



AMERICAN ACADEMY *of* ACTUARIES

May 28, 2002

To: NAIC Life Risk-Based Capital Working Group

From: Academy Life Capital Adequacy Subcommittee

Re: Category C Companies

This memo responds to the following question regarding the Life Risk-Based Capital instructions that was raised by Kerry Krantz in an e-mail dated March 28, 2002:

“If an actuarial opinion size C company answered Yes to question (1.1) on page LR23 in either of the two prior years after submitting an unqualified Section 8 opinion that year, but, as permitted by the actuarial opinion regulation did not submit a section 8 opinion in the current year, should a company be permitted to answer ‘Yes’ in the current year?”

Response

Under the circumstances outlined in Mr. Krantz’s e-mail, the members of the Academy’s Life Capital Adequacy Subcommittee believe that a size C company should be permitted to answer “Yes” to question 1.1 on page LR23 of the Life Risk-Based Capital worksheets. The following paragraphs outline the reasoning behind our response.

Background

The question relates to the National Association of Insurance Commissioners’ (NAIC) Model Actuarial Opinion and Memorandum Regulation (AOMR) as originally adopted in January 1993. The NAIC adopted a new model AOMR in November 2001, which has yet to be enacted by the individual state legislatures. The January 1993 version of the AOMR is the context in which this response is provided.

A “size C company” refers to those companies that are defined as “Category C” in the AOMR. The AOMR grants, under a given set of circumstances, Category C companies with a partial exemption whereby they are required to file a Statement of Actuarial Opinion Based On an Asset Adequacy Analysis (a “Section 8 opinion”) once every three years instead of every year. Question 1.1 on page LR23 of the Life Risk-Based Capital worksheets asks if the company actuary has prepared an unqualified Section 8 opinion. A “Yes” response results in a lower factor in the determination of the C-3 component of Risk-Based Capital.

Thus, if a Category C company files an unqualified Section 8 opinion every three years, in accordance with the provisions of the AOMR, the question is whether such company is permitted to answer “Yes” to question 1.1 in those years in which a Section 8 opinion is not filed.

Rationale

In filing a Section 8 opinion once every three years, valuation actuaries for Category C companies have met their regulatory and professional obligations. The net effect of this provision of the AOMR is that Section 8 opinions for Category C companies are valid for three years. Consistency between reserve and Risk-Based Capital requirements would ordain that, question 1.1 on page LR023 of the Risk-Based Capital worksheets, be answered “Yes” over the same three-year period.

If Category C companies were required to file a Section 8 opinion every year in order to be permitted to answer “Yes” to question 1.1 on page LR023, the Risk-Based Capital rules would effectively usurp the exemption that is granted by the AOMR. Category C companies, faced with the choice of either dealing with significant year-to-year volatility in their Risk-Based Capital ratios or filing annual Section 8 opinions, would likely opt for the latter. We do not believe that Risk-Based Capital rules are intended to override provisions of the AOMR, nor do we believe that it is appropriate for them to do so.

The partial exemption provided by the AOMR for Category C companies requires the meeting of certain criteria which are defined in Section 6 of the AOMR. Also, Section 3 of the AOMR empowers the Commissioner to require a Section 8 opinion if he or she deems it necessary. Thus, there are sufficient provisions in place that require more frequent Section 8 opinions from Category C companies if warranted by the situation.