



AMERICAN ACADEMY *of* ACTUARIES

September 5, 2003

To: Mike Boerner
Chair, Ad Hoc Subgroup of the NAIC Risk-Based Capital Task Force

From: Rowen Bell
Chair, AAA Joint Risk-Based Capital Work Group

Re: Trend Test Charge

I wanted to confirm in writing the Academy's willingness to accept the charge articulated by the Ad Hoc Subgroup at its June 2003 meeting, which we understand to be as follows:

“Provide recommendations regarding possible trend test(s) for P&C RBC and for Health RBC and provide recommendations regarding any changes to the Life RBC trend test. Any trend test should strive to provide regulatory action level reporting prior to a company entering an action level which may be based on a significant deterioration in RBC ratios. Considerations and support should be provided for recommendations made.

Based on initial discussions within our work group, we see this project as having two distinct phases. In the first phase, we will prepare a written interim report in which we define and document many of the relevant issues regarding the trend test concept. We would anticipate completing the first phase in the fourth quarter of 2003. In the second phase, we will prepare a final report containing recommended solutions, based on the framework laid out in the interim report and on our analysis of relevant data. We expect that work on the second phase will continue into 2004.

Since much of the work in the second phase will rely heavily on data analysis, we wanted to provide the NAIC now with an initial data request. Although we may later find that we require additional data, we think the information below will allow us to get a good start on our analysis.

For each of the three¹ formulas, and for each year available going back to the inception of each formula, we would like to have the following information on a company-by-company basis:

- NAIC company code;
- NAIC group code;
- State of domicile;
- Business type from jurat page [applies only to post-2000 Health blank];

¹ Prior to 2001, the MCO (now Health) formula had two variants, HMO and HMDI, corresponding to the two blanks in use at that time. We will want information for each of these variants.

- Total Adjusted Capital;
- Authorized Control Level RBC;
- “Net premium”, i.e. the top line of the income statement (P&C and HMDI = premiums earned; Life = premium and annuity considerations; Health = net premium income; HMO = premium);²
- “Loss reserves”, i.e. the top line of the P&C and Health liability statement (P&C = losses; Life = accident & health contract claims; Health and HMDI = claims unpaid; HMO = claims payable);
- “Loss adjustment reserves”, i.e. the third line of the P&C and Health liability statement (P&C = loss adjustment expenses; Health and HMDI = unpaid claim adjustment expenses; Life and HMO = N/A);
- “Policy reserves”, i.e. the top lines of the Life liability statement (Life = aggregate reserve for life + accident & health; Health = aggregate policy reserves; P&C, HMO, HMDI = N/A)
- Change in surplus notes;
- Cumulative effect of changes in accounting principles;
- Capital changes and surplus adjustments [note this is six separate statement lines];
- Dividends to stockholders.

Since part of our analysis will involve tracking the time series evolution of individual companies’ RBC levels and understanding whether or not that evolution was affected by any exogenous circumstances, we feel it is important that we be able to identify individual companies in the data by their actual NAIC company codes. As all of the information that we are currently requesting is in principle publicly available, we trust that this will not be a problem. If in a later data request we were to ask for information that is not publicly available (e.g., information available only in the RBC Report), then we would need to discuss further confidentiality protections at that time.

By the same token, since it is vital for our purposes that we understand exactly why a given company vanishes from the NAIC database, we would additionally request any company-specific information that the NAIC can provide as to the timing of mergers, supervisions, and liquidations during the period being studied. Along the same lines, any information that the NAIC can provide as to which P&C companies are the “flagship” of their group would be beneficial.

Please let me know if you or any of the other members of the subgroup have any questions or concerns over our planned approach or over our data request.

² For P&C companies only, we would also like net premiums written in addition to premiums earned.