



AMERICAN ACADEMY *of* ACTUARIES

December 4, 2004

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

Re: Proposed Capital Requirements for Variable Annuities
("C-3 Phase 2") –Volatility and Transition

Dear Mr. Felice:

The C-3 Phase 2 Work Group of the American Academy of Actuaries' Life Capital Adequacy Subcommittee would like to offer some suggestions concerning the American Council of Life Insurers' (ACLI) proposal for "Volatility and Transition" as presented in the material exposed for comment on the NAIC website. We neither endorse nor oppose the proposal itself, since we have said from the start of this project that the issues of smoothing year to year volatility and of transition were regulatory decisions.

These comments are intended to be helpful suggestions if the decision is made to accept the ACLI approach:

- a) The ratios being averaged should use the Total Asset Requirement (TAR) not the RBC. The reason is that no averaging is being proposed for reserves, which will be volatile. If TAR is smoothed, the result will be that reserve volatility will be partly offset in RBC. If RBC were the item smoothed, the reserve volatility would produce a volatile TAR.
- b) Companies that fully hedge the risks should be allowed to choose not to use the averaging approach. The reason is that the hedge values on the asset side will pass through the full impact of market moves without smoothing. Smoothing on the liability side will therefore result in a more volatile impact on surplus than if no smoothing were done. We suggest making this a company's choice to allow for the possibility that some companies may choose to hedge only partially (i.e. in a manner such that the change in the hedge asset value is less than 100% of the change in the liability value).
- c) Some insurers have covered products (such as reinsurance) that carry no cash surrender value. The cash surrender value of the underlying contracts may not be available. In that situation, we suggest using the contractholder fund values as the basis for the ratios being used. This doesn't represent a conceptual change from the method proposed, but just addresses a data problem

We will be glad to discuss these comments at your convenience.

Sincerely,
Robert A. Brown – Chairperson

Cc: Philip Barlow, DC
Todd Sells, NAIC
William Schreiner, ACLI