



AMERICAN ACADEMY *of* ACTUARIES

Ms. Elise Liebers
Chair, NAIC RBC Task Force
New York Department of Insurance
25 Beaver Street
New York, New York 10004

Re: Academy Assistance in Review of RBC for Assets

Dear Ms. Liebers:

The Joint Risk Based Capital (RBC) Committee of the American Academy of Actuaries¹ has reviewed the proposed request as outlined in Part 5 of the NAIC RBC Task Force minutes of December 7, 1999.

We note that there are three specific components mentioned, although two have multiple parts:

- 1a) The common stock component;
- 1b) Varying RBC factors to reflect the relative risk profile of a carrier's common stock portfolio;
- 2a) RBC factors for Health Care Delivery Assets (HCDA);
- 2b) RBC factors for Other Assets established or revalued under codification; and
- 3) Asset risks as impacted by covariance.

We also recognize that there was substantial discussion of the scope of such a charge to the Academy - to include all three formulas or to address some of the above for only the Managed Care Organizations' Risk Based Capital (MCO-RBC) formula. The Academy is prepared to assist the NAIC. We make the following comments solely to assure that you have the best information to formulate the charge or charges you wish to give the Academy to be accomplished within an acceptable time frame, given other areas of each formula that you are expecting the Academy to devote time to during 2000.

1a) Common Stock Component

The RBC factor for common stocks, including how it is affected by covariance, is different for the three formulas. The factors for the Property and Casualty (P&C) and Life and Health (L&H) formulas were developed at different times using different bases for analyzing potential variations in value. No separate work was done for the MCO-RBC formula that used the P&C factor and the Life covariance. Thus, none of the formulas would produce the same effect from the same statutory amount of common stock.

A limited review by the Academy's Health Organization Risk Based Capital (HORBC) Task Force

focusing on which basis for the factor and covariance is most suitable for the MCO-RBC formula is doable during 2000. This assumes that the Academy would not be expected to review alternatives to the existing three approaches.

We also note that the existing common stock factors, to the extent adjusted to reflect the statutory impact of federal income tax in the previous RBC development, may be subject to change because of the establishment of a deferred tax asset as part of codification. The Academy's Life RBC Task Force is preparing recommendations for changes resulting from codification and the other Academy groups will review that work for the other formulas during 2000.

1b) Common Stock Component - Variations Based on Portfolio Risk Profile

Both life insurance industry representatives and insurance regulators have already suggested more extensive analysis of the common stock component. Some work has been done to date. This change could be done fairly quickly if the definitions that were developed for Life Blank Beta adjustments to Asset Valuation Reserve (AVR) for common stocks were the only factors used. The definitions are attached. Anything more extensive than this approach, for example, expanding the Beta adjustment beyond publicly traded common stocks to the extent material, could take substantially longer.

2a) RBC Factor for Health Care Delivery Assets

The Academy's HORBC Task Force is prepared to review the use of a single factor (based on the Life formula real estate data) for all types of HCDAs. We expect that this should be completed prior to June 2001 and reflect HCDA information collected as part of the 1998 and 1999 MCO-RBC filings.

2b) RBC Factors for Other Assets Established or Revalued by Codification

As noted in the discussion of 1a), the Academy's Life RBC Task Force is already underway in this analysis. The plan is to present recommendations in June 2000 based only on changes in the way in which the statutory value of assets is determined after January 1, 2001. New asset types, or assets now established subject to special admitted limitations (electronic data processing equipment, Goodwill and Deferred Federal Income Taxes), will be reviewed for recommended factors solely to be consistent with the factors for other assets. Thus, no new studies of asset value variations are anticipated.

3) Asset Risks Impacted by Covariance

The Academy is prepared to assist the NAIC staff in an analysis of the impact of changing existing covariance rules for each formula to each of the other existing covariance rules, if the NAIC is looking to increase the consistency of the formulas.

Much work has been done on the covariance between common stocks and bonds. For example, the life insurance industry prepared such an analysis between common stocks and bonds during 1998. An additional extensive review of historical statistical covariance values with the goal of

recommending values other than zero or one could be a major undertaking.

Academy staff and members of the various RBC Task Forces will be on the conference call to answer any questions. The members of the Academy's Joint RBC Committee are:

William C. Weller, Chairperson
Robert A. Brown
Burton D. Jay
Albert A. Riggieri

Ralph S. Blanchard III
Alan D. Ford
James F. Reiskytl
Michael L. Zurcher

Sincerely,

Donna C. Novak
Vice President, Financial Reporting Council

Attachment

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¹ The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, regulators and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance.