AMERICAN ACADEMY *of* ACTUARIES

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June 6, 2018

Mr. Stephen Wiest
Chair, Operational Risk (E) Subgroup
National Association of Insurance Commissioners

Re: Discussion of Prospective Operational Risk Growth Charge to be incorporated into the Life RBC ("LRBC") Formula

Mr. Wiest,

On behalf of the Life Operational Risk Work Group of the American Academy of Actuaries,[1] and as a follow-up to our previous letters and discussions surrounding a growth component to be potentially incorporated into the LRBC framework (an Operational Risk Growth Charge, or "Growth Charge"), we are pleased to assist the NAIC by providing our commentary on a potential Growth Charge to be incorporated into LRBC.

Executive Summary

We do not believe that an explicit charge for growth should be added to the LRBC formula due primarily to the following (additional commentary is provided in the next section):

- Unlike the majority of health insurance and property & casualty (P/C) insurance businesses, life insurance business is long duration in nature. Therefore, should a company experience rapid growth, any potential impact would manifest itself over many years.
- We note that rapid growth would increase the existing C1 – C4 factors correspondingly; said differently, growth is already implicitly addressed by the current factors.
- We note that rapid growth for life insurance companies has typically been the result of an acquisition, entrance into a new market, or introduction of a new product type. In such instances, any additional risk exposure has typically been absorbed within a relatively

[1] The American Academy of Actuaries is a 19,000-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.

short period of time, and normal operations continued, subject to the insurer's existing controls.

- We believe there are other tools (detailed below) which regulators have at their disposal that would likely be more effective in addressing any cases of rapid growth in the circumstance where an insurer has not successfully absorbed the growth.

- We also note the lack of any past circumstances where life insurance company insolvency was the direct result of rapid growth.

Life Insurance Fundamentals

Unlike the health and P/C insurance businesses, where products tend to be annually renewable and shorter duration in nature, the life insurance industry has historically been a sector of slow and steady growth. Such slow growth is driven by the long duration nature of the products that life insurers write, the lack of significant first mover advantage due to ease of replication of new products across the industry, high attention paid to risk measurement, and mitigation across the industry. Most life insurers have well defined distribution channels which are not easily penetrated by competitors, at least not for any meaningful period of time. In short, life insurance contracts are "for life." Life insurance premiums are not reset annually or periodically to reflect changing risks as is the case with most health and P/C premiums.

For these reasons, a significant spike in growth for a life insurer over a number of years would be extremely unusual. Should such growth occur, we believe regulators have tools at their disposal which would be more effective in identifying and addressing the specific situation. Specifically: (1) Insurance Regulatory Information System ("IRIS") ratios are available to review in conjunction with past insolvencies or troubled company situations; (2) Own Risk and Solvency Assessment ("ORSA") filings require companies to assess their operational risk exposures, which includes excessive growth; (3) The NAIC has several working groups (e.g., the Financial Analysis Working Group and the ORSA Implementation Subgroup), which provide information to regulators on an ongoing basis and which helps inform how they look at the risk exposures of the companies they oversee; and (4) The regular financial examination process, which can be supplemented by off-cycle "targeted" exams if needed.

We also note that the current LRBC charges, C1 – C4, are calculated as prescribed percentages of four elements of a life insurer's financials: (1) net amount at risk ("NAR"), (2) direct written premium, (3) policy reserves, and (4) invested assets. Any case of rapid growth would increase most, and likely all, of elements (1) – (4), which would increase LRBC correspondingly. Essentially, growth is implicitly addressed in the C1 – C4 factors currently in place. We believe it would be redundant to add a separate charge for growth, or for any sub-risk under the umbrella of operational risk.

Insolvency History

Since the implementation of RBC in the early 1990s, there have been very few life insurance company insolvencies. We note that, upon cursory review, rapid growth was not a primary driver of any of those insolvencies. We are happy to perform further research on such insolvencies.

Conclusion

We do not believe that there is a need for a separate Growth Charge in LRBC. We believe that the longer duration nature of the life business, the fact that the current LRBC factors already implicitly address growth, and the other, much more effective tools which regulators have at their disposal to address growth, all support this view.

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Thank you for the opportunity to comment. If you have any questions or would like to further discuss these topics, please contact Ian Trepanier (trepanier@actuary.org) at the American Academy of Actuaries.

Sincerely,

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Chairperson, Life Operational Risk Work Group
American Academy of Actuaries

Cc: Lou Felice, Solvency and Capital Policy Advisor, NAIC
Philip Barlow, Chair, NAIC Life RBC Working Group