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RBC Developments Include New C-3 Approach

by Bob Brown

The American Academy of Actuaries Life Risk Based Capital Task Force has presented a recommendation for a revised risk-based capital formula to the NAIC, in response to their request. This recommendation introduces a refinement to the development of the interest rate risk (C-3) component.

The proposed method capitalizes on cash flow models used for Asset Adequacy Analysis, if they exist, by requiring that certain interest sensitive products (generally, annuity products) be evaluated against a set of adverse interest rate scenarios and the results used in place of the current tabular factors. As a way to provide flexibility in the trade off between effort and accuracy, the proposal provides for a set of 50 scenarios, with reasonable calibration, and a more conservative 12 scenario set. The insurance company may choose which set they use.

In addition to the scenario-generated result for tested products and the tabular factors (using the original factors) for untested products, this recommendation has a third component for assets which are callable below the current statutory carrying value.

The task force recommendation is that the sum of the three items described here be compared to the tabular C-3 result determined under the current formula and, at least initially, that the final RBC amount be constrained to the range of .5 times to 2 times the amount determined by using the current formula.

The full text of the Academy's recommendation can be found on-line at: *http://www.actuary.org/1999.htm*

This report was delivered at the October 1999 NAIC meeting and exposed for comment. Two comment letters from the industry were received. They requested that the regulators consider the possibility of allowing highly capitalized companies with modest C-3 exposure to be exempt from having to do scenario testing. These comments were discussed at the December NAIC meeting. The NAIC Working Group asked those who made that suggestion to develop a specific approach for review and consideration and to do so by early February, with a conference call to be scheduled for discussion.

The next steps will be for the regulators to vote on whether to modify the Risk Based Capital calculation as recommended by the Academy, either with or without the exemption from scenario testing for some companies. The Academy recommendation provides for a December 31, 2000, effective date, but that is also up to the NAIC.

Beyond this phase, the Academy was asked to develop a methodology to measure C-3 risk (asset mismatch risk) for mismatches other than interest rate-driven, such as equity indexed products, variable products, and guaranteed index products. That will be the focus of the Academy task force's future work.

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Tradition lives on

Outgoing chairperson Shirley Shao passes on the traditional chairperson's green coat to incoming chairperson Mike McLaughlin at the October 1999 Council meeting. (L - R) Mike Lombardi and Ed Robbins join in the joke.