may use the Category 1 credit above and eliminate the effect of these payments on the calculation of the Category 2 credit. However, where payments that would otherwise fall under Category 0 are the only payments included in the credit calculation, the maximum credit is 15%. Mr. McNaughton reminded the Working Group that only one category may be used for each dollar of claims payment. Additional instructions and clarifications have been incorporated over time.
Ms. Rankin said that this could still be evolving with some of the federal Centers for Medicare & Medicaid Services (CMS) benefits and the rural hospital model as there could be some new factors that may affect this going forward.

The Working Group directed NAIC staff to continue to investigate how the formula is being calculated in comparison to the instructions.

5. **Heard an Update on the Health Test Ad Hoc Group**

Mr. McNaughton said the Health Test Ad Hoc Group met Aug. 26 and continued its discussion of revisions to the health test language that include: 1) removal of the reserve ratio requirement; and 2) added language that would provide guidance to state insurance regulators as to when a company would or would not move blanks if premium ratio falls below 90%. He said that the group also discussed the possibility of field testing. The group would like life insurers that meet the revised health test requirements to volunteer to complete the health RBC forecasting spreadsheet. This would assist state insurance regulators with understanding the overall impact of moving from the life RBC formula to the health RBC formula, as well as assist in identifying schedules that may be considered as supplements across blanks. He said the ad hoc group will next meet Sept. 27.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.
**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 | [ ] SMI RBC (E) Subgroup |
| [ ] C3 Phase II/ AG43 (E/A) Subgroup | [ ] P/C RBC (E) Working Group | [ ] Stress Testing (E) Subgroup |

**DATE:** 3-6-19

**CONTACT PERSON:** Crystal Brown

**TELEPHONE:** 816-783-8146

**EMAIL ADDRESS:** cbrown@naic.org

**ON BEHALF OF:** Health RBC (E) Working Group

**NAME:** Patrick McNaughton

**TITLE:** Chief Financial Examiner/Chair

**AFFILIATION:** WA Office of Insurance Commissioner

**ADDRESS:** PO Box 40255

Olympia, WA 98504-0255

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### Agenda Item # 2019-04-H

**FOR NAIC USE ONLY**

<table>
<thead>
<tr>
<th>Agenda Item # 2019-04-H</th>
<th>Year 2020</th>
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</table>

**DISPOSITION**

[ ] ADOPTED

[ ] REJECTED

[ ] DEFERRED TO

[ ] REFERRED TO OTHER NAIC GROUP

[ ] EXPOSED May 7, 2019, Aug. 18, 2019

[ ] OTHER (SPECIFY)

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### IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

[ x ] Health RBC Blanks

[ ] Property/Casualty RBC Blanks

[ ] Life RBC Instructions

[ ] Fraternal RBC Blanks

[ x ] Health RBC Instructions

[ ] Property/Casualty RBC Instructions

[ ] Life RBC Instructions

[ ] OTHER __________

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**DESCRIPTION OF CHANGE(S)**

Add a break out for health care receivables accrued vs. recovered from the CY and PY.

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**REASON OR JUSTIFICATION FOR CHANGE **

The purpose of the proposal is to apply an additional charge for receivable amounts that were accrued in the PY but not recovered in the CY.

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**Additional Staff Comments:**

The proposal is being exposed would be on an informational only basis for 2020 & 2021 reporting with full implementation to the formula in 2022. The factors and instructions will be discussed in more detail on future calls and will exposed around the Summer National Meeting.

The proposed calculations include the current 5% and 19% factors for the health care receivables, additional consideration to change the factors will be addressed by the Working Group after 2020 data has been received.

4-7-19 cgb The WG exposed the proposal along with a copy of the numeric examples for a 30-day comment period ending on 5-7-19.

5-7-19 cgb Comment letter received from UnitedHealth Group.

7-17-19 cgb Instructions were incorporated into the proposal. The WG agreed to re-expose the proposal for comment on the structure including annual statement references and instructions for a 30-day comment period ending on 8-19-19.

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**This section must be completed on all forms.**

Revised 11-2013

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XR020 - Other Receivables – L(25) through L(31)

There is an RBC requirement of 1 percent of the annual statement amount of investment income receivable and an RBC requirement of 5 percent of the annual statement amount for pharmaceutical rebates and amounts due from parents, subsidiaries, and affiliates, and aggregate write-ins for other than invested assets and an RBC requirement of 19 percent of the annual statement amount for all other health care receivables reported in Lines (26.2) through (26.6). Enter the appropriate value in Lines (25) through (31).

Line (26.1). Pharmaceutical rebates are arrangements between pharmaceutical companies and reporting entities in which the reporting entities receive rebates based upon the drug utilization of its subscribers at participating pharmacies. These rebates are sometimes recorded as receivables by reporting entities using estimates based upon historical trends which should be adjusted to reflect significant variables involved in the calculation, such as number of prescriptions written/filled, type of drugs prescribed, use of generic vs. brand-name drugs, etc. In other cases, the reporting entity determines the amount of the rebate due based on the actual use of various prescription drugs during the accumulation period and then bills the pharmaceutical company. Oftentimes, a pharmacy benefits management company may determine the amount of the rebate based on a listing (of prescription drugs filled) prepared for the reporting entity’s review. The reporting entity will confirm the listing and the pharmaceutical rebate receivable. Pharmaceutical rebates may relate to insured plans or uninsured plans. Only the receivable amount related to the insured plans should be reported on this line. Amount comes from annual statement Exhibit 3, Column 7, Line 0199999.

Line (26.2). Claim overpayments may occur as a result of several events, including but not limited to claim payments made in error to a provider. Reporting entities often establish receivables for claim overpayments. Amount comes from annual statement Exhibit 3, Column 7, Line 0299999.

Line (26.3). A health entity may make loans or advances to large hospitals or other providers. Such loans or advances are supported by legally enforceable contracts and are generally entered into at the request of the provider. In many cases, loans or advances are paid monthly and are intended to represent one month of fee-for-service claims activity with the respective provider. Amount comes from annual statement Exhibit 3, Column 7, Line 0399999.

Line (26.4). A capitation arrangement is a compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider. In some instances, advances are made to a provider under a capitation arrangement in anticipation of future services. Amount comes from annual statement Exhibit 3, Column 7, Line 0499999.

Line (26.5). Risk sharing agreements are contracts between reporting entities and providers with a risk sharing element based upon utilization. The compensation payments for risk sharing agreements are typically estimated monthly and settled annually. These agreements can result in receivables due from the providers if annual utilization is different than that used in estimating the monthly compensation. Amount comes from annual statement Exhibit 3, Column 7, Line 0599999.

Line (26.6). Any other health care receivable not reported in Lines (26.1) through (26.5). Amount comes from annual statement Exhibit 3, Column 7, Line 0699999.

Line (27). Only include on this line amounts receivable related to pharmaceutical rebates on uninsured plans that are in excess of the liability estimated by the reporting entity for the portion of such rebates due to the uninsured accident and health plans.
There is an RBC requirement of 1 percent of the annual statement amount of investment income receivable and an RBC requirement of 5 percent of the annual statement amount for amounts receivable relating to uninsured accident and health plans, amounts due from parents, subsidiaries, and affiliates, and aggregate write-ins for other than invested assets.

An additional charge will be applied to health care receivables amounts reported in Lines (30) through (35) that were accrued in the prior year but not recovered in the current year.

An example of the calculation is included below:

Example 1:

Claim overpayment receivable as of 12/31/2020 with substantial recoveries (but still a little less than the accrual)

a. Claim overpayment receivable as of 12/31/2020 of $1,000,000
b. Claim overpayment receivable as of 12/31/2019 of $900,000
c. Claim overpayment recoveries of $800,000 reported achieved in 2020 against accruals at 12/31/2019
d. Current formula amount: $1,000,000 x 0.19 = $190,000
e. Informational formula amount =
   = $1,000,000 x 0.19 + (1 - 0.19) x max(0, $900,000 - (1 + 0.19) x $800,000)
   = $190,000 + 0.81 x max(0, $900,000 - $952,000)
   = $190,000 + 0.81 x max(0, -$52,000)
   = $190,000

Example 2:

Claim overpayment receivable as of 12/31/2020, but with no recoveries:

a. Claim overpayment receivable as of 12/31/2020 of $1,000,000
b. Claim overpayment receivable as of 12/31/2019 of $900,000
c. Claim overpayment recoveries of $0 reported achieved in 2020 against accruals at 12/31/2019
d. Current formula amount: $1,000,000 x 0.19 = $190,000
e. Informational formula amount =
   = $1,000,000 x 0.19 + (1 - 0.19) x max(0, $900,000 - (1 + 0.19) x $0)
   = $190,000 + 0.81 x max(0, $900,000)
   = $190,000 + 0.81 x $900,000
   = $190,000 + $729,000
   = $919,000
Example 3:

Claim overpayment receivable as of 12/31/2020, but with recoveries of half the amount of the accrual:

a. Claim overpayment receivable as of 12/31/2020 of $1,000,000
b. Claim overpayment receivable as of 12/31/2019 of $900,000
c. Claim overpayment recoveries of $450,000 reported achieved in 2020 against accruals at 12/31/2019
d. Current formula amount: $1,000,000 x 0.19 = $190,000
e. Informational formula amount =
   = $1,000,000 x 0.19 + (1 - 0.19) x max(0, $900,000 - (1 + 0.19) x $450,000)
   = $190,000 + 0.81 x max(0, $900,000 - $535,500)
   = $190,000 + 0.81 x $364,500
   = $190,000 + $295,245
   = $485,245
### Other Receivables (excluding Health Care Receivables)

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Annual Statement Source</th>
<th>(1) Amount</th>
<th>Factor</th>
<th>(2) RBC Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>Investment Income Receivable</td>
<td>Page 2, Col. 3, Line 14</td>
<td>0.010</td>
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<td>26</td>
<td>Accounts Receivable Relating to Uninsured Accident and Health Plans</td>
<td>Included in Page 2, Col. 3, Line 17</td>
<td></td>
<td>0.050</td>
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<tr>
<td>27</td>
<td>Amounts Due from Parents, Subs, and Affiliates</td>
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<td>28</td>
<td>Aggregate Write-Ins For Other Than Invested Assets</td>
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<td>Sub-Total Other Receivables RBC</td>
<td>Sum L(25) through L(28)</td>
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### Health Care Receivables

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Annual Statement Source</th>
<th>(1) Amount</th>
<th>Factor</th>
<th>(2) RBC Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.1</td>
<td>Pharmaceutical Rebate Receivables – Current Year</td>
<td>Exhibit 3, Col. 7, Line 0199999 (CY)</td>
<td></td>
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<tr>
<td>30.2</td>
<td>Pharmaceutical Rebate Receivables – Prior Year</td>
<td>Exhibit 3, Col. 7, Line 0199999 (PY)</td>
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<tr>
<td>30.3</td>
<td>Pharmaceutical Rebates – Prior Year Collected in the Current Year</td>
<td>Exhibit 3A, Col. 1, Line 1 ???</td>
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<tr>
<td>31.1</td>
<td>Claim Overpayment Receivables – Current Year</td>
<td>Exhibit 3, Col. 7, Line 0299999 (CY)</td>
<td></td>
<td>0.190</td>
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<tr>
<td>31.2</td>
<td>Claim Overpayment Receivables – Prior Year</td>
<td>Exhibit 3, Col. 7, Line 0299999 (PY)</td>
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<td></td>
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<td>31.3</td>
<td>Claim Overpayment Rebates – Prior Year Collected in the Current Year</td>
<td>Exhibit 3A, Col. 1, Line 2 ???</td>
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<tr>
<td>32.1</td>
<td>Loan and Advances to Providers – Current Year</td>
<td>Exhibit 3, Col. 7, Line 0399999 (CY)</td>
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<td>0.190</td>
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<td>32.2</td>
<td>Loan and Advances to Providers – Prior Year</td>
<td>Exhibit 3, Col. 7, Line 0399999 (PY)</td>
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<tr>
<td>32.3</td>
<td>Loan and Advances to Providers – Prior Year Collected in the Current Year</td>
<td>Exhibit 3A, Col. 1, Line 3 ???</td>
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<tr>
<td>33.1</td>
<td>Capitation Arrangement Receivables – Current Year</td>
<td>Exhibit 3, Col. 7, Line 0499999 (CY)</td>
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<td>0.190</td>
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</tr>
<tr>
<td>33.2</td>
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<td>Exhibit 3, Col. 7, Line 0499999 (PY)</td>
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<tr>
<td>33.3</td>
<td>Capitation Arrangement – Prior Year Collected in the Current Year</td>
<td>Exhibit 3A, Col. 1, Line 4 ???</td>
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<td>34.1</td>
<td>Risk Sharing Receivables – Current Year</td>
<td>Exhibit 3, Col. 7, Line 0599999 (CY)</td>
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<td>34.2</td>
<td>Risk Sharing Receivables – Prior Year</td>
<td>Exhibit 3, Col. 7, Line 0599999 (PY)</td>
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<td>34.3</td>
<td>Risk Sharing Receivables – Prior Year Collected in the Current Year</td>
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<tr>
<td>35.1</td>
<td>Other Health Care Receivables – Current Year</td>
<td>Exhibit 3, Col. 7, Line 0699999 (CY)</td>
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<td>0.190</td>
<td></td>
</tr>
<tr>
<td>35.2</td>
<td>Other Health Care Receivables – Prior Year</td>
<td>Exhibit 3, Col. 7, Line 0699999 (PY)</td>
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<td></td>
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<td>35.3</td>
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<td>Sub-Total Health Care Receivables</td>
<td>Sum of Line (30.1) through Line (35.3)</td>
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<tr>
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<td>Total Other Receivables RBC</td>
<td>Line (29) + Line (36)</td>
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</tr>
<tr>
<td>38</td>
<td>Adjusted Informational Credit RBC</td>
<td>Line (17) + Line (29) + Line (37)</td>
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<td></td>
</tr>
</tbody>
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---

Denotes items that must be manually entered on filing software

- For Pharmaceutical Rebates: \[
\text{[Greater of 0 or L(30.2) minus (1 + .05) times Line (30.3)] times (1 - .05)}
\]

- For Claim Overpayment, Loan and Advances to Providers, Capitation Arrangements, Risk Sharing, and Other Health Care Receivables: \[
\text{[Greater of 0 or L(3.2) minus (1 + .19) times L(3.3)] times (1 - .19)}
\]
### CALCULATION OF TOTAL RISK-BASED CAPITAL AFTER COVARIANCE

#### H3 - CREDIT RISK

<table>
<thead>
<tr>
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<th>RBC Amount</th>
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<tbody>
<tr>
<td>(28)</td>
<td>Total Reinsurance RBC</td>
</tr>
<tr>
<td>(29)</td>
<td>Intermediaries Credit Risk RBC</td>
</tr>
<tr>
<td>(30)</td>
<td>Total Other Receivables RBC</td>
</tr>
<tr>
<td>(31)</td>
<td>Total H3</td>
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#### H3A - CREDIT RISK (For Informational Purposes Only)

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<tr>
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<th>RBC Amount</th>
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<tbody>
<tr>
<td>(28A)</td>
<td>Total Reinsurance RBC</td>
</tr>
<tr>
<td>(29A)</td>
<td>Intermediaries Credit Risk RBC</td>
</tr>
<tr>
<td>(30A)</td>
<td>Total Other Receivables RBC</td>
</tr>
<tr>
<td>(31A)</td>
<td>Total H3A (For Informational Purposes Only)</td>
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#### H4 - BUSINESS RISK

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<tr>
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<th>RBC Amount</th>
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<tbody>
<tr>
<td>(32)</td>
<td>Administrative Expense RBC</td>
</tr>
<tr>
<td>(33)</td>
<td>Non-Underwritten and Limited Risk Business RBC</td>
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<tr>
<td>(34)</td>
<td>Premiums Subject to Guaranty Fund Assessments</td>
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<tr>
<td>(35)</td>
<td>Excessive Growth RBC</td>
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<tr>
<td>(36)</td>
<td>Total H4</td>
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<table>
<thead>
<tr>
<th></th>
<th>RBC after Covariance Before Basic Operational Risk</th>
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</thead>
<tbody>
<tr>
<td>(37)</td>
<td>H0 + Square Root of (H1² + H2² + H3² + H4²)</td>
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<tr>
<td>(38)</td>
<td>Basic Operational Risk</td>
</tr>
<tr>
<td>(39)</td>
<td>C-4a of U.S. Life Insurance Subsidiaries</td>
</tr>
<tr>
<td>(40)</td>
<td>Net Basic Operational Risk</td>
</tr>
<tr>
<td>(41)</td>
<td>RBC After Covariance Including Basic Operational Risk</td>
</tr>
<tr>
<td>(42)</td>
<td>Authorized Control Level RBC</td>
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#### For Informational Purposes Only

<table>
<thead>
<tr>
<th></th>
<th>RBC after Covariance Before Basic Operational Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>(37A)</td>
<td>H0 + Square Root of (H1² + H2² + H3A² + H4²)</td>
</tr>
<tr>
<td>(38A)</td>
<td>Basic Operational Risk</td>
</tr>
<tr>
<td>(39A)</td>
<td>C-4a of U.S. Life Insurance Subsidiaries</td>
</tr>
<tr>
<td>(40A)</td>
<td>Net Basic Operational Risk</td>
</tr>
<tr>
<td>(41A)</td>
<td>RBC After Covariance Including Basic Operational Risk</td>
</tr>
<tr>
<td>(42A)</td>
<td>Authorized Control Level RBC</td>
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</tbody>
</table>

**Denotes items that must be manually entered on filing software.**
August 15, 2019

Mr. Patrick McNaughton, Chair  
Health Risk-Based Capital (E) Working Group  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO  64106-2197  

Via electronic mail to Crystal Brown.

Re:  Proposal 2019-04-H

Dear Mr. McNaughton:

I am writing on behalf of UnitedHealth Group Incorporated.  We appreciate the opportunity to comment on RBC Proposal 2019-04-H, exposed for comment by the Health Risk-Based Capital (E) Working Group on July 19, 2019. The proposal seeks to alter the risk charges applied to health care receivables, on an informational-only basis in 2020 and 2021, with the expectation of full implementation in 2022. The current proposal is a modification, adding instructional language, of the proposal exposed on April 8, 2019.

Need for changes to the proposal.

The currently exposed proposal, while adding instructional language to the previously exposed proposal, does not make any substantive changes to that proposal. In particular, it does not address any of the points raised in our May 7, 2019, comment letter, which we have attached for reference.

We recognize that initially the proposed charge for health care receivables would be used for informational purposes only, and would not affect the Risk-Based Capital measures on which regulatory action may be based. We also recognize that, at least in part, the proposed charge is intended to encourage accurate financial reporting by penalizing entities that fail to properly report their experience with the collection of health care receivables. However, once the proposed charge becomes fully implemented in 2022, its use as a penalty will no longer be appropriate; the charge will affect the solvency regulation of insurance companies and HMOs, and must be directed solely to that purpose. Therefore, before 2022, the charge for health care receivables must be put in a form that will enhance solvency regulation. As explained in our
previous comment letter, the current formulation of the charge does not seem to serve that purpose well.

As the charge will not be fully implemented until 2022, there is still time to refine it. However, the informational phase of the charge will be most useful if the informational formula is as close as possible to what will ultimately be implemented. The entities subject to RBC will also be able to plan more effectively if the informational charge closely represents the ultimate form. Therefore, as far as possible, any anticipated changes to the charge should be made now, at the beginning of the informational period.

We note again that while this charge probably will not be significant for most reporting entities, it may be significant in specific cases. If that were never true, there would be no purpose in revising the charge at all. Therefore, if the charge is indeed to be revised, it should be revised to be as appropriate and effective as possible.

Specific recommendations.

It seems clear to us that some changes to the proposal are indeed necessary. The changes that we recommend, and the rationales for those changes, are addressed in detail in the attached comments from May 7; but we will summarize them here, for convenience.

Mathematical structure of the formula.

The mathematical structure of the exposed formula is unintuitive. A simpler form is recommended, which would have a more obvious interpretation.

Asymmetry.

Under the current proposal, reporting entities are penalized for poor collection experience, but receive no benefit from good collection experience. This does not seem to reflect relative risks properly. We recommend that the formula also allow a charge below the current standard factor, with a floor of 1%.

Exclusion of remaining receivables.

The current proposal reflects only those amounts collected in the following year, and not amounts outstanding at the end of the year that are still expected to be received. This is especially problematic for items such as loans and advances to providers, which may not ever have been intended to be collected in full within the first year. We recommend that the receivables still outstanding at the end of the year also be reflected.

Lack of proportionality.

The proposed add-on charge is based on the prior-year receivable. We recommend that it be scaled proportionally to the current-year receivable, as better reflecting the current risk profile of the reporting entity.
Limitation to one year of history.

The proposed charge is based on one year of run-out. The result could be distorted by one-time issues, as well as normal year-to-year fluctuations in experience. A longer, but still relatively current, time period should be used. We recommend the use of three years of experience (including, as noted above, any receivables still remaining at the end of each year). Although there was some concern expressed by members of the Working Group that this would add complexity, the necessary data would be readily available and the complexity is more an appearance than an actual practical hindrance. A more stable and meaningful result would justify the use of the additional years of data.

Recommended formula.

Based on the matters discussed above, we recommended the following formula for the risk charge for each category of health care receivables.

\[
\begin{align*}
(A) & \quad \text{Sum of receivables for the preceding three years.} \\
(B) & \quad \text{Sum of collections of those receivables in the subsequent year, plus any amount of such receivables that remained outstanding at the end of the subsequent year.} \\
(C) & \quad \text{Shortfall percentage: } [1 - (B) / (A)]/
\end{align*}
\]

\[
(D) \quad \text{Receivable for the current year.}
\]

\[
(E) \quad \text{Risk charge: greater of } [0.01 \cdot (D)] \text{ and } [(C) \cdot (D)].
\]

There may be instances where an entity does not have recent history for a particular type of receivable (e.g., because a provider risk-sharing arrangement produced a payable rather than a receivable in the prior year). This would probably occur less frequently if the calculation used three years of history, as we have recommended, but might still occur. In such cases, it would be appropriate for the risk charge to default to the current standard factor (i.e., 5% for pharmacy rebate receivables and 19% for other categories of health care receivables) multiplied by the current receivable amount.

Instructional language.

The instructional language that was added to the latest exposed proposal seems appropriate for the proposal as such. However, it would need to be modified to reflect the recommendations stated above. Such modified language follows the body of this letter.

* * * * * *

We appreciate your consideration of our comments, and we would be happy to discuss this matter further with the Working Group.
James R. Braue
Director, Actuarial Services
UnitedHealth Group

Attachment: UnitedHealth Group comment letter of May 7, 2019

cc: Crystal Brown, NAIC
    Randi Reichel, UnitedHealth Group
XR020-A Other Receivables for Informational Purposes Only

There is an RBC requirement of 1 percent of the annual statement amount of investment income receivable and an RBC requirement of 5 percent of the annual statement amount for amounts receivable relating to uninsured accident and health plans, amounts due from parents, subsidiaries, and affiliates, and aggregate write-ins for other than invested assets.

An additional charge will be applied to health care receivables amounts reported in Lines (30) through (35) that were accrued in prior years but not recovered in later years.

Examples of the calculations are included below:

Example 1:
Claim overpayment receivable as of 12/31/2020 with substantial recoveries (but still a little less than the accrual)
   a. Claim overpayment receivable as of 12/31/2020 of $1,000,000
   b. Claim overpayment receivable as of 12/31 in 2017 through 2019 totaling $2,700,000
   c. Claim overpayment recoveries of $2,400,000 received or accrued in 2018-2020 against accruals at 12/31 for 2017-2019
   d. Shortfall percentage: \(1 - \frac{2,400,000}{2,700,000} = 11.1111\%\)
   e. Informational formula amount
      \[= \max(1\%, 11.1111\%) \times 1,000,000 = 111,111\]

Example 2:
Claim overpayment receivable as of 12/31/2020, but with no recoveries:
   a. Claim overpayment receivable as of 12/31/2020 of $1,000,000
   b. Claim overpayment receivable as of 12/31 in 2017 through 2019 totaling $2,700,000
   c. Claim overpayment recoveries of $0 received or accrued in 2018-2020 against accruals at 12/31 for 2017-2019
   d. Shortfall percentage: \(1 - \frac{0}{2,700,000} = 100\%\)
   e. Informational formula amount
      \[= \max(1\%, 100\%) \times 1,000,000 = 1,000,000\]

Example 3:
Claim overpayment receivable as of 12/31/2020, but with recoveries of half the amount of the accrual:
   a. Claim overpayment receivable as of 12/31/2020 of $1,000,000
   b. Claim overpayment receivable as of 12/31 in 2017 through 2019 totaling $2,700,000
   c. Claim overpayment recoveries of $1,350,000 received or accrued in 2018-2020 against accruals at 12/31 for 2017-2019
   d. Shortfall percentage: \(1 - \frac{1,350,000}{2,700,000} = 50\%\)
e. Informational formula amount = \[
\text{max}(1\%, 50\%) \times \$1,000,000
\]
\[
= \$500,000
\]
May 7, 2019

Mr. Patrick McNaughton, Chair
Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO  64106-2197

Via electronic mail to Crystal Brown.

Re: Proposal 2019-04-H

Dear Mr. McNaughton:

I am writing on behalf of UnitedHealth Group, Incorporated. We appreciate the opportunity to comment on RBC Proposal 2019-04-H, exposed for comment by the Health Risk-Based Capital (E) Working Group on April 8, 2019. The proposal seeks to alter the risk charges applied to health care receivables, on an informational-only basis in 2020 and 2021, with the expectation of full implementation in 2022.

We understand the purpose of the changes being proposed. We do have several concerns, however, about how the underlying intent would be implemented by this proposal. Our concerns relate to several areas, as indicated by the headings below.

Mathematical structure of the formula.

The proposed risk charge formula can be summarized as follows, where “f” means the factor of 0.05 for pharmaceutical rebate receivables and 0.19 for all other categories of health care receivables; “CY” and “PY” refer to “current year” and “prior year” receivables, respectively; and “COLL” is the collections during the current year on the prior-year receivable. The proposed risk charge is equal to the currently applicable risk charge, f • CY, plus an add-on equal to the greater of zero and the following:

\[(1 – f) \cdot (PY – [1+f] \cdot COLL)\]

This add-on (when not zero) can be restated as:

\[(1 – f) \cdot PY - (1 – f^2) \cdot COLL\]
The proper interpretation of this expression is not clear. The motivation for the add-on perhaps is that if the shortfall in collections of the prior-year receivable exceeds the risk charge that the existing formula would have produced, the excess should be treated as an additional risk charge. However, that is not the outcome of the formula as proposed. For that purpose, the formula should be comparing the prior-year risk charge, \((f \cdot PY)\), to the shortfall in collections, \((PY - COLL)\). In that case, the add-on would be the greater of zero and \((PY - COLL - f \cdot PY)\); that last expression can also be written as \(([1-f] \cdot PY - COLL)\).

Note that the add-on as currently proposed is either greater than or equal to the revised add-on suggested above.

**Asymmetry.**

As currently proposed, the add-on is one-sided: reporting entities are penalized for poor collection experience, but receive no benefit from good collection experience. Even if the entity collects every dollar which it reported as receivable — in fact, even if it recovers more than it conservatively expected to — it receives no reduction from the standard risk charge.

This is particularly troublesome with respect to the categories of health care receivables to which the factor of 0.19 applies. As we explained in our letter of May 20, 2016, regarding RBC Proposal 2016-06-H, we have several concerns about the analysis that led to the adoption of the 0.19 factor. Given the tenuous basis for that factor, it should not be considered a floor. At a minimum, the add-on should be allowed to be negative, at least to the extent that it reduced the effective factor to the original level of 0.05.

However, it is questionable whether even 0.05 should be the floor. The 0.05 factor was intended to cover a fairly wide range of possible outcomes, in order to provide the appropriate level of conservatism for RBC. If a wider range of unfavorable outcomes will be addressed by the add-on, then presumably a lower factor can be applied to the entities with favorable outcomes. A minimum of 0.01 (which is the maximum charge for non-controlled assets, the charge for NAIC 2 bonds and preferred stock, and the charge for investment income receivable) might be more appropriate.

**Exclusion of remaining receivables.**

Based on the tentative references in the proposal, which refer to Exhibit 3A column 1 only and not to column 3, only actual collections during the subsequent year would be recognized in determining the add-on. For some receivables, such as pharmaceutical rebate receivables, it might be reasonable to suppose that substantially all collections would take place within one year. However, for other receivables, such as loans and advances to providers, the intention of the parties may very well have been that the amount would be repaid over a longer period of time. Therefore, not only the subsequent-year collections, but any receivable remaining at the end of the year, should be reflected in calculating the add-on. That is to say, both column 1 and column 3 of Exhibit 3A should be used (or, equivalently, column 5, which is the sum of columns 1 and 3).
We realize that there may have been some concern about the collectability of any receivable remaining after the passage of a full year. However, we note that the reporting entity is required to perform an analysis of the collectability of its receivables, and to write off any amounts if it is probable that they are uncollectable (per Statement of Statutory Accounting Principles No. 84). This analysis is subject to review by the entity’s auditors and examination by the entity’s regulators. It does not seem appropriate to completely exclude assets that are deemed to have value under the NAIC’s accounting rules.

We note furthermore that the remaining receivable will in fact be subject to a credit risk charge, along with all other health care receivables reported at year-end. Therefore, the collectability of such receivables will be addressed by the credit risk charge calculation.

**Lack of proportionality.**

The add-on is based on the prior-year receivable; but this is appropriate only if the level of receivables is reasonably stable from year to year. Receivables for pharmaceutical rebates are likely to be stable if the volume of business is stable, but receivables for provider risk-sharing can be quite volatile; and even receivables for pharmaceutical rebates can change greatly from year to year if there is significant growth or decline in the book of business. This could, in some cases, lead to the total risk charge (basic risk plus add-on) actually exceeding the current-year receivable, which seems wholly unreasonable.

To address this problem, it would be appropriate to scale the add-on based on the relationship of the current-year receivable to the prior-year receivable.

**Limitation to one year of history.**

The add-on is calculated based on one year of run-out for the most recent prior-year receivable. This could lead to the results being distorted by a non-recurring issue, e.g., difficulty in collecting claim overpayments from a provider group that has been terminated from the network. Since the group has been terminated, it will not be producing additional receivables subject to collection; but the proposed formula will penalize the entity for that past problem, regardless of its applicability to the future.

One way to address this is to look at the collection history over a longer period. It is true that a longer period might mute the effect of changes in methodology (either estimation methodology or collection methodology); however, such changes would not be picked up in the year they occurred in any case. That said, it is true that the longer the historical period that is reviewed, the less relevance it may have to current conditions. Therefore, it seems appropriate to use an intermediate-length period such as three years.

Because of the possibility of non-recurring issues, and just normal year-to-year fluctuations in experience, the add-on factor could be highly variable in amount from year to year. This creates problems for the reporting entities, which will find capital planning much more difficult. It also creates problems for the regulator, as it calls into question the meaningfulness of RBC if the
amount changes significantly from year to year for a reasonably stable book of business. The use of a multi-year experience period will help to smooth out this volatility.

We understand the Working Group’s preference to use only information that is available from the current year’s Annual Statement. However, there are other portions of the Health RBC formula that use information available only from company records. As in those cases, it seems that here the advantages of using extra information outweigh the disadvantages, especially since the extra information can be verified from previous years’ Annual Statements rather than relying on internal company records.

Conclusion.

We have discussed above the problems that we perceive to exist with the proposal, related to the interpretation of the add-on charge, the asymmetry of that charge, the exclusion of the receivables remaining at the end of the year, the non-proportionality of the charge, and the volatility of the charge. We believe that all of those problems can be addressed, by using a calculation such as the following:

(A) Sum of receivables for the preceding three years.

(B) Sum of collections of those receivables in the subsequent year, plus any amount of such receivables that remained outstanding at the end of that subsequent year.

(C) Shortfall percentage: \[1 - \frac{(B)}{(A)}\].

(D) Receivable for the current year.

(E) Risk charge: greater of \[0.01 \cdot (D)\] and \[\frac{(C)}{(D)}\].

(Note that (C) is based on the sum of three years’ amounts, rather than the average of percentages calculated separately for each year. This is so that a small amount in one year will not be given undue weight.)

It might be suggested that this somewhat more complicated formula is not warranted, because the covariance adjustment will greatly reduce the impact of this risk charge. While that may be true in general, the charge could be significant for specific reporting entities. If that were not the case — if this charge were never significant — then there would be no need to alter the formula at all. If any change is to be contemplated, it should be designed to address the concerns that we have stated above.

We appreciate your consideration of our comments, and we would be happy to discuss this matter further with the Working Group.
James R. Braue
Director, Actuarial Services
UnitedHealth Group

cc: Crystal Brown, NAIC
    Randi Reichel, UnitedHealth Group
August 19, 2019

Mr. Patrick McNaughton  
Chair, Health Risk-Based Capital Working Group  
National Association of Insurance Commissioners  
2301 McGee Street, Suite 800  
Kansas City, Missouri  64108-2662  

Re: Comments on Exposure of Proposed 2019-04-H  

Dear Mr. McNaughton:

America’s Health Insurance Plans (AHIP) appreciates the opportunity to provide these comments on the exposure of 2019-04-H with respect to Healthcare Receivables.

We understand that the general approach as outlined by the Academy’s proposal is trying to address the issue that a number of companies do not report significant payments against the various Healthcare Receivable amounts established at each year-end. Because this is more than just a few companies, the factor applied to the year-end admitted asset to be higher than necessary. We have some concern with using the RBC filing to address financial reporting issues that are more a financial analysis function. That being said, if the resulting approach reduces the RBC requirement for those companies that are correctly reporting payments of these receivables and/or increases the accuracy of the reporting of payments, we can support the temporary use of the proposed informational filing, thus giving time for the actual issue to be addressed in the proper forum.

We would support small modifications to the proposal as recommended by UnitedHealth Group as follows:

1. Adjust the portion of the uncovered Healthcare receivable from the prior year by the ratio of the current year amount to the prior year amount. We would recommend that this be done during the test phase in two parts – (i) for Pharmacy Rebates and (ii) for all other types combined. This is because there is less credible data for the types of receivables other than Pharmacy rebates and the same average factor is applied to all other types. We also recommend that this ratio factor be limited to a minimum of not more than 2.00 so that a small amount of prior year receivable amounts do not overly increase the RBC for the assumed non-recovery for the current year receivable amounts.

2. Adjust the factor applied to the current year-end amount to 60-75% of the current factor to recognize that the new approach applies a significant factor to address the under-reporting of payments against these receivables. Since the large under-reporting is the cause of the use of a higher factor than if such under-reporting did not occur (i.e. if there was only mis-estimation of the amount to be recovered, the factor should be significantly lower), the test
should assume that, after review of the information reported in 2020-2021, the Academy will be recommending some reduction from the 5% or 19% current factors.

To make the above changes (using 60% of the current factor) on page XR020A, the factor in line (30.1) would be 0.030 and the factor in Lines (31.1, 32.1, 33.1, 34.1 and 35.1) would be 0.120. In addition, the footnotes on page XR020A would be changed to:

# For Pharmaceutical Rebates: \[\text{Greater of 0 or L(30.2) minus (1+.03) times Line (30.3)}\times (1-.03)\times \min(2, \{\text{Line (30.1) divided by Line (30.2)}\})\]\footnote{If Line 30.2 is zero use a ratio factor of 1.}

* For Claim Overpayment, Loan and Advances to Providers, Capitation Arrangements and Risk Sharing, and Other Health Care Receivables: \[\text{Greater of 0 or (L3_.2 minus (1+.12) times L(3_.3)}\times (1-.12)\times \min(2, \{\text{Sum of L(31.1) + L(32.1) + L(33.1) + (L34.1) + L35.1) divided by Sum of L(31.2) + L(32.2) + L(33.2) + (L34.2) + L35.2)}\}]\footnote{If the sum of Lines 31.2 + 32.2 + 33.2 + 34.2 + 35.2 is zero use a ratio factor of 1.}

Attached are our recommended revisions to the instructions consistent with the above changes to the formula.

We would be happy to address any questions the Working Group has with these comments.

Sincerely,

William C. Weller
Actuarial Consultant to AHIP

c/c: Crystal Brown, NAIC
Candy Gallaher, AHIP
XR020 - Other Receivables – L(25) through L(31)

There is an RBC requirement of 1 percent of the annual statement amount of investment income receivable and an RBC requirement of 5 percent of the annual statement amount for pharmaceutical rebates and amounts due from parents, subsidiaries, and affiliates, and aggregate write-ins for other than invested assets and an RBC requirement of 19 percent of the annual statement amount for all other health care receivables reported in Lines (26.2) through (26.6). Enter the appropriate value in Lines (25) through (31).

Line (26.1). Pharmaceutical rebates are arrangements between pharmaceutical companies and reporting entities in which the reporting entities receive rebates based upon the drug utilization of its subscribers at participating pharmacies. These rebates are sometimes recorded as receivables by reporting entities using estimates based upon historical trends which should be adjusted to reflect significant variables involved in the calculation, such as number of prescriptions written/filled, type of drugs prescribed, use of generic vs. brand-name drugs, etc. In other cases, the reporting entity determines the amount of the rebate due based on the actual use of various prescription drugs during the accumulation period and then bills the pharmaceutical company. Oftentimes, a pharmacy benefits management company may determine the amount of the rebate based on a listing (of prescription drugs filled) prepared for the reporting entity’s review. The reporting entity will confirm the listing and the pharmaceutical rebate receivable. Pharmaceutical rebates may relate to insured plans or uninsured plans. Only the receivable amount related to the insured plans should be reported on this line. Amount comes from annual statement Exhibit 3, Column 7, Line 0199999.

Line (26.2). Claim overpayments may occur as a result of several events, including but not limited to claim payments made in error to a provider. Reporting entities often establish receivables for claim overpayments. Amount comes from annual statement Exhibit 3, Column 7, Line 0299999.

Line (26.3). A health entity may make loans or advances to large hospitals or other providers. Such loans or advances are supported by legally enforceable contracts and are generally entered into at the request of the provider. In many cases, loans or advances are paid monthly and are intended to represent one month of fee-for-service claims activity with the respective provider. Amount comes from annual statement Exhibit 3, Column 7, Line 0399999.

Line (26.4). A capitation arrangement is a compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider. In some instances, advances are made to a provider under a capitation arrangement in anticipation of future services. Amount comes from annual statement Exhibit 3, Column 7, Line 0499999.

Line (26.5). Risk sharing agreements are contracts between reporting entities and providers with a risk sharing element based upon utilization. The compensation payments for risk sharing agreements are typically estimated monthly and settled annually. These agreements can result in receivables due from the providers if annual utilization is different than that used in estimating the monthly compensation. Amount comes from annual statement Exhibit 3, Column 7, Line 0599999.

Line (26.6). Any other health care receivable not reported in Lines (26.1) through (26.5). Amount comes from annual statement Exhibit 3, Column 7, Line 0699999.

Line (27). Only include on this line amounts receivable related to pharmaceutical rebates on uninsured plans that are in excess of the liability estimated by the reporting entity for the portion of such rebates due to the uninsured accident and health plans.

XR020-A Other Receivables for Informational Purposes Only
There is an RBC requirement of 1 percent of the annual statement amount of investment income receivable and an RBC requirement of 5 percent of the annual statement amount for amounts receivable relating to uninsured accident and health plans, amounts due from parents, subsidiaries, and affiliates, and aggregate write-ins for other than invested assets. These are intended to reflect the potential for mis-estimation of the amount to be received in the following year as well as a small amount to reflect the potential for non-payment.

For health care receivable amounts, there is an additional risk that repayments will not occur or will not be appropriately reported as repayments. This makes it more difficult to use a single factor to reflect both risks. This informational filing will address these risks separately. There is an RBC requirement of 3% of the annual statement amount for pharmacy rebates and an RBC requirement of 12 percent of the annual statement amount for the other health care receivables reported in lines 31.1 through 35.1 and an additional charge will be applied to health care receivables amounts reported in Lines (30) through (35) applied where the amount accrued in the prior year was not recovered in the current year – calculated as a factor times the current year amount times the ratio of the current year amount reported as a receivable to the prior year amount reported as a receivable. For pharmacy rebates this calculation is done for that line itself. For the other health care receivables a single ratio is calculated and applied to lines 31.3 through 35.3. To avoid applying too large a factor, the ratio has a maximum value of 2. Where the prior year receivable amount(s) used for a ratio is zero, a factor of 1 is used.

Examples of the calculation are included below but do not include the use of a common ratio of prior year amounts repaid to prior year receivable:

Example 1:
Claim overpayment receivable as of 12/31/2020 with substantial recoveries that still a little less than the accrual

a. Claim overpayment receivable as of 12/31/2020 of $1,000,000 (col (1) Line 31.1)
b. Claim overpayment receivable as of 12/31/2019 of $900,000 (col (1) Line 31.2)
c. Claim overpayment recoveries of $840,000 reported achieved in 2020 against accruals at 12/31/2019 (col (1) Line 31.3)
d. Current formula amount: $1,000,000 x 0.19 = $190,000 XR020 (col (3) Line 30.2)
e. Informational formula amount XR020A
   \[
   \text{max}(0, 900,000 - (1 - 0.19) x 840,000) = 0
   \]
   \[
   0 x (1 - 0.19) x \text{min}(2, \frac{\text{Sum of Lines 31.3 + 32.3 + 33.3 + 34.3 + 35.3}}{\text{Sum of Lines 31.2 + 32.2 + 33.2 + 34.2 35.2}}) \leq 0
   \]
   \[
   \text{(3) Line 31.3}
   \]

Example 2:
Claim overpayment receivable as of 12/31/2020, but with no recoveries:

a. Claim overpayment receivable as of 12/31/2020 of $1,000,000
b. Claim overpayment receivable as of 12/31/2019 of $900,000
c. Claim overpayment recoveries of $0 reported achieved in 2020 against accruals at 12/31/2019
d. Current formula amount: $1,000,000 x 0.19 = $190,000 XR020 (col (3) Line 30.2)
e. Informational formula amount XR020A
   \[
   \text{max}(0, 900,000 - (1 - 0.19) x 0) = 900,000
   \]
   \[
   900,000 x (1 - 0.19) x \text{min}(2, \frac{\text{Sum of Lines 31.3 + 32.3 + 33.3 + 34.3 + 35.3}}{\text{Sum of Lines 31.2 + 32.2 + 33.2 + 34.2 35.2}}) \leq 0
   \]
   \[
   \text{(3) Line 31.3}
   \]
Example 3:

Claim overpayment receivable as of 12/31/2020, but with recoveries of half the amount of the accrual:

a. Claim overpayment receivable as of 12/31/2020 of $1,000,000 (col (1) Line 31.1)
b. Claim overpayment receivable as of 12/31/2019 of $900,000 (col (1) Line 31.2)
c. Claim overpayment recoveries of $450,000 reported achieved in 2020 against accruals at 12/31/2019 (col (1) Line 31.3)
d. Current formula amount: $1,000,000 x 0.19 = $190,000 XR020 (col (3) Line 30.2)
e. Informational formula amount XR020A

\[
\text{Total RBC} = 880,000 + 387,200 = 1,267,200
\]

Example 3:

Claim overpayment receivable as of 12/31/2020, but with recoveries of half the amount of the accrual which is much smaller than current year receivable:

a. Claim overpayment receivable as of 12/31/2020 of $1,000,000 (col (1) Line 31.1)
b. Claim overpayment receivable as of 12/31/2019 of $200,000 (col (1) Line 31.2)
c. Claim overpayment recoveries of $100,000 reported achieved in 2020 against accruals at 12/31/2019 (col (1) Line 31.3)
d. Current formula amount: $1,000,000 x 0.19 = $190,000 XR020 (col (3) Line 30.2)
e. Informational formula amount XR020A

\[
\text{Total RBC} = 154,880 + 154,880 = 309,760
\]
MEMORANDUM

TO: Patrick McNaughton, Chair, Health Risk-Based Capital (E) Working Group

FROM: Stephen Wiest, Chair, Operational Risk (E) Subgroup

DATE: February 26, 2019

RE: Referral for Further Work on Health Growth Operational Risk

The operational Risk (E) Subgroup believes that there is an opportunity to improve the assessment of growth risk in the Health Risk-based Capital (HRBC) formula. While alternatives to the existing growth risk methodology that have been tested by the Subgroup have not proved to be better indicators of risk, there are reasons to consider whether the existing methodology is working as intended. The Health RBC (E) Working Group is best positioned to continue the review. The Operational Risk (E) Subgroup recommends that the review focus on the existing growth risk by forming an ad hoc subgroup of regulators and interested parties familiar with the HRBC formula similar to what was utilized to review the existing growth risk methodology and factors in the Property RBC formula. This document should be used as a starting point for that review. That ad hoc group would provide suggestions for potential enhancements to the existing growth charge to the HRBCWG. The review could include:

- Given the current array of company types that now file Health RBC, should the variables used in the application of the 10% threshold be reversed (i.e., the charge is assessed if risk revenue is increasing faster than RBC)?
- Determine if a 10% threshold is still reasonable.
- Should the normal growth risk calculation (existing or as adjusted) apply to start-up companies? If not, what adjustments should be applied to the calculation for start-ups?
- Should the Health RBC growth risk methodology (existing or as adjusted) be adopted into the Life RBC formula for companies that write a material amount (e.g. > X%) of their premiums in health business, where such business would be subject to the growth risk calculation in the Health RBC formula?

Background

How the Existing Growth Risk Charge Works:

- Growth in Underwriting Risk RBC year over year is measured against growth in underwriting risk revenue year over year. Thus, the formula recognized that as risk was added, revenue should respond accordingly.
- If growth Underwriting Risk RBC exceeds growth in underwriting risk revenue by greater than 10%, growth risk is triggered.
- A factor of 50% is applied to the excess of growth in Underwriting Risk RBC above the 10% threshold.
Considerations in Developing the Existing Methodology:

- The risk of growth, while included in H-4, is most related to increased pricing risk caused by growth rather than increased operational risk that may be caused by rapid growth.
- The methodology is better designed to capture change in product mix or introductions of new managed care products with differing levels of managed care features.
- At the time that the HRBC formula was being developed, there were significant issues around transfer of risk to providers which were driving a change from capitated arrangements and HMO products to greater use of contractual fee-for-service and withholds / incentives in provider agreements and PPO and POS products.
- The developers of the HRBC formula considered the potential for premium rate impact related to increasing competition from national carriers into local markets, and consolidation in the market.

Reasons to Consider a Change to the Existing Methodology:

- The original Health Organizations RBC (HQRBC) formula applied primarily to HMOs and Not-for-profit health plans (e.g., hospital and medical indemnity plans). In the early 2000s, with the adoption of Statutory Accounting Principles and the Health financial reporting blank (and the addition of a health test to that reporting blank), insurers became subject to the renamed Heath RBC (HRBC) formula.
- Relatively few entities triggered the current growth risk charge, even during recent periods of rapid growth caused by the ACA.
- The application of growth risk to new entities is unclear. A number of entities that were new to the market and which grew rapidly in 2014 and 2015 ultimately failed regardless of original projections. If sufficient capital was put in place during the licensing process based on reasonably accurate projections, then there should be little impact from growth risk. If not, perhaps growth risk should be recognized as an early warning indicator. The growth should smooth out over time and the charge removed.
- For various reasons, neither the informational approach nor other alternatives explored thus far by the Operational Risk (E) Subgroup have indicated a significantly improved ability to identify companies that are not sufficiently capitalized to absorb the impact of rapid growth.
- Companies that file the Life RBC formula, but write the same type of health business written by companies that are required to file the Health RBC formula are not currently subject to a growth risk capital requirement.
July 29, 2019

Mr. Patrick McNaughton
Chair, Health Risk-Based Capital Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, Missouri 64108-2662

Re: Comments on Health Growth Risk Analysis

Dear Mr. McNaughton:

America’s Health Insurance Plans (AHIP) appreciates the opportunity to provide these comments on the potential review of changes to the manner in which growth risk is addressed by the Health RBC formula.

We have followed the extensive work done within the Operations Risk WG to look at alternatives to the current growth risk. It does not appear that any of the potential ways that were reviewed changed the number of companies that had an increase in their RBC values when a changed growth approach was applied to several prior years data. We note that different approaches for a growth risk charge caused different companies to have an increase in their RBC values. That analysis did not show whether any of the companies with such an added charge fell into lower RBC levels or insolvency in the immediate following two years. We believe that only if another approach proved more useful in identifying such failing companies should the current growth risk approach be changed for mature companies.

With respect to non-mature companies in their first five or so years, we believe that the current growth risk approach does address changes in “mix” of the managed care credit for the coverage provided and that that issue is important for the regulators to be aware of. The actual growth in premium volume and number of covered lives necessary for a new company to reach maturity is much higher than any “normal” growth risk. The actual growth should be compared to the planned growth for such companies. Where actual growth exceeds planned growth by a significant amount, revised plans would be a more appropriate vehicle for regulatory review than RBC reporting – it does not require waiting for annual RBC reporting or the use of an average growth assumption.

Finally, we do not support the inclusion of a separate health growth risk adjustment in the Life RBC formula. Whether or not the companies using the Life Blank that write significant amounts

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1 We recommend excluding companies with less than five years of RBC reporting experience for this part of future analysis.
of health premium are impacted by changes to the Health Test and the results of any application of a growth segment to the Life RBC formula are ongoing considerations that must be addressed first. We believe that it would be necessary to establish some link between continuing declines and ultimate insolvency of Life companies and their health lines of business before any such extensive changes are considered.

We would be happy to address any questions the Working Group has with these comments.

Sincerely,

William C. Weller
Actuarial Consultant to AHIP

c/c: Crystal Brown, NAIC
Candy Gallaher, AHIP
July 23, 2019

Mr. Patrick McNaughton, Chair
Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Via electronic mail to Crystal Brown.

Re: Excessive Growth Charge Referral Letter

Dear Mr. McNaughton:

I am writing on behalf of UnitedHealth Group, Incorporated. We appreciate the opportunity to comment on the memorandum addressed to you from the chair of the Operational Risk (E) Subgroup, dated February 26, 2019, on the subject, “Referral for Further Work on Health Growth Operational Risk.” This referral memorandum recommended that your Working Group review certain aspects of the Excessive Growth Risk charge as it currently exists in the Health Risk-Based Capital formula. For the reasons set forth below, we do not believe any change to the RBC Excessive Growth Risk charge (except perhaps for start-up companies) is necessary or appropriate.

We will examine each of the areas recommended for review below, but first we must address the need for review in general. Where factors within the RBC formula are developed from theoretically appropriate models using actual historical data, it is reasonable to periodically review and possibly revise those factors to reflect updated information (and perhaps enhancements to the models). In this case, however, where the RBC charge was not based on historical data, there can be no updated data that would compel an update to the charge. The only reason for a change would be if the existing Excessive Growth Risk charge has not been performing adequately. So far, no evidence has been presented that would indicate that this has been the case, especially with respect to established companies that have significant experience and expertise in health insurance. It is important that any changes to the formula be based on an
analysis of how the Excessive Growth Risk charge has performed historically, especially if the changes being contemplated might result in a broader application or more burdensome level of the charge.

The referral memorandum cites the experience of certain new entities in 2014 and 2015. However, these entities were all or nearly all CO-OPs established under the ACA, and they are not relevant for several reasons. First, the CO-OPs were not just growing rapidly; they were start-ups, with no operating history at all. That is very different from rapid growth of an established book of business. Second, the CO-OPs were operating in a marketplace that was undergoing significant disruption, where pricing was particularly difficult because of the lack of relevant historical data. Third, the pricing difficulties were severely exacerbated by the failure of the federal government to meet its obligations arising from the ACA Risk Corridor program. Fourth, the non-profit structure of the majority of the CO-OPs meant that they did not have ready access to additional capital. These conditions were unique to the CO-OPs and that specific period of time, and have nothing to do with how the health insurance market generally functions.

Therefore, while there may be some rationale for revisiting the application of the formula to start-up companies, we suggest that any more general review should be preceded by an evaluation of how the existing Excessive Growth Risk charge has performed historically. If there are instances (other than the CO-OPs as just cited) where excessive growth has led to financial difficulties for an entity, and the Excessive Growth Risk charge did not properly reflect those circumstances, they should be identified and thoroughly discussed prior to determining if any changes are necessary. If there are no such instances, then presumably the Excessive Growth Risk charge is working as intended, and no further review is needed.

With that preface, we address in more detail each of the areas recommended for review by the referral memorandum.

1. Given the current array of company types that now file Health RBC, should the variables used in the application of the 10% threshold be reversed (i.e., the charge is assessed if risk revenue is increasing faster than RBC)?

There is no evident rationale for such a change. Reversing the calculation would suggest that an entity has greater risk if its growth is in lower-risk products. That could only occur if those products were not actually lower-risk, which would call into question the remainder of the underwriting risk charges in the Health RBC formula. As we explain below, if the concern is simply that there is a shift to new products, that is adequately addressed by the current structure of the Excessive Growth risk charge.

There is a clear rationale for the Excessive Growth Risk charge as it exists today in the Health RBC formula, and the charge serves to capture operational risk as opposed to pure underwriting risk. To the extent that underwriting (pricing) risk increases proportionately with growth in business volume, the additional risk is reflected in the H-2 (Underwriting Risk) section of the formula. In contrast, the Excessive Growth Risk charge is applicable when underwriting risk is
growing significantly faster than business volume. There are a variety of reasons why this might occur, including the following:

- The business mix may be shifting from provider payment mechanisms that control underwriting risk to a higher degree (such as capitations) to mechanisms that provide less control (such as payment at usual and customary rates).

- The business mix may be shifting from products that are considered to have a lower degree of risk (such as Medicare Supplement) to products that are deemed higher-risk (such as Comprehensive Medical).

- The degree of risk control provided via premium stabilization reserves may have been reduced as such reserves decrease.

- The loss ratio for the business may be deteriorating for some reason other than the three just listed.

In each of those situations, pricing is made more difficult by changing from a less-risky to a more-risky environment. However, the reporting entity’s risk increases disproportionately only if its pricing and underwriting processes are unable to deal with that change (and the fourth situation above may in fact be evidence of such an inability); otherwise, the change in risk is captured adequately by the H-2 section of the RBC formula. But the failure of the entity’s pricing and underwriting processes to appropriately address these changes is in fact a form of operational risk, as that has been defined by the NAIC. Therefore, very clearly, the existing Excessive Growth Risk charge is structured appropriately to address the operational risks that arise from excessively rapid growth.

It is true that the current Excessive Growth Risk charge is focused on the failure of one category of operational functions. However, this category — that is, pricing and underwriting processes — is the category that is most likely to be adversely affected by dramatic growth in business, and therefore should in fact be the focus of the Excessive Growth Risk charge.

Another potential financial problem arising from rapid growth is the entity’s inability to process claims properly, leading to excessive losses. This would lead to the fourth situation in the list above, and therefore also would be addressed by the existing Excessive Growth Risk charge.

We also point out that, if the growth were occurring in products that were nominally lower-risk, but the extent of the growth was causing operational issues, those issues would be reflected in the manner described above.

Accordingly, we believe that the structure of the Excessive Growth Risk charge as it exists currently in the Health RBC formula is an appropriate means to address any additional risk that arises from excessive growth in business.
2. **Determine if a 10% threshold is still reasonable.**

   In our comments on area #1 above, we noted that we believe the existing structure of the Excessive Growth Risk charge is appropriate. That does not automatically imply that the 10% threshold itself is appropriate. As we discussed in our opening comments, any revision of this aspect of the formula should be based on a review of how the Excessive Growth Risk charge has performed historically. The only way to know whether the 10% threshold is reasonable is to determine whether it has excluded some entities that suffered operational failures from excessive growth (i.e., the threshold is too high), or has included entities that were growing but did not experience material adverse effects from growth (i.e., the threshold is too low). Without such a review, we see no way to make a determination as to the reasonableness of the 10% threshold.

3. **Should the normal growth risk calculation (existing or as adjusted) apply to start-up companies? If not, what adjustments should be applied to the calculation for start-ups?**

   As we state above, there may be some justification for reconsidering how the Excessive Growth Risk charge should apply to start-up entities. We will note again, though, that the problems cited in the referral memorandum had causes that went far beyond excessive growth.

   We also note that applying too high a charge to start-up business would discourage entry into a market by new parties, which would tend to limit competition to the detriment of consumers.

   Accordingly, we suggest that the treatment applied to start-ups should not reflect all the problems underlying the failures previously cited, but should be focused on excessive growth per se, as being more relevant to the broader industry; and we believe the resulting capital requirement should not be so onerous as to discourage new entries into the marketplace.

4. **Should the Health RBC growth risk methodology (existing or as adjusted) be adopted into the Life RBC formula for companies that write a material amount (e.g. > X%) of their premiums in health business, where such business would be subject to the growth risk calculation in the Health RBC formula?**

   As we have discussed above, having seen no evidence to the contrary, we suggest that the Excessive Growth Risk charge as it currently exists in the Health RBC formula is performing as it was intended, addressing the risk that arises from immoderate growth. Therefore, we see no compelling reason why it should not be imported into the Life RBC formula as well.

   We are not certain that a percentage threshold for health business is necessary. If health business represents only a small part of an entity’s business, then any Excessive Growth Risk charge would presumably have negligible impact on the entity’s Company Action Level, especially when the effect of the covariance adjustment is taken into account. A threshold for application would be necessary only if the data collection and entry for the Excessive Growth Risk component of the formula were deemed to be a material burden.
We appreciate your consideration of our foregoing comments. We would be happy to discuss the matter with you further.

James R. Braue
Director, Actuarial Services
UnitedHealth Group

cc: Crystal Brown, NAIC
    Randi Reichel, UnitedHealth Group
### OFF-BALANCE SHEET SECURITY LENDING COLLATERAL AND SCHEDULE DL, PART 1 ASSETS

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Denotes items that must be manually entered on the filing software.
### FIXED INCOME ASSETS

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Denotes items that must be vendor linked.
## FIXED INCOME ASSETS (cont.)

### MISCELLANEOUS FIXED INCOME ASSETS

| (28) | Cash | Page 2, Line 5, inside amount 1 |
| (29) | Cash Equivalents | Page 2, Line 5, inside amount 2 |
| (30) | Less: Cash Equivalent, Bonds included in Schedule D, Part 1A | Sch E Pt 2, C7, L8399999, in part |
| (31) | Less: Exempt Money Market Mutual Funds* | Sch E Pt 2, C7, L8599999 |
| (32) | Net Cash Equivalents | $L(29) - L(30) - L(31)$ |
| (33) | Short-Term Investments | Page 2, Line 5, inside amount 3 |
| (34) | Short-Term Bonds * | Sch DA, Pt 1, Col 7, L8399999 |
| (35) | Total Other Short-Term Investments | $L(33) - L(34)$ |
| (36) | Mortgage Loans - First Liens | Page 2, Col 3, Line 3.1 |
| (37) | Mortgage Loans - Other Than First Liens | Page 2, Col 3, Line 3.2 |
| (38) | Receivable for Securities | Page 2, Col 3, Line 9 |
| (39) | Aggregate write-ins for invested assets | Page 2, Col 3, Line 11 |
| (40) | Collateral Loans | Included in Page 2, Col 3, Line 8 |
| (41) | NAIC 01 Working Capital Finance Investments | Notes to Financial Statement 5M(01a), Col 3 |
| (42) | NAIC 02 Working Capital Finance Investments | Notes to Financial Statement 5M(01b), Col 3 |
| (43) | Other Long-Term Invested Assets Excluding Collateral Loans and Working Capital Finance Investments | Included in Page 2, Col 3, Line 8 |
| (44) | Federal Guaranteed Low Income Housing Tax Credits | Schedule BA Part 1, Column 12 Lines 3199999 + 3299999 |
| (45) | Federal Non-Guaranteed Low Income Housing Tax Credits | Schedule BA Part 1, Column 12 Lines 3399999 + 3499999 |
| (46) | State Guaranteed Low Income Housing Tax Credits | Schedule BA Part 1, Column 12 Lines 3599999 + 3699999 |
| (47) | State Non-Guaranteed Low Income Housing Tax Credits | Schedule BA Part 1, Column 12 Lines 3799999 + 3899999 |
| (48) | All Other Low Income Housing Tax Credits | Schedule BA Part 1, Column 12 Lines 3999999 + 4099999 |
| (49) | Total Other Long-Term Invested Assets (Page 2, Col 3, Line 8) | $L(40) + L(41) + L(42) + L(43) + L(44) + L(45) + L(46) + L(47) + L(48)$ |
| (50) | Derivatives | Page 2, Col 3, Line 7 |
| (51) | Total Fixed Income Assets RBC | $L(27) + L(28) + L(32) + L(35) + L(36) + L(37) + L(38) + L(39) + L(49) + L(50)$ |

Denotes items that must be manually entered on filing software.

* These bonds appear in Schedule D Part 1A Section 1 and are already recognized in the Bond portion of the formula.
## EQUITY ASSETS

### PREFERRED STOCK - UNAFFILIATED

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<td>(3)</td>
<td>NAIC 03 Preferred Stock</td>
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<td>(4)</td>
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<td>(5)</td>
<td>NAIC 05 Preferred Stock</td>
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<td>Total - Unaffiliated Preferred Stock</td>
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(Should equal Page 2, Col 3, Line 2.1 less Sch D Sum, Col 1, L18)

### HYBRID SECURITIES - UNAFFILIATED

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### COMMON STOCK - UNAFFILIATED

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Denotes items that must be manually entered on filing software.
### ASSET CONCENTRATION

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Note: Ten issuer sections and a grand total page will be available on the filing software. The grand total page is calculated as the sum of issuers 1-10 by asset type.

Denotes items that must be manually entered on filing software.
**CALCULATION OF TOTAL RISK-BASED CAPITAL AFTER COVARIANCE**

**H0 - AFFILIATES W/RBC AND MISC. OTHER AMOUNTS**

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<td>(4) Directly Owned Health Entity Subject to RBC</td>
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**H1 - ASSET RISK - OTHER**

| (9) Investment Affiliates | XR003, Affiliates Page, L(5) |
| (10) Holding Company Excess of Subsidiaries | XR003, Affiliates Page, L(6) |
| (11) Investment in Parent | XR003, Affiliates Page, L(9) |
| (12) Other Affiliates | XR003, Affiliates Page, L(10) |
| (13) Fair Value Excess Affiliate Common Stock | XR003, Affiliates Page, L(11) |
| (14) Fixed Income Assets | XR006, Off-Balance Sheet Collateral, L(27) + L(37) + L(38) + L(39) + XR007.2, Fixed Income Assets Page, L(52) |
| (15) Replication & Mandatory Convertible Securities | XR008, Replication/MCS Page, L(9999999) |
| (16) Unaffiliated Preferred Stock and Hybrid Securities | XR006, Off-Balance Sheet Collateral, L(34) + XR009, Equity Assets Page, L(7) |
| (17) Unaffiliated Common Stock | XR006, Off-Balance Sheet Collateral, L(35) + XR009, Equity Assets Page, L(13) |
| (18) Property & Equipment | XR006, Off-Balance Sheet Collateral, L(36) + XR010, Prop/Equip Assets Page, L(9) |
| (19) Asset Concentration | XR011, Grand Total Asset Concentration Page, L(27) |
| (20) Total H1 | Sum L(9) through L(19) |

**H2 - UNDERWRITING RISK**

| (21) Net Underwriting Risk | XR012, Underwriting Risk Page, L(21) |
| (22) Other Underwriting Risk | XR014, Underwriting Risk Page, L(25.3) |

XR024
(23) Disability Income

XR014, Underwriting Risk Page, L(26.3)+L(27.3)+L(28.3)+(29.3)+(30.6)+(31.3)+(32.3)

(24) Long-Term Care

XR015, Underwriting Risk Page, L(41)

(25) Limited Benefit Plans

XR016, Underwriting Risk Page, L(42.2)+L(43.6)+L(44)

(26) Premium Stabilization Reserve

XR016, Underwriting Risk Page, L(45)

(27) Total H2

Sum L(21) through L(26)

Denotes items that must be manually entered on filing software.
Security lending programs are required to maintain collateral. Some entities post the collateral supporting security lending programs on their financial statements, and incur the related risk charges on those assets. Other entities have collateral that is not recorded on their financial statements. While not recorded on the financial statements of the company, such collateral has risks that are not otherwise captured in the RBC formula.

The collateral in these accounts is maintained by a third party (typically a bank or other agent). The collateral agent maintains on behalf of the company detail asset listings of the collateral assets, and this data is the source for preparation of this schedule. The company should maintain such asset listings, at a minimum CUSIP, market value, book/adjusted carrying value, and maturity date.

The asset risk charges are derived from existing RBC factors for bonds, preferred and common stocks, other invested assets, and invested assets not otherwise classified (aggregate write-ins).

Specific Instructions for Application of the Formula


Off-balance sheet collateral included in General Interrogatories Part 1, Lines 24.05 and 24.06 of the annual statement should agree with Line (4922), Column (1).

Lines (1) through (926) – Bonds – Bond factors described on page XR007.1 – Fixed Income Assets – Bonds.

Line (4828) through (4633) – Preferred Stock – Preferred stock factors described on page XR009 – Equity Assets

Line (4735) – Common Stock – Common stock factors described on page XR009 – Equity Assets

Line (4836) – Real Estate and Property and Equipment Assets – Real Estate and Property and Equipment Assets factors described on page XR010 – Property & Equipment Assets

Line (4937) – Other Invested Assets – Other invested assets factor described on page XR007.2 – Fixed Income Assets – Miscellaneous Assets.

Line (2038) – Mortgage Loans on Real Estate – Mortgage Loans on Real Estate factors described on page XR007.2 – Fixed Income Assets – Miscellaneous Assets.

Line (3924) – Cash, Cash Equivalents and Short-Term Investments – Cash, Cash Equivalents and Short-Term Investments factors described on page XR007.2 – Fixed Income Assets – Miscellaneous Assets.
FIXED INCOME ASSETS
XR007.1 AND XR007.2

The RBC requirement for fixed income assets is largely driven by the default risk on those assets. There are two major subcategories: Bonds and Miscellaneous. Bonds are obligations issued by business units, governmental units, and certain nonprofit units, having a fixed schedule for one or more future payments of money. This definition includes commercial paper, negotiable certificates of deposit, repurchase agreements, and equipment trust certificates. Miscellaneous fixed income assets are other assets with fixed repayments schedules, such as mortgages and collateral loans.

Bonds

The bond risk factors for investment grade bonds (NAIC Classes 1.A - 2.C) are based on cash flow modeling, using historically adjusted default rates for each bond category. For each of 2,000 trials, annual economic conditions were generated for the ten-year modeling period. Each bond of a 400-bond portfolio was annually tested for default (based on a “roll of the dice”) where the default probability varies by designation category and that year’s economic environment. When a default takes place, the actual loss considers the expected principal loss by category, the time until the sale actually occurs, and the assumed tax consequences. Only default risk is recognized in the RBC factors because, under statutory accounting, bonds are generally carried at their amortized value on the statutory annual statement, so changes in the market value of the bonds following swings in interest rates do not, as a general rule, affect the capital and surplus of the regulated entities unless the bonds are actually sold. The accounting for reporting entities can be substantially different from other regulated entities, but the RBC formula continues to recognize only default risk. The default probabilities were based on historical data intended to reflect a complete cycle of favorable and unfavorable credit environments. The risk of default was measured over a 2-year time horizon, selected considering the duration of health assets and liabilities.

U.S. government bonds that are direct and guaranteed and backed by the full faith and credit of the U.S. government (including SVO Identified Funds that are determined by the SVO to be the equivalent of U.S. government guaranteed bonds or NAIC 01 bonds) receive a zero factor (see Annual Statement Instructions). There is no RBC requirement for bonds guaranteed by the full faith and credit of the United States because there is virtually no default risk associated with these securities.

The factors for NAIC Classes 3.A to 6 recognizes that the book/adjusted carrying value of these non-investment grade bonds reflects a loss of value upon default by being marked to market. These bond risk factors are based on the market value fluctuation for each of the NAIC classes compared to the market value fluctuation of stocks during the 2008-2009 financial crisis.

A bond portfolio adjustment has been incorporated into the bond factors based on a portfolio of 382 issuers.

The book/adjusted carrying value of all bonds and related fixed income investments should be reported in Column (1). The bonds are split into seven different risk classifications. These risk classifications are based on the NAIC designations assigned. For long-term bonds, these classifications are found on Lines 10.1 through 10.6 of Schedule D, Part 1A, Section (b) in the electronic only column of Schedule D, Part 1; short-term bonds will be found in the electronic only column of Schedule DA, Part 1 and the bonds reported as cash equivalents will be found in the electronic only column of Schedule E, Part 2 of the annual statement.

Enter the book/adjusted carrying value of the bonds, by NAIC designation, in Column (1). The RBC requirement will be automatically calculated in Column (2).
**Miscellaneous Fixed Income Assets**

The factor for cash is 0.3 percent. It is recognized that there is a small risk related to possible insolvency of the bank where cash deposits are held and this factor, equivalent to an unaffiliated NAIC 01 bond, reflects the short-term nature of this risk. The required risk-based capital for cash will not be less than zero, even if the company’s cash position is negative.

The Short-Term Investments to be included in this section are those short-term investments not reflected elsewhere in the formula. The 0.3 percent factor is equal to the factor for cash. The amount entered here should equal the total short-term investments found in Schedule DA, Part 1, Column 7, Line 8399999 less bonds that are contained in Schedule D, Part 1A, Section 1.

Collateral loans and mortgage loans are generally a small portion of the total portfolio value. A factor of 5 percent is consistent with other risk-based capital formulas studied by the working group.

The book adjusted carrying value of NAIC 01 and 02 Working Capital Finance Investments, Lines (2441) and (2542), should equal the Notes to Financial Statement, Lines 5M(01a) and 5M(01b), Column 3 of the annual statement.

Other Long-Term Invested Assets are those that are listed in Schedule BA and are somewhat more speculative and risky than most other investments. Therefore, a 20 percent factor is consistent with other risk-based capital formulas studied by the working group.

Low income housing tax credit investments are reported in Column (1) in accordance with SSAP No. 93—Low Income Housing Tax Credit Property Investments.

Federal Guaranteed Low-Income Housing Tax Credit (LIHTC) investments are to be included in Line (2744). There must be an all-inclusive guarantee from an ARO-rated entity that guarantees the yield on the investment.

Federal Non-Guaranteed LIHTC investments with the following risk mitigation factors are to be included in Line (2845):

a) A level of leverage below 50 percent. For a LIHTC Fund, the level of leverage is measured at the fund level.

b) There is a tax credit guarantee agreement from general partner or managing member. This agreement requires the general partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For an LIHTC fund, a tax credit guarantee is required from the developers of the lower-tier LIHTC properties to the upper-tier partnership.

State Guaranteed LIHTC investments that at a minimum meet the federal requirements for guaranteed LIHTC investments are to be included in Line (2946).

State Non-Guaranteed LIHTC investments that at a minimum meet the federal requirements for non-guaranteed LIHTC investments are to be included on Line (3047).

All Other LIHTC investments, state and federal LIHTC investments that do not meet the requirements of Lines (2744) through (3047) would be reported on Line (4844).
EQUITY ASSETS
XR009

Unaffiliated Preferred Stocks
Experience data to develop preferred stock factors is not readily available; however, it is believed that preferred stocks are somewhat more likely to default than bonds. The loss on default would be somewhat higher than that experienced on bonds; however, formula factors are equal to bond factors.

The RBC requirements for unaffiliated preferred stocks and hybrids are based on the NAIC designation. Column (1) amounts are from Schedule D, Part 2, Section 1 not including affiliated preferred stock. The preferred stocks and hybrids must be broken out by asset designation (NAIC 01 through NAIC 06) and these individual groups are to be entered in the appropriate lines. The total amount of unaffiliated preferred stock and hybrids reported should equal annual statement Page 2, Column 3, Line 2.1, less any affiliated preferred stock in Schedule D Summary by Country, Column 1, Line 18. The total amount of hybrid securities reported should equal annual statement Schedule D, Part 1A, Section 1, Column 7, Line 7.7.

Unaffiliated Common Stock
Non-government money market mutual funds are more like cash than common stock, therefore it is appropriate to use the same factor as for cash. Federal Home Loan Bank Stock has characteristics more like a fixed income instrument rather than common stock. A 2.3 percent factor was chosen. The factor for other unaffiliated common stock is based on studies which indicate that a 10 percent to 12 percent factor is needed to provide capital to cover approximately 95 percent of the greatest losses in common stock over a one-year future period. The higher factor of 15 percent contained in the formula reflects the increased risk when testing a period in excess of one year. This factor assumes capital losses are unrealized and not subject to favorable tax treatment at the time of loss in market value.

ASSET CONCENTRATION
XR011

The purpose of the asset concentration calculation is to reflect the additional risk of high concentrations of certain types of assets in single exposures, termed “issuers.” An issuer is a single entity, such as IBM or the Ford Motor Company. When the reporting entity has a large portion of its asset portfolio concentrated in only a few issuers, there is a heightened risk of insolvency if one of those issuers should default. An issuer may be represented in the reporting entity’s investment portfolio by a single security designation, such as a large block of NAIC Designation Category 02–2.A bonds, or a combination of various securities, such as common stocks, preferred stocks, and bonds. The additional RBC for asset concentration is applied to the ten largest issuers.

Concentrated investments in certain types of assets are not expected to represent an additional risk over and above the general risk of the asset itself. Therefore, prior to determining the ten largest issuers, you should exclude those assets that are exempt from the asset concentration factor. Asset types that are excluded from the calculation include: NAIC 06 bonds and NAIC 06 preferred stock; affiliated common stock; affiliated preferred stock; affiliated bonds; property and equipment; U.S. government guaranteed bonds (including SVO Identified Funds that are determined by the SVO to be the equivalent of U.S. government guaranteed bonds or NAIC 01 bonds); NAIC 01 bonds and NAIC 01 preferred stock and hybrids; any other asset categories with risk-based capital factors less than 1 percent, and investment companies (mutual funds) and common trust funds that are classified within the meaning of the federal Investment Company Act of 1940 [Section 5(b) (1)]. The pro rata share of individual securities within an investment company (mutual fund) or common trust fund are to be included in the determination of concentrated investments, subject to the exclusions identified.

With respect to investment companies (mutual funds) and common trust funds, the reporting entity is responsible for maintaining the appropriate documentation as evidence that such is diversified within the meaning of the federal Investment Company Act and providing this information upon request of the Commissioner, Director or Superintendent of the Department of Insurance. The reporting entity is also responsible for maintaining a listing of the individual securities and corresponding
book/adjusted carrying values making up its investment companies (mutual funds) and common trust funds portfolio, in order to determine whether a concentration charge is necessary. This information should be provided to the Commissioner, Director or Superintendent upon request.

The assets that **ARE INCLUDED** in the calculation when determining the 10 largest issuers are as follows:

- NAIC Designation Category 2.A Unaffiliated Bonds
- NAIC Designation Category 2.B Unaffiliated Bonds
- NAIC Designation Category 2.C Unaffiliated Bonds
- NAIC Designation Category 3.A Unaffiliated Bonds
- NAIC Designation Category 3.B Unaffiliated Bonds
- NAIC Designation Category 3.C Unaffiliated Bonds
- NAIC Designation Category 4.A Unaffiliated Bonds
- NAIC Designation Category 4.B Unaffiliated Bonds
- NAIC Designation Category 4.C Unaffiliated Bonds
- NAIC Designation Category 5.A Unaffiliated Bonds
- NAIC Designation Category 5.B Unaffiliated Bonds
- NAIC Designation Category 5.C Unaffiliated Bonds
- NAIC 02 Unaffiliated Bonds
- NAIC 03 Unaffiliated Bonds
- NAIC 04 Unaffiliated Bonds
- NAIC 05 Unaffiliated Bonds
- Collateral Loans
- Mortgage Loans
- NAIC 02 Unaffiliated Preferred Stock
- NAIC 03 Unaffiliated Preferred Stock
- NAIC 04 Unaffiliated Preferred Stock
- NAIC 05 Unaffiliated Preferred Stock
- NAIC 02 Hybrids
- NAIC 03 Hybrids
- NAIC 04 Hybrids
- NAIC 05 Hybrids
- Other Long-Term Assets
- NAIC 02 Working Capital Finance Investments
- Federal Guaranteed Low Income Housing Tax Credits
- Federal Non-Guaranteed Low Income Housing Tax Credits
- State Guaranteed Low Income Housing Tax Credits
- State Non-Guaranteed Low Income Housing Tax Credits
- All Other Low Income Housing Tax Credits
- Unaffiliated Common Stock

The concentration factor basically doubles the risk-based capital factor (up to a maximum of 30 percent) for assets held in the 10 largest issuers. Since the risk-based capital of the assets included in the concentration factor has already been counted once in the basic formula, this factor itself only serves to add an additional risk-based capital requirement on these assets.
The name of each of the largest 10 issuers is entered at the top of the table and the appropriate statement amounts are entered in Column (2). Lines (1) through (262) show the book/adjusted carrying value for the assets owned, and the 10 largest issuers are subject to a concentration factor. From this pool, aggregate by issuer. The aggregate book/adjusted carrying value of the assets for all issuers is then calculated and the 10 largest issuers are subject to a concentration factor. The total investment in each issuer is $15,000,000. If that is the largest issuer, then the identifier (IBM Corporation) would be entered under the book/adjusted carrying value column for Line (1) (NAIC Designation Category 42.A unaffiliated common stock) and $5,000,000 would be entered on Line (262) (unaffiliated common stock).

Replicated assets other than synthetically created indices should be included in the asset concentration calculation in the same manner as other assets.
July 12, 2019

Mr. Patrick McNaughton, Chair
Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO  64106-2197

Via electronic mail to Crystal Brown.

Re:  Draft Bond Structure and Instructions

Dear Mr. McNaughton:

I am writing on behalf of UnitedHealth Group Incorporated.  We appreciate the opportunity to comment on the Draft Bond Structure and Instructions that were exposed for comment by your Working Group on June 24, 2019.

From your remarks during the conference call on June 24, we understand that the focus of this exposure is the new structure for bond risk charges, and not the values of the risk factors themselves.  Accordingly, we will simply note in passing that we continue to have concerns about the values of the factors, as expressed in our letter of October 4, 2018, addressed to you and the chair of the Investment Risk-Based Capital (E) Working Group.

With regard to the draft structure per se, and the accompanying instructions, we support the expansion of the bond risk factors to twenty-one categories from the current seven.  Additionally, we would again refer you to our 10/4/18 comment letter — specifically, to the following paragraph.

Other asset classes.

As the Academy notes (page 13 of the report), there are other factors in the Health RBC formula that are based directly on the bond factors.  They cite the factors for cash and preferred stock; the factor for receivables for securities is another example.  We feel strongly that all such factors should be updated to be consistent with any new bond factors that are adopted.
That position has implications not only for the factors themselves, but also for the structure of the formula and the corresponding instructions. Therefore, we recommend the following.

1. In the instructions for Miscellaneous Fixed Income Assets on the second page of the exposure document, we recommend restoring the deleted language that linked the factor for cash to the factor for NAIC 01 bonds. We recognize that, now that the NAIC 01 designation will be split into three NAIC Designation Categories, the reference may become more complicated. Nonetheless, we believe that the linkage between the factors should be maintained, and that it should be appropriately documented in the instructions.

2. Likewise, in the instructions for Unaffiliated Preferred Stocks on the third page of the exposure document, we recommend restoring the deleted language that states that the preferred stock factors are equal to the bond factors for the corresponding categories. We note that the expanded system of NAIC Designation Categories has been proposed to apply to preferred stocks as well as bonds, and that therefore the necessary split of preferred stock holdings should be available.

3. In keeping with our recommendation #2 immediately preceding, we recommend that the list of preferred stock categories on the fifth page of the exposure document be expanded to reflect the NAIC Designation Categories. We point out that even if some other set of factors is ultimately selected for preferred stocks, those can be mapped to the NAIC Designation Categories; whereas, if the bond factors are used, those cannot be directly applied to the current seven-category structure.

4. Similarly, on the drafts of Page XR006 (the sixth page of the exposure document), Page XR009 (the tenth page of the exposure document), and Page XR011 (the eleventh page of the exposure document), the list of preferred stock categories should be expanded to reflect the NAIC Designation Categories.

We appreciate your consideration of our comments. We would be happy to discuss the matter with you further.

James R. Braue
Director, Actuarial Services
UnitedHealth Group

cc: Crystal Brown, NAIC
Randi Reichel, UnitedHealth Group
November 13, 2018

Kevin Fry, Chair
Investment Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO  64106-2197

Via electronic mail to Jane Barr and Julie Garber.

Dear Mr. Fry:

We are writing today as a follow-up to our comment letter of October 4, 2018, and the discussion of that letter during the October 23, 2018, conference call of the Investment Risk-Based Capital Subgroup. In particular, we would like to expand our comments on the subject of including investment income in the calculation of the bond risk factors for the Health Risk-Based Capital formula.

During the call, a speaker suggested that incorporating investment income into the analysis would be contrary to the current system of regulating insurance entities’ capital flows. We believe that this comment arose from a misunderstanding of what our recommendation entailed, and although we tried to correct that misunderstanding during the conference call, we believe it will be useful to provide additional written comments on the subject.

It is certainly true that, because of entities’ ability to dividend out their earnings on a regular basis, it would not be appropriate to accumulate investment income over multiple years to offset losses in future years. However, that objection does not really apply to investment income (in this case, interest income) being earned contemporaneously with the losses. It is unlikely that an entity would dividend out all of its income over the course of the year, right up until December 31, and then suddenly discover that it had losses to offset. That does not mean that all of the investment income from that year would necessarily be available; but it seems reasonable to suppose that some part of it would be. Therefore, it does seem appropriate to include some reasonably conservative level of investment income in the analysis.

We understand that it would be difficult to modify the Academy’s models to reflect the investment income on a year-by-year basis. However, we believe that a relatively simple bottom-line adjustment could be made to the Academy’s proposed factors in order to reflect investment income. In the remainder of this letter, we will describe how such an adjustment could be constructed.
There are four elements of the adjustment to be considered: the portion of the annual investment income that should be considered available; the portion of the bonds that are generating income; the yield on the bonds; and the discount factor. Below, we will address each of these in turn.

**Portion of annual investment income available.**

In actuality, statutory limitations on ordinary dividends are typically based on prior-year income and surplus. Accordingly, an ordinary dividend should not be considered to include current-year investment income.

An entity can request an extraordinary dividend, which requires regulatory approval. Although the dividend request will usually include projections of year-end surplus and Authorized Control Level RBC, the regulators will also review the most recently filed financial statements. Therefore, unless the dividend is being requested very late in the year, the regulatory review will reflect at most one-half of the year’s investment income; and, if the dividend is being requested late in the year, probably a large portion of the losses on bonds will also be known, and taken into account in both the request and the review.

Accordingly, it seems reasonably but not excessively conservative to assume that 50% of the year’s investment income would be available to offset losses on bonds.

Ideally, this offset would be applied to losses on a year-by-year basis. However, to further simplify the calculation, and to add further conservatism, we can assume that all of the losses take place in a single year, and therefore only 50% of one year’s income is available. Since the modeling for the Health RBC bond factors used a two-year period, the conservatism introduced by this assumption, while significant, should be acceptable.

**Portion of bonds that are generating income.**

Not all of the bonds will actually be generating income during the year; some portion will be in default. Again, it is possible to make some reasonably conservative simplifying assumptions about the portion of bonds that are non-income-producing.

For investment-grade bonds, the Academy’s modeling for the bond factors indicates the proportion that is in default. Ideally, the year-by-year defaults would be examined to determine the portion of bonds that were income-producing. However, as a simplification, we can assume that all of the defaults take place in a single year. That is the maximum that could take place in a single year, and thus is a conservative assumption; also, it is consistent with the assumption stated above with regard to how many years of investment income should be considered.

Therefore, for example, if the Academy’s analysis produced a default factor of 5%, we would assume that only 95% of the bonds were producing income during that year. This is additionally conservative, as it assumes that the defaulting bonds are in default for the full year.
For speculative-grade bonds, the Academy’s factors were based on an analysis of market-value changes, rather than defaults. However, the Academy did publish the corresponding default-based factors in Table IV-1 of their report. Those default-based factors could be used in the same fashion as proposed above for investment-grade bonds.

We will note that the Academy’s bond factors are present values, and therefore could be considered to be understated for the purpose described here. However, in light of the two-year projection period used by the Academy, the understatement should be small, and should be more than compensated for by the conservatism introduced into this calculation elsewhere.

Yield on bonds.

Yield assumptions should be set separately for each credit rating category. Yields may vary significantly between the highest-rated and lowest-rated bonds.

The yields should be selected assuming a two-year maturity. In general, the bond portfolios of health entities have a somewhat longer average maturity than two years. However, since yields generally increase with maturity, using the two-year yield will introduce some additional conservatism. Also, the Academy’s selection of a two-year projection period was based on their analysis of liability duration; to the extent that assets are longer on average than liabilities, the additional income could be considered as compensation for the mismatch risk, and therefore not available for the present purpose.

The NAIC has performed substantial analysis, in connection with its Principle-Based Reserving activities, of how bond yields have historically varied by credit rating and maturity. The information that the NAIC has already collected for that purpose should be useful in determining appropriate yields for the calculation described here.

Discount factor.

The bond risk factors are calculated as a present value, and therefore the offset for investment income should be calculated in the same fashion. The discount rate should be the same as was used by the Academy for discounting the risk factors, as a matter of consistency. For purposes of conservatism, the discount should be applied assuming that the offset takes place at the end of the projection period (i.e., two years out), which would produce the maximum discount.

In conclusion.

The offset factor for each credit category would then be calculated as:

\[ 50\% \times (1 - \text{default }\% ) \times \text{yield }\% \times (\text{discount factor}) \]

The resulting offset factor would then be subtracted from the bond risk factor for the same credit category.
Obviously, many simplifying assumptions have been made in this approach, and it therefore is not altogether correct from a theoretical standpoint. However, we believe it provides a reasonable approximation of the proper offset. The simplifying assumptions tend to add significant conservatism to the approximation, which should make it more acceptable for purposes of RBC.

We will again note that ignoring investment income entirely in the determination of the bond factors introduces significant, and at this point unquantified, conservatism to the factors. If the Working Group chooses not to reflect investment income at all, then you should recognize that the formula will include this extra level of conservatism, and take that into account in any other decisions that you make.

We would be happy to discuss this matter further with your Working Group.

Sincerely,

James R. Braue
Director, Actuarial Services
UnitedHealth Group

cc: Jane Barr, NAIC
    Tim Deno, Co-Chair of the American Academy of Actuaries Joint P&C/Health Bond Factors Analysis Work Group
    Julie Garber, NAIC
    Randi Reichel, UnitedHealth Group
October 4, 2018

Kevin Fry, Chair
Investment Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO  64106-2197

Patrick McNaughton, Chair
Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO  64106-2197

Via electronic mail to Jane Barr and Julie Garber.

Dear Mr. Fry and Mr. McNaughton:

We are writing in regard to the report from the American Academy of Actuaries titled, “An Update to the Property & Casualty and Health Risk-Based Capital Bond Factors: Report to the NAIC Investment Risk-Based Capital (E) Working Group, Health Risk-Based Capital (E) Working Group, and Property and Casualty Risk-Based Capital (E) Working Group,” as exposed for comment by your Working Groups. UnitedHealth Group is one of the nation’s largest managed care and healthcare services companies, which administers and provides healthcare benefits serving individuals in all fifty states and the District of Columbia. We thank you for the opportunity to comment on the Academy’s report.

We begin with a comment regarding the treatment of investment income in the analysis. Beyond that, our comments are directed at three distinct areas addressed by the Academy’s report: investment-grade bonds; speculative-grade bonds; and other asset classes. All of our comments relate solely to the factors for Health Risk-Based Capital (RBC), although some of our comments may also be relevant to the comparable aspects of the analysis for Property and Casualty RBC.

Treatment of investment income.

Our first comment is relevant to both investment-grade bonds and speculative-grade bonds. We would like to raise a point that we cannot recall being addressed in previous discussions (and which we have not ourselves raised previously).
Investment income (i.e., bond coupon payments) was not reflected in the development of the bond risk factors for the Life RBC formula, except to a very limited extent. In their report of August 3, 2015, titled, “Model Construction and Development of RBC Factors for Fixed Income Securities for the NAIC’s Life Risk-Based Capital Formula,” the Academy explained the exclusion of most investment income as follows (on page 13): “The implicit assumption is that any profit from investments is fully distributed to policyholder dividends or used to absorb product or operational losses.” (The “profit from investments” referred to was previously described as “investment income (e.g., coupon income”).

These considerations do not seem relevant to Health RBC. For companies subject to the Health RBC formula, generally very little of their business provides policyholder dividends (or retrospective rate credits) that involve investment income. (The Medical Loss Ratio rebate requirements for some business could be considered to be similar to policyholder dividends, but those rebates do not reflect investment income.) As to absorbing “product or operational losses,” we do not believe that the corresponding risk factors in the Health RBC formula were developed on the assumption that losses would be offset by investment income. If that latter understanding is correct, then neither reason that the Academy stated for exclusion of investment income in the Life analysis would be applicable to Health.

In light of that, it does seem appropriate to include investment income in the development of the bond risk factors for the Health RBC formula. Just as the formula would not reflect losses from insurance claims and operating expenses without also reflecting the insurance premium that is charged to fund those losses, likewise the formula should not reflect the losses from investments without reflecting the income from those investments. However, as the report being commented on does not describe a deviation from the Life default model in this respect, we must suppose that the proposed Health bond risk factors do not reflect investment income, except to the very limited extent permitted in the Life default model.

Accordingly, we request that your Working Groups consider whether investment income should be included, on some conservative basis, in the development of the bond factors for the Health RBC formula.

**Investment-grade bonds.**

For the most part, we agree with the Academy’s approach for investment-grade bonds. The assumptions made for purposes of the analysis seem reasonable (with the caveat about investment income discussed above), and the results of the analysis likewise do not present significant concerns, except in one area.

For the Aaa and Aa1 rating classes, the Academy’s analysis indicated risk factors of zero percent (at least, rounded to the nearest tenth of a percent). For reasons of conservatism, the Academy imposed a minimum risk factor of 0.1%, which is also the factor for the Aa2 rating class.

We understand and agree with the need for conservatism. However, we feel it is also necessary to reflect that the Aaa and Aa1 classes are indeed less risky than Aa2 (as borne out by the Academy’s analysis for longer bond durations). Therefore, while we agree that the factors
should be greater than zero, we also believe they should be lower than the factor for Aa2 bonds. That would not appear to be a problem from a mechanical standpoint, since the Health RBC formula already includes factors that are stated to the hundredth of a percent (e.g., the current factors for Working Capital Finance Investments).

We propose, therefore, that the factors for Aaa and Aa1 be graded down from the factor for Aa2; and as a matter of convenience, we suggest using the same proportions as represented by the Academy’s proposed factors for Property and Casualty RBC. Thus, the factor for Aaa would be \((0.2\%/0.6\%) \times 0.1\% = 0.03\%\), and the factor for Aa1 would be \((0.4\%/0.6\%) \times 0.1\% = 0.07\%\).

If, for the sake of consistency, your Working Groups wanted to round all of the bond factors to the nearest hundredth of a percent, that would be reasonable. However, we do not feel it is absolutely necessary.

Speculative-grade bonds.

The Academy has noted, in their report, many potential shortcomings of their analysis underlying the proposed bond risk factors for speculative-grade bonds. We do feel concern about several aspects of the analysis. However, given the limited amount of information available, we do not feel that there is a superior alternative. In particular, we do not feel that an analysis such as that presented in Appendix 3, using the standard deviations of S&P bond indices, provides an appropriate comparison. Standard deviation reflects favorable fluctuations as well as unfavorable ones, and the issue at hand is how the potential losses on speculative-grade bonds compare with the potential losses on common stock. Also, the Annual Statement data that the Academy used reflect that bonds are held at the lower of amortized cost and market value; this has a dampening effect on fluctuations in value, which is not reflected in the index data. Furthermore, as the Academy has noted, the composition of the bond indices is not necessarily representative of the bonds actually held by insurers. Therefore, we believe that an analysis based on the fluctuations in value of bonds held by insurers is preferable.

In keeping with that belief, the only adjustment that we would suggest to the analysis of speculative-grade bonds is the inclusion of investment income, as discussed above.

Other asset classes.

As the Academy notes (page 13 of the report), there are other factors in the Health RBC formula that are based directly on the bond factors. They cite the factors for cash and preferred stock; the factor for receivables for securities is another example. We feel strongly that all such factors should be updated to be consistent with any new bond factors that are adopted.

* * * * *

We look forward to discussing these matters with your Working Groups.
Sincerely,

James R. Braue  
Director, Actuarial Services  
UnitedHealth Group

cc: Jane Barr, NAIC  
    Julie Garber, NAIC  
    Randi Reichel, UnitedHealth Group
September 4, 2019

Patrick McNaughton  
Chair, Health Risk-Based Capital (E) Working Group  
National Association of Insurance Commissioners (NAIC)  

Re: Draft Bond Structure and Instructions  

Dear Mr. McNaughton:  

The American Academy of Actuaries\(^1\) Health Solvency Subcommittee is pleased to provide this response letter to the NAIC Health Risk-Based Capital (HRBC) Working Group. This letter is in response to the HRBC Working Group comment letters received on the exposure of the Draft Bond Structure and Instructions.

**United Health Group (UHG) sent two comment letters which comprised comments on:**

**Treatment of Investment Income**

Investment income is utilized in the development of the underwriting risk in the property and casualty (P&C) Risk-Based Capital Formula. Therefore it would be redundant to include as an offset to the default risk within the bond factor development. It is unclear whether the Health Risk-Based Capital Formula used a similar consideration in the development of the underwriting risk. The HRBC Working Group should consider the implications of investment income already included in the formula.

As stated in UHG’s second letter dated November 13, 2018, the bond factors would require a number of considerations and assumptions in order to accommodate the impact of investment income in the model. An alternative approach could be considered if determined appropriate.

**Investment-Grade Bonds**

As noted in the UHG comments, the Joint P&C/Health Bond Factors Analysis Work Group’s (PCHWG) report\(^2\) suggests a minimum risk factor of 0.1%, which UHG has stated it views as being too conservative. In considering the minimum risk charge, it’s important to recognize the risk charge associated with cash. If cash has a risk charge, then bonds should have a charge at

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\(^1\) 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.

\(^2\) *An Update to the Property & Casualty and Health Risk-Based Capital Bond Factors*, Joint P&C/Health Bond Factors Analysis Work Group, July 30, 2018.
least as great. Related to bond risk, there may be other risks outside of the modeled risk of misuse or loss that should be taken into consideration.

**Speculative-Grade Bonds**

While the UHG comments expressed some general concerns with the approach, UHG also acknowledged that given the limited amount of information available, there was no superior alternative.

**Other Asset Classes**

UHG has stated it concurs with the PCHWG report on page 13—that all factors based upon bond factors should be updated.

**America’s Health Insurance Plans (AHIP) provided comments on:**

**Speculative Grade—Size Adjustment**

The AHIP comments surround the use of a bond size factor in the development of the speculative grade bond factors. It’s important to note that both life and P&C utilize a bond size adjustment factor on speculative-grade bond factors in their respective formulas. Therefore from a consistency standpoint, health incorporated a similar type of adjustment on the speculative-grade bond factors.

It’s important to note that footnote 74 in the PCHWG report acknowledged that the modeled approach was simplified and identified potential inconsistencies. However, the last sentence outlines why the approach was reasonable overall: “However, as the bond size factor is based on the total number of issuers (excluding US government issuers), rather than issuers by rating class, and as the proportion of [speculative-grade] bonds is not large for either life or P&C, we believe this approach is reasonable.”

If the HRBC Working Group decided to adjust the speculative-grade modeling to remove the size adjustment factor, then the investment-grade bonds would also need to be adjusted to account for a lower number of issuers on this asset class. This would lead to an increase in the proposed size adjustment and resulting factors.

*****

We appreciate the opportunity to provide these comments and would welcome the opportunity to speak with you regarding these comments in more detail and answer any questions you might have. If you have any questions or would like to discuss further, please contact David Linn, the Academy’s senior health policy analyst, at 202-223-8196 or linn@actuary.org.

Sincerely,

Tim Deno, MAAA, FSA  
Chairperson, Health Solvency Subcommittee  
American Academy of Actuaries
July 29, 2019

Mr. Patrick McNaughton  
Chair, Health Risk-Based Capital Working Group  
National Association of Insurance Commissioners 
2301 McGee Street, Suite 800  
Kansas City, Missouri   64108-2662

Re: Comments on Draft Bond Structure and Instructions

Dear Mr. McNaughton:

America’s Health Insurance Plans (AHIP) appreciates the opportunity to provide these comments on the request for comments on the proposed changes to the RBC calculations for bonds that include more categories and revised factors for both Investment Grade bonds (IG) and Speculative Grade bonds (SG). We would ask that the NAIC consider an alternative to the use of “speculative” for bonds in NAIC classes 3-5. Many bonds in these categories may have been purchased when they were rated as Investment Grade and have since had the rating lowered but are still in fully compliant status. A better term would be Higher Risk bonds.

The Academy has developed bond factors under two different approaches for Investment Grade bonds and Speculative Grade bonds.

For IG bonds, the model looked at the impact of bond default rates applied to an average portfolio. The HRBCWG is recommending an average bond size adjustment from the model’s assumption for portfolio size to the average for a Health insurer. It is based on statistical variations of a default/no-default modeling approach.

For SG bonds, the Academy developed factors based on the same model (since some of these factors are actually used for the LRBC formula) and modified them to 50% of the model value to reflect the different Statutory accounting rules for these bonds versus the assumptions in the model (held at amortized book value). The Academy recommended an alternative approach for SG Bonds. This alternative was a market value change approach and relied on the decrease in market value of bonds from 2007-2008.

However, the final factors for SG Bonds presented by the Academy included the same adjustment for portfolio size used for IG Bonds. We can find no basis for the assumption that the statistical fluctuation based on portfolio size from the default/no-default variation is appropriate for any presumed variation by portfolio size due to market value fluctuations. We continue to request that the WG seek review of this issue by the Academy.
We do not have any comments with respect to the instructions as proposed.

We would be happy to address any questions the Working Group has with these comments.

Sincerely,

William C. Weller
Actuarial Consultant to AHIP

c/c: Crystal Brown, NAIC
    Candy Gallaher, AHIP
## NAIC BLANKS (E) WORKING GROUP

**Blanks Agenda Item Submission Form**

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<thead>
<tr>
<th>DATE: 7-12-19</th>
<th>FOR NAIC USE ONLY</th>
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<tbody>
<tr>
<td>CONTACT PERSON: Crystal Brown</td>
<td>Agenda Item #</td>
</tr>
<tr>
<td>TELEPHONE: 816-783-8146</td>
<td>Year Tentative 2021</td>
</tr>
<tr>
<td>EMAIL ADDRESS: <a href="mailto:cbrown@naic.org">cbrown@naic.org</a></td>
<td>Changes to Existing Reporting [ ]</td>
</tr>
<tr>
<td>ON BEHALF OF: Health Risk-Based Capital (E) WG</td>
<td>New Reporting Requirement [ ]</td>
</tr>
<tr>
<td>NAME: Patrick McNaughton</td>
<td>REVIEWED FOR ACCOUNTING</td>
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<tr>
<td>TITLE: Chair</td>
<td>PRACTICES AND PROCEDURES IMPACT</td>
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<tr>
<td>AFFILIATION: WA Office of the Insurance Commissioner</td>
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<tr>
<td>ADDRESS: 810 3rd Avenue, Suite 650</td>
<td>Modifies Required Disclosure [ ]</td>
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<td>Seattle, WA 98104</td>
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**BLANK(S) TO WHICH PROPOSAL APPLIES**

- [ ] ANNUAL STATEMENT
- [ ] QUARTERLY STATEMENT
- [ ] INSTRUCTIONS
- [ ] CROSSCHECKS
- [x] BLANK
- [x] Life, Accident & Health/Fraternal
- [x] Property/Casualty
- [x] Health
- [ ] Separate Accounts
- [ ] Protected Cell
- [ ] Health (Life Supplement)

Anticipated Effective Date: ____________________________

**IDENTIFICATION OF ITEM(S) TO CHANGE**

Revise the Health Annual Statement Test language

**REASON, JUSTIFICATION FOR AND/OR BENEFIT OF CHANGE**

The purpose of the change is to move those filers who write predominantly health business and file on the life blank to begin filing on the health blank.

**NAIC STAFF COMMENTS**

Comment on Effective Reporting Date: ____________________________

Other Comments:

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**This section must be completed on all forms.**

Revised 7/18/2018
**Health Annual Statement**

**GENERAL**

The annual statement is to be completed in accordance with the *Annual Statement Instructions and Accounting Practices and Procedures Manual* except to the extent that state law, rules or regulations are in conflict with these publications. In cases of conflict, the health annual statement will be filed pursuant to such state’s filing requirements. The domiciliary state’s insurance regulatory authority shall maintain full discretion in determining which NAIC annual statement blank must be filed. The annual statement blank filed with the domiciliary state shall be the blank submitted to, and maintained by, the NAIC, and barring conflict as described above, should be filed with all jurisdictions in which the reporting entity is licensed.

1. **Health Statement Test:**

   If a reporting entity completes the health annual statement for the reporting year, the reporting entity must complete the Health Statement Test.

   The Health Statement Test is designed to determine whether a reporting entity reports predominantly health lines of business. The purpose of this test is to identify a reporting entity writing predominantly health business (premium ratio of 90% or more) to file on a Health Statement and the associated Health RBC filing (if required). Health lines include hospital or medical policies or certificates, comprehensive major medical expense insurance and managed care contracts and exclude other health coverage such as credit insurance, disability income coverage, automobile medical coverage, workers’ compensation, accidental death and dismemberment policies and long-term care policies.

   **Passing the Test:**

   A reporting entity is deemed to have passed the Health Statement Test if the values for the premium ratio in the Health Statement Test (General Interrogatories, Part 2) equal or exceed 90% for both the reporting and prior year.

   **Failing the Test:**

   Once the reporting entity has passed the health test and is currently filing on the Health Statement (Health RBC filing), the health test will be used to demonstrate that the insurer is still predominantly writing health business as defined above. If the premium ratio falls below 90% the company could still be viewed as writing predominantly health business and should continue to file on the Health Statement (and Health RBC Filing) but notify the domestic regulator as indicated below.

   **Variances from following these instructions:**

   If the reporting entity has consistently reported a premium ratio of 90% or greater and filed on the health blank but falls below the 90% premium ratio, the reporting entity shall apprise the domestic regulator if they fall below 90% and should advise of significant changes in their business at the time of their annual statement filing. This will allow the domestic regulator to work with the reporting entity to determine if the company should continue to complete the health annual statement and risk-based capital report or if the reporting entity should begin completing the life, accident and health and fraternal or property and casualty annual statement form and risk-based capital report. The domestic regulator shall notify the reporting entity in writing by June 1 of the year following the reporting year in which the Health Statement Test is submitted.
GENERAL INTERROGATORIES
PART 2 – HEALTH INTERROGATORIES

2. Health Test:

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
<th>Reporting Year Annual Statement Data</th>
<th>Prior Year Annual Statement Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1 Premium Numerator</td>
<td>Health Premium values listed in the Analysis of Operations by Line of Business (Gain and Loss Exhibit), Line 1, Column 2 through Column 9 (in part, excluding credit insurance, disability income coverage, automobile medical coverage, workers’ compensation, accidental death and dismemberment policies and long-term care policies).</td>
<td>Health Premium values listed in the Analysis of Operations by Line of Business (Gain and Loss Exhibit), Line 1, Column 2 through Column 9 (in part, excluding credit insurance, disability income coverage, automobile medical coverage, workers’ compensation, accidental death and dismemberment policies and long-term care policies).</td>
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</tr>
<tr>
<td>2.2 Premium Denominator</td>
<td>Net Premium Income (Page 4, Line 2, Column 2) of the reporting year’s annual statement.</td>
<td>Net Premium Income (Page 4, Line 2, Column 2) of the prior year’s annual statement.</td>
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<tr>
<td>2.3 Premium Ratio</td>
<td>2.1/2.2</td>
<td>2.1/2.2</td>
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PART 2 – HEALTH INTERROGATORIES

2. This General Interrogatory is designed to determine whether a reporting entity reports predominantly health lines of business. Health lines include hospital or medical policies or certificates, comprehensive major medical expense insurance and managed care contracts and exclude other health coverage such as credit insurance, disability income coverage, automobile medical coverage, workers’ compensation, accidental death and dismemberment policies and long-term care policies.

All reporting entities should file the test.

Premium information is obtained from the annual statement sources referenced on the form or from the related risk-based capital report for the corresponding premium descriptions relating to the current and prior reporting periods.
Life Annual Statement

GENERAL

The annual statement is to be completed in accordance with the Annual Statement Instructions and Accounting Practices and Procedures Manual except to the extent that state law, rules or regulations are in conflict with these publications. In cases of conflict, the life, accident and health annual statement will be filed pursuant to such state’s filing requirements. The domiciliary state’s insurance regulatory authority shall maintain full discretion in determining which NAIC annual statement blank must be filed. The annual statement blank filed with the domiciliary state shall be the blank submitted to, and maintained by, the NAIC, and barring conflict as described above, should be filed with all jurisdictions in which the reporting entity is licensed.

1. Health Statement Test:

   If a reporting entity is licensed as a life and health insurer and completes the life, accident and health annual statement for the reporting year, the reporting entity must complete the Health Statement Test.

   The purpose of the Health Statement Test is to identify a reporting entity writing predominantly health lines of business (premium ratio of 90% or more), to move and file on a Health Statement and the associated Health RBC filing (if required). Health lines include hospital or medical policies or certificates, comprehensive major medical expense insurance and managed care contracts and exclude other health coverage such as credit insurance, disability income coverage, automobile medical coverage, workers’ compensation, accidental death and dismemberment policies and long-term care policies.

Passing the Test:

   A reporting entity is deemed to have passed the Health Statement Test if:

   The values for the premium ratio in the Health Statement Test equal or exceed 90% for both the reporting and prior year

   If a reporting entity completes the Life, Accident and Health annual statement for the reporting year and b) passes the Health Statement Test (as described above), the reporting entity must begin completing the health statement with the first quarter’s statement for the second year following the reporting year in which the reporting entity passes the Health Statement Test and must also file the corresponding risk-based capital report and the life supplements for that year-end. (e.g. If the company passed the health test for year-end-2019 reporting, the company must begin filing the health blank with first quarter 2021).

Variances from following these instructions:

   If the reporting entity has consistently reported a premium ratio of 90% or greater and filed on the health blank but falls below the 90% premium ratio, the reporting entity shall apprise the domestic regulator if they fall below 90% and should advise of significant changes in their business at the time of their annual statement filing. This will allow the domestic regulator to work with the reporting entity to determine if the company should continue to complete the health annual statement and risk-based capital report or if the reporting entity should begin completing the life, accident and health and fraternal or property and casualty annual statement form and risk-based capital report. The domestic regulator shall notify the reporting entity in writing by June 1 of the year following the reporting year in which the Health Statement Test is submitted.
GENERAL INTERROGATORIES

PART 2 – LIFE ACCIDENT AND HEALTH COMPANIES/FRATERNAL BENEFIT SOCIETIES INTERROGATORIES

2. Health Test:

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<th>Item</th>
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<td>Dental and Vision</td>
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<td>Medicaid Pass-Through Payments</td>
<td>Medicaid Pass-Through Payments</td>
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<td>Reported as Premiums</td>
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<td>Stop Loss and Minimum Premium</td>
<td>Stop Loss and Minimum Premium</td>
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<td>Federal Employee Health and Benefit Plan</td>
<td>Federal Employee Health and Benefit Plan</td>
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<td>Medicaid Pass-Through Payments</td>
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<td>Reported as Premiums</td>
<td>Reported as Premiums</td>
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<tr>
<td>2.2</td>
<td>Premium Denominator</td>
<td>Premium and Annuity Considerations (Page 4, Line 1) of the reporting year’s annual statement</td>
<td>Premium and Annuity Considerations (Page 4, Line 1) of the prior year’s annual statement</td>
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<tr>
<td>2.3</td>
<td>Premium Ratio</td>
<td>2.1/2.2</td>
<td>2.1/2.2</td>
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The annual statement is to be completed in accordance with the *Annual Statement Instructions* and *Accounting Practices and Procedures Manual* except to the extent that state law, rules or regulations are in conflict with these publications. In cases of conflict, the property and casualty annual statement will be filed pursuant to such state’s filing requirements. The domiciliary state’s insurance regulatory authority shall maintain full discretion in determining which NAIC annual statement blank must be filed. The annual statement blank filed with the domiciliary state shall be the blank submitted to, and maintained by, the NAIC, and barring conflict as described above, should be filed with all jurisdictions in which the reporting entity is licensed.

1. **Health Statement Test:**

   If a reporting entity is licensed as a property and casualty insurer and completes the property and casualty annual statement for the reporting year, the reporting entity must complete the Health Statement Test.

   The purpose of Health Statement Test is to identify a reporting entity writing predominantly health lines of business, to move and file on a Health Statement and the associated Health RBC filing (if required). Health lines include hospital or medical policies or certificates, comprehensive major medical expense insurance and managed care contracts and exclude other health coverage such as credit insurance, disability income coverage, automobile medical coverage, workers’ compensation, accidental death and dismemberment policies and long-term care policies.

   **Passing the Test:**

   A reporting entity is deemed to have passed the Health Statement Test if:

   The values for the premium ratio in the Health Statement Test equal or exceed 90% for both the reporting and prior year.

   If a reporting entity is a) completes the property and casualty annual statement for the reporting year and b) passes the Health Statement Test (as described above), the reporting entity must begin completing the health statement with the first quarter’s statement for the second year following the reporting year in which the reporting entity passes the Health Statement Test and must also file the corresponding risk-based capital report and the property/casualty supplements for that year-end. (e.g. if the company passed the health test for YE-2019 reporting, the company must begin filing the health blank with first quarter 2021)

   **Variances from following these instructions:**

   If the reporting entity has consistently reported a premium ratio of 90% or greater and filed on the health blank but falls below the 90% premium ratio, the reporting entity should apprise the domestic regulator if they fall below 90% and should advise of significant changes in their business at the time of their annual statement filing. This will allow the domestic regulator to work with the reporting entity to determine if the company should continue to complete the health annual statement and risk-based capital report or if the reporting entity should begin completing the life, accident and health and fraternal or property and casualty annual statement form and risk-based capital report. The domestic regulator shall notify the reporting entity in writing by June 1 of the year following the reporting year in which the Health Statement Test is submitted.
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<td>2.1 Premium Numerator</td>
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<tr>
<td>2.2 Premium Denominator</td>
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<tr>
<td>2.3 Premium Ratio (2.1/2.2)</td>
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**PART 2 – PROPERTY AND CASUALTY INTERROGATORIES**

2. This General Interrogatory is designed to determine whether a reporting entity reports predominantly health lines of business. Health lines include hospital or medical policies or certificates, comprehensive major medical expense insurance and managed care contracts and exclude other health coverage such as credit insurance, disability income coverage, automobile medical coverage, workers compensation, accidental death and dismemberment policies and long-term care policies.

All reporting entities should file the test.

Premium information is obtained from the annual statement sources referenced on the form or from the related risk-based capital report for the corresponding premium descriptions relating to the current and prior reporting periods.

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<th>Prior Year Annual Statement Data</th>
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<tbody>
<tr>
<td>2.1</td>
<td>Premium Numerator</td>
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<td><strong>Health Premium</strong> values listed in the statement value column (Column 1) of the prior year’s P&amp;C RBC report:</td>
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<td>Reported as Premiums</td>
<td>Reported as Premiums</td>
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<tr>
<td>2.2</td>
<td>Premium Denominator</td>
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<tr>
<td>2.3</td>
<td>Premium Ratio</td>
<td>2.1/2.2</td>
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</tr>
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</table>
November 20, 2019

Mr. Patrick McNaughton
Chair, Health Risk-Based Capital (E) Working Group

Re: Health Test Exposure

Dear Mr. McNaughton:

The American Council of Life Insurers (ACLI)\(^1\) is pleased to submit the following comments regarding the exposed revisions to the health test.

ACLI is appreciative of the simplification of the health test from the prior requirements, but we have some concerns about the practical implications of the changes. The reduction in the premium threshold from 95% to 90% will increase the likelihood of companies to “bounce” back and forth between meeting the requirement and not, which may potentially create undue burden on the companies. ACLI is appreciative of the discretion granted the domestic commissioner in the “Variances from following these instructions” section, but note as constructed is a one-way test. ACLI would suggest strengthening this safe harbor to be a two-way test that gives greater discretion to the commissioner.

ACLI believes the premium threshold should be characterized as a “threshold”, rather than as passing/failing a test. We would suggest changing the sections from “Passing the Test” and “Failing the Test” to “Meeting the Test Threshold” and “Not Meeting the Test Threshold”.

ACLI is concerned that without greater clarification of the changes, it could create undue cost and effort for companies, which ultimately would create a worse outcome for consumers. There are considerable differences between the Health Blank and the Life Blank, and companies needing to switch between the two would need to develop expertise on how to properly complete them. Further, companies would need to license different software due to the change, which would cause additional cost. Insurance groups with multiple companies achieve efficiencies within the organization through consistency in reporting, with appropriate processes and controls and systems in place. From a regulator’s perspective, it may be difficult to properly assess the solvency position of the company due to swings in the RBC ratios were they to move from one set of RBC requirements to another.

We look forward to a discussion of these issues. Thank you.

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\(^1\) The American Council of Life Insurers (ACLI) advocates on behalf of 280 member companies dedicated to providing products and services that promote consumers’ financial and retirement security. 90 million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers’ products for peace of mind. ACLI members represent 95 percent of industry assets in the United States. Learn more at [www.acli.com](http://www.acli.com).
Sincerely,

[Signature]

cc  Crystal Brown, NAIC
    Steve Clayburn, ACLI
    Jan Graeber, ACLI
    Mike Monahan, ACLI
The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Austin, TX, Dec. 7, 2019. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Eric Unger (CO); Carolyn Morgan (FL); Vincent Tsang (IL); Fred Andersen (MN); William Leung (MO); Rhonda Ahrens (NE); Seong-min Eom (NJ); Puran Bheamsain (NY); Mike Boerner and Rachel Hemphill (TX); and Tomasz Serbinowski (UT). Also participating were: Mike Yanacheak (IA); and Peter Weber (OH).

1. Adopted its Oct. 23 and Summer National Meeting Minutes

Mr. Ostlund made a motion, seconded by Ms. Eom, to adopt the Working Group’s Oct. 23 (Attachment Three-A) and Aug. 3 (see NAIC Proceedings – Summer 2019, Capital Adequacy (E) Task Force, Attachment Three) minutes. The motion passed unanimously.


Ms. Ahrens made a motion, seconded by Mr. Ostlund, to adopt the Longevity Risk (A/E) Subgroup’s Nov. 25 (Attachment Three-B), Nov. 4 (Attachment Three-C), Oct. 7 (Attachment Three-D), Sept. 30 (Attachment Three-E) and Sept. 18 (Attachment Three-F) minutes. The motion passed unanimously.

3. Exposed the Longevity Risk (A/E) Subgroup’s Recommendation for Public Comment

Ms. Ahrens said the Subgroup has been meeting to work on its recommendation for a longevity C-2 charge. She said the Subgroup’s memorandum (Attachment Three-G) to the Working Group provides an introduction with the general discussions that the Subgroup has had, provides its recommendation that the Working Group accept the factors proposed by the American Academy of Actuaries (Academy) Longevity Risk Task Force (Academy Task Force) (see NAIC Proceedings – Spring 2019, Capital Adequacy (E) Task Force, Attachment Five-D), and highlights the areas where the Subgroup did not reach full agreement. She said one of these areas is scope and, specifically, longevity reinsurance transactions (LRT) where there are still some complicated questions that need to be addressed. She said the Subgroup is recommending that the Working Group move forward with LRT scoped out for now with direction to the Subgroup to continue its study of LRT. She said the memorandum also addresses correlation and includes the Subgroup’s conclusion that correlation between longevity and mortality risk within the formula extends beyond the Subgroup’s charge. She said the memorandum includes as attachments the Academy Task Force’s original proposal, which is what the Subgroup’s recommendation is based upon (see NAIC Proceedings – Spring 2019, Capital Adequacy (E) Task Force, Attachment Five-D), the Academy Task Force’s update on correlation, which was presented to the Working Group at the Summer National Meeting (see NAIC Proceedings – Summer 2019, Capital Adequacy (E) Task Force, Attachment Three-H), and the actual proposal form with the risk-based capital (RBC) blank and instruction changes. She highlighted the fact that the blank and instruction changes being recommended do not include correlation (Attachment Three-H), but that the Academy Task Force also submitted an alternative presentation of the blank and instruction changes, which does include correlation (Attachment Three-I). Brian Bayerle (American Council of Life Insurers—ACLI) presented the ACLI’s comment letter (Attachment Three-J) suggesting that the Working Group include the Academy Task Force’s alternative, including correlation in any exposure.

The Working Group agreed with the Subgroup’s recommendation to scope out LRT for now with direction to the Subgroup to continue its work on this aspect. The Working Group also agreed to having consideration of correlation done by the Working Group. The Working Group agreed to expose the Subgroup’s recommended RBC blank and instructions changes, which do not include correlation, along with the Academy Task Force’s alternative, including correlation in order to get comments on both, for a public comment period ending Feb. 7, 2020.
4. **Heard an Update from the Academy C2 Work Group**

Chris Trost (Academy) said the Academy C2 Work Group’s charge is to review and, if appropriate, recommend changes to the life mortality RBC factors which, for the most part, have not been updated since they were originally developed. He said an update was given to the Working Group in June covering the assumptions and methods that were being used, and they have tried to incorporate the feedback that they got into their work. While the Work Group had presented some preliminary factors, based on that feedback and other constraints, he said the Work Group is not yet at a point to recommend factors; but he provided an update (Attachment Three-K) that includes that feedback’s impact on its work on each of the components of mortality risk. Mr. Barlow suggested scheduling a call specifically to discuss this before a final proposal is presented so Working Group member’s questions regarding some of the technical considerations can be addressed.

5. **Received an Update on ESGs**

Pat Allison (NAIC) said a request was made to NAIC staff during a July 16 joint conference call of the Working Group and the Life Actuarial (A) Task Force to develop a request for proposal (RFP) to find a vendor to provide an economic scenario generator (ESG) to replace the Academy’s ESG and be enhanced over time. She said work is continuing on the RFP, and the plan is for it to be a prescribed ESG for life and annuity reserves and capital involving VM-20, Requirements for Principle-Based Reserves for Life Products; VM-21, Requirements for Principle-Based Reserves for Variable Annuities; C3 Phase I; and C3 Phase II. She said the group drafting the RFP includes state insurance regulators, NAIC staff, the Academy, the ACLI, and industry subject-matter experts (SMEs); and it is working with a target completion date of the first quarter of 2020. She said there are a lot of steps after the RFP is issued, and the earliest implementation date would be 2022.

6. **Discussed Comments Received on Life Growth Risk**

Mr. Barlow said there were two comment letters received (Attachments Three-L and Three-M). Mr. Bayerle presented the ACLI’s comment letter and said the ACLI does not believe that there is a need for a life growth risk at this time, and he highlighted the two main points detailed in their comment letter: 1) state insurance regulators already have tools to assess life growth risk; and 2) rapid growth is less prevalent than in health or property/casualty (P/C) insurance. Mr. Barlow said he struggles with the same issue that the Operational Risk (E) Subgroup did in that there does not appear to be a good way to implement a growth risk charge for life insurance. He suggested tabling this issue until an actual approach to implementing it is presented or otherwise arises as something the Working Group needs to address. The Working Group agreed.

7. **Discussed Other Matters**

Ms. Hemphill detailed an issue with the new Variable Annuities Framework with regard to the phase in and smoothing. She said if there are voluntary reserves under the old framework, they will inappropriately reduce the C-3 RBC amount in the total asset requirement (TAR) under the new framework, even if there are no voluntary reserves being held under the new framework. She said there is a disconnect in that for the VM-21 reserve, the phase in is done as of Dec. 31, 2020. Doing a comparison between the old and the new frameworks while the C-3 phases in is based on a 2019 year-end calculation. She said there is a related issue with smoothing due to the treatment of voluntary reserves. She said she has discussed this with Mr. Bayerle, and there is agreement that this was an unintended piece of the language that was adopted, so they will be working on a way to address this. This can be addressed for 2020 on the capital side, but it is an issue to the extent that companies have voluntary reserves early adopted for 2019. Mr. Barlow noted that it is too late for the Working Group to change anything for 2019, but he suggested that the Working Group could issue some guidance on this issue and asked NAIC staff to assist in facilitating this.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.
Life Risk-Based Capital (E) Working Group
Conference Call
October 23, 2019

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Oct. 23, 2019. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Perry Kupferman (CA); Deborah Batista (CO); Wanchin Chou (CT); Gilbert Moreau (FL); Bruce Sartain (IL); John Robinson and Fred Andersen (MN); William Leung (MO); Rhonda Ahrens (NE); Kevin Clarkson (NJ); Bill Carmello (NY); Andrew Schallhorn (OK); and Mike Boerner (TX). Also participating was: Mike Yanacheak (IA).

1. Discussed the Comments Received on a Proposal to Update the RBC Charge for Unaffiliated Common Stock Supporting Long-Horizon Contractual Commitments

Mr. Barlow said the Working Group received several comment letters. He said there was an additional letter from Allstate, which is not included in the materials because it came in after the comment period. However, he said those comments can be raised as part of this discussion. He provided those submitting comment letters the opportunity to speak on their comments.

Mark Prindiville (Allstate) said Allstate submitted the original proposal, documentation of the underlying rationale, a 20-page example, a comment letter (Attachment Three-A1) and a response to the American Academy of Actuaries’ (Academy) comment letter, so Allstate’s views are well documented for the Working Group. He said the six guiding principles that form the foundation of the proposal that are listed on page three of Allstate’s comment letter. He made two points in response to the Academy’s comment letter. The first is whether the proposal should be implemented in the C-3 risk component as opposed to the C-1 component. Mr. Prindiville said this has been a discussion almost from the beginning. He agreed that there are reasons to support C-3 because there is a long horizon and a liability connection, so Allstate understands this position. However, he said by definition of the framework, this is a C-1 issue. C-1 covers the change in equity value, exclusively, while C-3 covers the risk of loss due to changes in interest rate levels and variable products. As a result, there is not any question, according to the current definition, this is a C-1 issue. He asked whether there should be a massive framework overhaul and move equity volatility to C-3 because of the long horizon and liability question. He said this would be complicated with which scenarios to use and how to do covariance. Mr. Prindiville said it would end up with the same issue, and it centers on that low-water mark. For short-term investing, that low-water mark is very important, but for a long-horizon product with the type of guardrails Allstate is proposing, he said this is much less relevant.

Mr. Prindiville said the second point is potential disconnect with the accounting because there are differing amounts of volatility modeled in risk-based capital (RBC) versus what may be included in statutory surplus and the capitalization ratio. He said there is not internal consistency currently and that the capitalization ratio amortization concept included in the proposal is an attempt to provide more consistency because the capitalization ratios would both be calibrated to seven-year horizons. He said Allstate does not believe accounting needs to change but that RBC is the modernization of statutory capital as a measurement of strength because statutory capital does not incorporate how risky a portfolio is or the recoverability of assets over longer horizons. What RBC measures is the claims paying ability of assets, which changes over the short run and the long run. Mr. Prindiville said that over the long run, if equities are used demonstrably, the claims paying ability is higher because the returns are much greater than those for bonds and much more able to support a long-term product.

Brian Bayerle (American Council of Life Insurers—ACLI) presented the ACLI’s comment letter (Attachment Three-A2). He said the ACLI’s comments are high-level and that they do not take an explicit position on the proposal. He said the ACLI appreciates the Working Group and other state insurance regulators having these discussions about how to improve retirement security. Obviously, the purpose of the RBC framework is to make sure companies are appropriately capitalized, and he said the ACLI would not be in favor of anything that would weaken that. Conceptually, he said the ACLI believes the Allstate proposal has appropriate guardrails, but in discussing any details, that main objective needs to be maintained. He said the ACLI’s comment letter addresses several technical issues but that the ACLI believes there are more discussions that could be had on this topic with other potential solutions.

Chris Trost (Academy) presented the Academy’s comment letter (Attachment Three-A3). With respect to the point made by Allstate about the inconsistency between the accounting and RBC, he said the Academy is concerned because the capital will be immediately impacted and fully reflected in the capital position on the statutory statement by reductions in the equity market, while RBC would be assuming some amortization. He said the Academy also commented that product-specific features tend
to be reflected in C-3 and not C-1. When looking at the product liabilities being considered here, the long-horizon contracts, he said there is really no aspect of those liability cash flows that would offset the loss. Mr. Barlow asked about the Academy’s point that product-specific investment choices are reflected in C-3. In the current RBC framework, Mr. Trost said there are certain specific places where liability characteristics are reflected, and those are with variable annuities and fixed annuities, where interest rates and assets are addressed. To reflect the common stock component in C-3, he said that would require redesign of the RBC framework where it would bring in equity performance for fixed annuities where it currently does not exist.

Mr. Andersen said he believes Allstate did a good job of presenting the history of stock market performance over the long-term but reiterated his concern that there needs to be an equal analysis of theory to prevent an unreasonable result where money can be borrowed at a low rate with a guarantee of a higher rate over time.

Mr. Carmello reiterated New York’s position that this proposal is a bad idea as it is not the time to be reducing RBC for equities. He noted that there was a 66% drop in equities in 2008 and 2009.

Mr. Barlow said this proposal would be a significant change to RBC and something requiring a lot of consideration. He said with other proposals in the past, the Working Group has referred them to the Academy for consideration, conducted field tests or asked NAIC staff to do some work. He asked Working Group members for any additional thoughts on the proposal and any input on how to move forward with the proposal. Ms. Ahrens said her initial thought is to agree with Mr. Andersen and suggested also that the Working Group should study this from more of a macro perspective beyond one company. She said the Working Group needs to keep in mind the concern Mr. Carmello raised about equities losing two-thirds of their value in recent history. She said there are a lot of questions to answer about whether this is a C-1 or C-3 risk. While she believes it is a C-3 risk, she said she does not fully agree that C-3 is not already set up in some ways to address something like this, citing C-3 Phase I cash-flow testing, which could potentially be leveraged to accommodate it. She said she believes there is a lot of discussion that needs to take place before the Working Group moves forward on something like this.

Mr. Sartain said this may be the same type of issue companies have with having reserves at too high a level and affecting pricing in that RBC charges that are too high can affect investment decisions. He said it seems indisputable that if you have a long-term liability, you are going to want to match that with some equities. He said this is probably true on the investment side, but the question is whether it fits into the RBC framework. If RBC is a regulatory tool, he asked how it is so critical for companies to make sure the RBC charges are not too conservative. He said rating agencies have their own capital models and that RBC is generally recognized as a blunt regulatory tool. He said it would be helpful to get the perspective of companies on that.

Mr. Barlow said he has had that same question for a long time. He said he was on a panel last year where there were quotes from analysts specifically referencing the RBC of a company and indicating that if that RBC fell below a certain percentage, it was time to be concerned. He said that certain percentage was not 200% but something significantly higher. He said while RBC is a tool with a single purpose to identify weakly capitalized companies, it seems this dynamic is a fact of life right now for the insurance industry. He said Allstate indicated to him that it is following a strategy of investing in equities for these liabilities currently and has not been dissuaded by the existing RBC charges to invest in a sub-optimal way. He said the life insurance industry seems to be well capitalized without much in the way of solvency issues, which is good but may highlight the issue of the other uses of RBC beyond the regulatory purpose.

Mr. Prindiville confirmed that Allstate has invested its block along the lines of what it believes is an optimal RBC charge because in its own economic capital framework, it has made the change that is being proposed. He said this was not easy and took several years of internal dialogue to get everyone comfortable with the underlying concepts and to ensure that all the right protections were in place so that Allstate will be able to withstand an untoward event in the markets. He said Allstate believes the concepts are more widely applicable and could be useful to the entire industry, which is why it has submitted the proposal. Mr. Robinson asked how long Allstate has been using this investment approach. Mr. Prindiville said about five years. In response to Mr. Andersen’s comment on theory, he said the last two pages in its comment letter are an attempt to provide the kind of theory being requested but that Allstate would be happy to engage further on this topic.

When considering whether equities are appropriate for immediate annuities, Mr. Trost said a portion of equities may be appropriate. However, he said he believes the real issue is that it is necessary to cover what the potential downside of the equities is, which is the short, concentrated event where losses can occur in a hurry. Mr. Sartain said it seems like the proposal covers this, at least in part, by having seven years of liquidity. He said the research would show that the longer the years extend, the more unlikely there would be that negative return on the equities. With equities, Mr. Trost said there is not the luxury of
waiting for that entire seven-year period. He noted the example given of equities dropping rapidly by two-thirds. He said the issue is that this would be reflected in a much lower capital position in the statutory statements if they had a large portion of equities as opposed to if they did not invest in equities. He said it is a mismatch between how an insurance company’s capital is measured relative to its particular investment strategy. If there was a change in statutory accounting, whether or not it makes sense to hold them at something other than market value given their fluctuations, he said there would be a better consistency between the proposal and how statutory solvency would be measured.

Mr. Barlow agreed and said one of his concerns is a scenario where a company is insolvent but has a healthy RBC. He acknowledged that this would take an extraordinary set of circumstances but said it does happen occasionally. Mr. Prindiville said the capitalization ratio amortization part of the proposal is an attempt to mimic what the asset valuation reserve (AVR) does for statutory surplus. Mr. Yanacheak said he shares Mr. Barlow’s concern and said he believes that scenario definitely exists. He said it is a severe scenario, and while it may not be likely, severe scenarios are never regarded as likely. If it is a conditional tail expectation (CTE) type analysis, he said, when looking at tail events, he believes it might flip to likely, and that concerns him about this proposal. Mr. Barlow said there are some guardrails in the proposal that are good for what they do, but he is concerned that companies could use equities in a way that may not be appropriate for the liabilities they are backing and then, at the end of the year, trade to something for the purpose of RBC and then go back afterward. He said he does not yet have a clear view of what the next step is but suggested the Working Group could come up with additional questions. He asked Working Group members for their thoughts. Mr. Carmello suggested rejecting the proposal and moving on to other issues. He said RBC has been reduced for the last 20 years, and that is why the rating agencies’ multiples are up to four or five. Mr. Boerner said he has been struggling with what type of analysis would be useful right now, but he is not comfortable with the proposal at this point and said he would not oppose Mr. Carmello’s suggestion.

Mr. Carmello made a motion, seconded by Mr. Boerner, to reject the proposal. Mr. Andersen said he supports that for now but suggested a more independent and rigorous study as to what happens over a 30-year period would make this a discussion worth having again. The motion passed, with Illinois abstaining.

2. Exposed the Memorandum on Potential Further Work on Life Growth Operational Risk

The Working Group agreed to expose the memorandum from the Operational Risk (E) Subgroup for a 25-day public comment period ending Nov. 20. Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.
September 20, 2019

VIA ELECTRONIC MAIL – dfleming@naic.org

Philip Barlow, Chair
Life Risk-Based Capital Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108

Re: Comments on Exposure of a Proposal to Update the RBC Charge for Unaffiliated Common Stock Supporting Long-Horizon Contractual Commitments

Dear Associate Commissioner Barlow, and members of the Life Risk-Based Capital Working Group:

We are writing on behalf of Allstate Life Insurance Company and its affiliated insurance companies (collectively, Allstate) regarding the Life Risk-Based Capital Working Group’s exposure of a proposal, sponsored by the Illinois Department of Insurance, to Update the Risk-Based Capital (RBC) Charge for Unaffiliated Common Stock Supporting Long-Horizon Contractual Commitments (Proposal). Allstate acknowledges the important work of the Life Risk-Based Capital Working Group (Working Group) and appreciates the significant contributions that Associate Commissioner Barlow, many state regulators, industry groups and peers have made in helping refine this Proposal. Feedback has consistently helped us to refine and strengthen the Proposal, and we welcome further dialogue once comments have been received.

Allstate is a multi-line insurance company with approximately $40 billion in annual revenues, 130 million policies in force, and $80 billion of assets under management, of which $9 billion backs structured settlement and immediate annuity policies. These commitments are long term in nature and fixed in all respects other than mortality. As is the case for pensions and endowments with similar obligations, equity investments can play an important role in the asset portfolio. Our research shows that an allocation to equity investments for products like these is likely to enable greater returns to policyholders while reducing the long-term solvency risk of the insurer. Such
investments diversify insurer portfolios and strengthen their long term financial ability to meet contractual guarantees.

Despite the expected benefits of holding equity investments for the long-term in a low interest rate environment, RBC charges for all insurance company investments are still tied to a short time horizon. The current C-1cs capital charge for unaffiliated common stock is 30% regardless of the underlying contractual obligations. As a result, insurers with business that includes long-term contractual obligations that are not subject to disintermediation risk often hold suboptimal economic portfolios that are too heavy on bonds and too light on equities. This investment mix reduces long-term investment performance and increases the risk to all stakeholders from extended periods of low interest rates. It also creates disincentives for the insurance industry to participate in solutions to long-term retirement needs such as pension buyouts and individual payout annuities.

Accordingly, this Proposal is to revise the life RBC framework to incorporate the existence of time diversification in equity markets. The amended life RBC calculation would allow eligible companies to voluntarily elect a C-1cs credit for unaffiliated common stock in the range of 15-20% pre-tax against the current 30% C-1cs capital charge specifically relating to equity investments backing long-term, contractual obligations not subject to disintermediation risk. An extensive set of guardrails will prevent an increase in risk to the insurance industry as a whole and mitigate insolvency risk at the company level.

Such guardrails include:

1. Equities must back reserves held for 7 years or more;
2. Reserves must not be subject to discretionary withdrawals which could shorten the time horizon;
3. An effective asset-liability strategy must be in place to mitigate short term liquidity risk;
4. A certification from a qualified Actuary is required to ensure documentation and transparency;
5. A management certification is required as to the company's "intent and ability" to execute its investment strategy and live into the required guardrails;
6. Segmentation is required to separate long-duration assets and enhance transparency; and
7. Volatility associated with long horizon equities would be amortized into the Capitalization Ratio over a 7-year period.
Under this Proposal, we believe that insurers would be encouraged to follow sound, responsible investment policies that benefit consumers many years into the future, providing retirement security or a safe, reliable income stream for individuals with special needs.

Allstate believes strongly in a set of defining principles that form the foundation of this Proposal:

1. The RBC framework can be enhanced to encourage solutions that target the retirement security gap that exists for consumers;
2. Equity investments can help achieve the returns necessary to meet legacy obligations and improve the consumer value proposition for newly designed products;
3. Equities held for the long term demonstrate lower volatility and risk due to the benefit of time diversification;
4. Any credit for time diversification should be linked to company intent and ability to maintain equity exposure over the long term;
5. Companies taking such a credit must demonstrate compliance with guardrails designed to maintain the financial strength of companies and the industry; and
6. Payout annuities, with no exposure to disintermediation risk, are a simple and transparent test case to introduce a credit for time diversification.

To provide further context, we provide supplementary materials that relate the current Proposal to prior analysis, including a memorandum issued as part of the 2013 study by the NAIC Investments RBC Working Group. Through this lens, the Proposal can be seen as a logical extension of prior discussion. It evolves the RBC framework away from a rigid "one size fits all" approach to equities by linking the calibration interval to the expected duration of the investment. If a long horizon and requisite liquidity can be guaranteed, a "beginning to end" lens is more appropriate than application of a quarterly low watermark calculation.

**RBC Payout
Annuities August 201**

As noted during the August 3rd Working Group meeting, Chairman Barlow outlined key questions to help guide the analysis and discussion of this Proposal by group members. Although Allstate has discussed and answered many of these questions in prior conversations with individual regulators, we now provide answers on the record for the benefit of all interested parties.
1. **Allstate is focusing on the element of time diversification and urging that it be incorporated into the formula. Is C-1 the right place to accomplish that?**

Following many conversations on this topic, Allstate continues to believe that the C-1 charge is the appropriate place to recognize time diversification of investment risk. The C-1 framework already recognizes other types of diversification - for example, diversification across issuers and industries. Diversification across time periods has a similarly powerful and beneficial impact on risk and is a logical addition in cases where it can be assured by demonstrating intent and ability to hold. The C-1 framework includes actuarial and management certifications to provide transparency and disclosure regarding this intent and ability.

Moreover, C-1 is the appropriate place according to the definitions and rules of the RBC framework itself. C-1 is defined and calibrated to cover the risk of asset default of principal and interest, or the risk of fluctuation in fair value. The latter part of this definition clearly encompasses equity risk, which varies significantly by horizon due to the existence of time diversification.

C-3, in contrast, is defined to cover the risk of loss due to changes in interest rate levels and changes in market levels associated with variable products. The volatility associated with equity investments backing immediate annuities and structured settlements is not in scope, as the products under discussion are not variable products.

Though equity volatility could in theory be moved to the C-3 calculation, this would represent a fundamental change to the overall framework, introducing a large number of complicated issues such as the scenarios to be used, the usage of “low watermark” adjustments, and the calibration of diversification assumptions across RBC categories. A more straightforward approach is to retain equity volatility within C-1 capital, but to consider it in the context of the investment horizon. Charges based on a short holding period are appropriate in cases where liquidity constraints exist. In contrast, where liquidity is not an issue and where a long holding period can be supported, time diversification reduces the impact of short-term volatility and reduces tail risk over the length of the holding period. Appropriate holding period requirements would be required in calculating C-1 charges to maintain the integrity and consistency of RBC category definitions.

The proposed C-1 adjustment modernizes the RBC framework while requiring full transparency and disclosure, and without the complexities associated with measuring risk in a C-3 context.

2. **Is Allstate saying there is a risk of not holding equities?**

The key consideration is the investment horizon. Over short time periods, stocks are generally acknowledged to be a higher risk investment than bonds. Over long time periods, in contrast, stocks benefit from compounding of returns and time diversification of risk. These two forces significantly increase the likelihood of a favorable outcome for stocks when compared to bonds.
Over this longer time period, the expected return of a diversified stock portfolio becomes much higher than that of a bond portfolio, due primarily to the compounding of returns. More importantly from a capital perspective, 95th percentile tail outcomes become more favorable for stocks than for bonds, due in large part to the impact of time diversification.

When considering the risk of not being able to make liability payments across the entire life of a long-tailed product line, a properly diversified stock portfolio represents a lower risk investment than a portfolio of bonds. Especially at times when interest rates are low for extended periods, stocks provide greater returns than fixed income securities and improve the insurer’s ability to meet obligations associated with long horizon liabilities.

3. **Should there be a change in NAIC accounting standards as well as the RBC formula?**

Allstate believes that NAIC accounting standards provide a sound and robust valuation of the capital of the company. RBC complements capital and measures the ability for the capital to meet policyholder obligations. Capitalization levels can only be evaluated in light of the company’s assets and liabilities. In cases where there is no disintermediation risk and liquidity is managed appropriately, liabilities due long into the future do not require immediate liquidation of balance sheet assets, and RBC charges should be adjusted to reflect the fact that short term price volatility is less important.

Though Allstate believes that a change in accounting standards is not necessary, proposed adjustments to the Capitalization Ratio would modernize it in a manner consistent with the incorporation of a time diversification credit for long horizon equity investments.

If equity C-1 charges are differentiated by time horizon as proposed, accounting and RBC frameworks will remain internally consistent to the extent that equity-related volatility is realized in a pattern that reflects the investment horizon used to calibrate the C-1 charges. In cases where C-1 charges are set to reflect a seven-year horizon, consistency suggests that equity gains and losses be amortized into the Capitalization Ratio over an identical seven-year period. Doing so equilibrates the *expected* volatility embedded in the C-1 charge to the *realized* volatility likely to flow through the Capitalization Ratio.

4. **The proposal assumes a diversified portfolio of equities. How can regulators be assured of that?**

Concentration risk is an important consideration that is not unique to this Proposal. Existing RBC charges assume a diversified portfolio of equities; adjustments and regulations are in place to guarantee diversified portfolios.

Single issuer concentration limits vary by state. In Illinois, for example, equity investments in a single issuer must be less than 3% of admitted assets. In addition, incremental capital charges are applied to large portfolio concentrations. "Top five" equity concentrations currently receive a 50% capital surcharge, effectively increasing the base C-1 charge from 30% to 45%. Finally,
beta adjustments increase required capital in cases where lack of diversification increases stock portfolio volatility above that of the market. These limits, penalties, and adjustments would all remain in place under the Proposal. Management certifications will continue to include statements of intent to follow all applicable statutes, including these revised requirements.

Reassessment of whether these protections are sufficient may be a worthy exercise, though it can be undertaken separately from the current Proposal.

From an audit perspective, Allstate agrees that a clear trail must be prepared showing that the assets receiving the credit are clearly intended to retire liabilities far into the future. Such assets should be segregated into company records with appropriate audit trails to the RBC workpapers.

5. How would reinsurance impact this change in the formula?

The credit is designed net of reinsurance. The equity assets identified for the credit will be demonstrated in the supporting memo of the actuarial certification to back long horizon liabilities.

6. How can we ensure the proposed change is limited to payout annuities/structured settlements?

Supplemental exhibits and certifications must be filed by companies opting for the credit, as framed by three interrogatories in the Blue Book presentation:

- Will the Risk-Based Capital Credit for Long Horizon Equity Investments Supplement Exhibits be filed with the state of domicile and the NAIC by March 1?

- Will the Actuarial Certification Related to the Risk-Based Capital Credit for Long Horizon Equity Investments be filed with the state of domicile and the NAIC by March 1?

- Will the Management Certification Related to the Risk-Based Capital Credit for Long Horizon Equity Investments be filed with the state of domicile and the NAIC by March 1?

A new supplement to Note 32 will show amounts applicable to the credit. As proposed, line 32.G.1 will include the liability related to the long horizon credit.

Finally, the equity assets identified for the credit will be demonstrated in the supporting memo of the actuarial certification to back only long horizon annuity liabilities.

7. Are there implications for PBR?

PBR, a reserve measurement framework, is separate from the RBC calculation. No implications are expected.
8. The NAIC is discussing the importance of retirement security. Could this proposal help with that? Should the NAIC take that into consideration?

Allstate believes that the changes proposed would provide social benefits in two ways. First, the Proposal enhances the ability of insurers to play an integral role in helping consumers to navigate challenges associated with saving for retirement. In an era of low interest rates, bond investments do not provide returns sufficient to meet the goals and needs of future retirees. Investment theory has consistently demonstrated that equities are a very important component of a diversified portfolio for investors with long time horizons. Allowing insurers to voluntarily elect this RBC credit allows them to diversify their investment risk and strengthen their long-term financial ability to meet the guarantees provided to customers. A supportive RBC framework would foster innovation within the life insurance industry and encourage companies to offer a wider array of products at attractive rates and terms that meet the retirement-oriented needs of consumers.

Our nation faces a second challenge in the form of its aging infrastructure. For many years, we have underinvested in this area and have fallen behind other countries, threatening our economic competitiveness. Infrastructure investments are long term in nature, and many are made in equity form. Because the characteristics of infrastructure investments align with the risk and return profile desired by long term investors, this Proposal would result in greater insurance industry participation in these investments. Notwithstanding this Proposal, if the NAIC is interested in encouraging infrastructure investments, capital requirements could be further reduced.

9. Should the proposal be limited to forward-looking investments and liabilities only, or can it be used for existing blocks of business?

Allstate believes that the Proposal should apply both to existing blocks and to new business. For existing blocks, which were generally written in economic regimes characterized by higher interest rates, appropriately-managed equity investments increase expected portfolio returns and reduce long term solvency risk. For new business, equity investment strategies enable insurers to offer higher returns that meet policyholder needs.

10. We have had a low interest rate environment for some time. What if interest rates go back up?

The principles of return compounding and time diversification are durable across time. They are not limited to a low interest rate environment. The data that backs our research goes all the way back to 1800. These two principles are apparent in all subsets of data that we have analyzed, including recent history.

The historical record clearly demonstrates that equities provide a long run return premium over bonds, observable across a wide variety of time periods, economic regimes, and geographic
markets. Whether interest rates are low or high, we expect this premium to persist and to compound through time, making stock investments an attractive part of a long horizon portfolio.

In addition, equity returns are ultimately tied to corporate earnings growth in the economy. Cyclical volatility exists, related to short term growth cycles as well as changing investor sentiment and expectations for the future. However, this volatility is generally resolved across a longer-term horizon. This has been demonstrated in both high interest rate regimes (early 1980’s) and low interest rate regimes (the 2008 financial crisis and its aftermath).

Though durable, these principles are even more important in the existing environment, with bond yields well below guaranteed payment rates. Reinvestment risk associated with fixed income investments is acute. Making matters worse, many debt instruments have call or refinancing provisions that would delay expected benefits should yields to return to higher levels. Though borrowers may opt to refinance when rates fall, they tend to hold their loans when rates increase. Lower yielding bonds can be much “stickier” than their higher-yielding cousins. All told, the likelihood of bonds providing necessary returns for legacy structured settlement and payout blocks has declined significantly, making the equity alternative even more compelling than usual.

Regardless of interest rate conditions, we believe that the principles of return compounding and time diversification should be leveraged appropriately by long run investors. Time diversification and the proposed credit should be a permanent part of the RBC framework.

11. Time diversification has been demonstrated empirically, but is there corresponding theory to support the concept?

The previously cited connection of stock returns to corporate earnings growth is highly relevant. Popular models decompose stock returns into two underlying components: (1) current income (dividends) and (2) corporate earnings growth (which evolves into future dividends). Corporate earnings are cyclical in nature, tied to the much-studied business cycle. Periods of optimism, borrowing, capital investment, and earnings growth swing naturally to periods characterized by pessimism, deleveraging, and retrenchment. Stock returns will continue to traverse cyclical patterns, and the recovery parts of such cycles form the theoretical underpinning of time diversification.

Though derived and calibrated using empirical data, statistical theories regarding time diversification have also been advanced. Many risk models assume that returns across time periods are independent, demonstrating zero correlation between one period and the next. Under this assumption, cumulative risks associated with stock investments continue to grow with time, though at a decreasing rate as the horizon gets longer.

However, the historical record suggests that correlations are negative across time, particularly after a large directional change. All available information may be incorporated continuously into stock prices, but investors tend to overreact to news over short periods of time. According to this theory, negative returns in one period (a correction or bear market) are likely to be followed
by positive returns (recovery and the return of "animal spirits"). Mean-reverting behavior has long been a staple of interest rate risk modeling and forecasting, and similar concepts are being applied to stock returns by researchers and practitioners.

Academic and practitioner literature on this topic is deep, and we would be happy to provide examples to interested parties. One comprehensive reference is Jeremy Siegel’s book “Stocks for the Long Run” (fifth edition published in 2014 by McGraw-Hill).

12. Is long run equity investing a “money machine” that should not exist in principle?

This is a broad question that is not specific to stock markets. Historically, investors have earned “risk premia” in asset markets by bearing different types of risk. Versus a “safe” alternative such as Treasury bills, investors can earn expected profits by taking interest rate risk and investing in long term bonds. They can take credit risk and invest in corporate bonds, and they can take equity risk in the stock market. With the historical record as our guide, these investments should indeed be profitable over the long run, and the term “money machine” could be reasonably applied.

However, the reason that investors are compensated for taking these risks is the uncertainty and potential for short term loss. Interest rates could rise, borrowers could default, and equity markets could fall. Aversion to such losses creates the need for a premium paid on investments that involve greater risk and forms a foundation that provides attractive return opportunities for long run investors.

These short run risks are real and must be managed appropriately. Periods of steep short term loss and investor insolvency can be found across markets, including interest rates (the inflationary 1970’s), credit investments (the junk bond crisis), and equity risk (the recent financial crisis). In most cases of insolvency, liquidity was not available to allow the investor to weather the storm. An important part of our Proposal is to require demonstration of adequate short term liquidity that would forestall recognition of short term losses. At Allstate, we manage the payout annuity portfolio in two parts – (1) a laddered, high quality bond portfolio structured to provide seven years of liquidity to pay liability cash flows, and (2) an equity portfolio to leverage the powerful forces of return compounding and time diversification.
Allstate appreciates the opportunity to work with you and the members of the Life RBC Working Group to develop these proposed changes to RBC. Thank you very much for your consideration of these comments. Should you have any questions concerning the matters raised in this letter, please feel free to contact us.

Sincerely,

Theresa Resnick
Vice President and Appointed Actuary
Allstate Life & Retirement

Mark Prindiville
Senior Vice President
Data, Discovery, and Decision Science

cc: Dave Fleming, NAIC
    Kevin Fry, Deputy Director of Financial Corp. Regulation, Illinois Department of Insurance
    Mary Jane Fortin, President, Allstate Financial Businesses
    Bob Zeman, Government & Industry Relations, Allstate
The C-1 charge for equity investments was formally reconsidered by the Investment RBC Working Group in 2013.

An accompanying Memorandum was informed by rigorous analysis of historical stock market losses.

The S&P 500 was chosen as the representative public equity universe.

### 2013 IRBCWG Memorandum – Summary of Key Elements

<table>
<thead>
<tr>
<th>Element</th>
<th>Options Considered</th>
<th>Option Chosen</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical Period</td>
<td>• 1926 – 2012&lt;br&gt;• 1946 – 2012&lt;br&gt;• 1960 – 2012&lt;br&gt;• 1982 – 2012</td>
<td>• 1946 - 2012</td>
<td>• The Great Depression and World War eras (as well as preceding periods) may not be representative of the modern era&lt;br&gt;• Starting with the post-WW2 period, a longer data set is preferable in order to include more economic regimes&lt;br&gt;• Usage of short data sets would make calibration volatile</td>
</tr>
<tr>
<td>Horizon</td>
<td>• One Year&lt;br&gt;• Two Years&lt;br&gt;• Longer</td>
<td>• Two Years</td>
<td>• Usage of two years is more conservative than one year, and captures most of the maximum drawdown for a buy-and-hold investor</td>
</tr>
<tr>
<td>Interval</td>
<td>• Worst Monthly&lt;br&gt;• Worst Quarterly&lt;br&gt;• Beginning to End</td>
<td>• Worst Quarterly</td>
<td>• Monthly intervals incorporate too much short term volatility&lt;br&gt;• Quarterly intervals align with statutory reporting&lt;br&gt;• Pros and cons of “Beginning to End” are summarized on the next page</td>
</tr>
<tr>
<td>Confidence Level</td>
<td>• 92nd&lt;br&gt;• 94th&lt;br&gt;• 95th</td>
<td>• 95th</td>
<td>• The 92nd and 94th percentiles offer consistency with other studies, but the 95th percentile is standard in the investment industry (roughly two standard deviations) and adds a measure of conservatism</td>
</tr>
<tr>
<td>Beta</td>
<td>• Retain beta adjustments&lt;br&gt;• Eliminate beta adjustments</td>
<td>• Retain beta adjustments</td>
<td>• It is logical for more volatile, higher beta portfolios to receive a greater charge&lt;br&gt;• Existing beta factors appear to appropriately differentiate insurer portfolios</td>
</tr>
<tr>
<td>Private Equity</td>
<td>• Same charge as common stock&lt;br&gt;• Different charge</td>
<td>• Same charge as common stock</td>
<td>• Once historical private equity returns are adjusted for serial correlation, their annual standard deviation is comparable to that of the S&amp;P 500</td>
</tr>
</tbody>
</table>

**Recommendation:** maintain 30% C-1 charge for common stock and schedule BA private equity investments, retaining beta adjustments with an embedded cap and floor.
On pages 4 and 11, the Memorandum notes that the equity C-1 charge would decrease if a longer horizon were applied.

On page 12, the Memorandum quotes from a 1997 predecessor in debating the relevance of intermediate results, comparing “low watermark” and “beginning to end” approaches.

Appendix 2 included a chart which graphically illustrated these considerations.

The chart included in Appendix 2 is based on data from 1960 to 2012 and uses 94th percentile results. This approach differs slightly from that used to frame the recommendation (1946 to 2012, 95th percentile), through the illustrated trends remain consistent.

This shorter data set excludes the 1950s, a period of general calm and low volatility. As such, the blue “intermediate results” approach suggests a capital charge above 30% at horizons of 20 months or greater. However, in its red “beginning to end” line, the chart affirms the central observation driving the current proposal: somewhere between five and seven years, equity market losses tend to flip to gains, even in tail scenarios.
The Current Proposal as an Extension of the 2013 Study

- In 2013, the Investment RBC Working Group took a “one size fits all” approach to equity C-1 charges
  - It adopted a 30% charge for all equity holdings, regardless of product line and holding period
  - For a single, uniform charge to be applied in all cases, 30% was a reasonable outcome
- The current proposal modernizes the framework by adding nuance in dimensions foreseen by the 2013 Working Group
  - “One size fits all” is not appropriate to long investment horizons, where time diversification and compounding alter the landscape
  - Net of the proposed credit, a 15% charge is conservative and prudent, sufficient even in 99th percentile outcomes

Current Proposal – Summary of Key Elements

<table>
<thead>
<tr>
<th>Element</th>
<th>Options Considered</th>
<th>Option Chosen (Most Equities)</th>
<th>Option Chosen (Long Horizon Equities)</th>
</tr>
</thead>
</table>
| Historical Period| • 1926–2012  
• 1946–2012  
• 1960–2012  
| Horizon          | • One Year  
• Two Years  
• Longer | • Two Years                   | • Seven Years                |
| Interval         | • Worst Monthly  
• Worst Quarterly  
• Beginning to End | • Worst Quarterly             | • Beginning to End            |
| Confidence Level | • 92nd  
• 94th  
• 95th | • 95th                        | • 99th                        |
| Beta             | • Retain beta adjustments  
• Eliminate beta adjustments | • Retain beta adjustments    | • Retain beta adjustments       |
| Private Equity   | • Same charge as common stock  
• Different charge | • Same charge as common stock | • Same charge as common stock   |

Recommendation: maintain 30% C-1 charge for most equity investments; reduce to 15% in cases where investments are intended for long horizons and align with specified guardrails
September 20, 2019

Mr. Philip Barlow
Chair, Life Risk-Based Capital Working Group

Re: Risk-Based Capital Requirements for Long-Horizon Equity Investments Exposure

Dear Philip:

The American Council of Life Insurers (ACLI) is pleased to submit the following comments regarding the long-horizon equity investments proposal.

While not currently taking a position on this proposal, the ACLI supports solutions that enable consumers to purchase products they need to protect their financial and retirement security. Reducing the RBC charge for equities under certain circumstances could increase the availability of products and make those products more affordable. That said, companies must maintain appropriate capital levels to ensure that they can deliver on the promises they make.

ACLI supports continued discussion of the details associated with this proposal, and how this and similar approaches may benefit consumers. While this proposal only addresses payout annuities and structured settlements, we believe that the concepts could apply in other instances. If this proposal is pursued, ACLI also believes any such proposal should apply to all business, and not solely have a forward looking view. If solvency is appropriately measured and maintained, incentives can help achieve returns necessary to meet legacy obligations as well as improve consumer value for newly designed products.

Every capital framework introduces incentives and disincentives; this proposal addresses the disincentives in the RBC framework for companies to invest in equities. The concept behind the proposal is that well-capitalized companies would be able to weather the volatility of the assets held over the long term.

ACLI recognizes that, should this proposal be introduced into the RBC framework, appropriate guardrails would need to be established to maintain the financial strength of each company and the industry. Such guardrails may include requirements around the level of diversity of the portfolio and the minimum RBC ratio before the credit is allowed.

ACLI has identified technical aspects of this proposal that should be further discussed before proceeding. The proposal involves revisions to the RBC framework without explicit changes to the current accounting treatment of equities. Because equities are accounted for on a market value basis, an RBC
ratio that amortizes equity losses will not reflect adverse equity impacts in the midst of a market downturn. Care needs to be taken if the NAIC does not intend to eventually revise the accounting treatment of equities to be on a book value basis, which aligns with the proposed concept.

We look forward to a discussion of these issues. Thank you.

Sincerely,

[Signature]

cc Dave Fleming, NAIC
September 20, 2019

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

Dear Philip,

The Life Capital Adequacy Committee (LCAC) of the American Academy of Actuaries’ (Academy) Life Practice Council is pleased to submit comments on the “Risk-Based Capital (RBC) Requirements for Long-Horizon Equity Investments” exposure. The exposure proposes a reduction in the RBC C-1 (asset risk) equity charge for a portion of equities that support long-duration payout contracts.

The LCAC does not support the reduction in the RBC C-1 equity charge for a portion of equities that back long-duration payout contracts for the following reasons:

1. Any consideration of product specific investment choices is reflected in C-3, not C-1. The C-1 component covers the risk of asset performance (e.g., default, change in equity value) as reported in statutory surplus.
2. The C-1 common stock equity charge is already reduced through the RBC covariance adjustment. For example, 2018 overall industry data shows about a 50% reduction.
3. The proposal only measures loss at the end of a stated period. RBC is designed to cover the capital requirement throughout a stated period consistent with a Greatest Present Value of Accumulated Deficiency (GPVAD) approach.
4. The proposed approach for determining total adjusted capital (TAC) in RBC (i.e., amortization of equity gains and losses) is inconsistent with how actual statutory capital is reported. As a result, the RBC amount calculated for the purposes of identifying weakly capitalized companies would not reflect the actual statutory solvency risk.
5. The potential statutory capital loss from equity risk would be based on asset performance only and would not be offset by the long-duration payout liabilities.

With those general comments in mind, the LCAC has drafted the following responses to the questions that were raised at the Life Risk-Based Capital Working Group meeting on Aug. 3:

1. Is time diversification something that should be reflected in RBC and if so, is it appropriately considered in the C-1 Risk category?

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.
Our comments reflect two possible aspects of “time diversification”:

One aspect is that time diversification occurs when different risks emerge more fully at different points in time, so the total amount needed to satisfy a risk measure at any one time is less than the sum of each separate risk measure across all time points in a projection. We believe this aspect of time diversification should be reflected in RBC. Under the current RBC framework:

- This phenomenon is directly considered in RBC covariance adjustments.
- This phenomenon is not directly considered in C-1 RBC because the risks are evaluated over different time horizons that are consistent with the typical cycle of each risk.
- This phenomenon is partially considered in C-3 testing, but only within each scenario, rather than across scenarios, because the GPVAD methodology takes results from potentially many different time horizons.

Another aspect is that time diversification occurs when the holding period for a stock increases and that results in a lower probability of losing money relative to the initial investment. However, equity investments like common stocks are held at market value, so any change in market value of a stock is immediately reflected in its statement value, and hence, immediately reflected in statutory capital. An entire stock portfolio, regardless of when it is acquired, is subject to the same mark-to-market risk. The RBC requirement is based on the GPVAD over the specified period, so RBC is determined to be sufficient both at the end of a specified period and at interim points as well. We believe this aspect of time diversification should not be reflected in RBC because it does not reduce mark-to-market risk.

2. Is there an unrecognized solvency risk with payout annuities and structured settlements in this ongoing low interest rate environment and will a shift to equity investments to back those products alleviate that risk?

There is not an unrecognized solvency risk with payout annuities and structured settlement options in the ongoing low-interest-rate environment. This risk is appropriately captured in RBC C-3 and asset adequacy testing. A shift to equities, while potentially leading to a higher expected return, would also increase mark-to-market risk (i.e., the risk of statutory losses from declines in market value of the common stocks) and would not decrease solvency risk.

3. Should there be a complementary change to the accounting for the equities or is the proposal to modify the total adjusted capital (TAC) to smooth equity gains and losses sufficient?

RBC is calibrated to identify potentially weakly capitalized companies. In order for the RBC ratio to operate as intended, the calculation needs to be on the same accounting basis as the reported statutory capital. Otherwise, the calculated capital amount will not be accurate for the statutory solvency risk. Therefore, if smoothing of TAC is done in the RBC calculation, the same change would need to be made to the accounting of statutory capital. This statutory change, if made, must also be reviewed for other impacts as well.

4. The proposal assumes a diversified portfolio. How do we require an initial diversified portfolio backing the reserves and how do we allow reasonable trades in that portfolio while preventing inappropriate activity?

To the extent that an individual insurer’s stock portfolio is more or less diversified than the diversification in the S&P 500 portfolio assumed in the proposal, a more sophisticated approach for measuring the relative diversification risk would need to be developed. For example, the
current LRBC formula adjusts the equity charge through a beta adjustment that measures the volatility of an individual stock relative to the S&P 500 index; the bond charges are adjusted based on the number of bond holdings in an insurer’s bond portfolio; and both bonds and stocks have a concentration factor requirement.

5. How might the use of reinsurance impact this proposal?

RBC should reflect the net risks that a company retains or assumes.

6. How do we ensure that this proposal is strictly limited to payout annuities and structured settlements?

An approach to accurately measure, monitor, and report which equity investments are allocated to payout annuities and structured settlements would need to be developed. It should be noted that other products like long-term care have similar characteristics as to payout annuities (i.e., longer liabilities with no immediate cash needs). Any adoption of a change to RBC should establish the rationale for the change as well as for excluding or including other product types.

7. Are there implications in this proposal for PBR or Asset Adequacy Analysis and if so, how should those be coordinated?

The proposal only addresses the calculation of RBC. The requirements for PBR and asset adequacy analysis would be unchanged. Any change in investment strategy that a company would choose as a result of this proposal would need to be reflected in its PBR and asset adequacy testing.

8. Retirement security is a big issue and a proposal that has the potential to put more money into the hands of retired people will help, but should that be a criterion that we consider in developing RBC?

The focus and purpose of RBC has always been a tool for regulators to identify weakly capitalized companies. Introducing other objectives would dilute that objective and introduce judgment and subjectivity in determining the capital requirement for risks.

9. Should this proposal be forward looking only? Given that there is no opportunity to adjust the payments for existing payout annuities and structured settlements is there a reason to allow it for existing contracts?

The issues that we have identified in the proposal are applicable to both new and existing contracts. In addition, RBC has not been designed to establish separate capital requirements by year of issue.

10. Does the proposal work for environments other than the current low-interest environment?

This proposal would introduce similar risks in different interest rate environments. The tradeoff of investing in equities is the prospect of higher expected returns but also greater risk of market value loss on a statutory basis. The capital requirements should appropriately reflect the higher level of risk. RBC factors and requirements are designed to measure risks accurately over most economic environments.
In addition to the questions that the Life Risk-Based Capital Working Group posed, we identified the following questions regarding this proposal that you may want to consider:

1. How does the analysis differ if periods other than seven years are used?
2. Would smoothed results also be used for insolvency impacts as to when state guaranty fund systems would be used?
3. Are equity dividends included, or just price movements?
4. How do the risk/return characteristics of this option compare with a variable payout annuity that has an allocation to variable and fixed funds?
5. How would federal income taxes be impacted?
6. Would the RBC covariance adjustment be appropriate in light of the proposed change?

If you have any questions on our comments, please contact Ian Trepanier, life policy analyst at the Academy (trepanier@actuary.org).

Sincerely,

Chris G. Trost, MAAA, FSA
Chairperson, Life Capital Adequacy Committee
American Academy of Actuaries
The Longevity Risk (A/E) Subgroup of the Life Actuarial (A) Task Force and the Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Nov. 25, 2019. The following Subgroup members participated: Rhonda Ahrens, Chair (NE); Seong-min Eom (NJ); Bill Carmello (NY); and Peter Weber (OH). Also participating was Philip Barlow (DC).

1. **Adopted its Recommendation to the Life Risk-Based Capital (E) Working Group on Longevity Risk**

Ms. Ahrens said the Subgroup is considering adoption of the recommendation to the Life Risk-Based Capital (E) Working Group on new C-2 factors for longevity risk. She discussed the memorandum, which includes as attachments: 1) the American Academy of Actuaries (Academy) Longevity Risk Task Force’s proposal document, which was presented at the Spring National Meeting; 2) the Academy’s update on correlation, which was presented at the Summer National Meeting; and 3) the actual proposed changes to the risk-based capital (RBC) blank and instructions. She said this memorandum was also discussed during the Subgroup’s Nov. 4 conference call and now includes the edits that have been suggested. With respect to longevity reinsurance transactions (LRT), Ms. Ahrens said the issues that have been discussed by the Subgroup are highlighted in the third paragraph, with the following paragraph indicating that the Subgroup believes these transactions should ultimately be in scope of the proposal but that the Subgroup needs more time and guidance from the Working Group on this aspect. She said the issue of correlation is presented next explaining the discussions the Subgroup has had along with its recommendation that this is an issue to be considered by the Working Group.

Mr. Carmello suggested modifying the memorandum to indicate that a majority of the Subgroup members, as opposed to the Subgroup as a whole, supports scoping out LRT for now since he believes there is a way to have it included and it was not unanimous. He also suggested inclusion of the changes needed for the tax page and the authorized control level (ACL) page, LR030 and LR031, respectively, as part of the recommended RBC blank changes.

Ms. Eom expressed concern with the statement in the Academy’s proposal document concerning longevity reinsurance indicating that premium amounts excluded from statutory reserves should be netted against C-2 capital. She said she wants to make it clear that not everyone supports this. The Subgroup agreed to modify the paragraph on LRT to make clear that the need for further analysis is because the Subgroup did not reach a consensus, along with modifying the premium offset bullet point to reference a portion of future premiums, as opposed to all future premiums.

Mr. Carmello made a motion, seconded by Ms. Eom, to adopt as the recommendation to the Working Group the memorandum with the changes discussed along with the three attachments with pages showing the changes needed to LR030 and LR031 without correlation added. Brian Bayerle (American Council of Life Insurers—ACLI) said the Subgroup indicates in the memorandum that it has not taken a position on correlation and said the ACLI believes it would be better to advance the recommendation with versions of LR030 and LR031 with and without correlation and let the Working Group decide whether it wants to expose one or both of the versions. Mr. Barlow said he appreciates Mr. Bayerle’s comments and that he is not speaking for the Working Group, but it would be his preference that only one version rather than multiple versions be advanced to the Working Group. The motion passed unanimously.

2. **Discussed the Academy’s Offer of Additional Assistance on Correlation**

Ms. Ahrens said the Academy submitted a letter on the implementation of longevity C-2 with correlation that includes the RBC changes that would be needed. With the Subgroup not taking a position on correlation, she said she believes this is something the Academy could direct to the Working Group. Paul Navratil (Academy) said the Academy is presenting this to make sure that the operational details are provided to facilitate the Working Group’s discussion of the issue. Mr. Barlow said he understands that the correlation aspect may fall outside of the specific consideration of longevity risk and is something that the Working Group can appropriately address.

Having no further business, the Longevity Risk (A/E) Subgroup adjourned.
The Longevity Risk (A/E) Subgroup of the Life Actuarial (A) Task Force and the Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Nov. 4, 2019. The following Subgroup members participated: Rhonda Ahrens, Chair (NE); Mike Yanacheak (IA); John Robinson (MN); Seong-min Eom (NJ); Bill Carmello (NY); and Peter Weber (OH).

1. Continued Discussion of the Academy’s Longevity Risk Task Force Proposal

Ms. Ahrens said a memorandum to the Life Risk-Based Capital (E) Working Group was drafted per the Subgroup’s discussion on Oct. 7 describing the Subgroup’s work on the proposed longevity risk C-2 charges. She said the memorandum outlines the Subgroup’s recommendation, which includes the proposal document along with the actual risk-based capital (RBC) blank and instruction changes, the discussions to date and the presentations from the American Academy of Actuaries (Academy) Longevity Risk Task Force. She said the memorandum also includes the Subgroup’s consideration of correlation explaining that the Subgroup believes that this aspect may not be in the Subgroup’s purview. Ms. Ahrens said the Subgroup has also discussed the scope of products to be included and, specifically, longevity reinsurance. She said state insurance regulators received some education on this during a regulator-to-regulator conference call held on Oct. 21 to discuss the similarities and differences to other longevity exposures in the life and fraternal annual statement that are included in the proposal’s scope. She said she believes it should be in scope but that the Subgroup seems to be divided on how a credit for this would be calculated or whether there should be a credit at all. Because there is more work to be done in this area, she believes that rather than holding up C-2 factors for other products, it should be scoped out for now and the additional work done possibly by a drafting group.

The Subgroup discussed edits to the memorandum, including adding detail to explain the issues with respect to longevity reinsurance, along with more clarity on those products that are within the scope of the proposal. Ms. Ahrens suggested: 1) having the suggested edits included; 2) having Subgroup members, the American Council of Life Insurers (ACLI) and the Academy review the updated memorandum; and 3) scheduling another conference call to consider adoption of the recommendation prior to the Fall National Meeting. The Subgroup agreed with this approach.

Having no further business, the Longevity Risk (A/E) Subgroup adjourned.
The Longevity Risk (A/E) Subgroup of the Life Actuarial (A) Task Force and the Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Oct. 7, 2019. The following Subgroup members participated: Rhonda Ahrens, Chair (NE); Mike Yanacheak (IA); Seong-min Eom (NJ); Bill Carmello and Amanda Fenwick (NY); and Peter Weber (OH).

1. **Continued Discussion of the Academy’s Longevity Risk Task Force Proposal**

Ms. Ahrens said two remaining aspects of the American Academy of Actuaries (Academy) Longevity Risk Task Force’s proposal to incorporate a charge for longevity risk in the life and fraternal risk-based capital (RBC) formula are the covariance and the scope. With respect to scope, she said there may be a need to schedule a regulator-to-regulator conference call to provide some education on pension risk transfer (PRT) transactions. With respect to the covariance aspect, she asked whether this was actually part of the Task Force’s recommendation or whether it was an aspect it is highlighting for additional consideration.

Paul Navratil (Academy) said the proposal document, which was presented to the Life Risk-Based Capital (E) Working Group at the Spring National Meeting, presented the work done on the factors for longevity risk, but the recommendation was that in implementing the factors, covariance needed to be considered at the same time. He said the presentation at the Summer National Meeting provided more detail, but the summary was that the recommendation was for a correlation of -33% between longevity and mortality C-2. He said the key premise in the work when the factors for longevity risk were developed was to calibrate them to get to a 95th percentile, which entailed including consideration of both longevity risk and mortality risk.

Ms. Ahrens noted the presentation included other jurisdictions having correlations of -50% and -25%. She asked Subgroup members for their thoughts on what the Subgroup should present to the Life Risk-Based Capital (E) Working Group as part of the recommendation with respect to correlation. Ms. Fenwick reiterated New York’s opposition to including any correlation within C-2. When the Subgroup first started to look at longevity risk, she said it was to introduce a factor for longevity, and it is being watered down and made less conservative with the work looking at different assumptions on reserve levels and covariance. She said it is uncertain what is going to happen with longevity risk because it involves two different groups of people with life insurance versus annuities, and how this ultimately works out is an inexact science. Mr. Weber said that Ohio would probably favor some correlation. He said there may be some appeal in recommending something less than the -33%. He acknowledged that it is not an exact science but that 0% seems extreme so perhaps -25% as another jurisdiction is using may be appropriate. Ms. Ahrens noted concern expressed with the possibility of the overall C-2 component actually going down with the introduction of longevity risk and suggested a possible approach could be to require a floor of one of the two C-2 components on its own after application of any covariance adjustment. Mr. Yanacheak reiterated his belief that this is a Life Risk-Based Capital (E) Working Group-level discussion. He said he thinks the Subgroup has an obligation to point out this issue as it has been presented to the Subgroup that relates to the longevity risk and what the Subgroup is proposing. He said if the Working Group wants the Subgroup to do additional work, it can provide that guidance. Brian Bayerle (American Council of Life Insurers—ACLI) said the ACLI believes covariance is appropriate but would support consideration of this aspect going to the Working Group.

Ms. Ahrens suggested moving forward with recommending the Task Force’s Spring National Meeting proposal to Working Group along with a memorandum documenting: 1) the Subgroup’s considerations of the factors and the assumptions; 2) the actual RBC blank and instruction changes needed to implement the proposal; and 3) the Subgroup’s consideration of covariance with the consensus that the Subgroup believes this is an aspect that merits the Working Group’s consideration but that the Subgroup is willing to continue work on it with further direction. Mr. Yanacheak supported this approach. Mr. Bayerle said the ACLI supports the approach as well.

Having no further business, the Longevity Risk (A/E) Subgroup adjourned.
The Longevity Risk (A/E) Subgroup of the Life Actuarial (A) Task Force and the Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Sept. 30, 2019. The following Subgroup members participated: Rhonda Ahrens, Chair (NE); Mike Yanacheak (IA); Seong-min Eom (NJ); Bill Carmello (NY); and Peter Weber (OH). Also participating was: Vincent Tsang (IL).

1. Continued Discussion of the Academy’s Longevity Risk Task Force Proposal

The Subgroup continued its discussion of the requested sensitivities the American Academy of Actuaries (Academy) Longevity Risk Task Force provided in its Sept. 10 letter. Ms. Ahrens reminded the Subgroup that the Task Force’s proposal targets a 95th percentile total asset requirement (TAR) assuming an 85th percentile reserve. She said the Subgroup questioned whether this assumption could actually be made and what the factors would be at different assumed reserve levels that the Task force provided. Mr. Carmello reiterated his preference to go with the factors at the 75th percentile level without a covariance adjustment. Mr. Yanacheak said reserves are to cover moderately adverse events and that he believes the 85th percentile is close to a mean plus one standard deviation, so he is not opposed to going with the 85th percentile factors. Ms. Eom said she is also supportive of the 85th percentile since that is what is assumed for reserves in other product lines and, if there is a problem with the actual reserve level, the reserves can be addressed separately.

Ms. Ahrens said she agrees with using the 85th percentile. She noted a small study done with Nebraska companies that have payout products when she was new to the Subgroup. She said the study was not to determine what the current reserve formulation produces but rather to: 1) determine whether there was an issue with asset adequacy testing not working for these types of risks; and 2) verify that they were testing the longevity risk and that it was covered in the establishment of the moderately adverse condition coverage. She said there was also acknowledgement of the fact that there most likely was a lot of aggregation on the life sufficiency used to prevent additional asset adequacy reserves. At that time, she said she believes the Subgroup decided to focus on the risk-based capital (RBC) charge and that any insufficiencies in the reserves could be addressed separately. Mr. Weber said that is his recollection of the study; they were looking at things in aggregate and that there were certain sensitivities around it. He said he is supportive with using the 85th percentile.

Ms. Ahrens noted Mr. Carmello’s concerns with potential reserve inadequacies and asked him if he thought even using the 75th percentile would actually be the appropriate assumption. Mr. Carmello said the only positive about going with the 85th percentile is that state insurance regulators could start holding companies to it as another reason to increase reserves. For this product especially, he said he does not believe companies are very far from best estimates. He said he would pick the 60th percentile. Brian Bayerle (American Council of Life Insurers—ACLI) said the ACLI is supportive of using the 85th percentile and that the ACLI believes any concern with reserves not being at the appropriate level should be addressed separately.

Nancy Bennett (Academy) said that when RBC was developed, it was designed to establish minimum capital requirements and was built on the premise that reserves were adequate whether it was formulaic or formulaic plus any additional reserves established through cash flow testing. She said RBC was not intended to rectify any problems with reserves but rather to be built on top of that and that there was nothing specifically quantified about reserves in the development of individual RBC factors. Ms. Ahrens said her preference would be that the Subgroup recommend using the 85th percentile but explain that the Subgroup also looked at other levels and why as part of the recommendation. Mr. Yanacheak, Ms. Eom and Mr. Weber expressed support for this approach.

With respect to the sensitivity to the assumed average reserve per policy, Ms. Ahrens said she does not have an issue with the assumed average although she said she is surprised it was only 50,000 for payout-type products and questioned whether this might go up over time as insurers’ expertise with these products increased. Mr. Yanacheak said he does not have a concern with the 50,000 average assumption. Mr. Tsang noted the reduction in the factors as the size of the total reserve increases and the fact that the reductions get proportionally smaller with the increases. He questioned whether this would penalize smaller companies. Paul Navratil (Academy) said the two main risks considered were: 1) mortality improvement or trend risk, which is a risk that applies evenly to all sizes of business; and 2) estimation of base mortality or mortality level risk, which is much
higher on a small block of business. He said the grading down of the factors reflects the fact that level risk is much higher on a small block of business and then levels off as trend risk becomes the more dominant risk.

With respect to covariance, Ms. Ahrens said she has discussed the potential for the introduction of a covariance factor, which does not currently exist at Life Risk-Based Capital (E) Working Group meetings. She said there is a case to be made that diversification is a positive, and she asked for members’ thoughts. Mr. Carmello reiterated his opposition to this aspect. Mr. Yanacheak suggested this may be an issue for the Working Group to decide and expressed concern with the Subgroup potentially leading them astray if they have not specifically directed the Subgroup to address this aspect. Ms. Ahrens said she understands the theoretical justification for including this aspect but shares that concern. She suggested making the recommendation on factors and highlighting the potential for a correlation component along with alternatives for how it could be implemented, including limitations or guardrails that would address concerns about the introduction of an RBC charge potentially leading to decreased RBC.

Having no further business, the Longevity Risk (A/E) Subgroup adjourned.

w:\national meetings\2019\Fall\tf\CapAdequacy\LRBC\Att Longevity Risk Subgroup 2019-9-30 minutes.docx
The Longevity Risk (A/E) Subgroup of the Life Actuarial (A) Task Force and the Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Sept. 18, 2019. The following Subgroup members participated: Rhonda Ahrens, Chair (NE); Mike Yanacheak (IA); John Robinson (MN); Seong-min Eom (NJ); Bill Carmello and Amanda Fenwick (NY); and Peter Weber (OH).

1. Continued Discussion of the Academy's Longevity Risk Task Force Proposal

Ms. Ahrens said the Subgroup discussed the comments received on the questions posed by the Subgroup as part of the exposure of the American Academy of Actuaries (Academy) Longevity Risk Task Force’s proposed approach for incorporating a risk charge into the life and fraternal risk-based capital (RBC) formula during its July 17 conference call. As part of that discussion, she said the Subgroup asked the Academy for some sensitivities around the assumed 85th percentile reserve level and the assumed average reserve per policy. Paul Navratil (Academy) presented the Academy’s responses (Attachment Three-F1).

With respect to what issues remained prior to being able to go forward with its recommendation, Ms. Ahrens said the correlation component is one. She said she has indicated to the Life Risk-Based Capital (E) Working Group that the Subgroup is focused on longevity and that it may be appropriate for the Working Group, where there is a larger audience, to decide whether there should be a correlation component within C-2. She said the Subgroup’s choices include simply adopting the Academy’s proposal and working with the Working Group on the next steps or also providing the Working Group with some alternatives along with the pros and cons of each.

Ms. Eom suggested that another issue is to limit the products to which the proposal will be specifically applicable. Ms. Ahrens agreed and said she believes the Subgroup may indicate that there may be other C-2 factors that need to be developed for products that are outside the scope of the proposal. The Subgroup discussed differences between various products and the possible need for a different approach for some, specifically longevity, reinsurance. Mr. Navratil indicated that this product was included in the Task Forces’ request in the field study, but there were not enough responses received from participating companies. Mr. Robinson asked if there was a maintenance recommendation as to how often the factors should be reviewed or updated. Mr. Navratil suggested that it might be more appropriate to look at that aspect in terms of things changing around product structure and the emergence and expectation of longevity risk as opposed to timeframe. Ms. Ahrens said she believes the Subgroup is in a position to recommend C-2 factors for longevity for year end 2020, and she suggested that the recommendation could include the Subgroup continuing to work on this product for the following year.

Ms. Ahrens asked Subgroup members for comments on the range of factors in the sensitivities presented with respect to the reserve level. Mr. Carmello acknowledged that the 85th percentile may be ideal, but it is not what the reality is and has been in that it is actually in the 60–65th percentile range for payout annuities; so the 75th percentile would be a compromise. Ms. Ahrens said the Subgroup has discussed in force versus business going forward and noted the complications of developing a factor that addresses both. She asked how this might tie into the discussion of a maintenance schedule and, specifically, how to address choosing a factor at the 75th percentile and then having reserves updated for business going forward. Mr. Carmello said that if the new mortality tables are more conservative than thought to be, it would be something that needed to be reviewed. The Subgroup discussed potential ways to identify the blocks of business in the information available in the annual statement.

Ms. Ahrens asked Subgroup members for comments on the range of factors in the sensitivities presented with respect to the reserve level. Mr. Carmello acknowledged that the 85th percentile may be ideal, but it is not what the reality is and has been in that it is actually in the 60–65th percentile range for payout annuities; so the 75th percentile would be a compromise. Ms. Ahrens said the Subgroup has discussed in force versus business going forward and noted the complications of developing a factor that addresses both. She asked how this might tie into the discussion of a maintenance schedule and, specifically, how to address choosing a factor at the 75th percentile and then having reserves updated for business going forward. Mr. Carmello said that if the new mortality tables are more conservative than thought to be, it would be something that needed to be reviewed. The Subgroup discussed potential ways to identify the blocks of business in the information available in the annual statement.

Ms. Ahrens said she believes the Subgroup needs to discuss three things during upcoming calls: 1) whether the Subgroup wants to recommend one of the longevity factor choices presented by the Academy, given the discussions on assumed reserve levels; 2) whether the Subgroup wants to make any adjustment to the assumed average reserve size; and 3) whether the Subgroup recommends a correlation component, which is part of the Academy’s proposal.

Having no further business, the Longevity Risk (A/E) Subgroup adjourned.

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September 10, 2019

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

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

Re: Requested sensitivities to longevity risk-based capital (RBC) factors

Dear Rhonda,

On behalf of the Longevity Risk Task Force of the American Academy of Actuaries,¹ I am providing additional assumption sensitivities to the proposed longevity C-2 risk factors as requested by the Longevity Risk Subgroup at the July 17, 2019, call.

1. Sensitivity to Assumed Reserve Level (85th percentile)

The proposed longevity C-2 factors we have suggested were calibrated to cover risk between a reserve level that was assumed to represent an 85th percentile outcome and a 95th percentile capital objective. The following are important to consider in setting the reserve level assumption for the purpose of calibrating risk-based capital factors:

- The appointed actuary is required to opine that aggregate reserves are adequate under moderately adverse conditions.
- Principle-based reserve requirements (e.g., VM-20 and VM-21) define prudent estimate assumptions at a conditional tail expectation (CTE) 70 level that is at least as adverse as the 85th percentile, although this is different from prescribing reserves at a specific level.
- The sufficiency of the overall reserve is the important result and key assumption in calibrating capital levels. It is not necessary or appropriate to consider the severity level of individual assumptions prescribed in statutory reserves—only whether aggregate reserve levels are appropriate.

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.
• RBC is based on the premise that reserves are adequate. If there are concerns that prescribed statutory reserve levels are insufficient, these are best addressed in reserve requirements directly.

• There should be consistency in assumed reserve levels across the RBC framework and any change to this fundamental RBC assumption should be applied consistently across risks rather than arbitrarily to longevity risk alone.

The sensitivities below show the impact to the RBC factor if the longevity stress were adjusted to represent the difference between reserves at different assumed levels of adequacy (85th, 80th, 75th) and the total asset requirement consistently calibrated to a 95th percentile outcome, as requested. Factors continue to be expressed as a percentage of statutory reserves as reported through the longevity risk field study (denominator is consistent across all sensitivities).

Providing these requested sensitivities does not imply that there is an actuarial basis for these alternatives or constitute any level of endorsement that they would be appropriate for use in calibrating risk-based capital factors.

### 2. Sensitivity to Assumed Average Reserve per Policy ($50k)

There was discussion at the July 17 Longevity Risk Subgroup call of the average reserve per policy assumption used to scale the factors on a dollar reserve basis rather than a life count basis.

We commented in our [original proposal](#) that the number of individual exposures is a better proxy for scaling longevity risk than the dollar size of reserves and would support such an approach if it is judged to be feasible to implement within RBC.

The preliminary factors we proposed are scaled to the dollar size of reserves, which is a simplification that more easily aligns to existing statutory reported values. In our view, $50,000 average reserve per policy is a reasonable assumption, though we do expect that this average reserve would vary significantly across companies and blocks of business.

<table>
<thead>
<tr>
<th>C-2 Longevity After-Tax Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Reserves</strong></td>
</tr>
<tr>
<td>(in scope products)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>
The sensitivity below shows alternative scaling of the factors using different assumed reserve per policy values ($40k, $50k, $60k).

<table>
<thead>
<tr>
<th>$40k/Policy</th>
<th>$50k/Policy</th>
<th>$60k/Policy</th>
<th>C-2 Longevity After-Tax Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Reserves (in scope products)</td>
<td>Total Reserves (in scope products)</td>
<td>Total Reserves (in scope products)</td>
<td></td>
</tr>
<tr>
<td>up to $200M</td>
<td>up to $250M</td>
<td>up to $300M</td>
<td>1.35%</td>
</tr>
<tr>
<td>next $200M</td>
<td>next $250M</td>
<td>next $300M</td>
<td>0.85%</td>
</tr>
<tr>
<td>next $400M</td>
<td>next $500M</td>
<td>next $600M</td>
<td>0.75%</td>
</tr>
<tr>
<td>over $800M</td>
<td>over $1B</td>
<td>over $1.2B</td>
<td>0.70%</td>
</tr>
</tbody>
</table>

*****

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
TO: Philip Barlow, Chair, Life Risk-Based Capital (E) Working Group  
FROM: Rhonda Ahrens, Chair, Longevity Risk (A/E) Subgroup  
DATE: November 25, 2019  
RE: Recommendation for incorporating an RBC charge for longevity risk

The NAIC’s Longevity Risk (A/E) Subgroup was formed in 2016 with the charge to provide recommendations for recognizing longevity risk in statutory reserves and/or risk-based capital (RBC), as appropriate. The Subgroup has worked closely with the American Academy of Actuaries’ (Academy) Longevity Risk Task Force (Academy Task Force) over the ensuing three years to focus efforts on addressing RBC for longevity risk after determining that statutory reserves would be addressed through the work of other NAIC groups. After many discussions and considerable input from the Subgroup, the Academy Task Force conducted a field study in 2018. The intent of the field study was to quantify longevity risk coverage at an appropriate confidence level. The results of that field study were presented to the Life Risk-Based Capital (E) Working Group at the 2018 Summer National Meeting. Those results were used to produce a proposal for an RBC charge for longevity (the proposal) which was exposed for comment by the Subgroup, along with a list of questions on which the Subgroup requested input, on its March 5, 2019 conference call. The proposal was presented to the Working Group at the 2019 Spring National Meeting (Attachment 1). The comments and the responses to the Subgroup’s questions were discussed on its July 17, 2019 conference call.

The Subgroup wants the Working Group to be aware that special consideration was given to the proposal’s assumption of statutory reserves being at the 85th percentile. While differing views were expressed, the Subgroup’s consensus is that any deviation in reality from this assumption should be addressed as part of consideration of reserves and not as a factor in determining a capital charge. The Academy Task Force did produce potential factors that would address the gap if reserves were actually at the 75th or 80th percentile. Those factors are not included in the proposal being recommended as the Subgroup reached consensus on the after-tax factors as presented on page three of the proposal. These factors are then included on a pre-tax basis in the RBC instructions.

The Subgroup has also evaluated longevity reinsurance transactions (LRT), a reinsurance arrangement initially in scope for longevity C-2. LRT is a relatively new type of arrangement which involves the transfer of longevity risk associated with group annuities to a reinsurer and is discussed on slide nine of the proposal. While the Subgroup has held several discussions on LRT, because the Subgroup did not reach a consensus, we believe further analysis of the arrangement addressing key considerations is necessary for the Subgroup to issue a recommendation. These key considerations include:

- The basis for the factors – Statutory reserves may not be the appropriate basis to which the factor applies since reserves are generally zero at inception. The present value of future payout benefits using VM 22 criteria was discussed as a potential basis, however this would not be a statutory reporting item that could be pulled from the financial statement. The basis needs to be determined and the process for including it in the RBC pages needs to be established.
- Premium offset – Whether and how to allow a portion of future premiums due to the reinsurer under a reinsurance arrangement to offset the capital requirement resulting from applying the factor to the present value of benefits.
- Treatment for primary insurer – How capital would be reflected for a primary insurer that has reinsured longevity risk to a reinsurer.
The Subgroup recommends LRT arrangements should ultimately be included in scope for longevity C-2, however, additional time is needed in order to further review and consider these key issues. Therefore, for purposes of our current recommendations to the Working Group, a majority of the Subgroup supports scoping out LRT and seeks support on forming a drafting group to continue evaluation and development of a recommendation.

Another aspect the Subgroup discussed at length with differing viewpoints expressed was possible correlation between longevity and mortality risk. Correlation is an aspect that the Subgroup feels extends beyond our charges and is an issue for the Working Group to decide. The proposal includes the Academy Task Force’s recommendation that updated C-2 mortality factors and new C-2 longevity factors be implemented concurrently along with a covariance adjustment within C-2. Various correlation factors of 0%, -25% and -50% were included to demonstrate hypothetical company impacts related to implementation with or without correlation noting that additional work on coordinating and consideration of the proper level of covariance was needed. An update on this by the Academy Task Force was included in a presentation to the Working Group at the 2019 Summer National Meeting (Attachment 2). The Subgroup believes the factors presented by the Academy Task Force may be reasonable but believes the Working Group is in a better position to consider this as it involves more than just the longevity component. As such, the Subgroup is only providing a recommendation for the factors as presented in slide three of the proposal, and is raising the topic of correlation for the entire Working Group to address.

The proposal, as produced and presented by the Academy Task Force, is included as Attachment 1 and includes the Academy Task Force’s objectives and analysis approach along with the results of the field study and the calibration of the longevity factor. Attachment 3 presents the RBC blank and instruction changes necessary to implement the proposal.
# 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 |

| CONTACT PERSON: | Dave Fleming | FOR NAIC USE ONLY |
| TELEPHONE: | 816-783-8121 | Agenda Item # 2019-13-L |
| EMAIL ADDRESS: | dfleming@naic.org | Year | 2019 |
| ON BEHALF OF: | Longevity Risk (A/E) Subgroup | DISPOSITION |
| NAME: | Rhonda Ahrens, Chair |
| TITLE: | Chief Actuary |
| AFFILIATION: | Nebraska Department of Insurance |
| ADDRESS: | 1135 M Street, Suite 300 |
|  | Lincoln, NE 68501-2089 |

### IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

| [ ] | Health RBC Blanks |
| [ ] | Health RBC Instructions |
| [ ] | OTHER | [ ] Property/Casualty RBC Blanks |
| [ ] | Property/Casualty RBC Instructions |
| [x ] | Life and Fraternal RBC Instructions |
| [x ] | Life and Fraternal RBC Blanks |

### 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. Revised 2-2019
LONGEVITY RISK
LRtbld

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 079999; 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>
</tr>
</thead>
<tbody>
<tr>
<td>First 250 Million</td>
<td></td>
<td>X 0.0171 =</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Next 250 Million</td>
<td></td>
<td>X 0.0108 =</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Next 500 Million</td>
<td></td>
<td>X 0.0095 =</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Over 1,000 Million</td>
<td></td>
<td>X 0.0089 =</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total Life Contingent Annuity Reserves
### Longevity Risk

<table>
<thead>
<tr>
<th>Life Contingent Annuity Reserves</th>
<th>Annual Statement Source</th>
<th>Statement Value</th>
<th>Factor</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) General Account Life Contingent Annuity Reserves</td>
<td>Blue Book Exhibit 5 column 2 row 029999, in part †</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) General Account Life Contingent Supplemental/Contract Reserves</td>
<td>Blue Book Exhibit 5 column 2 row 039999, in part †</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(3) General Account Life Contingent Miscellaneous Reserves</td>
<td>Blue Book Exhibit 5 column 2 row 079999, in part †</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(4) Separate Account Life Contingent Annuity Reserves</td>
<td>Green Book Exhibit 5 column 2 row 029999, in part †</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(5) Total Life Contingent Annuity Reserves</td>
<td>Lines (1) = (2) + (3) + (4)</td>
<td></td>
<td></td>
<td></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.

Denote 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)</td>
<td>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>
</tr>
<tr>
<td>(135)</td>
<td>Life Insurance C-2 Risk</td>
<td>LR025 Life Insurance Column (2) Line (8)</td>
<td>X 0.2100 =</td>
</tr>
<tr>
<td>(136)</td>
<td>Group Insurance C-2 Risk</td>
<td>LR025 Life Insurance Column (2) Lines (20) and (21)</td>
<td>X 0.2100 =</td>
</tr>
<tr>
<td>(136b)</td>
<td>Longevity C-2 Risk</td>
<td>LR02d Longevity Risk Column (2) Line (5)</td>
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<tr>
<td>(137)</td>
<td>Disability and Long-Term Care Health Claim Reserves</td>
<td>LR024 Health Claim Reserves Column (4) Line (9) + Line (15)</td>
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</tr>
<tr>
<td>(138)</td>
<td>Premium Stabilization Credit</td>
<td>LR026 Premium Stabilization Reserves Column (2) Line (10)</td>
<td>X 0.0000 =</td>
</tr>
<tr>
<td>(139)</td>
<td>Total C-2 Risk</td>
<td>Lines (133) + (134) + (135) + (136) + (136b) + (137) + (138)</td>
<td></td>
</tr>
<tr>
<td>(140)</td>
<td>Interest Rate Risk</td>
<td>LR027 Interest Rate Risk Column (3) Line (36)</td>
<td>X 0.2100 =</td>
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<tr>
<td>(141)</td>
<td>Health Credit Risk</td>
<td>LR028 Health Credit Risk Column (2) Line (7)</td>
<td>X 0.0000 =</td>
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<tr>
<td>(142)</td>
<td>Market Risk</td>
<td>LR027 Interest Rate Risk Column (3) Line (37)</td>
<td>X 0.2100 =</td>
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<tr>
<td>(143)</td>
<td>Business Risk</td>
<td>LR029 Business Risk Column (2) Line (40)</td>
<td>X 0.2100 =</td>
</tr>
<tr>
<td>(144)</td>
<td>Health Administrative Expenses</td>
<td>LR029 Business Risk Column (2) Line (57)</td>
<td>X 0.0000 =</td>
</tr>
<tr>
<td>(145)</td>
<td>Total Tax Effect</td>
<td>Lines (109) + (120) + (132) + (139) + (140) + (141) + (142) + (143) + (144)</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>
</thead>
<tbody>
<tr>
<td>LR025 Life Insurance Column (2) Line (8)</td>
<td>LR025 Life Insurance Column (2) Lines (20) and (21)</td>
</tr>
<tr>
<td>LR eid Longevity Risk Column (2) Line (5)</td>
<td>LR024 Health Claim Reserves Column (4) Line (18)</td>
</tr>
<tr>
<td>LR026 Premium Stabilization Reserves Column (2) Line (10)</td>
<td>Sum of Lines (43) through (46)</td>
</tr>
<tr>
<td>LR030 Calculation of Tax Effect for Life and Fraternal Risk-Based Capital Column (2) Line (139)</td>
<td>Line (47) - Line (48)</td>
</tr>
</tbody>
</table>

**Insuranc e Risk (C-2)**

| (43) Individual and Industrial Life Insurance | (44) Group and Credit Life Insurance and FEGI/SGLI |
| (45) Total Health Insurance | (46) Premium Stabilization Reserve Credit |
| (47) Total (C-2) - Pre-Tax | (48) (C-2) Tax Effect |
| (49) Net (C-2) - Post-Tax | |
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 LRbd 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.

1830 M Street NW Suite 300 Washington, DC 20036 Telephone 202 223 8196 Facsimile 202 872 1948 www.actuary.org

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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>(1) Source</th>
<th>(2) RBC Amount</th>
<th>(3) Tax Factor</th>
<th>(4) RBC Tax Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-Term Care LR019 Health Premiums Column (2) Line (29) + LR023 Long-Term Care Column (4) Line (7)</td>
<td>X 0.2100</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Group Insurance C-2 Risk LR025 Life Insurance Column (2) Line (8)</td>
<td>X 0.2100</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Disability and Long-Term Care Health LR030 Disability and Long-Term Care Health Column (2) Line (10)</td>
<td>X 0.2100</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Premium Stabilization Credit LR026 Premium Stabilization Reserves Column (2) Line (10)</td>
<td>X 0.0000</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Total C-2 Risk LR030 Total Risk Column (2) Line (109)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Rate Risk LR027 Interest Rate Risk Column (3) Line (36)</td>
<td>X 0.2100</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Business Risk LR029 Business Risk Column (2) Line (40)</td>
<td>X 0.2100</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Health Administrative Expenses LR029 Business Risk Column (2) Line (57)</td>
<td>X 0.0000</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Total Tax Effect Lines (109) + (120) + (139) + (140) + (141) + (142) + (143) + (144)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Alternative with CapGrowth Factor:**

\[
L(133) + L(134) + L(137) + L(138) + \text{Square Root of } \left( L(135) + L(136) \right)^2 + L(136b)^2 = 2 \times \text{CapGrowth Factor} \times L(135) + L(136) \times L(136b) \]

**Interest Rate Risk LR027 Interest Rate Risk Column (3) Line (36) X 0.2100**

**Health Credit Risk LR028 Health Credit Risk Column (2) Line (7) X 0.0000**

**Market Risk LR027 Interest Rate Risk Column (3) Line (37) X 0.2100**

**Business Risk LR029 Business Risk Column (2) Line (40) X 0.2100**

**Health Administrative Expenses LR029 Business Risk Column (2) Line (57) X 0.0000**

**Total Tax Effect Lines (109) + (120) + (139) + (140) + (141) + (142) + (143) + (144)**

**NAIC Company Code**

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### Calculation of Authorized Control Level Risk-Based Capital (continued)

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Source</th>
<th>NAIC Company Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual and Industrial Life Insurance</td>
<td>LR025 Life Insurance Column (2) Line (8)</td>
<td></td>
</tr>
<tr>
<td>Group and Credit Life Insurance and FSG/SGLI</td>
<td>LR025 Life Insurance Column (2) Lines (20) and (21)</td>
<td></td>
</tr>
<tr>
<td>Longevity Risk</td>
<td>LR056 Longevity Risk Column (2) Line (5)</td>
<td></td>
</tr>
<tr>
<td>Total Health Insurance</td>
<td>LR024 Health Claim Reserves Column (4) Line (18)</td>
<td></td>
</tr>
<tr>
<td>Premium Stabilization Reserve Credit</td>
<td>LR026 Premium Stabilization Reserve Column (2) Line (10)</td>
<td></td>
</tr>
<tr>
<td>Total C-2) Pre-Tax</td>
<td>LR055 C-2) T-Tax Effect Line (47) - Line (48)</td>
<td></td>
</tr>
<tr>
<td>Interest Rate Risk C-3a</td>
<td>LR027 Interest Rate Risk C-3a Line (36)</td>
<td></td>
</tr>
<tr>
<td>Net C-3a) - Post-Tax</td>
<td>LR055 C-3a) T-Tax Effect Line (50) - Line (51)</td>
<td></td>
</tr>
<tr>
<td>Health Credit Risk C-3b</td>
<td>LR028 Health Credit Risk C-3b Column (2) Line (7)</td>
<td></td>
</tr>
<tr>
<td>Total Health Credit Risk Pre-Tax</td>
<td>LR055 C-3b) T-Tax Effect Line (53) - Line (54)</td>
<td></td>
</tr>
<tr>
<td>Market Risk C-3c)</td>
<td>LR027 Interest Rate Risk C-3c Line (37)</td>
<td></td>
</tr>
<tr>
<td>Net C-3c) - Post-Tax</td>
<td>LR055 C-3c) T-Tax Effect Line (56) - Line (57)</td>
<td></td>
</tr>
</tbody>
</table>

**Alternative with Guardrail Factor:**

\[
\text{Adjusted C-2) Pre-Tax} = \begin{cases} 
\text{Max} & (\text{C-2) Pre-Tax} - \text{Pre-Tax} - \text{Post-Tax}) \\
\text{Max} & \text{Max}(\text{Max}(\text{Max}(\text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor})), \text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor})), \\
\text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor}), \\
\text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor}), \\
\text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor}), \\
\text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor}), \\
\text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor}), \\
\text{Max}(\text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor} \cdot \text{Guardrail Factor}) \\
\end{cases} 
\]
November 26, 2019

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

Re: Longevity Risk (A/E) Subgroup Recommendation for incorporating an RBC charge for longevity risk

Dear Philip:

The American Council of Life Insurers (ACLI)\(^1\) appreciates the opportunity to provide comments regarding the November 25\(^{th}\), 2019 Recommendation for incorporating an RBC charge for longevity risk (Recommendation) from Longevity Risk (A/E) Subgroup (Subgroup).

While ACLI believes the memorandum itself appropriately captures the deliberations and decisions made by the Subgroup, we are concerned about the removal of the formula reflecting the correlation adjustment between the C-2 mortality and longevity factors in LR030 and LR031. As the Recommendation makes clear, the Subgroup deemed it appropriate that any decision on the correlation adjustment be made by the Life Risk-Based Capital (E) Working Group (Working Group). However, the removal of the formula is equivalent to a +100% correlation between the factors, which is inconsistent with the Recommendation and the American Academy of Actuaries’ (Academy) proposal. ACLI strongly urges any exposure from the Working Group reflect the correlation factor in the formulas on LR030 and LR031. We note that the Academy recommended formula would work correctly regardless of the level of correlation that the Working Group ultimately decides.

The following table illustrates the formula using the examples of the Academy deck, and specifically that a +100% correlation factor is equivalent to the sum of the mortality and longevity risk charges. Formulically, the C-2 risk is $\text{SQRT}(C_{2a}^2 + C_{2b}^2 + 2 \times (\text{Correlation Factor}) \times C_{2a} \times C_{2b})$:

<table>
<thead>
<tr>
<th>C2a Mortality/Other Insurance Risk</th>
<th>25.1</th>
<th>25.1</th>
<th>25.1</th>
<th>25.1</th>
</tr>
</thead>
<tbody>
<tr>
<td>C2b Longevity Insurance Risk</td>
<td>75.4</td>
<td>75.4</td>
<td>75.4</td>
<td>75.4</td>
</tr>
<tr>
<td>Correlation Factor</td>
<td>100%</td>
<td>0%</td>
<td>-25%</td>
<td>-33%</td>
</tr>
<tr>
<td>C-2 Insurance Risk</td>
<td>100.5</td>
<td>79.5</td>
<td>73.3</td>
<td>71.2</td>
</tr>
</tbody>
</table>

We appreciate the consideration of our comments in the Working Group’s exposure.

---

\(^1\) The American Council of Life Insurers (ACLI) advocates on behalf of 280 member companies dedicated to providing products and services that promote consumers’ financial and retirement security. 90 million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers’ products for peace of mind. ACLI members represent 95 percent of industry assets in the United States. Learn more at [www.acli.com](http://www.acli.com).
Sincerely,

[Signature]

cc Dave Fleming, NAIC
Academy C-2 Mortality Work Group Update

C-2 Mortality Overall Approach
- C-2 requirement covers mortality risk at the 95th percentile and is not of risk covered in statutory reserves
- C-2 requirement includes mortality risks related to:
  - Variability Risk – natural statistical deviations in experienced mortality
  - Level Risk – error in base mortality assumption
  - Trend Risk – adverse mortality trend
  - Catastrophe Risk – large temporary mortality increase from a severe event
- Evaluate mortality risks using Monte Carlo simulation
- Express capital requirement using a factor-based approach (e.g., factor applied to NAIC)

Current C-2 Life Mortality Risk-Based Capital

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Unadjusted</th>
<th>Adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Floor 70000</td>
<td>3.75</td>
<td>2.75</td>
</tr>
<tr>
<td>Floor 25000</td>
<td>2.45</td>
<td>2.45</td>
</tr>
<tr>
<td>Floor 10000</td>
<td>1.57</td>
<td>1.57</td>
</tr>
<tr>
<td>vMOR</td>
<td>0.87</td>
<td>0.87</td>
</tr>
<tr>
<td>vMORB</td>
<td>0.87</td>
<td>0.87</td>
</tr>
</tbody>
</table>

*Note: Flow values are in non-cumulative.

Agenda
- Methods and assumptions
  - Follow-up from June update
  - Directional change in individual life C-2 mortality factors
  - Next steps
Method and Assumption Comparison

<table>
<thead>
<tr>
<th>Risk Component</th>
<th>Key Updates</th>
<th>Estimated Directional Impact on the C-2 Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volatility</td>
<td>✓ Green book mortality rates</td>
<td>Increased 2%</td>
</tr>
<tr>
<td>Level</td>
<td>✓ Increase in 2020 cancer rates based on 2015 incidence</td>
<td>Decreased 5.0%</td>
</tr>
</tbody>
</table>

Directional Impact on Individual Life C-2 Factors

<table>
<thead>
<tr>
<th>Risk Component</th>
<th>Impact on current factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volatility</td>
<td></td>
</tr>
<tr>
<td>Level</td>
<td></td>
</tr>
<tr>
<td>Trend</td>
<td></td>
</tr>
<tr>
<td>Catastrophe</td>
<td></td>
</tr>
<tr>
<td>Overall</td>
<td>Possible decrease</td>
</tr>
</tbody>
</table>

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Summary of Current Developments

- Preliminary analysis suggests a possible decrease in C-2 requirement, however more analysis needed
- Biggest reductions are due to exclusion of AIDS scenarios at early '90s estimates and improvement in mortality levels compared to what was expected in the original C-2 factors
- Some increase in trend and catastrophe components

Next Steps

- Additional analysis
  - Appropriate projection period
  - Differences between products
  - Size breakpoints; exposure base
  - Analysis of industry data; implication of "high" vs. "low" mortality company
  - Group Life
- Preliminary factor development completion targeted for 2020
- Provide LRBCWG call update in Q1/Q2

Questions?

Additional Questions, contact:
Chris Treat, MAAA, FSA
Charperson, C-2 Work Group
Ian Trepanier
Life Policy Analyst
American Academy of Actuaries
trepanier@actuary.org
## Risk Distribution Approach Comparison

<table>
<thead>
<tr>
<th>Event</th>
<th>Original Decs</th>
<th>Capital Review Proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Two independent components.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Two independent components.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Normal mortality variability ((\sigma_{\text{norm}}))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Normal mortality variability ((\sigma_{\text{norm}}))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continuous normal distribution.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Natural</td>
<td></td>
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</tr>
<tr>
<td>Event</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A general class group improvement elevation variable (2)</td>
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<td></td>
</tr>
<tr>
<td>A general class group improvement elevation variable (2)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continuous normally distributed random variables.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Catastrophic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Event</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pandemic</td>
<td></td>
<td></td>
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<tr>
<td>Pandemic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Continuous normally distributed random variables.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Via email

- We are in favor of having a growth risk RBC charge for life insurers. There have been several insolvencies or near insolvencies over the years triggered in part by rapid growth including Executive Life and Mutual Benefit Life in the early 1990s. Many of these involved excessive sale of deferred annuities and/or GICs with high guaranteed interest rates. Even within the last five years, we have had to stop some insurers from selling deferred annuities with high guaranteed interest rates.

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

New York State Department of Financial Services
One Commerce Plaza, Albany, NY 12257
November 20, 2019

Mr. Philip Barlow
Chair, Life Risk-Based Capital Working Group

Re: Life Growth Operational Risk Memorandum

Dear Philip:

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the March 27th NAIC Operational Risk (E) Subgroup Memorandum “Potential Further Work on Life Growth Operational Risk” (Memorandum) on behalf of our member companies.

As previously articulated in comments and captured in the Memorandum, ACLI does not support the inclusion of a life growth risk charge to the Life RBC formula. Our main arguments against the need for a life growth risk charge are summarized as follows:

1) Regulators already have tools to assess life growth risk

The Life Trend Test already captures the impact of growth by testing if a similar amount of strain in the next year would lead to an RBC event. Under today’s RBC formula, fast-growing companies will indeed have corresponding fast-growing RBC requirements. Furthermore, if a company grows through acquisition, regulators must approve such transactions and have extensive access to information about both the acquiring company and the target company.

2) Rapid growth is less prevalent than in health or property/casualty insurance

The purpose of a growth risk charge is to measure the risk associated with rapid growth of a company’s book of business. In the health and property/casualty space, much of the business is renewed annually, and entire books of business may turn over in a few years. Rapid growth is likely a sign of mispricing that is not adequately captured in the pricing risk charge. For life insurance, the duration of the business is measured in years, and does not generally allow for frequent premium re-rating. As such, life books of business are generally stable over time. Further, the life insurance industry is fairly mature which limits aggregate growth. Rapid growth for a life insurer is more likely a sign of a reinsurance transaction or block acquisition, both of which would adequately be covered by the additional C-1, C-2, C-3, and C-4 charges that would occur when the business is added. Both the proposed methods for life growth risk charges may result in many companies being subject to a growth charge, which is not only counterintuitive, but not indicative of additional risk not already captured elsewhere.

1 The American Council of Life Insurers (ACLI) advocates on behalf of 290 member companies dedicated to providing products and services that promote consumers’ financial and retirement security. 90 million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers’ products for peace of mind. ACLI members represent 95 percent of industry assets in the United States.
3) Appropriate measurement is difficult and application of a single year charge is inappropriate

Unlike in health or property/casualty insurance, a one-year measurement is not appropriate for life insurance due to the long duration of the business written. Were a life growth risk charge to be developed, it would likely need to look very different than the rest of the RBC framework, applicable for several years after the risk is first added to the life insurance company. The Memorandum acknowledges Method 1 (informational filing) was flawed and would not be an effective measurement of growth risk. Method 2 (enhanced add-on) creates an arbitrary threshold which is not risk sensitive and would create a “cliff effect”. Treating all companies below the threshold identically won’t give regulators reliable information about the riskiness of the various companies. For some companies, this has the potential to lead to an on-again, off-again application of this charge that would be difficult to plan for and would not add meaningful signal value to the company or its regulator.

While we agree that RBC is an integral part of the regulatory framework to address risk, we believe that an explicit life growth charge creates challenges. A question for regulators is whether an explicit life growth charge is necessary for the RBC calculation given that growth is implicitly captured elsewhere in the RBC framework; the absence of an explicit measure is not an indication that a risk is not being captured. Other regulatory risk frameworks have different purposes than RBC, so there is not an apples-to-apples comparison between frameworks. Finally, while we acknowledge that smaller companies may not be subject to the same regulatory tools as larger companies, the introduction of an additional life growth risk charge may introduce unwarranted volatility into the RBC ratio for smaller companies and thus make them less competitive in the marketplace.

We are available to discuss our positions on this topic at the convenience of working group members or other regulators.

Sincerely,

[Signature]

cc Dave Fleming, NAIC
The Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Austin, TX, Dec. 8, 2019. The following Working Group members participated: Tom Botsko, Chair (OH); Sheila Travis (AL); Eric Unger (CO); Wanchin Chou (CT); Virginia Christy (FL); Judy Mottar (IL); Anna Krylova (NM); Lee Hill (SC); Miriam Fisk (TX); and Randy Milquet (WI). Also participating were: Patrick McNaughton and Steve Drutz (WA).

1. **Adopted its Nov. 8 Minutes**

Mr. Botsko said the Property and Casualty Risk-Based Capital (E) Working Group met Nov. 8 in joint session with the Catastrophe Risk (E) Subgroup and took the following action: 1) adopted the Catastrophe Risk (E) Subgroup’s Summer National Meeting minutes; 2) adopted the Property and Casualty Risk-Based Capital (E) Working Group’s Summer National Meeting minutes; 3) adopted proposal 2019-11-P, which clarifies instructions regarding Lloyd’s of London and the 2019 reporting guideline; 4) adopted proposal 2019-12-P, which removes PR038 adjustment for reinsurance penalty; 5) exposed the 2019 catastrophe event lists; 6) heard updates from the American Academy of Actuaries (Academy) on reviewing the underwriting risk components; 7) discussed the appropriate factor of unrated uncollateralized recoverables; and 8) discussed the factor of using aggregate exceedance probability (AEP) basis vs. occurrence exceedance probability (OEP) basis.

Mr. Chou made a motion, seconded by Ms. Mottar, to adopt the Working Group’s Nov. 8 minutes (see NAIC Proceedings – Fall 2019, Capital Adequacy (E) Task Force, Attachment Four-B). The motion passed unanimously.

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

Mr. Botsko said the Catastrophe Risk (E) Subgroup met Dec. 6 and took the following action: 1) adopted its Nov. 8 minutes; 2) adopted proposal 2019-14-CR (2019 Catastrophe Event Lists); 3) heard presentations from the Academy on: a) “Wildfire: Lessons Learned from the 2017-2018 Events”; and b) the Actuaries Climate Index (ACI); and 3) discussed the possibility of allowing additional third-party commercial vendor models.

Ms. Mottar made a motion, seconded by Ms. Travis, to adopt the report of the Catastrophe Risk (E) Subgroup (Attachment Four-A). The motion passed unanimously.

3. **Exposed Proposal 2018-19-P (Vulnerable 6 or Unrated Risk Charge)**

Mr. Botsko said the purpose of this proposal is to modify the instruction to reflect the factors for all uncollateralized reinsurance recoverable from unrated reinsurers be the same for authorized, unauthorized, certified and reciprocal reinsurance. He stated that the current 14% factors for uncollateralized reinsurance recoverable was based on Standard & Poor’s 500 index (S&P 500) asset risk factors for reinsurance credit risk plus a margin of 3% for other than credit risk. Also, the analysis that the Working Group members performed earlier that confirmed that the factor changed between 10–30% would be minimally effective with respect to risk-based capital (RBC) action level changes for filers. Mr. Botsko recommended that the Working Group consider using the 14% in 2020 reporting. Then, the data will be re-evaluated annually until reaching any agreed upon change to the factor. Ralph Blanchard (Travelers) commented that unrated reinsurers should not be grouped with vulnerable companies.


4. **Discussed the 2020 P/C RBC Working Agenda**

Mr. Botsko summarized the changes to the 2020 Property/Casualty (P/C) RBC working agenda: 1) removed “evaluate the proposed changes from the Investment Risk-Based Capital WG related to Bond changes in the P/C formula” in the new items section; and 2) added “evaluate the possibility of using the NAIC as centralized location for reinsurer designations” and “evaluate the possibility of allowing additional third-party models to calculate the catastrophe model losses” in the carry-over items and new items sections, respectively.
Mr. Milquet made a motion, seconded by Mr. Chou, to agree to forward the 2020 P/C RBC working agenda to the Capital Adequacy (E) Task Force for consideration. The motion passed unanimously.

5. **Discussed the Possibility of Using the NAIC as a Centralized Location for Reinsurer Designations**

Mr. Botsko said based on the previous 2018 credit risk analysis, the Working Group identified a large amount of possible reporting errors on Schedule F, Part 3, such as incorrectly filed by: 1) wrongful categories; 2) pool status; and 3) overstated/understated reinsurer financial strength ratings. He stated that one of the possible solutions is using the NAIC as a centralized location for reinsurer designations. However, prioritization of the technology resources and obtaining the approval funds will be the biggest hurdle of this project. Mr. Botsko anticipated that it will move faster if the industry is willing to assist with the funding portion. Mr. Blanchard suggested that any such effort should focus on reinsurers with material volumes in Schedule F, Part 3, as this would reduce the cost. Mr. Milquet commented that one of the options is to integrate the jumpstart report to validate whether the items reported in the Schedule F are correct. Scott Williamson (Reinsurance Association of America—RAA) said analysis indicated that many reinsurer designations reported in the Annual Statement Schedule F were understated. Using the NAIC as a centralized location will benefit the industry, as this will potentially reduce the R3 charges. He also stated regarding the issue of the resources and cost of this project, that he anticipated that it should be a straightforward process; and it should not be taking a long time to implement it. Mr. Blanchard suggested that any effort should focus on reinsurers with material volumes in Schedule F, as this would reduce the cost. He also stated that reinsurers with small volumes below $100,000 are not significant, so it may not have an impact. Mr. Botsko asked all the interested parties to consider: 1) whether building a centralized location for reinsurer designations will be a benefit to both state insurance regulators and the industry; and 2) the possibility of funding the project from the industry.

6. **Discussed the Possible Treatment of the R3 Related to the Runoff and Captive Companies**

Mr. Botsko said during the previous call and meeting, some companies asked the Working Group to consider different R3 treatment for run-off and captive companies. Mr. Blanchard said that there are two types of runoff companies; vulnerary runoff and others. As for captives, he believed that most of the balances are collateralized, so they should not create any RBC issues. Mr. Williamson thought that identifying the run-off companies will be the biggest challenge for this issue. Mr. Botsko asked all the interested parties to consider what the appropriate charges are for these groups of companies and provide thoughts to the Working Group during the upcoming conference call.

7. **Discussed Other Matters**

Mr. Botsko said the Mortgage Guaranty Insurance (E) Working Group is currently working with the consultant on the testing and finalization of a proposed risk-based mortgage guaranty capital model for monoline mortgage guaranty insurers. The Working Group will closely monitor the model development and discuss any potential impact to the P/C RBC formula.

Mr. Botsko also said the Restructuring Mechanisms (E) Subgroup is considering the need to make changes to the P/C RBC formula to better assess the minimum surplus requirements for companies in runoff. He stated that the Working Group will work closely with the Subgroup to address this issue.

Having no further business, the Property and Casualty Risk-Based Capital (E) Working Group adjourned.
The Catastrophe Risk (E) Subgroup of the Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Austin, TX, Dec. 6, 2019. The following Subgroup members participated: Tom Botsko, Chair (OH); Virginia Christy, Vice Chair (FL); Rolf Kaumann (CO); Wanchin Chou and Qing He (CT); Judy Mottar (IL); Anna Krylova (NM); Andy Schallhorn (OK); Joe Cregan (SC); and Miriam Fisk (TX). Also participating was: Phil Vigliaturo (MN).

1. **Adopted its Nov. 8 Minutes**

Mr. Botsko said the Catastrophe Risk (E) Subgroup met via conference call Nov. 8, 2019, in joint session with the Property and Casualty Risk-Based Capital (E) Working Group and took the following action: 1) adopted the Catastrophe Risk (E) Subgroup’s Summer National Meeting minutes; 2) adopted the Property and Casualty Risk-Based Capital (E) Working Group’s Summer National Meeting minutes; 3) adopted proposal 2019-11-P, which clarifies the instruction regarding Lloyd’s of London and the 2019 reporting guideline; 4) adopted proposal 2019-12-P, which removes the PR038 adjustment for reinsurance penalty; 5) exposed the 2019 catastrophe event lists; 6) heard updates from the American Academy of Actuaries (Academy) on reviewing the underwriting risk components; 7) discussed the appropriate factor of unrated uncollateralized recoverables; and 8) discussed the factor of using aggregate exceedance probability AEP basis versus occurrence exceedance probability (OEP) basis.

Mr. Chou made a motion, seconded by Mr. Schallhorn, to adopt the Subgroup’s Nov. 8 minutes (see NAIC Proceedings – Fall 2019, Capital Adequacy (E) Task Force, Attachment Four-B). The motion passed unanimously.


Mr. Botsko said, in order to avoid double-counting the catastrophe losses in the risk-based capital (RBC) formula, the U.S. and non-U.S. catastrophe event lists provide a routine annual update for those catastrophe events that should be excluded from the R5 calculation. He stated that the Subgroup exposed the list during the Nov. 8 conference call; no comments were received during the exposure period. Mr. Botsko also indicated that any additional events that occur between Nov. 1 and Dec. 31 will be exposed during the first week of January 2020. The Subgroup will either schedule a conference call or conduct an e-vote to consider adoption of the updated list.

Mr. Kaumann made a motion, seconded by Mr. Chou, to adopt proposal 2019-14-CR (2019 Catastrophe Event Lists). The motion passed unanimously.

3. **Heard Presentations from the Academy on Wildfires and the ACI**

Jeri Xu (Academy) said wildfires in California in 2017 and 2018 were among the largest and most costly on record. However, modeling of wildfire risk is very complex; acceptance and use of wildfire models by insurers and regulators is limited. She recommended the Subgroup: 1) study detailed claims from recent events to improve understanding of wildfire losses; 2) increase stakeholders’ confidence in wildfire modeling by increasing the transparency of model assumptions; and 3) establish generally accepted modeling standards for wildfire model review.

Steve Jackson (Academy) said the Actuaries Climate Index (ACI) is an educational tool providing information about weather trends in the U.S. and Canada. It covers rainfall, temperature, dry spells, wind speed and sea level. He stated that the increase in average winter values is one factor driving the ACI’s five-year moving average to new highs.

Mr. Botsko encouraged interested parties to review the materials the Academy provided and share their comments during an upcoming conference call.
4. **Discussed the Factor of Using AEP Basis vs. OEP Basis**

Mr. Botsko said, based on the Risk Management Solutions (RMS) presentation at the Summer National Meeting, the factors to adjust OEP to AEP depend on: 1) peril; 2) geographic scope; 3) portfolio composition; and 4) insurance structure.

Mr. Botsko asked all interested parties to think about this issue and provide thoughts to the Subgroup during an upcoming conference call.

5. **Discussed Modeling of Projected Losses**

Mr. Botsko said, based on the RBC instructions, the projected losses can be modeled using: 1) one of the five approved third-party commercial vendor catastrophe models; or 2) any internal models that have been granted permission by the domestic or lead state insurance regulators. He stated that recently, more and more commercial vendors have informed the Subgroup on the process to become one of the approved vendors.

Mr. Botsko asked all interested parties to think about the potential approaches and provide thoughts to the Subgroup during an upcoming conference call.

Having no further business, the Catastrophe Risk (E) Subgroup adjourned.
## CAPITAL ADEQUACY (E) TASK FORCE

### WORKING AGENDA ITEMS FOR CALENDAR YEAR 2019

**Priority 1 – High priority**

<table>
<thead>
<tr>
<th>2020 #</th>
<th>Owner</th>
<th>Priority</th>
<th>Expected Completion Date</th>
<th>Working Agenda Item</th>
<th>Source</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Life RBC WG</td>
<td>Ongoing</td>
<td>Ongoing</td>
<td>Make technical corrections to Life RBC instructions, blank and/or methods to provide for consistent treatment among asset types and among the various components of the RBC calculations for a single asset type.</td>
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</table>

**Priority 2 – Medium priority**

| 2      | Life RBC WG | 1 | 2019 or later | A. Evaluate the overall effectiveness of the C3 Phase 2 and AG 43 methodologies by conducting an in-depth analysis of the models, modeling assumptions, processes, supporting documentation and results of a sample of companies writing variable annuities with guarantees and to make recommendations to the Capital Adequacy Task Force or Life Actuarial Task Force on any changes to the methodologies to improve their overall effectiveness. B. Develop and recommend changes to C-3 Phase II and AG 43 that implement, for 2018 adoption, the Variable Annuities Framework for Change. | CATF | Being addressed by the Variable Annuities Capital and Reserve (E/A) Subgroup |

| 3      | Life RBC WG | 1 | 2019 or later | Provide recommendations for recognizing longevity risk in statutory reserves and/or RBC, as appropriate. | New Jersey | Being addressed by the Longevity (E/A) Subgroup |

**Priority 3 – Low priority**

| 4      | Life RBC WG | 1 | 2019 or later | Update the current C-3 Phase I or C-3 Phase II methodology to include indexed annuities. | AAA | |

| 5      | Life RBC WG | 2 | 2019 or later | Develop guidance, for inclusion in the proposed NAIC contingent deferred annuity (CDA) guidelines, for states as to how current regulations governing risk-based capital requirements, including C-3 Phase II, should be applied to contingent deferred annuities (CDAs). Recommend a process for reviewing capital adequacy for insurers issuing CDAs and prepare clarifying guidance, if necessary, due to different nomenclature then used with regard to CDAs. The development of this guidance does not preclude the Working Group from reviewing CDAs as part of any ongoing or future changes where applicable and is made with the understanding that this guidance could change as a result of such a review. | 10/21/13 Referral from A Committee | It is important to consider the implications of work being done by the CDA and VA Issues Working Groups to ensure consistency in addressing these charges. The Working Group is monitoring the progress of that work. |

| 6      | Life RBC WG | 1 | 2019 | Review and evaluate company submissions for the RBC Shortfall schedule and corresponding adjustment to Total Adjusted Capital. | 10/16/2015 | |

| 7      | Life RBC WG | 1 | 2019 | Review and evaluate company submissions for the Primary Security Shortfall schedule and corresponding adjustment to Authorized Control Level. | 10/16/2015 | |

| 8      | Life RBC WG | 1 | 2019 | Continue consideration impacts and modifications necessary due to the Federal Tax Cuts and Jobs Act and develop guidance for users of RBC on those impacts. | 3/24/2018 | |

| 9      | Life RBC WG | 1 | 2019 | Determine if any adjustment is needed to the XXX/XXXX RBC Shortfall calculation to address surplus notes issued by captives. | 11/1/17 Referral from the Reinsurance (E) Task Force | |

**New Items - Life RBC**

| 10     | Life RBC WG | 1 | 2019 | Address changes needed due to elimination of the fraternal annual statement blank. | 9/1/2018 | |

| 11     | Life RBC WG | 1 | 2019 | Determine if any adjustment is needed due to the changes made to the Life and Health Guaranty Association Model Act, Model 0520. | 9/1/2018 | |

| 12     | Life RBC WG | 1 | 2019 | Determine if any adjustment is needed to the reinsurance credit risk in light of changes related to collateral and the changes made to the property RBC formula. | 9/1/2018 | |
### Capital Adequacy (E) Task Force

**Working Agenda Items for Calendar Year 2019**

#### Carry-Over Items Currently being Addressed – P&C RBC

<table>
<thead>
<tr>
<th>#</th>
<th>Owner</th>
<th>Priority</th>
<th>Expected Completion Date</th>
<th>Working Agenda Item</th>
<th>Source</th>
<th>Comments</th>
<th>Date Added to Agenda</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Cat Risk SG</td>
<td>1</td>
<td>Year-end 2020</td>
<td>Continue development of RBC formula revisions to include a risk charge based on catastrophe model output:</td>
<td></td>
<td></td>
<td>1/25/2018</td>
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<tr>
<td></td>
<td></td>
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<td></td>
<td>a) Evaluate other catastrophe risks for possible inclusion in the charge; b) Determine whether to recommend developing charges for any additional perils, which perils or perils those should be included.</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>Year-end 2020</td>
<td></td>
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<tr>
<td>14</td>
<td>P&amp;C RBC WG</td>
<td>1</td>
<td>Year-end 2020 or later</td>
<td>Evaluate a) the current growth risk methodology whether it is adequately reflects both operational risk and underwriting risk; b) the premium and reserve based growth risk factors either as a stand-alone task or in conjunction with the ongoing underwriting risk factor review with consideration of the operational risk component of excessive growth; c) whether the application of the growth factors to NET proxies adequately accounts for growth risk that is ceded to reinsurers that do not trigger growth risk in their own right.</td>
<td>Refer from Operational Risk Subgroup</td>
<td>1) Sent a referral to the Academy on 6/14/18 conference call.</td>
<td>1/25/2018</td>
</tr>
<tr>
<td>15</td>
<td>P&amp;C RBC WG</td>
<td>1</td>
<td>Year-end 2020</td>
<td>Evaluate the impact to RBC on a) Pre-Tax vs. After Tax; b) Tax reform on Total Adjusted Capital</td>
<td></td>
<td></td>
<td>1/25/2018</td>
</tr>
<tr>
<td>16</td>
<td>P&amp;C RBC WG</td>
<td>1</td>
<td>2020 Summer Meeting or later</td>
<td>Continue development of RBC formula revisions based on the Covered Agreement: a) consider eliminating the different treatment of uncollateralized reinsurance recoverable from authorized versus unauthorized, unrated reinsurers; b) consider whether the factor for uncollateralized, unrated reinsurers, runoff and captive companies should be adjusted; c) Evaluate the possibility of using NAIC as centralized location for reinsurer designations.</td>
<td>12/5/19 - The WG exposed Proposal 2018-19-P (Vulnerable 6 or unrated risk charge) for a 45-day exposure period.</td>
<td>8/4/2018</td>
<td></td>
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<tr>
<td>17</td>
<td>P&amp;C RBC WG</td>
<td>1</td>
<td>Year-end 2021 or later</td>
<td>Evaluate the proposed changes from the Affiliated Investment Ad Hoc Group related to P&amp;C RBC Affiliated Investments.</td>
<td></td>
<td></td>
<td>6/10/2019</td>
</tr>
<tr>
<td>18</td>
<td>P&amp;C RBC WG</td>
<td>1</td>
<td>2021 Summer Meeting or later</td>
<td>Continue working with the Academy to review the methodology and revise the underwriting (Investment Income Adjustment, Loss Concentration, LOB UW risk) charges in the PRBC formula as appropriate.</td>
<td></td>
<td></td>
<td>6/10/2019</td>
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#### New Items – P&C RBC

<table>
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<tr>
<th>#</th>
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<tbody>
<tr>
<td>19</td>
<td>Cat Risk SG</td>
<td></td>
<td>Year-end 2020 or later</td>
<td>Evaluate the possibility of allowing additional third party models to calculate the cat model losses</td>
<td>12/6/2019</td>
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</tbody>
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#### Ongoing Items – Health RBC

<table>
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<tr>
<th>#</th>
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<th>Working Agenda Item</th>
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</table>
## Capital Adequacy (E) Task Force

### Working Agenda Items for Calendar Year 2019

<table>
<thead>
<tr>
<th>#</th>
<th>Owner</th>
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<th>Date Added to Agenda</th>
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</thead>
<tbody>
<tr>
<td>20</td>
<td>Health RBC WG</td>
<td>3</td>
<td>Year-end 2021 RBC or later</td>
<td>Evaluate the impact of Federal Health Care Law on the Health RBC Formulas</td>
<td>4/13/2010 CATF Call</td>
<td>Adopted 2014-01H</td>
<td>1/11/2018</td>
</tr>
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<tr>
<td>21</td>
<td>Health RBC WG</td>
<td>3</td>
<td>Year-end 2021 RBC or later</td>
<td>Discuss and monitor the development of federal level programs and actions and the potential impact of these changes to the HRBC formula: - Development of the state reinsurance programs; - Association Health Plans; - Cross-border sales</td>
<td>HRBCWG</td>
<td>Discuss and monitor the development of federal level programs and the potential impact on the HRBC formula.</td>
<td>1/11/2018</td>
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</tr>
<tr>
<td>22</td>
<td>Health RBC WG</td>
<td>3</td>
<td>Year-end 2023 RBC or later</td>
<td>Consider changes for stop-loss insurance or reinsurance.</td>
<td>AAA Report at Dec. 2006 Meeting</td>
<td>(Based on Academy report expected to be received at YE-2016) 2016-17-CA</td>
<td>8/4/2018</td>
</tr>
<tr>
<td>23</td>
<td>Health RBCWG</td>
<td>2</td>
<td>Year-end 2023 RBC or later</td>
<td>Review the individual factors for each health care receivables line within the Credit Risk H3 component of the RBC formula.</td>
<td>HRBC WG</td>
<td>Adopted 2016-06-H</td>
<td>8/4/2018</td>
</tr>
<tr>
<td>24</td>
<td>Health RBC WG</td>
<td>1</td>
<td>Year-end 2022 or later</td>
<td>Establish an Ad Hoc Group to review the Health Test and annual statement changes for reporting health business in the Life and P/C Blanks</td>
<td>HRBCWG</td>
<td>Evaluate the applicability of the current Health Test in the Annual Statement instructions in today's health insurance market. Discuss ways to gather additional information for health business reported in other blanks.</td>
<td>8/4/2018</td>
</tr>
<tr>
<td>25</td>
<td>Health RBC WG</td>
<td>1</td>
<td>Year-end 2020 RBC or later</td>
<td>Review the Managed Care Credit calculation in the Health RBC formula - specifically Category 2a and 2b.</td>
<td>HRBCWG</td>
<td>Review the Managed Care Category and the credit calculated, more specifically the credit calculated when moving from Category 0 &amp; 1 to 2a and 2b.</td>
<td>12/3/2018</td>
</tr>
<tr>
<td>26</td>
<td>Health RBC WG</td>
<td>1</td>
<td>Year-end 2020 or later</td>
<td>Review referral letter from the Operational Risk (E) Subgroup on the excessive growth charge and the development of an Ad Hoc group to charge.</td>
<td>HRBCWG</td>
<td>Review if changes are required to the Health RBC Formula</td>
<td>4/7/2019</td>
</tr>
</tbody>
</table>

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**Summary**

The table above outlines the working agenda items for the Capital Adequacy (E) Task Force for the calendar year 2019, categorized by priority level (High, Medium, Low). Each item includes details such as the responsible owner, expected completion date, working agenda item description, source, comments, and date added to the agenda. The comments column provides additional context and rationale for each agenda item, highlighting the need for ongoing evaluation and adaptation in response to federal discussions and legislation.
### Working Agenda Items for Calendar Year 2019

<table>
<thead>
<tr>
<th>#</th>
<th>Owner</th>
<th>Priority</th>
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</thead>
<tbody>
<tr>
<td>27</td>
<td>CADTF</td>
<td>2</td>
<td>2018</td>
<td>Affiliated Investment Subsidiaries Referral Ad Hoc group formed Sept. 2016</td>
<td>Ad Hoc Group</td>
<td>Ad Hoc group will provide periodic updates on their progress.</td>
<td>10/11/2018</td>
</tr>
<tr>
<td>28</td>
<td>CADTF</td>
<td>3</td>
<td>2021</td>
<td>Receivable for Securities factor</td>
<td>Consider evaluating the factor every 3 years. (2018, 2021, 2024 etc.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>CADTF</td>
<td>3</td>
<td>2020</td>
<td>NAIC Designation for Schedule D, Part 2 Section 2 - Common Stocks</td>
<td>Referral from SAPWG 8/13/2018</td>
<td>Exposed for a 30-day Comment period ending 11/8/2019</td>
<td>10/11/2018</td>
</tr>
<tr>
<td>30</td>
<td>CADTF</td>
<td>3</td>
<td>2020 or Later</td>
<td>Structured Notes</td>
<td>Referral from SAPWG April 16, 2019</td>
<td>Exposed for a 30-day Comment period ending 11/8/2019</td>
<td>8/4/2019</td>
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<tr>
<td>31</td>
<td>CADTF</td>
<td>3</td>
<td>2020 or Later</td>
<td>SIRI – Line 13 Equity Interests</td>
<td>Referral from SAPWG 8/12/2019</td>
<td>Exposed for a 30-day Comment period ending 11/8/2019</td>
<td>10/8/2019</td>
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**Carry-Over Items Not Currently Being Addressed – Task Force**

<table>
<thead>
<tr>
<th>#</th>
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<tbody>
<tr>
<td>32</td>
<td>CADTF</td>
<td>2</td>
<td>2020 or Later</td>
<td>XXX/AXXX Captive Reinsurance RBC Shortfall</td>
<td>Referred to Reinsurance Task Force/RITF</td>
<td>Referred to Life RBC WG for consideration and comment</td>
<td>11/1/2017</td>
</tr>
<tr>
<td>33</td>
<td>CADTF</td>
<td>2</td>
<td>2020 or Later</td>
<td>Payout Annuities for RBC</td>
<td>Referred to Allstate and IL DOI</td>
<td>Referred to Life RBC WG for consideration and comment</td>
<td>3/25/2018</td>
</tr>
<tr>
<td>34</td>
<td>CADTF</td>
<td>2</td>
<td>2020 or Later</td>
<td>Guaranty Association Assessment Risk</td>
<td>Referred to Receivership and Insolvency (E) Task Force 5/1/2018</td>
<td>Referred to the Life RBC WG and Health RBC WG for consideration and comment</td>
<td>6/30/2018</td>
</tr>
</tbody>
</table>
### WORKING AGENDA ITEMS FOR CALENDAR YEAR 2019

<table>
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<th>Working Agenda Item</th>
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</tr>
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<tbody>
<tr>
<td><strong>Carry-Over Items Currently being Addressed – Investment RBC</strong></td>
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</tr>
<tr>
<td>35 Investment RBC WG</td>
<td>Prior</td>
<td>2020 or later</td>
</tr>
<tr>
<td><strong>Carry-Over Items not Currently being Addressed – Investment RBC</strong></td>
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<td></td>
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<tr>
<td>36 Investment RBC WG</td>
<td>Prior</td>
<td>Year-End 2021</td>
</tr>
<tr>
<td>37 Investment RBC WG</td>
<td>Prior</td>
<td>Year-End 2021</td>
</tr>
<tr>
<td>38 Investment RBC WG</td>
<td>Prior</td>
<td>Year-End 2021</td>
</tr>
<tr>
<td>39 Investment RBC WG</td>
<td>Prior</td>
<td>Year-End 2021</td>
</tr>
</tbody>
</table>
MEMORANDUM

TO: Commissioner David Altmaier (FL), Chair, Capital Adequacy (E) Task Force

FROM: Patrick McNaughton (WA), Chair, Health Risk-Based Capital (E) Working Group

DATE: October 21, 2019

RE: Recommendation Regarding Risk-Based Capital Charge for Guaranty Association Assessment Risk

On Sept. 21, 2018 the Health Risk-Based Capital (E) Working Group received a request from the Capital Adequacy (E) Task Force to review the referral letter regarding adopted amendments to the Life and Health Insurance Guaranty Association Model Act, Model #520. The referral outlined significant amendments to Model #520, including: 1) broadening the assessment base for long-term care insurance (LTCI) insolvencies to include both life and health insurers and splitting the assessment 50%/50% between the life and health insurers; 2) clarifying the guaranty associations’ coverage of LTCI; and 3) including health maintenance organizations (HMOs) as members of the guaranty association, similar to other health insurers. The referral letter requested that the Task Force consider if changes were warranted to the health RBC formula in light of the changes made to Model #520.

Based upon our review of existing Guaranty Fund Assessment Risk charge under the H4-Business Risk component, a charge of .5% is applied to direct earned premiums (as reported in Schedule T) in any state in which the reporting entity is subject to guaranty fund assessments. Based on the current instructions and reporting the Working Group does not believe that modifications to the Health Risk-Based Capital formula are required for the change to Model #520.

The recommendation above does not preclude the Working Group from potential changes to long-term care or the business risk component charge in the future.

If you have any questions regarding this memorandum, please contact me at PatM@oic.wa.gov or Crystal Brown (NAIC) at cbrown@naic.org.
The proposed changes clarify the reinsurance recoverable from individual syndicates of Lloyd’s of London that are covered under the Lloyd’s Central Fund may utilize the lowest financial strength group rating received from an approved rating agency.

Upon review of 2018 Schedule F Part 3 filings, it has been observed that many filers reported reinsurance recoverable amounts due from Lloyd’s of London Syndicates as being NAIC 6-Unrated; and therefore, subject to the highest credit risk charge.

Additional Staff Comments:
8-3-19 The PCRBCWG exposed for comment until 9-3-19
11-8-19 This proposal has been adopted at the Joint Catastrophe Risk Subgroup and Property/Casualty Risk-Based Capital Working Group conference call on Nov. 8.
**Credit Risk for Receivables**

**Reinsurance Recoverables**

The calculation of the credit risk charge for reinsurance recoverables is detailed in Schedule F Part 3 Columns 28 through 36 of the Property/Casualty Annual Statement. This calculation is performed at the transaction level and those results are then summed to determine the charge. Reinsurance balances receivable on reinsurance ceded to non-affiliated companies (excluding certain pools) and to alien affiliates are subject to the credit risk-based capital charge. The following types of cessions are exempt from this charge:

- Cessions to State Mandated Involuntary Pools and Associations or to Federal Insurance Programs.
- This category includes all federal insurance programs [e.g., National Flood Insurance Program (NFIP), Federal Crop Insurance Corporation (FCIC), etc., all state mandated residual market mechanisms and the National Council on Compensation Insurance (NCCI)].
- Cessions to U.S. Parents, Subsidiaries and Affiliates.

The categories above are automatically excluded from the data that is calculated in Schedule F Part 3 of the Annual Statement.

Since the Annual Statement requires the collectability of reinsurance balances be considered via the reinsurance penalty, the appropriate balances must be offset by any liability that has been established for this purpose. The amount from Page 3, Line 16 should be allocated to the appropriate (re)insurers listed on Schedule F. The total amount recoverable from reinsurers less any applicable reinsurance penalty is multiplied by 120% to stress the recoverable balance. The total of reinsurance payable and/or funds held amounts (not in excess of the stressed recoverable) are applied as offsets to arrive at the stressed net recoverable.

Since there are different reinsurance credit risk factors for collateralized and uncollateralized reinsurance recoverables, the stressed net recoverable should be offset by any available collateral, such as letters of credit, multiple beneficiary trusts, and single beneficiary trusts and other allowable offsets (not in excess of the stressed net recoverable). The collateralized amounts are derived from Schedule F Part 3 Column 32 and the uncollateralized amounts are derived from Column 33.

The risk-based capital for the various credits (including collateral offsets where applicable) taken for reinsurance may not be less than zero even if the amount reported or the amount net of offsets is negative.

The factor for reinsurance recoverables (paid and unpaid less any applicable reinsurance penalty) due from a particular reinsurer is determined based on that reinsurer’s financial strength rating assigned on a legal entity basis.

For the purpose of the credit risk-based capital charge, the equivalent rating category assigned will correspond to current financial strength rating received from an approved rating agency as outlined in the table below. Ratings shall be based on interactive communication between the rating agency and the assuming insurer and shall not be based solely on publicly available information. If the reinsurer is unauthorized and does not have at least one financial strength rating, it should be assigned the “Vulnerable 6 or Unrated Unauthorized” equivalent rating. If the reinsurer is authorized and does not have at least one financial strength rating, it should be assigned the “Unrated Authorized Reinsurers” equivalent rating. Amounts recoverable from unrated voluntary pools should be assigned the “Secure 3” equivalent rating. An authorized association including incorporated and individual unincorporated underwriters or a member thereof (e.g. individual authorized syndicates of Lloyds’ of London that are backed by the Central Fund) may utilize the lowest financial strength group rating received from an approved rating agency. The table below shows the R3 reinsurer equivalent rating categories and corresponding factors for A.M. Best, Standard and Poor’s, Moody’s and Fitch ratings.

### R3 Reinsurer Equivalent Rating Categories and Corresponding Factors

<table>
<thead>
<tr>
<th>Rating Category</th>
<th>Corresponding Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secure 3</td>
<td>1.0</td>
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<tr>
<td>Unrated Authorized Reinsurers</td>
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</tr>
<tr>
<td>Vulnerable 6 or Unrated Unauthorized</td>
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</tr>
<tr>
<td>A.M. Best Ratings</td>
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</tr>
<tr>
<td>Standard &amp; Poor’s Ratings</td>
<td></td>
</tr>
<tr>
<td>Moody’s Ratings</td>
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</tr>
<tr>
<td>Fitch Ratings</td>
<td></td>
</tr>
</tbody>
</table>

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<td>1.2</td>
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<tr>
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<td></td>
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<tr>
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<td></td>
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<tr>
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</tr>
</thead>
<tbody>
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<td>1.0</td>
</tr>
<tr>
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<td>1.1</td>
</tr>
<tr>
<td>Vulnerable 6 or Unrated Unauthorized</td>
<td>1.2</td>
</tr>
<tr>
<td>A.M. Best Ratings</td>
<td></td>
</tr>
<tr>
<td>Standard &amp; Poor’s Ratings</td>
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<tr>
<td>Moody’s Ratings</td>
<td></td>
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<tr>
<td>Fitch Ratings</td>
<td></td>
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Proposed Guidance Statement:

Upon review of 2018 Schedule F Part 3 filings, it has been observed that many filers reported reinsurance recoverable amounts due from Lloyd’s of London Syndicates as being NAIC 6-Unrated; and therefore subject to the highest credit risk charge.

**However, the RBC Instructions for PR012 - Credit Risk for Receivables provides that:** “An authorized association including incorporated and individual unincorporated underwriters or a member thereof may utilize the lowest financial strength group rating received from an approved rating agency.” *This instruction is applicable to reinsurance recoverable from individual syndicates of Lloyds’ of London that are covered under the Lloyd’s Central Fund; and are therefore eligible to be treated as rated for the purposes of PR012 and the R3 Credit Risk component of RBC. This treatment is consistent with the NAIC Credit for Reinsurance Model Law and Regulation concerning applicable NAIC ratings designations for the purpose of determining reduced collateral requirements.*
Capitol 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 [ ] Longevity Risk (A/E) Subgroup

DATE: 4/11/19

CONTACT PERSON: Eva Yeung
TELEPHONE: 816-783-8407
EMAIL ADDRESS: eyeung@naic.org
ON BEHALF OF: P/C RBC (E) Working Group
NAME: Tom Botsko
TITLE: Chair
AFFILIATION: Ohio Department of Insurance
ADDRESS: 50 West Town Street, Suite 300
Columbus, OH 43215

FOR NAIC USE ONLY
Agenda Item # 2019-12-P
Year 2020

DISPOSITION
[ ] ADOPTED
[ ] REJECTED
[ ] DEFERRED TO
[ ] REFERRED TO OTHER NAIC GROUP
[ x ] EXPOSED 8-3-19
[ ] OTHER (SPECIFY)

IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED
[ ] Health RBC Blanks [ x ] Property/Casualty RBC Blanks [ ] Life and Fraternal RBC Instructions
[ ] Health RBC Instructions [ ] Property/Casualty RBC Instructions [ ] Life and Fraternal RBC Blanks
[ ] OTHER ____________________________

DESCRIPTION OF CHANGE(S)
Eliminate PR038 Adjustment for Reinsurance Penalty for Affiliates Applicable to Schedule F.

REASON OR JUSTIFICATION FOR CHANGE **
As the computation of RBC charge for reinsurance recoverable has been moved to the Annual Statement Schedule F, Part 3 in 2018 reporting, the adjustment for Reinsurance Penalty for Affiliates Applicable to Schedule F in PR038 is no longer needed.

Additional Staff Comments:
8-4-19 The PCRBCWG exposed proposal 2019-12-P until 9-3-19.
11-8-19 This proposal has been adopted at the Joint Catastrophe Risk Subgroup and Property/Casualty Risk-Based Capital Working Group conference call on Nov. 8.

** This section must be completed on all forms.

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### Credit Risk for Receivables

<table>
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<tr>
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<th>Line</th>
<th>Column</th>
<th>Value</th>
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### Underwriting Risk - Reserves

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<th>Value (000 Omitted)</th>
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<td>Private Pass Auto Liab</td>
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<td>7</td>
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<td>Workers' Comp</td>
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<td>Comm Multi Peril</td>
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<td>7</td>
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<td>Medical Professional Liability - Claims-Made</td>
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<tr>
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<td>Other Liab - Occurrence</td>
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<td>0</td>
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<tr>
<td>Other Liab - Claims Made</td>
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<td>0</td>
</tr>
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<tr>
<td>Medical Tabular Reserve Discount - Reinsurance :Liability</td>
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<td>Medical Tabular Reserve Discount - Reinsurance :Financial Lines</td>
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<td>Product Liab - Occurrence</td>
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<td>Product Liab - Claims Made</td>
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<td>Warranty</td>
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### Underwriting Risk - Premiums

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<th>Column</th>
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<tr>
<td>Other Underwriting Expenses Incurred</td>
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<td>6</td>
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</table>

Denotes items that must be manually entered on the filing software.
**Capital Adequacy (E) Task Force**

**RBC Proposal Form**

| [ ] | Catastrophe Risk (E) Subgroup | [ ] | Investment RBC (E) Working Group | [ ] | Op Risk RBC (E) Subgroup |
| [ ] | C3 Phase II/AG43 (E/A) Subgroup | [ ] | P/C RBC (E) Working Group | [ ] | Stress Testing (E) Subgroup |

**DATE:** 11/8/2019  
**CONTACT PERSON:** Eva Yeung  
**TELEPHONE:** 816-783-8407  
**EMAIL ADDRESS:** eyeung@naic.org  
**ON BEHALF OF:** Catastrophe Risk (E) Subgroup  
**NAME:** Tom Botsko  
**TITLE:** Chair  
**AFFILIATION:** Ohio Department of Insurance  
**ADDRESS:** 50 West Town Street, Suite 300, Columbus, OH 43215

**IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED**

| [ ] | Health RBC Blanks | [ ] | Property/Casualty RBC Blanks | [ ] | Life RBC Instructions |
| [ ] | Fraternal RBC Blanks | [ ] | Health RBC Instructions | [ ] | Property/Casualty RBC Instructions |
| [ ] | Life RBC Blanks | [ ] | Fraternal RBC Instructions | [x] | OTHER __Cat Event Lists__ |

**DESCRIPTION OF CHANGE(S)**

2019 U.S. and non-U.S. Catastrophe Event Lists

**REASON OR JUSTIFICATION FOR CHANGE**

New events were determined based on the sources from Swiss Re and Aon Benfield.

**Additional Staff Comments:**

11/8/19 The Catastrophe Risk SG exposed the proposal for 14 days public comment period ending 11/24/19.

**This section must be completed on all forms.**

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<table>
<thead>
<tr>
<th>Type of Event</th>
<th>Name</th>
<th>Date</th>
<th>Location</th>
<th>Overall losses when occurred</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tropical Storm</td>
<td>Hermine</td>
<td>2010</td>
<td>$120,000,000,000</td>
<td>$25+ million</td>
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<tr>
<td>Hurricane</td>
<td>Earl</td>
<td>2011</td>
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<tr>
<td>Hurricane</td>
<td>Irene</td>
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<tr>
<td>Hurricane</td>
<td>Sandy</td>
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<tr>
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<td>Isaac</td>
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<tr>
<td>Hurricane</td>
<td>Deby</td>
<td>2012</td>
<td>$970,000,000,000</td>
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<tr>
<td>Tropical Storm</td>
<td>Lee</td>
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<tr>
<td>Hurricane</td>
<td>Patricia</td>
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<td>Florida, North Carolina, South Carolina, Georgia and Virginia</td>
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<tr>
<td>Hurricane</td>
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<td>2016</td>
<td>Florida, North Carolina, South Carolina, Georgia and Virginia</td>
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<tr>
<td>Hurricane</td>
<td>Harvey</td>
<td>2017</td>
<td>Texas, Louisiana</td>
<td>$25+ million</td>
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<tr>
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<td>Irene</td>
<td>2017</td>
<td>East Coast of the United States</td>
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<tr>
<td>Hurricane</td>
<td>Irma</td>
<td>2017</td>
<td>Eastern United States</td>
<td>$25+ million</td>
</tr>
<tr>
<td>Hurricane</td>
<td>Matina</td>
<td>2017</td>
<td>Southeastern United States, Mid-Atlantic States</td>
<td>$25+ million</td>
</tr>
<tr>
<td>Hurricane</td>
<td>Maria</td>
<td>2017</td>
<td>Louisiana, Mississippi, Alabama, Tennessee and</td>
<td>$25+ million</td>
</tr>
<tr>
<td>Hurricane</td>
<td>Nate</td>
<td>2017</td>
<td>Eastern United States</td>
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<td>Alberto</td>
<td>2018</td>
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<td>2018</td>
<td>Hawaii</td>
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<td>Dorian</td>
<td>2019</td>
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<td>$500+ million</td>
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<tr>
<td>Hurricane</td>
<td>Barry</td>
<td>2019</td>
<td>Southeast, Midwest, Northeast</td>
<td>$300+ million</td>
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</tbody>
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© 2019 National Association of Insurance Commissioners
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<tr>
<th>Year</th>
<th>Event Type</th>
<th>Begin</th>
<th>End</th>
<th>Event</th>
<th>Country</th>
<th>Affected Area (Detail)</th>
<th>Munich Re NatCATService Insured losses (in original values, US$m)</th>
<th>Criteria: insured losses equal/greater US$ 25m. Tries to reflect non-US losses only</th>
<th>Swiss Re Sigma: Insured Loss Est. US$m (mid point shown if range given) Mostly reflect total US and nonUS losses combined.</th>
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<td>04/04/2010</td>
<td>04/04/2010</td>
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<td>27/02/2010</td>
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<td>8000</td>
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<td>2011</td>
<td>Tropical Cyclone</td>
<td>22/08/2011</td>
<td>02/09/2011</td>
<td>Hurricane Irene</td>
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<td>CT; Bridgeport; DC; Washington; DE; Lewes; FL; MA; Boston; MD; Ocean City; ME; NC; New Bern; NH; NJ; Atlantic City; NY; New York City; PA; Philadelphia; RI; Bristol, Charlestown, Narragansett; South Kingstown, Westerly; SC; VA; VT; Montpelier, Wardsboro; Munich re losses are non-US losses</td>
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<td>5300</td>
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<td>2011</td>
<td>Earthquake</td>
<td>11/03/2011</td>
<td>11/03/2011</td>
<td>Earthquake</td>
<td>Japan</td>
<td>Honshu, Aomori, Tohoku; Miyagi, Sendai; Fukushima, Mito; Ibaraki, Tochigi, Urayonmyia, Iwate, Morioka; Yamagata, Chiba, Tokyo</td>
<td>35000</td>
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<tr>
<td>2011</td>
<td>Tropical Cyclone</td>
<td>09/02/2011</td>
<td>09/03/2011</td>
<td>Tropical Storm Talas</td>
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<td>New Zealand</td>
<td>South Island, Canterbury, Christchurch, Lyttelton</td>
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<td>02/02/2011</td>
<td>07/02/2011</td>
<td>Cyclone Yasi</td>
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<td>Queensland, Tully, Townsville, Mission Beach, Cardwell, Giri, Ingham, Innisfail, Cassowary Coast Shire, Cairns, Bedarra and Dunk Islands</td>
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<td>1360</td>
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<tr>
<td>2012</td>
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<td>29/05/2012</td>
<td>29/05/2012</td>
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<td>Italy</td>
<td>Emilia-Romagna, San Felice del Panaro, Cavezzo, Rovereto di Novi, Carpi, Concordia, Bologna, Mailand, Aosta Valley, Venice, Mirandola</td>
<td>1600</td>
<td>N/A</td>
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<tr>
<td>2014</td>
<td>Earthquake</td>
<td>07/07/2014</td>
<td></td>
<td>Earthquake</td>
<td>Mexico, Guatemala</td>
<td>N/A</td>
<td>N/A</td>
<td>25+million</td>
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<td>N/A</td>
<td>N/A</td>
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<tr>
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<td>12/02/2014</td>
<td></td>
<td>Earthquake</td>
<td>China</td>
<td>N/A</td>
<td>N/A</td>
<td>350+million</td>
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<tr>
<td>2014</td>
<td>Earthquake</td>
<td>05/04/2014</td>
<td></td>
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<td>N/A</td>
<td>N/A</td>
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<td>2014</td>
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<td>Thailand</td>
<td>N/A</td>
<td>N/A</td>
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<tr>
<td>2014</td>
<td>Tropical Storm</td>
<td>05/24/14</td>
<td></td>
<td>Tropical Storm</td>
<td>China</td>
<td>N/A</td>
<td>N/A</td>
<td>60+million</td>
<td></td>
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<tr>
<td>2014</td>
<td>Super Typhoon</td>
<td>07/08/14</td>
<td>07/11/14</td>
<td>STY Neoguri</td>
<td>Japan</td>
<td>N/A</td>
<td>N/A</td>
<td>100+million</td>
<td></td>
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<tr>
<td>2014</td>
<td>Super Typhoon</td>
<td>07/15/14</td>
<td>07/20/14</td>
<td>STY Rammasun</td>
<td>Philippines, China, Vietnam</td>
<td>N/A</td>
<td>N/A</td>
<td>570+million</td>
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<tr>
<td>2014</td>
<td>Typhoon</td>
<td>07/22/14</td>
<td>07/24/14</td>
<td>Typhoon Haiyan</td>
<td>Taiwan, China, Philippines</td>
<td>N/A</td>
<td>N/A</td>
<td>570+million</td>
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<td>2014</td>
<td>Cyclone</td>
<td>01/10/14</td>
<td>01/12/14</td>
<td>CY Ian</td>
<td>Tonga</td>
<td>N/A</td>
<td>N/A</td>
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<td>2014</td>
<td>Cyclone</td>
<td>04/10/14</td>
<td>04/14/14</td>
<td>CY Ita</td>
<td>Australia</td>
<td>N/A</td>
<td>N/A</td>
<td>1+million</td>
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<td>2015</td>
<td>Hurricane</td>
<td>08/16/92</td>
<td>08/23/92</td>
<td>Hurricane Andrew</td>
<td>Bahamas United States, Bahamas</td>
<td></td>
<td></td>
<td>&gt; 25 million</td>
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<td>2015</td>
<td>Hurricane</td>
<td>10/20/15</td>
<td>10/24/15</td>
<td>Hurricane Patricia</td>
<td>Central America, Mexico and Texas</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
<td></td>
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<tr>
<td>2015</td>
<td>Typhoon</td>
<td>06/26/15</td>
<td>07/13/15</td>
<td>Typhoon Chan-hom (Falcon)</td>
<td>Guam, Northern Mariana Islands, Philippines, Japan, Taiwan, Chian, Korea, Russian Far East</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
<td>2015</td>
<td>Severe Tropical Storm</td>
<td>07/01/15</td>
<td>07/10/15</td>
<td>Severe Tropical Storm Linfa (Egay)</td>
<td>Philippines, Taiwan, China</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<td>2015</td>
<td>Typhoon</td>
<td>07/02/15</td>
<td>07/18/15</td>
<td>Typhoon Nangka</td>
<td>Marshall Islands, Mariana Islands and Japan</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
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<td>07/29/15</td>
<td>08/12/15</td>
<td>Typhoon Soudelor (Hanna)</td>
<td>Mariana Islands, Japan, Philippines, Taiwan, Eastern China and South Korea</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
<td>2015</td>
<td>Typhoon</td>
<td>08/13/15</td>
<td>08/30/15</td>
<td>Typhoon Goni (Ineng)</td>
<td>Mariana Islands, Japan, Philippines, Taiwan, China, Russia and Korea</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
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<td>Severe Tropical Storm</td>
<td>09/06/15</td>
<td>09/11/15</td>
<td>Severe Tropical Storm Etau</td>
<td>Japan, Russian Far East</td>
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<td>N/A</td>
<td>&gt; 25 million</td>
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<td>2015</td>
<td>Typhoon</td>
<td>09/19/15</td>
<td>09/30/15</td>
<td>Typhoon Dujuan (Jenny)</td>
<td>Ryukyu Islands, Taiwan, East China</td>
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<td>N/A</td>
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<tr>
<td>2015</td>
<td>Typhoon</td>
<td>09/30/15</td>
<td>10/05/15</td>
<td>Typhoon Mujigae (Kabayan)</td>
<td>Philippines, Vietnam and China</td>
<td>N/A</td>
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<td>Year</td>
<td>Type</td>
<td>Start Date</td>
<td>End Date</td>
<td>Event Name</td>
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<td>Injuries</td>
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<tr>
<td>2015</td>
<td>Typhoon</td>
<td>10/12/15</td>
<td>10/21/15</td>
<td>Typhoon Koppu (Lando)</td>
<td>Northern Mariana Islands, Philippines, Taiwan, Ryukyu Islands</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
<td>2015</td>
<td>Typhoon</td>
<td>12/03/15</td>
<td>12/08/15</td>
<td>Storm Desmond</td>
<td>Ireland, Isle of Man, United Kingdom, Iceland, Norway and Sweden</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
<td>2015</td>
<td>Hurricane</td>
<td>09/28/15</td>
<td>10/15/15</td>
<td>Hurricane Joaquin</td>
<td>Turks and Caicos Islands, Bahamas, Cuba, Haiti, Southeastern United States, Bermuda, Azores, Iberian Peninsula</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
<td></td>
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<tr>
<td>2015</td>
<td>Earthquake</td>
<td>04/27/15</td>
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<td>Nepal</td>
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<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
<td>2015</td>
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<td>09/22/15</td>
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<td>Earthquake</td>
<td>Chile</td>
<td>N/A</td>
<td>N/A</td>
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<td></td>
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<td>Earthquake</td>
<td>09/28/15</td>
<td>10/10/16</td>
<td>Hurricane Matthew</td>
<td>Lesser Antilles, Leeward, Antilles, Venezuela, Columbia, Jamaica, Hispaniola, Cuba, Lucayan, Archipelago, eastern Canada</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
<td></td>
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<tr>
<td>2016</td>
<td>Hurricane</td>
<td>08/28/16</td>
<td>09/06/16</td>
<td>Hurricane Hermine</td>
<td>Dominican Republic, Cuba, The Bahamas</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
<td></td>
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<tr>
<td>2016</td>
<td>Tropical Cyclone</td>
<td>02/16/16</td>
<td>02/22/16</td>
<td>TC Winston</td>
<td>South Pacific Islands</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
<td></td>
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<tr>
<td>2016</td>
<td>Earthquake</td>
<td>02/06/16</td>
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<td>Earthquake</td>
<td>Taiwan, Asia</td>
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<tr>
<td>2016</td>
<td>Earthquake</td>
<td>01/03/16</td>
<td></td>
<td>Koahsiung EQ</td>
<td>India, Bangladesh, Myanmar</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<td>Earthquake</td>
<td>02/14/16</td>
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<td>Christchurch EQ</td>
<td>New Zealand</td>
<td>N/A</td>
<td>N/A</td>
<td>&gt; 25 million</td>
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<td>04/14/16</td>
<td>04/16/16</td>
<td>Kumamoto EQs</td>
<td>Japan</td>
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<td>N/A</td>
<td>&gt; 25 million</td>
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<td>04/18/16</td>
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<td>Ecuador EQ</td>
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<td>N/A</td>
<td>N/A</td>
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<td>05/23/16</td>
<td>CY Roanu</td>
<td>Sri Lanka, India, Bangladesh, China</td>
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<td>N/A</td>
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<td>08/24/16</td>
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<td>Italy EQ</td>
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<td>2016</td>
<td>Tropical Cyclone</td>
<td>09/14/16</td>
<td>09/16/16</td>
<td>STY Meranti</td>
<td>China, Taiwan, Philippines</td>
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<td>N/A</td>
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<td>07/08/16</td>
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<td>STY Nepartak</td>
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<td>N/A</td>
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<td>09/26/16</td>
<td>09/29/16</td>
<td>TY Megi</td>
<td>Taiwan, China</td>
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<td>N/A</td>
<td>&gt; 25 million</td>
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<tr>
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<td>Kagera EQ</td>
<td>Tanzania, Uganda</td>
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<td>08/29/16</td>
<td>09/01/16</td>
<td>TY Lionrock</td>
<td>China, Japan, South Korea</td>
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<td>09/19/16</td>
<td>09/22/16</td>
<td>TY Malakas</td>
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<td>08/18/16</td>
<td>08/20/16</td>
<td>TS Dianmu</td>
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<td>N/A</td>
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<td>Event</td>
<td>Dates</td>
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<td>Region</td>
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<tr>
<td>2016 Tropical Cyclone</td>
<td>07/31/16</td>
<td>08/03/16</td>
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<td>Asia</td>
<td>Typhoon</td>
<td>Nidia</td>
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<td>08/10/16</td>
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<td>Hurricane</td>
<td>Earl</td>
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<td>Asia</td>
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<td>Mindulle</td>
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<td>10/07/16</td>
<td>Japan, Korea</td>
<td>Asia</td>
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<td>Matthew</td>
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<td>Hermine</td>
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<td>China, Australia</td>
<td>Asia</td>
<td>Cyclone</td>
<td>Debbie</td>
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<tr>
<td>2017 Typhoon</td>
<td>07/29/17</td>
<td>07/31/17</td>
<td>China, Taiwan, Philippines</td>
<td>Asia</td>
<td>Typhoon</td>
<td>Nesat &amp; TS Haitang</td>
<td></td>
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<tr>
<td>2017 Typhoon</td>
<td>08/07/17</td>
<td>08/09/17</td>
<td>Japan</td>
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<tr>
<td>2017 Typhoon</td>
<td>08/23/17</td>
<td>08/25/17</td>
<td>China, Macau, Hong Kong</td>
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<tr>
<td>2017 Typhoon</td>
<td>08/25/17</td>
<td>08/28/17</td>
<td>China</td>
<td>Asia</td>
<td>Typhoon</td>
<td>Pakhar</td>
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<tr>
<td>2017 Hurricane</td>
<td>08/25/17</td>
<td>09/02/17</td>
<td>Windward Islands, Suriname, Guyana, Nicaragua, Honduras, Belize, Cayman Island, Trinidad and Tobago</td>
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<td>Harvey</td>
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<td>2017 Hurricane</td>
<td>09/05/17</td>
<td>09/26/17</td>
<td>Cape Verde, Leeward Islands, Greater Antilles</td>
<td>Caribbean</td>
<td>Hurricane</td>
<td>Irma</td>
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<td>09/16/17</td>
<td>09/26/17</td>
<td>Caribbean</td>
<td>Caribbean</td>
<td>Hurricane</td>
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© 2019 National Association of Insurance Commissioners
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<tr>
<th>Year</th>
<th>Event</th>
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<th>Locations</th>
<th>Damages</th>
<th>Losses</th>
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<tr>
<td>2017</td>
<td>Hurricane</td>
<td>09/16/17</td>
<td>10/03/17</td>
<td>Hurricane Maria, Lesser Antilles, Puerto Rico, Dominican Republic, Haiti, Turks and Caicos Islands, The Bahamas, Ireland, United Kingdom, France and Spain</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2017</td>
<td>Earthquake</td>
<td>09/07/17</td>
<td>10/03/17</td>
<td>Earthquake Mexico, Guatemala, Mexico City, Central America, Caribbean, Panama, Greater Antilles, Barbados, Jamaica, Peru, Ecuador, Chile, Argentina, Brazil, Georgia</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2017</td>
<td>Earthquake</td>
<td>09/19/17</td>
<td>10/03/17</td>
<td>Earthquake Mexico, Guatemala, Mexico City, Central America, Caribbean, Panama, Greater Antilles, Barbados, Jamaica, Peru, Ecuador, Chile, Argentina, Brazil, Georgia</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2017</td>
<td>Earthquake</td>
<td>09/26/18</td>
<td>10/03/17</td>
<td>Earthquake Mexico, Guatemala, Mexico City, Central America, Caribbean, Panama, Greater Antilles, Barbados, Jamaica, Peru, Ecuador, Chile, Argentina, Brazil, Georgia</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Earthquake</td>
<td>02/18/18</td>
<td>03/17/18</td>
<td>Earthquake Papua New Guinea, Solomon Islands, Vanuatu, Solomon Islands, Papua New Guinea, Solomon Islands</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Earthquake</td>
<td>02/18/18</td>
<td>03/17/18</td>
<td>Earthquake Papua New Guinea, Solomon Islands, Vanuatu, Solomon Islands, Papua New Guinea, Solomon Islands</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Cyclone</td>
<td>02/22/18</td>
<td>03/17/18</td>
<td>Cyclone Fiji, Fiji Islands, Tonga, Samoa, New Zealand, Tonga, Samoa, New Zealand</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Cyclone</td>
<td>03/17/18</td>
<td>04/12/18</td>
<td>Cyclone Fiji, Fiji Islands, Tonga, Samoa, New Zealand, Tonga, Samoa, New Zealand</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Tropical Storm</td>
<td>05/22/18</td>
<td>06/07/18</td>
<td>Tropical Storm Marcus, Taiwan, Japan, South Korea, Taiwan, Japan, South Korea</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Earthquake</td>
<td>05/21/18</td>
<td>06/07/18</td>
<td>Earthquake Papua New Guinea, Solomon Islands, Vanuatu, Solomon Islands, Papua New Guinea, Solomon Islands</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Earthquake</td>
<td>05/21/18</td>
<td>06/07/18</td>
<td>Earthquake Papua New Guinea, Solomon Islands, Vanuatu, Solomon Islands, Papua New Guinea, Solomon Islands</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Earthquake</td>
<td>06/07/18</td>
<td>07/05/18</td>
<td>Earthquake Papua New Guinea, Solomon Islands, Vanuatu, Solomon Islands, Papua New Guinea, Solomon Islands</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Earthquake</td>
<td>06/07/18</td>
<td>07/05/18</td>
<td>Earthquake Papua New Guinea, Solomon Islands, Vanuatu, Solomon Islands, Papua New Guinea, Solomon Islands</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Super Typhoon</td>
<td>07/12/18</td>
<td>07/21/18</td>
<td>Super Typhoon Harvey, Texas, Louisiana, Mid-Atlantic, Midwest, Texas, Louisiana, Mid-Atlantic, Midwest</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Tropical Storm</td>
<td>07/22/18</td>
<td>07/28/18</td>
<td>Tropical Storm Eunice, Taiwan, Japan, South Korea, Taiwan</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Tropical Storm</td>
<td>08/03/18</td>
<td>08/09/18</td>
<td>Tropical Storm Hector, Mexico, Central America, Caribbean, Gulf of Mexico, Mexico</td>
<td>&gt; 25 million</td>
<td>NA</td>
</tr>
<tr>
<td>2018</td>
<td>Typhoon</td>
<td>08/13/18</td>
<td>08/19/18</td>
<td>Typhoon Maria, Central America, Caribbean, Gulf of Mexico, Mexico, Central America, Caribbean, Gulf of Mexico, Mexico</td>
<td>&gt; 25 million</td>
<td>NA</td>
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<tr>
<td>2018</td>
<td>Super Typhoon</td>
<td>08/25/18</td>
<td>09/02/18</td>
<td>Super Typhoon Ida, Gulf of Mexico, Texas, Louisiana, Mid-Atlantic, Midwest, Texas, Louisiana, Mid-Atlantic, Midwest</td>
<td>&gt; 25 million</td>
<td>NA</td>
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<tr>
<td>2018</td>
<td>Typhoon</td>
<td>09/06/18</td>
<td>09/12/18</td>
<td>Typhoon Omega, Central America, Caribbean, Gulf of Mexico, Mexico, Central America, Caribbean, Gulf of Mexico, Mexico</td>
<td>&gt; 25 million</td>
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<tr>
<td>Year</td>
<td>Event</td>
<td>Start Date</td>
<td>End Date</td>
<td>Location</td>
<td>Damage</td>
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<td>--------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>2018</td>
<td>Typhoon</td>
<td>08/23/18</td>
<td>08/25/18</td>
<td>Japan, South Korea, China and Russia</td>
<td>&gt; 25 million</td>
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</tr>
<tr>
<td>2018</td>
<td>Typhoon</td>
<td>09/04/18</td>
<td>09/05/18</td>
<td>Japan, Mariana Islands, Taiwan, Japan, Russian Far East and Arctic</td>
<td>&gt; 25 million</td>
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<tr>
<td>2018</td>
<td>Earthquake</td>
<td>09/06/18</td>
<td></td>
<td>Japan, Hokkaido</td>
<td>&gt; 25 million</td>
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<tr>
<td>2018</td>
<td>Super Typhoon</td>
<td>09/15/18</td>
<td>09/18/18</td>
<td>N. Mariana Islands, Philippines, China and Hong Kong</td>
<td>&gt; 25 million</td>
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<tr>
<td>2018</td>
<td>Hurricane</td>
<td>09/23/18</td>
<td></td>
<td>Azores, Bermuda, Europe</td>
<td>&gt; 25 million</td>
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</tr>
<tr>
<td>2018</td>
<td>Hurricane</td>
<td>10/07/18</td>
<td>10/16/18</td>
<td>Central America, Yucatan Peninsula, Cayman Islands, Cuba, Atlantic, Canada</td>
<td>&gt; 25 million</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>Cyclone</td>
<td>05/03/19</td>
<td>05/05/19</td>
<td>India, Bangladesh</td>
<td>&gt;500 million</td>
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<tr>
<td>2019</td>
<td>Earthquake</td>
<td>06/17/19</td>
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<td>China</td>
<td>&gt; 25 million</td>
<td></td>
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<tr>
<td>2019</td>
<td>Tropical Storm</td>
<td>08/01/19</td>
<td>08/08/19</td>
<td>China, Vietnam</td>
<td>&gt; 25 million</td>
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<tr>
<td>2019</td>
<td>Typhoon</td>
<td>08/09/19</td>
<td>08/11/19</td>
<td>Typhoon, Lekima, China</td>
<td>&gt; 855 million</td>
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<tr>
<td>2019</td>
<td>Typhoon</td>
<td>08/15/19</td>
<td>08/16/19</td>
<td>Typhoon, Krosa, Japan</td>
<td>&gt; 25 million</td>
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<tr>
<td>2019</td>
<td>Hurricane</td>
<td>08/31/19</td>
<td>09/07/19</td>
<td>Hurricane, Dorian, Caribbean, Bahamas, Canada</td>
<td>&gt; 1 billion</td>
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<tr>
<td>2019</td>
<td>Typhoon</td>
<td>09/05/19</td>
<td>09/08/19</td>
<td>Typhoon, Lingling, Japan, China, Korea</td>
<td>&gt;5.78 billion</td>
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</tr>
<tr>
<td>2019</td>
<td>Typhoon</td>
<td>09/08/19</td>
<td>09/09/19</td>
<td>Typhoon, Faxai, Japan</td>
<td>&gt; 7 billion</td>
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<tr>
<td>2019</td>
<td>Hurricane</td>
<td>09/19/19</td>
<td>09/22/19</td>
<td>Hurricane, Hummber, Bermuda</td>
<td>&gt;25+ million</td>
<td></td>
</tr>
</tbody>
</table>

Source: Munich Re's NAT CAT Service, Swiss Re Sigma and Aon Benfield
Risk-Based Capital
Preamble

History of Risk-Based Capital by the NAIC

A. Background

1. The NAIC, through its committees and working groups, facilitated many projects of importance to the insurance regulators, industry and users of statutory financial information in the early 1990s. That was evidenced by the original mission statement and charges given to the NAIC Capital Adequacy (E) Task Force (CADTF) of the Financial Condition (E) Committee.

2. From the inception of insurance regulation in the middle 1800s, the limitation of insurance company insolvency risk has been a major goal of the regulatory process. The requirement of adequate capital has been a major tool in limiting insolvency costs throughout the history of insurance regulation. Initially, the states enacted statutes requiring a specified minimum amount of capital and surplus for an insurance company to enter the business or to remain in business.

3. Fixed minimum capital requirements were largely based on the judgement of the drafters of statutes and varied widely among the states. Those fixed minimum capital and surplus requirement have served to protect the public reasonably well for over a century. However, they fail to recognize variations in risk between broad categories of key elements of insurance, nor do they recognize difference in the amount of capital appropriate for the size of various insurers.

4. In 1992, the NAIC adopted the life risk-based capital (RBC) formula with an implementation date of year-end 1993. The formula was developed for specific regulatory needs. Four major categories were identified for the life formula: Asset Risk, Insurance Risk, Interest Rate Risk and All other Business Risk. The property and casualty and health formulas were implemented in 1994 and 1998, respectively. The focus of these formulas is Asset Risk, Underwriting Risk, Credit Risk and Business Risk (Health).

5. The total RBC needed by an insurer to avoid being taken into conservatorship is the Authorized Control Level RBC, which is 50 percent of the sum of the RBC for the categories, adjusted for covariance. The covariance adjustment is meant to take into account that problems in all risk categories are not likely to occur at the same time.

6. The mission of the Capital Adequacy (E) Task Force CADTF was to determine the minimum amount of capital an insurer should be required to hold to avoid triggering various specific regulatory actions. The risk-based capital (RBC) formula largely consists of a series of risk factors that are applied to selected assets, liabilities or other specific company financial data to establish the minimum capital threshold levels generally needed to bear the risk arising from that item.

37. To carry out the mission, the Capital Adequacy (E) Task Force CADTF was charged with carrying out the following initiatives:

- Evaluate emerging "risk" issues for referral to the risk-based capital (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.
Preamble

- Review and evaluate company submissions for the schedule and corresponding adjustment to total adjusted capital (TAC).
- Monitor changes in accounting and reporting requirements resulting from the adoption and continuing maintenance of the revised NAIC Accounting Practices and Procedures Manual (AP&P Manual) and the NAIC Valuation Manual to ensure that model laws, publications, formulas, analysis tools, etc., supported by the Task Force continue to meet regulatory objectives.

48. The Risk-based Capital (RBC) forecasting and instructions were developed and are now maintained in accordance with the mission of the Capital Adequacy (E) Task Force (CADTF) as a method of measuring the minimum threshold amount of capital appropriate for an insurance company to support its overall business operations in consideration of avoid capital specific regulatory requirements based on its size and risk profile.

B. Purpose of Risk-Based Capital

59. The purpose of risk-based capital (RBC) is to identify potentially weakly capitalized companies. This facilitates regulatory actions that in most cases ensure policyholders will receive the benefits promised without relying on a guaranty association or taxpayer funds. Consequently, the RBC formula calculates capital level trigger points that enable regulatory intervention in the operation of such companies.

610. RBC instructions, RBC reports and adjusted report(s) are intended solely for use by the commissioner/state in monitoring the solvency of insurers and the need for possible corrective action with respect to insurers and are considered confidential. All domestic insurers are required to file an RBC report unless exempt by the Commissioner. There are no state permitted practices to modify the RBC formula and all insurers are required to abide by the RBC instructions.

711. Comparison of an insurer’s TAC to any RBC level is a regulatory tool which may indicate the need for possible corrective action with respect to the insurer and is not intended as a means to rank insurers generally. Therefore, except as otherwise required under the provisions of Risk-Based Capital (RBC) for Insurers Model Act (#312) or Risk-Based Capital (RBC) for Health Organizations Model Act (#315) (Model Laws), the making, publishing, disseminating, circulation or placing before the public, or causing, directly or indirectly to be made, published, disseminated, circulated or placed before the public, in a newspaper, magazine or other publication, or in a form of a notice, or in any other way, an advertisement, announcement or statement containing an assertion, representation or statement with regard to the RBC levels of any insurer or of any component derived in the calculation by any insurer is prohibited.

C. History of Risk-Based Capital

8. From the inception of insurance regulation in the middle 1800s, the limitation of insurance company insolvency risk has been a major goal of the regulatory process. The requirement of adequate capital has been a major tool in limiting insolvency costs throughout the history of insurance regulation. Initially, the states enacted statutes requiring a specified minimum amount of capital and surplus for an insurance company to enter the business or to remain in business.

9. In 1992, the NAIC adopted the life risk-based capital formula with an implementation date of year-end 1993. The formula was developed for specific regulatory needs. Four major categories were identified for the life formula: Asset Risk, Insurance Risk, Interest Rate Risk, and All other Business Risk. The property and casualty and health formulas were implemented in 1994 and 1998, respectively. The focus of these formulas is Asset Risk, Underwriting Risk, Credit Risk, and Business Risk.
10. The total risk-based capital needed by an insurer to avoid being taken into conservatorship is the Authorized Control Level Risk-Based Capital, which is 50 percent of the sum of the risk-based capital for the categories, adjusted for covariance. The covariance adjustment is meant to take into account that problems in all risk categories are not likely to occur at the same time.

**BC. Objectives of Risk-Based Capital Reports**

11. The primary responsibility of each state insurance department is to regulate insurance companies in accordance with state laws with an emphasis on solvency for the protection of policyholders. The ultimate objective of solvency regulation is to ensure that policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute, to provide an adequate margin of safety.

To support this role, the RBC reports identify potentially weakly capitalized companies in that each insurer must report situations where the actual Total Adjusted Capital is below a threshold amount for any of the several RBC levels. This is known as an RBC Event and reporting is mandatory. The state regulatory response is likely to be unique to each insurer as each insurer’s risk profile will have some differences from the average risk profile used to develop the RBC Formula factors and calculations.

There are several RBC Levels with different levels of anticipated additional regulatory oversight following the reporting of an RBC Event. Company Action Level (CAL) has the least amount of additional regulatory oversight as it envisions the company providing to its regulator a plan of action to increase capital or reduce risk or otherwise satisfy the regulator of the adequacy of its capital. The Regulatory Action Level (RAL) is the next higher level where the regulator is more directly involved in the development of the plan of action. The Authorized Control Level (ACL) anticipates an even higher amount of regulatory action in implementing the plan of action.

**CD. Critical Concepts of Risk-Based Capital**

12. Fixed minimum capital requirements have been largely based on the judgement of the drafters of statutes and varied widely among the states. Those fixed minimum capital and surplus requirement have served to protect the public reasonably well for over a century. Beginning in the 1960’s rapidly rising inflation brought rapidly rising interest rates.

13. Over the years, various financial models have been developed to try to measure the “right” amount of capital that an insurance company should hold. Risk-based capital seeks to modify the risk profile of all insurance companies to the point where they all have an equal probability of insolvency. "No single formula or ratio can give a complete picture of a company’s operations, let alone the operation of an entire industry. However, a properly designed formula will help in the early identification of companies with inadequate capital levels and allow corrective action to begin sooner. This should ultimately lower the number of company failures and reduce the cost of any failures that may occur.”

14. Because the NAIC formula develops a minimum threshold levels of capitalization rather than a target level, it is impractical to use the RBC formula to compare the minimum RBC level Ratio developed by one insurance company to the minimum level RBC Ratio developed by another. Comparisons of amounts that exceed the minimum threshold standards do not provide a definitive assessment of their relative financial strength. For this reason, the Model Law prohibits insurance companies, their agents and others involved in the business of insurance using the company’s RBC results to compare competitors.

15. The principal focus of solvency measurement is determination of financial condition through analysis of the financial statements and risk-based capital. However, protection of the policyholders can...
only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise’s ability to maintain itself as a going concern.

1616. The Capital Adequacy Task Force (CADTF) and its RBC Working Groups are charged with evaluating refinements to the existing NAIC risk-based capital formula and considering improvements and revisions to the various RBC blanks to 1) conform the RBC blanks to changes made in other areas of the NAIC to promote uniformity (when it is determined to be necessary); and 2) oversee the development of additional reporting formats within the existing RBC blanks as needs are identified.

1717. The Capital Adequacy (E) Task Force (CADTF) and its RBC Working groups will monitor and evaluate changes to the Annual Statement Blanks and Purposes and Procedure Manual of the NAIC Investment Analysis Office to determine if assets or specifically investments evaluated by the Security Valuation Office are relevant to the Risk-Based Capital formula in determining the minimum threshold capital and surplus for all insurance companies or whether reporting available to the regulator as a more appropriate means to addressing the risk. The Task Force will consider different methods of determining whether a particular risk should be added as a new risk to be studied and selected for a change to the applicable RBC formula, but due consideration will be given to the materiality of the risk to the industry as well as the very specific purpose of the RBC formulas to develop regulatory minimum threshold capital levels.
September 9, 2019 - sent electronically -

Commissioner Dave Altmaier, CATF Chair
and Ms. Jane Barr, NAIC Company Licensing and RBC Manager
National Association of Insurance Commissioners
701 Hall of the States
444 North Capitol Street, N.W.
Washington, D.C. 20001-1509

Re: AHIP’s Comments on the August 2019 exposure of a Risk-Based Capital (RBC) Preamble

Dear Commissioner Altmaier and Ms. Barr:

America’s Health Insurance Plans (AHIP) appreciates the opportunity to provide these comments on the RBC Preamble exposed at the August 2019 Summer National NAIC Meeting.

As AHIP noted in comments to the previous draft, we believe that a preamble is a positive addition to the RBC Framework and are supportive of adding one. We thank the Task Force for their receptiveness to comments on the previous draft. We believe the new version contains many improvements, however there are a few remaining areas where we believe small changes are needed in order to clarify the intent of RBC. These areas are as follows: (Note that we have also included a mark-up of the exposed preamble with the suggested wording changes):

Paragraph 3 - The last sentence seems to imply that RBC was/is needed because of rising interest rates and inflation. However, we think that was not the rationale. From the very beginning the concerns were with companies’ capital and variation in risk, as well as size of the company. Therefore, we recommend suggesting adding in place of the paragraph’s last sentence the following:

‘However, they fail to recognize variations in risk between broad categories of key elements of insurance, nor do they recognize differences in the amount of capital appropriate for the size of various insurers.’

Paragraph 6 – we suggest avoiding the use of the term “minimum capital” anywhere in the Preamble. The original purpose of RBC is not intended to set minimums, but rather specifies four threshold amounts or trigger points for varying types of regulatory oversight (see the comments on paragraph 12). Since the RBC formulas do not address all company issues (e.g. expansion into new areas, concentration of risk, etc.), the trigger points are for IDENTIFICATION and potential specific actions not minimums (like the state statutory requirements).
Paragraph 7 - The third bullet should also note the need to monitor the NAIC Valuation Manual as changes to reserves may well impact the risks (up or down) to the company's capital and surplus.

Paragraph 8 – We again suggest replacement of the word “minimum” with “threshold”. In addition, support for a company’s business operations goes well beyond RBC including future plans and potential needs to maintain certain business financial ratings. These are addressed by ORSA not by RBC. Hence, we have suggested alternate wording.

Paragraph 9 - The ending of this paragraph appears to say the all companies identified as "potentially weakly capitalized companies" are indeed weakly capitalized. That has been shown to not always be the case, as many companies have shown their regulators how the RBC components mis-identify them. We would recommend changing the ending to "in the operation of such companies."

In Paragraph 12 - We believe that the Preamble should not be silent on one of its most important elements - the use of multiple thresholds to identify issues and address them with less regulatory action. We recommend including the following additional paragraphs which outline the structure of the RBC Events approach.

“To support this role, the RBC Reports identify potentially weakly capitalized companies in that each insurer must report situations where the actual Total Adjusted Capital is below a threshold amount for any of the several RBC Levels. This is known as an RBC Event and reporting is mandatory. The state regulatory response is likely to be unique to each insurer as each insurer’s risk profile will have some differences from the average risk profile used to develop the RBC Formula factors and calculations.

There are several RBC Levels with different levels of anticipated additional regulatory oversight following the reporting of an RBC Event. Company Action Level (CAL) has the least amount of additional regulatory oversight as it envisions the company providing to its regulator a plan of action to increase capital or reduce risk or otherwise satisfy the regulator of the adequacy of its capital. The Regulatory Action Level (RAL) is the next higher level where the regulator is more directly involved in the development of the plan of action. The Authorized Control Level (ACL) anticipates an even higher amount of regulatory action in implementing the plan of action.”

In Paragraph 14 - We recommend the use of “RBC Ratio” and “threshold” rather than “minimum level” and “minimum” in this paragraph.

In Paragraph 17 - We recommend replacing “minimum” with “threshold” in this paragraph.
We thank you for your consideration of these comments and would be happy to address any questions the Task Force may have.

Sincerely,

Candy Gallaher, Senior Advisor – Policy and Government Affairs
America’s Health Insurance Plans
cgallaher@ahip.org

cc: William Weller, Omega Squared – Consultant to AHIP
    Ray Nelson, TriPlus Services – Consultant to AHIP
History of Risk-Based Capital by the NAIC

A. Background

1. The NAIC, through its committees and working groups, facilitated many projects of importance to the insurance regulators, industry and users of statutory financial information in the early 1990s. That was evidenced by the original mission statement and charges given to the NAIC Capital Adequacy (E) Task Force (CADTF) of the Financial Condition (E) Committee.

2. From the inception of insurance regulation in the middle 1800s, the limitation of insurance company insolvency risk has been a major goal of the regulatory process. The requirement of adequate capital has been a major tool in limiting insolvency costs throughout the history of insurance regulation. Initially, the states enacted statutes requiring a specified minimum amount of capital and surplus for an insurance company to enter the business or to remain in business.

3. Fixed minimum capital requirements were largely based on the judgement of the drafters of statutes and varied widely among the states. Those fixed minimum capital and surplus requirement have served to protect the public reasonably well for over a century. Beginning in the 1960’s rapidly rising inflation brought rapidly rising interest rates. However, they fail to recognize variations in risk between broad categories of key elements of insurance, nor do they recognize differences in the amount of capital appropriate for the size of various insurers.

4. In 1992, the NAIC adopted the life risk-based capital (RBC) formula with an implementation date of year-end 1993. The formula was developed for specific regulatory needs. Four major categories were identified for the life formula: Asset Risk, Insurance Risk, Interest Rate Risk and All other Business Risk. The property and casualty and health formulas were implemented in 1994 and 1998, respectively. The focus of these formulas is Asset Risk, Underwriting Risk, Credit Risk and Business Risk (Health).

5. The total RBC needed by an insurer to avoid being taken into conservatorship is the Authorized Control Level RBC, which is 50 percent of the sum of the RBC for the categories, adjusted for covariance. The covariance adjustment is meant to take into account that problems in all risk categories are not likely to occur at the same time.

6. The mission of the Capital Adequacy (E) Task Force (CADTF) was to determine the minimum amount of capital an insurer should be required to hold to avoid triggering various specific regulatory actions. The risk-based capital (RBC) formula largely consists of a series of risk factors that are applied to selected assets, liabilities or other specific company financial data to establish the minimum capital threshold levels generally needed to bear the risk arising from that item.

32. To carry out the mission, the Capital Adequacy (E) Task Force (CADTF) was charged with carrying out the following initiatives:

- Evaluate emerging "risk" issues for referral to the risk-based capital (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.
- Review and evaluate company submissions for the schedule and corresponding adjustment to total adjusted capital (TAC).
Preamble

- Monitor changes in accounting and reporting requirements resulting from the adoption and continuing maintenance of the revised NAIC Accounting Practices and Procedures Manual (AP&P Manual) and the NAIC Valuation Manual to ensure that model laws, publications, formulas, analysis tools, etc., supported by the Task Force continue to meet regulatory objectives.

48. The Risk-based Capital (RBC) forecasting and instructions were developed and are now maintained in accordance with the mission of the Capital Adequacy (E) Task Force (CADTF) as a method of measuring the minimum threshold amount of capital appropriate for an insurance company to avoid capital specific regulatory requirements based on support its overall business operations in consideration of its size and risk profile.

B. Purpose of Risk-Based Capital

59. The purpose of risk-based capital (RBC) is to identify potentially weakly capitalized companies. This facilitates regulatory actions that in most cases ensure policyholders will receive the benefits promised without relying on a guaranty association or taxpayer funds. Consequently, the RBC formula calculates capital level trigger points that enable regulatory intervention in the operation of such weakly capitalized companies, determine the minimum capital (RBC levels) an insurer needs to operate its business and insurers should seek to maintain capital above the RBC levels.

610. RBC instructions, RBC reports and adjusted report(s) are intended solely for use by the commissioner/state in monitoring the solvency of insurers and the need for possible corrective action with respect to insurers and are considered confidential. All domestic insurers are required to file an RBC report unless exempt by the Commissioner. There are no state permitted practices to modify the RBC formula and all insurers are required to abide by the RBC instructions.

211. Comparison of an insurer’s TAC to any RBC level is a regulatory tool which may indicate the need for possible corrective action with respect to the insurer and is not intended as a means to rank insurers generally. Therefore, except as otherwise required under the provisions of Risk-Based Capital (RBC) for Insurers Model Act (#312) or Risk-Based Capital (RBC) for Health Organizations Model Act (#315) (Model Laws), the making, publishing, disseminating, circulation or placing before the public, or causing, directly or indirectly to be made, published, disseminated, circulated or place before the public, in a newspaper, magazine or other publication, or in a form of a notice, or in any other way, an advertisement, announcement or statement containing an assertion, representation or statement with regard to the RBC levels of any insurer or of any component derived in the calculation by any insurer is prohibited.

C. History of Risk-Based Capital

8. From the inception of insurance regulation in the middle 1800s, the limitation of insurance company insolvency risk has been a major goal of the regulatory process. The requirement of adequate capital has been a major tool in limiting insolvency costs throughout the history of insurance regulation. Initially, the states enacted statutes requiring a specified minimum amount of capital and surplus for an insurance company to enter the business or to remain in business.

9. In 1992, the NAIC adopted the life risk-based capital formula with an implementation date of year-end 1993. The formula was developed for specific regulatory needs. Four major categories were identified for the life formula: Asset Risk, Insurance Risk, Interest Rate Risk, and All other Business Risk. The property and casualty, and health formulas were implemented in 1994 and 1998, respectively. The focus of these formulas is Asset Risk, Underwriting Risk, Credit Risk and Business Risk (Health).

10. The total risk-based capital needed by an insurer to avoid being taken into conservatorship is the Authorized Control Level Risk-Based Capital, which is 50 percent of the sum of the risk-based capital for the categories, adjusted for covariance. The covariance adjustment is meant to take into account.
account that problems in all risk categories are not likely to occur at the same time.
Preamble

**BC. Objectives of Risk-Based Capital Reports**

1112. The primary responsibility of each state insurance department is to regulate insurance companies in accordance with state laws with an emphasis on solvency for the protection of policyholders. The ultimate objective of solvency regulation is to ensure that policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute, to provide an adequate margin of safety.

To support this role, the RBC Reports identify potentially weakly capitalized companies in that each insurer must report situations where the actual Total Adjust Capital is below a threshold amount for any of the several RBC Levels. This is known as an RBC Event and reporting is mandatory. The state regulatory response is likely to be unique to each insurer as each insurer’s risk profile will have some differences from the average risk profile used to develop the RBC Formula factors and calculations.

There are several RBC Levels with different levels of anticipated additional regulatory oversight following the reporting of an RBC Event. Company Action Level (CAL) has the least amount of additional regulatory oversight as it envisions the company providing to its regulator a plan of action to increase capital or reduce risk or otherwise satisfy the regulator of the adequacy of its capital. The Regulatory Action Level (RAL) is the next higher level where the regulator is more directly involved in the development of the plan of action. The Authorized Control Level (ACL) anticipates an even higher amount of regulatory action in implementing the plan of action.

**CD. Critical Concepts of Risk-Based Capital**

12. Fixed minimum capital requirements have been largely based on the judgement of the drafters of statutes and varied widely among the states. Those fixed minimum capital and surplus requirement have served to protect the public reasonably well for over a century. Beginning in the 1960’s rapidly rising inflation brought rapidly rising interest rates.

13. Over the years, various financial models have been developed to try to measure the “right” amount of capital that an insurance company should hold. Risk-based capital seeks to modify the risk profile of all insurance companies to the point where they all have an equal probability of insolvency. No single formula or ratio can give a complete picture of a company’s operations, let alone the operation of an entire industry. However, a properly designed formula will help in the early identification of companies with inadequate capital levels and allow corrective action to begin sooner. This should ultimately lower the number of company failures and reduce the cost of any failures that may occur.

14. Because the NAIC formula develops a minimum threshold levels of capitalization rather than a target level, it is impractical to use the RBC formula to compare the RBC Risk Minimum RBC level developed by one insurance company to the RBC Risk Minimum level developed by another. Comparisons of amounts that exceed the threshold minimum standards do not provide a definitive assessment of their relative financial strength. For this reason, the Model Law prohibits insurance companies, their agents and others involved in the business of insurance using the company’s RBC results to compare competitors.

15. The principal focus of solvency measurement is determination of financial condition through analysis of the financial statements and risk-based capital. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise’s ability to maintain itself as a going concern.

16. The Capital Adequacy Task Force (CDTF) and its RBC Working Groups are charged with evaluating refinements to the existing NAIC risk-based capital formula and considering improvements and revisions to the various RBC blanks to 1) conform the RBC blanks to changes made in other areas of the NAIC to promote uniformity (when it is determined to be necessary); and 2) oversee the development of...
Preamble

additional reporting formats within the existing RBC blanks as needs are identified

1717. The Capital Adequacy (E) Task Force (CADTF) and its RBC Working groups will monitor and evaluate changes to the Annual Statement Blanks and Purposes and Procedure Manual of the NAIC Investment Analysis Office to determine if assets or specifically investments evaluated by the Security Valuation Office are relevant to the Risk-Based Capital formula in determining the threshold minimum capital and surplus for all insurance companies or whether reporting available to the regulator as a more appropriate means to addressing the risk. The Task Force will consider different methods of determining whether a particular risk should be added as a new risk to be studied and selected for a change to the applicable RBC formula, but due consideration will be given to the materiality of the risk to the industry as well as the very specific purpose of the RBC formulas to develop regulatory threshold minimum capital levels.

1 Page 6- Report of the Industry Advisory Committee to the Life Risk-Based Capital (E) Working Group (11/17/91)

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To: Commissioner David Altmaier, Chair of the Capital Adequacy (E) Task Force  
Kevin Fry, Chair of the Valuation of Securities (E) Task Force  
Jake Garn, Chair of the Blanks (E) Working Group  

From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group  

Date: August 13, 2018  
Re: NAIC Designations for Schedule D, Part 2 – Section 2 – Common Stocks  

The purpose of this referral is to communicate the Statutory Accounting Principles (E) Working Group’s support for the consideration of reporting revisions to permit NAIC designations for SEC registered funds (mutual funds, closed end funds and unit investment trusts), in scope of SSAP No. 30—Unaffiliated Common Stock (reported on Schedule D, Part 2 – Section 2 – Common Stock (D-2-2)), if determined appropriate based on the underlying holdings of the fund. (It is presumed that such NAIC designations would only be permitted for SEC registered funds that are comprised of bond or qualifying preferred stock investments.)

This referral was developed in response to requests to move equity investments that have underlying bond investments from the scope of SSAP No. 30 to the scope of SSAP No. 26R—Bonds in order to obtain more appropriate risk-based capital (RBC) charges. In reviewing the request, the Statutory Accounting Principles (E) Working Group has concluded against moving these equity investments to SSAP No. 26R for the following reasons:

- SEC registered funds in scope of SSAP No. 30 are not bonds, and do not represent a creditor relationship whereby there is a fixed schedule for one or more future payments.

- The long-term bond schedule (Schedule D-1) is not conducive to the reporting of funds, and questions often arise on the proper completion of Schedule D-1 for the limited equity investments already captured in scope of SSAP No. 26R. (For example, several columns on Schedule D-1 are not applicable for funds including interest rate, par value, maturity date, etc.)

- Existing guidance that allows SVO-Identified ETFs to be reported in scope of SSAP No. 26R, on Schedule D-1, has historically resulted with inconsistent reporting for similar investments. Companies may not identify that they have investments permitted for reporting on Schedule D-1 and continue to report these investments on Schedule D-2-2, or companies may infer the limited SSAP No. 26R provisions to additional investments that do not qualify for Schedule D-1 reporting.

- The desire for equity investments to be within scope of SSAP No. 26R is driven by RBC charges and not the investment structure or the measurement method for the investment.

Although the Statutory Accounting Principles (E) Working Group supports the consideration of revisions to permit NAIC designations on Schedule D-2-2, the Statutory Accounting Principles (E) Working Group defers to each of the identified groups in determining whether it is appropriate and feasible to incorporate these revisions. The ability to report NAIC designations on Schedule D-2-2 would require revisions that would include, at a minimum, the following assessments:


2. Valuation of Securities (E) Task Force – Consider and establish a methodology for reviewing equity investments with underlying bond investments and in determining the appropriate NAIC designation.
3. Capital Adequacy (E) Task Force – Consider and determine the extent, if any, the reported NAIC designation for the SEC registered investment should be factored into the RBC calculation.

Although the Statutory Accounting Principles (E) Working Group has previously communicated that they do not plan to entertain future requests to reclassify investments to be in scope of a different SSAP when the key driver is an RBC charge, this issue was raised as part of the Statutory Accounting Principles (E) Working Group’s current project to review SSAP No. 30 under the investment classification project. Going forward, if future requests are received, the Working Group intends to direct inquirers to the appropriate NAIC group for RBC assessment.

A referral response is not expected, as there will be no statutory accounting impact regardless of the ultimate decision. As noted, the Statutory Accounting Principles (E) Working Group has previously concluded against moving these equity investments from the scope of SSAP No. 30 to SSAP No. 26R.

Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group with any questions.

Cc: Julie Gann, Robin Marcotte, Fatima Sediqzad, Jake Stultz, Charles A. Therriault, Robert Carcano, Mary Caswell, Calvin Ferguson, Jane Barr, Lou Felice
To: Commissioner Altmaier, Chair of the Capital Adequacy (E) Task Force
    Kevin Fry, Chair of the Valuation of Securities (E) Task Force
From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
Date: November 27, 2018
Re: Foreign Mutual Funds

During the Fall National Meeting, the Statutory Accounting Principles (E) Working Group exposed agenda item 2018-34 proposing to explicitly include registered foreign mutual funds in scope of SSAP No. 30R—Unaffiliated Common Stock. (The revisions explicitly exclude other foreign funds from the scope of the SSAP.) This agenda item was developed pursuant to an industry request in response to substantive revisions to SSAP No. 30R. Although industry supported adopting the substantive revisions, it was identified that foreign mutual funds have previously been captured in scope of SSAP No. 30 (under the generic scope reference of “mutual funds”). The industry comments identified that the substantive revisions to include SEC-registered open-end funds (mutual funds), closed-end funds and unit-investment trusts in scope of SSAP No. 30R, perhaps inadvertently excluded foreign mutual funds. Consistent with industry’s request, the substantive revisions to SSAP No. 30R were adopted during the Fall National Meeting (under agenda item 2017-32), and the Working Group exposed proposed revisions to consider foreign mutual funds in scope.

Although there is a general assessment that foreign mutual funds should be treated similarly to foreign common stock, (which are in scope of SSAP No. 30R), the Statutory Accounting Principles (E) Working Group directed referrals to the Valuation of Securities (E) Task Force and the Capital Adequacy (E) Task Force to inquire on the exposure and solicit input. Specifically, comments were requested on the following questions:

1) Should only certain jurisdictions be permitted to have their registered mutual funds included as common stock? (For example, UK, Hong Kong, Canadian, etc.)

2) Should Canadian registered mutual funds continue to be considered “domestic securities” in accordance with the current annual statement instructions? (Under current annual statement instructions, Canadian securities are considered domestic securities.) Would the classification of Canadian mutual funds as “domestic” securities result with an inappropriate assessment that they represent U.S. SEC registered funds? If reported as domestic securities, should a new code or other reporting mechanism be established to identify Canadian mutual funds on Schedule D-2-2?

3) Should all foreign mutual funds be captured in the Supplemental Investment Risk Interrogatory as foreign investments? For example, question 4.01 of the Interrogatory asks whether foreign investments are less than 2.5% of total admitted assets. If an entity has more than 2.5% in foreign investments, then additional information on the foreign securities is required. The ultimate question is whether an investment in a registered foreign mutual fund should be captured in determining whether the foreign threshold percentage is met. If included in the total, then the issue is whether the subsequent foreign investment Integratory questions should be answered in accordance with the country that registered the fund, without a look-through to the underlying origin of the investments held in the foreign mutual fund. (The subsequent questions ask for the foreign investment exposure by the NAIC sovereign designation.) The risk is that allocating a foreign mutual fund to the registration country may not provide accurate information on the actual exposure of the investments within the fund, particularly if the registered foreign fund is made up of investments from other countries.
For example, SEC-registered mutual funds could be “global funds,” meaning they invest primarily in foreign companies with investments also in U.S. companies, or “international funds,” meaning that they invest in companies outside of the United States. Other SEC-Registered funds include “regional or country funds,” which invest primarily in a particular region or country, or “international index funds,” which seek to track the results of a particular foreign market or international index.

4) Should there be clarification that only U.S. SEC registered mutual funds are permitted to be identified as “diversified” and excluded from the Asset Concentration Factor section of the risk-based capital filing, or should all funds that are diversified in accordance with the SEC Investment Company Act of 1940 be excluded from this factor?

- The current interrogatory asks whether there are diversified mutual funds reported on Schedule D-2-2 (diversified according to the SEC Investment Company Act of 1940, Section 5(b)(1)). Technically, this current question does not restrict the reporting to SEC registered mutual funds. As such, it is uncertain whether foreign mutual funds that meet the diversification requirements of the 1940 Act are permitted to be reported in this Interrogatory.

- It has been communicated that certain Exchange Traded Funds (ETFs), although not registered as mutual funds, are diversified in accordance with the Investment Company Act of 1940, Section 5(b)(1). The question is whether these funds should be captured in the general interrogatory for exclusion from the asset concentration factor for RBC purposes. (If these funds should be captured in the GI, then a subsequent revisions will likely be proposed to clarify what is permitted to be reported.)

Thank you for your attention to this referral. If possible, a response would be preferred by Feb 15, 2019 to correspond with the Statutory Accounting Principles (E) Working Group exposure deadline. Consideration of comments received is planned to occur during the 2019 Spring National Meeting.

Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group with any questions.

Cc: Charles A. Therriault, Robert Carcano, Jane Barr, Julie Gann, Robin Marcotte, Jake Stultz and Fatima Sediqzad

Attachment: Agenda Item 2018-34
MEMORANDUM

TO: David Altmaier, Chair, Capital Adequacy (E) Task Force

FROM: Kevin Fry, Chair, Valuation of Securities (E) Task Force

CC: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
Robert Carcano, NAIC Consultant

RE: Referral to the Capital Adequacy (E) Task Force – Request for Assignment of Risk-Based Capital (RBC) Charges for Funds That Predominantly Hold Bonds

DATE: May 10, 2019

1. Introduction – The Valuation of Securities (E) Task Force requests that the Capital Adequacy (E) Task Force consider formally integrating the comprehensive instructions for mutual funds recently adopted for the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) into the NAIC RBC framework. The mutual funds for which integration is sought: 1) are issued by investment companies registered with and regulated by the U.S. Securities and Exchange Commission (SEC); 2) whose offering is registered with the SEC; 3) whose published investment objective is to invest solely in bonds or solely in preferred stock; 4) are all within scope of the Accounting Practices and Procedures Manual (AP&P Manual); 5) cannot be purchased and reported as filing exempt (FE) on the basis of a nationally recognized statistical rating organization (NRSRO) credit rating; and 6) are subject to a pre-purchase review and identification procedure performed by the SVO.1

2. Background – The primary financial solvency tool of the Valuation of Securities (E) Task Force is a number of related analytical methodologies for the quantification of non-payment risk. These tools have often been used to identify and facilitate investments that provide insurers a needed return at a lower non-payment risk. The Task Force first recognized that bond mutual funds could be structured to perform much better than equity in 1991. Over the next (almost) 30 years, the Task Force developed specific narrow exceptions where the SVO could analyze the cash flow from these specific bond fund types and determine if there would be lower non-payment risk than that associated with shares of common stock. Two Task Force exceptions adopted prior to the adoption of the AP&P Manual and one adopted afterward sought to characterize shares of such funds as being “bond-like” and were accommodated by including them as in scope of Statement of Statutory Accounting Principles SSAP No. 26R—Bonds. Over time, it became increasingly clear that the reporting of non-bond instruments in a framework developed for bonds produces reporting problems that can be avoided if it is recognized that the intent is to provide regulatory treatment consistent with credit risk.

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1 The Valuation of Securities (E) Task Force’s procedure permits the sponsor of a fund or an insurer to request an SVO assessment of a fund to determine if it meets requirements imposed by the Task Force for more appropriate treatment and if the fund is in scope of the AP&P Manual. If the fund is eligible, the SVO adds the name of the fund to the relevant list with a preliminary NAIC designation. The various lists are published. If an insurance company buys a fund on a list, it files that security with the SVO for an official NAIC designation. The SVO assigns an official NAIC designation and enters the security and designation into NAIC systems only after it confirms that nothing has changed since its initial assessment.
Since 2013, the SVO has expressed concern that it was frequently presented with bond mutual funds it could not designate, solely because they were not issued by an investment company operating as open-end management companies (the only company in scope of SSAP No. 30R—Unaffiliated Common Stock). Significant staff resources were being expended by the SVO and the NAIC Financial Regulatory Services (FRS) Division to manage the situation. In 2017, the SVO and the FRS Division asked the Task Force for permission to draft a clarifying amendment to the P&P Manual, explaining that mutual funds should not be filed with the SVO unless they strictly comply with the rules in the P&P Manual and AP&P Manual. The SVO staff also cautioned that the lack of a comprehensive approach to this asset class posed a significant risk to state insurance regulation because credit rating organizations were assigning credit ratings to funds that insurers could use to report fund shares as bonds under the FE rule. Therefore, the SVO urged the Task Force to consider modernizing the rules for bond mutual funds. On Sept. 27, 2017, the Task Force directed NAIC staff to develop a comprehensive proposal to ensure consistent treatment for investments in funds that only hold bond portfolios across all the schedules. About the same time, the Statutory Accounting Principles (E) Working Group announced a project to expand the scope of SSAP No. 30R to bring in scope funds issued by closed-end management companies and unit investment trusts. Subsequently, and in partial response to the Task Force’s fund initiative, the Working Group and the Blanks (E) Working Group expressed support for adding a column to Schedule D, Part 2, Section 2 that would permit funds designated by the SVO (and only funds designated by the SVO) to be reported on that schedule, but with an NAIC designation that could, in turn, align with an RBC factor to be determined by the Capital Adequacy (E) Task Force.

3. Referral – The Valuation of Securities (E) Task Force received and considered 18 comment letters: 15 in support and three opposed. The letters in support emphasized that the continued designation of bond funds assists financial solvency objectives of all insurers, but it is especially important for small and medium-size insurers, who face significant challenges and incur significant costs when purchasing individual bonds.

One letter opposed to the instructions argued that C-1 for bonds is based on default which bonds held by a fund will never experience because fund managers have an incentive to sell any bond that is downgraded. (The commenter’s observation that bonds in a portfolio would be sold before the default would seem to the SVO staff to be a positive attribute and in alignment with financial solvency objectives.) The point of this commenter was that funds are more likely to experience losses attributable to credit deterioration than to default, with the conclusion being that funds are not a proper subject for RBC. A second comment letter agreed that the current C-1 treatment for funds could be refined, but expressed concern that adopting a credit rating methodology could trigger materially lower, and potentially inadequate, life RBC charges without proper consideration of the risks to statutory surplus. Both of these arguments interpose highly technical arguments that not only ignore that the NAIC, through the Task Force and the SVO, have been assessing the cash flow and risk characteristics of bond funds for almost 30 years, but also ignores that the Task Force intentionally made a policy decision to use NAIC designations as a proxy to represent those risk characteristics of bond funds. They also ignore that while RBC factors are derived from an assessment of corporate bond defaults, they are applied to municipal and structured securities, as well as many other instruments that are not corporate bonds and do not have the cash flow or default risk characteristics of corporate bonds. The proposed continued use of the RBC framework for bond mutual funds is a similar recognition of the need to use available tools to provide workable (if imperfect) solutions to real-world challenges. Concerns expressed in a third comment letter were factually clarified in a number of public discussions, and the factual clarifications are summarized below for your convenience.2

2 The comprehensive instructions do not expand bond treatment or permit funds not in scope of the SSAPs. The proposal expands the existing framework to funds issued by investment companies organized as closed-end management companies and unit investment trusts. This was done to recognize that such U.S. Securities and Exchange Commission (SEC)-regulated funds may be identical to those issued by open-end management companies and to align the SVO framework with the AP&R Manual SSAPs, which bring these entities in scope of SSAP No. 30R as common stock reported on Schedule D, Part 2, Section 2. Investments in SVO-verified money market funds would still be reported as cash equivalents under SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments without a designation. SVO-identified bond exchange-traded funds (ETFs) would still be reported as bonds under SSAP No. 26R with an SVO-assigned NAIC designation, as has been the case since 2006. Investments in ETFs not captured on an SVO listing would continue to be reported as common stock under SSAP No. 30R without an NAIC designation. Private funds would still be reported as joint ventures under SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies captured on...
The Task Force requests that the Capital Adequacy (E) Task Force consider attributing the bond RBC factors to all bond and preferred stock funds. This approach is easy to implement and consistent with past NAIC practice; including both the role of the Valuation of Securities (E) Task Force in identifying the risks in securities and the practical approach expressed in the administration of the RBC framework, which is based on default characteristics of corporate bonds but applied to many other instruments with risk and default characteristics unlike those of corporate bonds. The recommended approach is sought for an NAIC activity successfully conducted for almost 30 years and for an asset class that is heavily regulated, has been successful for 85 years in many differing economic environments and provides potentially significant efficiencies to insurers.

Schedule BA, and annual financial statement instructions will continue to permit life and fraternal companies to report an NAIC designation for fixed-income investments.
MEMORANDUM

To: David Altmaier, Chair, Capital Adequacy (E) Task Force
From: Kevin Fry, Chair, Valuation of Securities (E) Task Force
Cc: Robert Carcano, Senior Counsel, NAIC Investment Analysis Office
    Julie Gann, Senior Manager, NAIC Financial Regulatory Services Division
Date: September 21, 2018
Re: Referral to the Capital Adequacy Task Force - Comprehensive Fund Proposal

1. Introduction – In mid-2017, the SVO and FRS asked for an instruction to draft guidance for the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to clarify eligibility of fund investments for assignment of NAIC Designations. The SVO explained that many funds are excluded from designation eligibility but are structurally identical to those permitted under the P&P Manual and the Accounting Practices and Procedures Manual (AP&PM). On Sept. 27, 2017, the Valuation of Securities (E) Task Force (VOS TF) directed NAIC staff to develop a comprehensive proposal to ensure consistent treatment for investments that involved funds that invest in bond portfolios.

2. Background – The VOS TF has permitted more appropriate treatment to funds that invest in bonds and possess other defined characteristics since 1991, as summarized below:
   - 1992 – Funds holding U.S. direct and full faith and credit obligations - exempted from reserving
   - 1995 – Short-term bond funds - holding high quality corporate & U.S./GSO obligations) - Schedule D; market value & reserved as bonds for AVR and RBC.
   - 2003 – Exchange Traded Funds that held bonds – report as bonds.
   - 2005 – BA assets with fixed income characteristics can be assigned NAIC Designations.
   - 2017 – SVO authorized to assign NAIC Designations to private Schedule BA funds, joint ventures or partnership interests if underlying investments are fixed-income like to align with Annual Reporting Instruction.

Significant efforts have also been made to align guidance in the P&P Manual and the AP&PM for this investment, as summarized below:
   - Investments in money market mutual funds are reported as cash equivalents under SSAP No. 2R without an NAIC Designation.
   - SVO-Identified Bond ETFs are reported as bonds under SSAP No. 26R with an NAIC designation as assigned by the SVO.
   - SVO-Identified Preferred Stock ETFs are reported as preferred stock under SSAP No. 32 with an NAIC designation as assigned by the SVO.

1 NAIC Proceedings 1991 Vol I-A pages 505, 520, 531
2 NAIC Proceedings, 1993 Vol 1B, page 770; and Nov. 9, 1992 minutes of the IMR/AVR Study Group
3 NAIC Proceedings, 1995 2Q, pages 419, 437, 467 – 472
4 NAIC Proceedings 2003 1Q, page 730; 2003 2Q, pages 810 - 813; 4Q page, 1859
6 See the minutes of the Valuation of Securities (E) Task Force conference call held November 13, 2017
Investments in ETFs (not captured on an SVO listing) are reported as common stock under SSAP No. 30 without an NAIC designation.

SVO-Identified Bond Mutual Funds are reported under SSAP No. 26R with an NAIC 1 designation.

All other mutual funds (regardless of what they hold, if they are not on an SVO listing) are reported under SSAP No. 30 without an NAIC designation.

Under a current initiative related to a review of SSAP No. 30 the SAP WG is considering whether all investments in a registered investment company should be captured in scope of SSAP No. 30. (This would expand the current reference to “mutual funds” to also include closed-end funds and unit investment trusts within scope of SSAP No. 30.) *(A related initiative is discussed in this footnote.)*

Guidance for non-SEC registered funds is not explicit within the AP&PM, but industry has reported such investments as joint ventures pursuant to **SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies.** These investments are captured on Schedule BA, with an NAIC designation permissible for fixed-income investments held by life and fraternal companies.

The Comprehensive Fund Proposal would unify guidance for all fund investments in a new section in the P&P Manual. All existing procedures for fund investments developed by the VOS TF since 1991 would be retained.8 The proposal would expand existing policy to funds issued by an investment company that is a closed end fund or a unit investment trust type registered with and regulated by the U.S. SEC. This tracks the SAPWG’s proposed expansion of SSAP No. 30 discussed above and the blanks initiative discussed in footnote 7. The policy that fund investments are not eligible for filing exemption would be extended to the new fund procedure and to private (Schedule BA) funds. Analytical definitions, criteria, methodology and instructions are modernized. Greater detail on analytics provides enhanced transparency to insurers.

### 3. Referral

The VOS TF refers to the CAD TF a recommendation that it conduct a comprehensive review of all funds (as described above) that can be assigned NAIC Designations by the SVO and consider how those NAIC Designations should be included into the RBC calculation; specifically, for the CAD TF to consider what RBC changes they would like to make once NAIC Designations are added to Schedule D-2-2. Currently, bond ETFs and private funds receive different RBC treatment than other similarly structured funds. Equalizing the RBC treatment for assets with similar credit risk, represented by the SVO assigned NAIC Designation, when joined with the proposed changes in the P&P Manual and those made in the AP&PM over the last several years would provide a consistent and uniform NAIC process consistent with regulatory needs for an asset that has experienced significant evolution since 1991.

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7 In furtherance of its consideration of SSAP No. 30, on August 15, 2018, the SAP WG sent a referral to the Capital Adequacy (E) Task Force, Valuation of Securities (E) Task Force and the Blanks (E) Working Group noting support for the consideration of revisions to permit NAIC designations on Schedule D-2-2 – Common Stock. As detailed within that referral, the SAPWG defers to each of the noted groups in determining whether it is appropriate and feasible to incorporate the revisions.

8 In each of the above assignments, if the SVO confirms that criteria and characteristics specified by the VOS TF are met, it places the name of the fund on a published List. An insurer can purchase any fund on the List and then files the fund shares with the SVO for an NAIC Designation. If the criteria and characteristics have not changed in the interim, the SVO assigns an NAIC Designation to the fund and annually reviews the Designation.