



AMERICAN ACADEMY *of* ACTUARIES

Report of the American Academy of Actuaries Life Risk-Based Capital Task Force on Risk-Based Capital Charges for Affiliated Alien (non-Canadian) Life Insurers to the National Association of Insurance Commissioners' Life Risk-Based Capital Working Group

March 2000 - Chicago, IL

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The American Academy of Actuaries' Life Risk-Based Capital Task Force prepared this report.

Life Risk-Based Capital Task Force

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Risk-Based Capital Charges for Affiliated Alien (non-Canadian) Life Insurers

Background

The NAIC Life Risk-Based Capital Working Group requested the AAA Life Risk-Based Capital Task Force to review the risk factor for Affiliated Alien (non-Canadian) Life Insurers. In both the Life and Property and Casualty formulas, the charge for this risk is a component of C_0 . The charge is 100% of statement value in the Life formula but only 50% of statement value in the Property and Casualty formula.

Recommendation

The Task Force reviewed the risk factor for this asset class and recommends that no change be made in the Life RBC calculation. Factors considered in reaching this recommendation include:

- The current risk factor of 100% of statement value is the highest risk factor for any asset class, including the 30% risk factor for domestic insurers not subject to Risk Based Capital.
- History suggests the risk factor is reflective of concerns over potential inability to access surplus in foreign life insurance subsidiaries to absorb risks in other operations, as well as a concern about “stacking” these subsidiaries to reduce measured risk.
- We considered an approach similar to that now used for Canadian life insurers, but rejected it on the grounds of practicality. The effort required to understand fully the products, accounting and reserving standards, and regulatory capital models in a number of countries appeared to outweigh the value of this refinement in the model for the vast majority of companies.
- Companies with the highest proportion of Surplus and Asset Valuation Reserve invested in this asset class would benefit the most from a potential reduction in risk factor to 50%. Within that group, companies with the highest RBC ratio would enjoy the largest percentage increase in their RBC ratio. On the other hand, a reduction in the risk factor may result in some companies, whose current RBC ratio is within the range of regulatory attention, being able to escape that attention. Since the RBC Model is intended to help focus regulatory attention, that result does not appear helpful.
- Continuing the risk factor at 100% of statement value would continue to provide the incentive to company management to move these investments out from under the ownership of the domestic life parent, increasing the transparency of financial results and capital adequacy of the life insurance company parent, and simplifying the review of the parent by state insurance regulators.

If you have any questions concerning this report, please contact Damien McAndrews of the American Academy of Actuaries at 202-223-8196.