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December 19, 2016

Mr. Alan Seeley
Chair, Operational Risk (E) Subgroup
National Association of Insurance Commissioners

Re: Proposed Operational Risk Factors and Growth Charge

Dear Mr. Seeley:

The Property and Casualty Risk-Based Capital Committee and Health Solvency Subcommittee of the American Academy of Actuaries¹ appreciate the opportunity to comment on the NAIC's Operational Risk Subgroup's Oct. 17, 2016, exposure draft that proposes changes to the risk-based capital (RBC) formulas for property/casualty and health.

We recognize the desirability of considering operational risk in the RBC Formulas. We believe the add-on approach, with an add-on of no more than 3 percent of RBC, is a reminder of the existence of the risk, while not being unduly disruptive to the current P/C and health RBC formulas.

If the magnitude of the add-on were increased, we believe the following issues should be considered:

- Overlap between operational risk and the risks already included in the RBC formula need to be reviewed carefully. In particular, we note that the underwriting risk element of the RBC formula has been calibrated with essentially complete industry data that includes the financial effects of many operational risks. We also note that the growth risk of the P/C and health formulas also include elements of operational risk.
- The scope of operational risks to be included in the new risk charge should be reviewed to assist in evaluating the extent of the overlap.
- The calibration of the magnitude of the add-on should be carefully considered. For example, in setting a P/C or health add-on, based on a benchmark from another formula

¹ The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

or individual companies, the relevance of the benchmark source to U.S. RBC for the applicable types of companies needs to be considered.

Finally, we note that the add-on approach, combined with the nature of the R0 and H0 (subsidiary risk) element of the RBC formula, means that there is potential for duplication of operational risk charges between parent insurance companies and insurance subsidiaries. The impact of this issue should be reviewed in 2017 for possible adjustments for 2018.

As noted above, we are supportive of the proposal to implement an add-on of 3 percent to represent basic operational risk and remain committed to working with the NAIC in conducting further analysis of this topic. If you have questions, please contact David Linn, health policy analyst (linn@actuary.org), or Marc Rosenberg, senior casualty policy analyst (rosenberg@actuary.org).

Sincerely,

Tim Deno, MAAA, FSA
Chairperson, Health Solvency
Subcommittee
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Tom McIntyre, MAAA, FCAS, CERA
Chairperson, Property/Casualty RBC
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Cc: Lou Felice, Solvency and Capital Policy Advisor, NAIC
Patrick McNaughton, Chair, NAIC Health RBC Working Group
Tom Botsko, Chair, NAIC Property and Casualty RBC Working Group