



AMERICAN ACADEMY *of* ACTUARIES

TO: NAIC Life Risk-Based Capital Task Force

FROM: The Academy's Life Risk-Based Capital Task Force

DATE: December 3, 1998

SUBJECT: Revised Life Risk-Based Capital Instructions for C-1 Risk for Modified Coinsurance and Funds Withheld.

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At the request of the NAIC Life Risk-Based Capital Task Force, the Academy's Life Risk-Based Capital Task Force has developed a recommendation for specific changes to the C-1 component of the Life Risk-Based Capital instructions to reflect the effect of modified coinsurance and funds withheld reinsurance agreements.

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As requested by the NAIC Life Risk-Based Capital Task Force, the Academy's Life Risk-Based Capital Task Force has developed a recommendation for specific changes to the C-1 component of the Life Risk Based Capital instructions to reflect the effect of modified coinsurance and funds withheld reinsurance agreements.

The principles used in the development of the changes follow:

1. The guiding document is the Academy Proposal dated March 11, 1998 (attached).
2. We didn't want to complicate the form too much (i.e., we didn't want to triple the amount of lines required when adding ceded and assumed). Thus, for most asset classes we simply added three lines (one ceded, one assumed and one net).
3. We thought it impractical and unwise to do a separate adjustment for the concentration factor.
 - In most instances, the concentration factor is a small percentage of the total RBC.
 - The necessary aggregation or non-aggregation by issuer is often quite complex, let alone taking into account mod-co adjustments and the timing of reporting.
 - In this context, there is no ready definition for the assets net of ceded.
4. Instructions and factors for C-2 and C-3 RBC are as per the May, 1997 NAIC draft.

Attached are the following:

- Exhibit A. Modco and Funds Withheld Reinsurance Agreements
- Exhibit B. Changes to LR002, LR004, LR005, LR006, LR007, LR008, and LR009; and
- Exhibit C. Two additional forms showing the breakdown by company of the C-1 adjustments for reinsurance ceded and reinsurance assumed. The form requires that the C-1 adjustments be shown in two parts – (1) the adjustment to RBC for bonds before application of the size factor, and (2) the sum of all other C-1 adjustments.

We would be happy to work with the NAIC as needed to finalize these instructions.

EXHIBIT A

Modco and Funds Withheld Reinsurance Agreements

Basis

When the default risk in modified coinsurance (MODCO) and other reinsurance transactions with funds withheld is transferred, this transfer should be recognized by reducing the RBC for the ceding company and increasing it for the assuming company.

Assets

The total RBC related to assets (i.e., bonds, mortgages, unaffiliated preferred and common stock, separate accounts, real estate, and other long term assets) in MODCO and Funds Withheld reinsurance agreements, should be reduced (increased) by the amounts of RBC ceded (assumed). There is a separate line in each asset section to achieve this reduction (i.e. "Reduction in RBC for MODCO and Funds Withheld reinsurance ceded agreements") The amount ceded is determined using the assets supporting the ceded liabilities as of December 31. (In some instances, there may be assets in a trust that exceed the amount needed to support the liabilities; only the portion of assets used to support the ceded liabilities is used to determine the ceded RBC). The ceding company will need to supply the assuming company with sufficient information in order for the assuming company to determine the amount of RBC assumed. With the exception of the impact of the size factor, the amount of RBC ceded should be equal to the amount of RBC assumed. Put another way, there should be "mirror imaging" of RBC, except for the impact of the size factor. For MODCO and Funds Withheld reinsurance agreements, there will be no specific, line-by-line inventory of ceded assets and corresponding ceded RBC; however, ceding and assuming companies must keep detailed records, and be prepared to produce those records upon request.

Size Factor

Companies with MODCO and Funds Withheld reinsurance agreements should adjust their year-end size factors according to the way the bonds are handled in the treaties. The assuming company includes the bonds that support its share of the liabilities; the ceding company includes the bonds that support its share of the liabilities. No adjustment is made for bonds that were purchased subsequent to June 30 of the valuation year and which solely support ceded liabilities.

Mortgages

The amount of RBC for mortgages is based upon the ceding company's calculation for the mortgages, or portion of these mortgages, which support the ceded liabilities. Thus, the amount of RBC ceded is equal to the amount of RBC assumed.

EXHIBIT B

Changes to LR002

- (17) Total Long-Term and Short-Term Bonds (pre-MODCO/Funds Withheld
- (18) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (19) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (20) Total Long-Term and Short-Term Bonds (incl. MODCO/Funds Withheld adjustments.) Lines (17) - (18) + (19)
- (21) Non-exempt Asset Class 1 U.S. **
- (22) Bonds Subject to Size Factor. Lines (20) - (1) - (9) - (21)
- (23) Number of Issuers
- (24) Size Factor for Bonds
- (25) Bonds Subject to Size Factor after the Size Factor is applied. Lines (22) x (24)
- (26) Total Bonds. Lines (21) + (25)

** Only investments in asset Class 1 U.S. Government agency bonds previously reported in Lines (2) and (10), net of those included on Line (18), plus the portion of Line (19) attributable to ceding companies' Lines (2) and (10) should be included on Line (21). No other class 1 bonds should be included on this line. Exempt U.S. Government bonds shown on Lines (1) and (9) should not be included on Line (21). Refer to the bond section of the risk-based capital instructions for more clarification.

Changes to LR004

- (19a) Total Mortgages (including due and unpaid taxes) Sum of Lines (1) through (18)
- (19b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (19c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (19d) Total Mortgages (including MODCO/Funds Withheld.) Lines (19a) - (19b) + (19c)

Changes to LR005

- (14a) Total Unaffiliated Preferred and Common Stock. Line (7) + Line (13)
- (14b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (14c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (14d) Total Unaffiliated Preferred and Common Stock (including MODCO/Funds Withheld.)

EXHIBIT B - Continued

Lines (14a) - (14b) + (14c)

Changes to LR006

- (4a) Total Assets in Separate Accounts with Guarantees. Line (1) + Line (2) + Line (3)
- (4b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (4c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (4d) Total Assets in Separate Accounts with Guarantees (including MODCO/Funds Withheld) Lines (4a) - (4b) + (4c)

Changes to LR007

- (13a) Total Real Estate. Lines (4) + (8) + (12)
- (13b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (13c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (13d) Total Real Estate (including MODCO/Funds Withheld.) Lines (13a) - (13b) + (13c)
- (17a) Total Schedule BA Real Estate. Lines (14) - (15) + (16)
- (17b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (17c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (17d) Total Schedule BA Real Estate (including MODCO/Funds Withheld.)
Lines (17a) - (17b) + (17c)

Changes to LR008

- (8a) Total Schedule BA Bonds. Sum of Lines (1) through (7)
- (8b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (8c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (8d) Total Schedule BA Bonds (including MODCO/Funds Withheld.)
Lines (8a) - (8b) + (8c)
- (15a) Total Schedule BA Preferred Stock. Sum of Lines (9c) through (14)
- (15b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (15c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (15d) Total Schedule BA Preferred Stock (including MODCO/Funds Withheld.)
Lines (15a)-(15b)+(15c)
- (22a) Total Rated Surplus Notes. Sum of Lines (16) through (21)

EXHIBIT B - Continued

- (22b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (22c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (22d) Total Rated Surplus Notes (including MODCO/Funds Withheld.)
Lines (22a) - (22b) + (22c)

Changes to LR009

- (8a) Total Schedule BA Mortgages Sum of Lines (1) through (7)
- (8b) Reduction in RBC for MODCO/Funds Withheld reinsurance ceded agreements
- (8c) Increase in RBC for MODCO/Funds Withheld reinsurance assumed agreements
- (8d) Total Schedule BA Mortgages (including MODCO/Funds Withheld.)
Lines (8a) - (8b) + (8c)

EXHIBIT C

**Summary Statement of C-1 RBC for Companies
With MODCO or Funds Withheld Reinsurance Agreements**

Reinsurance Ceded

Bonds

List below, by reinsurer, the amount of C-1 RBC you have ceded that is attributable to Bonds. Attach additional sheets if necessary. The "total" should equal the amount of the reduction in C-1 RBC shown on Line 18 of page LR002 in the NAIC Life Risk-Based Capital Report.

Reinsurer Ceded C-1 RBC Amount

- 1)
 - 2)
 - 3)
 - 4)
 - 5)
-

Total

All Other Assets

List below, by reinsurer, the amount of C-1 RBC you have ceded attributable to all assets except Bonds. Attach additional sheets if necessary. The "total" should equal the total amount of the reduction of C-1 RBC attributable to all assets except bonds in the NAIC Life Risk-Based Capital Report for MODCO.

Reinsurer Ceded C-1 RBC Amount

- 1)
 - 2)
 - 3)
 - 4)
 - 5)
-

Total

EXHIBIT C - continued

Reinsurance Assumed

Bonds

List below, by ceding company, the amount of C-1 RBC you have assumed that is attributable to Bonds. Attach additional sheets if necessary. The "total " should equal the amount of the increase in C-1 RBC shown on Line 19 of page LR002 in the NAIC Life Risk-Based Capital Report.

<u>Ceding Company</u>	<u>Assumed C-1 RBC Amount</u>
1)	
2)	
3)	
4)	
5)	
<hr/>	
Total	

All Other Assets

List below, by ceding company, the amount of C-1 RBC you have assumed attributable to all assets except Bonds. Attach additional sheets if necessary. The "total " should equal the total amount of the Increase of C-1 RBC attributable to all assets except bonds in the NAIC Life Risk-Based Capital Report for MODCO and Funds Withheld Agreements.

<u>Ceding Company</u>	<u>Assumed C-1 RBC Amount</u>
1)	
2)	
3)	
4)	
5)	
<hr/>	
Total	
