



AMERICAN ACADEMY *of* ACTUARIES

June 18, 2014

Mark Birdsall, Chair
Life Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners

Dear Mark,

The American Academy of Actuaries'¹ Stress Testing Work Group has reviewed your straw-man proposal for stress testing and we have some initial thoughts and follow up questions for you that might be useful in shaping future discussions.

Our understanding of your current proposal is as follows:

- Objectives:
 - Determine the capital requirements policies whose reserves are PBR based – an alternative to C-3 Phase 3. PBR will be applied to new business but C-3 RBC is expected to be applied to inforce.
 - The change to RBC should be proportional to the risk. In other words, the effort involved with calculating the capital requirements should acknowledge an insurer's exposure to that risk.
 - Modify the RBC process to facilitate changes in a more efficient, less time consuming manner.
- The stress testing would apply to all business of life insurers (i.e., total balance sheet). As a point of clarification, would the stress testing also apply to the non-insurance business of a life insurer?
- The stress testing requirement would apply only to insurers that are exempt from ORSA.
- Stress tests might be a combination of company designed and mandated scenarios.
- Initially, the stress testing results would be submitted on an informational only basis. Eventually, the stress testing results could form the basis for recalibrating the regulatory action triggers (e.g., supplement the current 150 – 75% action levels).

The Academy's Stress Testing Work Group has the following observations and questions:

1. You stated a goal of completing field testing from July-December 2014. Based on our experience with modeling and stress testing, six months is a very aggressive schedule to design, implement, and analyze stress testing. This schedule is particularly burdensome for smaller companies, especially those insurers not expected to be subject to ORSA. Our understanding is that you are hoping to alleviate some of the work load for the smaller companies, or those companies whose

¹ The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists 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.

risks do not suggest the need for sophisticated modeling. As contemplated, the requirement for smaller companies to produce stress testing may be greater than the resources needed to produce an ORSA.

Thus far, ORSA has been discussed in the context of size exemptions. However, we think that once ORSA becomes an established practice, there will likely be some pressure to use consistent or even identical stress tests for ORSA and in the calculation of statutory reserves and capital. Whether the use of consistent stress tests is appropriate is an important issue in need of discussion. The effort involved with ORSA compliance, PBR, and other statutory requirements is significant; this stress testing requirement will require additional effort. Ideally, this stress testing requirement can be constructed with consideration of the resources required.

2. A practical issue for the Academy's Life Practice Council is how best to utilize our volunteer resources. We are interested in supporting any efforts that help evaluate the strength of insurers' balance sheets. What is the expected process and timing for NAIC approval? This information will help us determine how best to utilize resources and prioritize this project.
3. Have you received any feedback from industry groups or insurers on your proposal?
4. As the use of stress testing has been discussed over the last several months, several concepts have been put forward. The replacement of the C-3 component with stress testing has been discussed, as has replacing or supplementing the regulatory RBC trigger points with a stress testing framework. Further, some discussions moved beyond RBC with the goal of integrating reserve and capital levels via stress testing. The effort with stress testing varies tremendously depending on the scope, as does the potential impact on insurance regulation. Has the subgroup finalized the scope of the proposal that will be tested?

The Life Practice Council and the Academy's Stress Testing Work Group is very interested in being involved with the conceptual design and potential implementation of your stress testing proposal. However, we recognize the potential game-changing impact of the use of stress testing in U.S. statutory reporting. We also want to be mindful of the time and resources needed to engage in this project. A discussion of the questions we raised above will go a long way toward shaping this project for a successful outcome.

We look forward to further discussions and if you have any questions please contact John Meetz, the Academy's life policy analyst (202-223-8196; meetz@actuary.org).

Sincerely,

Dana Hunt, FSA, MAAA,
Chairperson, Stress Testing Work Group
American Academy of Actuaries