



AMERICAN ACADEMY *of* ACTUARIES

To: Elise Liebers, Chair, NAIC P&C RBC Working Group
From: Ralph Blanchard, Chair, AAA P&C RBC Task Force
Date: December 7, 1998
Subject: Report on AAA P&C RBC Task Force projects as of 12/7/98.

The following is a report on our current projects as of 12/7/98. It includes **one new recommendation, three updates of previous reports**, and status reports for projects to be completed next year.

New Recommendation - RBC for insurance affiliates held at (haircut) market value - (Attachment 1).

As requested, we have finished our analysis of RBC for insurance affiliates held at a haircut¹ market value.

After analysis by a subgroup, then discussion by the full American Academy of Actuaries P&C RBC Committee, we recommend an additional RBC charge for these insurance affiliates. The additional charge would be the excess of (haircut) market over statutory book, times the risk factor for non-insurance affiliates (currently 22.5% in the NAIC P&C RBC formula). This additional charge would be placed in R2, where the charges for non-insurance affiliates are currently found. (A more detailed write-up of our recommendation, including the underlying rationale, can be found in attachment 1.)

Updates of the False Positive, False Negative, and Ratio Stability analyses.

As requested, attached are updates to our previous analyses of RBC formula effectiveness. These updates reflect data through year-end 1997, where our previous reports only included data through year-end 1996.

¹ The haircut results from statutory valuations produced by the Securities Valuation Office, or SVO, and not from RBC. In the future, the haircut may also result from application of SSAP 46.

Attachment 2 contains an update of the False Positive analysis, attachment 3 contains an update of the False Negative analysis, and attachment 4 contains an update of the Ratio Stability analysis. These updates were consistent with the original reports' findings and recommendations, none of which would lead to a change in the current formula.

Status Reports for projects due for 1999 completion.

Codification - Included in attachment 5 is a list of SSAPs that will be reviewed by our committee. We hope to have reports on their RBC impacts by early 1999, with analysis of possible RBC reactions during 1999.

Analysis of loss sensitive credit - primary insurers - using Sched. P - Part 7 - Analysis uncovered numerous data issues in several companies' Schedule P - Part 7 filings. We are still pursuing research on these issues, but in the interim have started drafting possible instructions for future reporting. These instructions are meant to be a clarification, not a change in the schedule, and we hope to present them at the March NAIC meeting.

Analysis of loss sensitive credit - reinsurers - using Sched. P - Part 7 - Analysis in this area has also uncovered numerous data issues in individual company Schedule P - Part 7 filings. We hope to expand on the Part 7A instructions being drafted to produce recommended Part 7B instructions.

Adequate analysis of loss sensitive credits may depend on data improvements arising from these recommended instructions.

Analysis of two-year lines using ten-year data - Data has been received, courtesy of Todd Sells of the NAIC. Analysis is currently taking place, with completion expected by March 1999.

Retroactive Reinsurance treatment under RBC - We are finalizing our analysis of this issue. Our preliminary findings are that current RBC treatment could either over or understate the risk capital implications of these treaties. In some cases, the retroactive reinsurance could significantly reduce risk inherent in the loss reserves, implying that lower reserve risk charges would be justified. Other times the reinsurance may work in a similar fashion to non-tabular discounting, but with more favorable RBC treatment than that afforded non-tabular discounting. We expect to finalize our analysis shortly, with a final report presented once available, but no later than the March NAIC meeting.

Reinsurance discount factors - Lastly, given the data issues that impacted our last analysis of these factors, our committee decided an updated analysis (using 12/98 data) was justified. We expect to report on this analysis at the Fall 1999 NAIC meeting