



Risk-Based Capital Newsletter

NAIC

National Association of Insurance Commissioners

C-3 Phase I Instructions Modified to Include More Companies

At the June 10, 2006, meeting of the Life Risk-Based Capital Working Group, instruction changed for the C-3 Phase I calculation. The instructions were modified to require the additional RBC cash flow testing for more companies.

Companies with more than \$100 million in assets and with products that qualify for testing will be required to do the additional RBC testing. Companies with less than \$100 million in assets will only need to complete the testing if either of the LR043 exemption tests were triggered.

The LR024 Interest Rate Risk Line (33) instructions were changed to read as follows:

“Line (33) should only be completed by companies who do cash flow testing of certain annuities and single premium life insurance for asset adequacy (see Appendix 1) except those with less than \$100 million in admitted assets at the end of 2006, unless the answer to Line (14) or Line (22) of LR043 Exemption Test: Cash Flow Testing for C-3 RBC is “Yes” or if the company chooses to do C-3 RBC cash flow testing on a continuing basis.”

What RBC Pages Should be Submitted?

For year-end 2006 Life RBC, submit hard copies of pages **LR001 through LR043** to the NAIC in addition to the electronic filing. If any actuarial certifications are required per the RBC instructions those should be included as well.

Other pages, such as the mortgage and real estate worksheets, do not need to be submitted, but still need to be retained by the company as documentation.

C-3 Phase II Instructions Changed

Numerous changes were made to clarify the year-end 2006 C-3 Phase II Market Risk instructions as a result of questions received from year-end 2005. Those changes were adopted at the June 10, 2006, meeting of the Life Risk-Based Capital Working Group.

The changes made to the instructions include: (The page references are to the year-end 2005 life RBC instructions.)

- a. Page 11 – Instructions added for LR006 Lines 11 and 12 for CARVM expense allowances. Changes address Q&A #6.
- b. Page 43 – The five-step process for calculating Line (35) was changed to a nine-step process as follows:
 1. Calculate the Total Asset Requirement – TAR, and include the tax adjustment.
 2. Reduce the amount in step 1 by the interest rate portion of the risk.
 3. Calculate standard scenario amount.
 4. Take the greater of steps 2 and 3.
 5. Apply the smoothing and transition rules (if applicable) to the step 4 amount.
 6. Add the general account interest rate portion of the risk to the amount in step 5.

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C-3 Phase II Instructions Changed (Continued)

- b. Page 43 – The five-step process for calculating Line (35) was changed to a nine-step process as follows: (Continued)
 - 7. Subtract the statutory reserves from the amount in item 6 subject to a floor of zero.
 - 8. Divide the amount in step 6 by 0.65 for a pre-tax amount.
 - 9. Split the amount in step 8 into an interest rate risk portion and a market risk portion.
- c. Page 44 – Clarification and expansion were made to item G actuarial certification instructions due to company questions and to better match the requirements specified in the American Academy of Actuaries (AAA) June 2005 C-3 Phase II report.
- d. Page 44 – Item H added to specify that the actuarial memorandum needs to be completed to match AAA June 2005 report.
- e. Page 48 – Sentence added and amounts changed in Table I for the proposal to have one 20% drop rather than two 10% drops for the standard scenario.
- f. Pages 51 and 52 – Changes to smoothing and transition that had already been adopted last year for year-end 2006. Should address Q&A #14.
- g. Page 52 – Sentences added to indicate smoothing is optional and approval will be needed to change smoothing decision. Should address Q&A #16.
- h. Page 53 – Sentence added under “LR024 Line 35 Amount” to clarify reporting of C-3 Phase I amounts on Line 33. Changes were made because of Q&A #1.
- i. Page 54 – Instructions for living benefits were deleted since they no longer apply. Addressed Q&A #17.

The 2005 Q&A can currently be found at: http://www.naic.org/documents/committees_e_cap_ad_lrbc_C3_phasell_questions.doc

The 2006 proposal can currently be found on page 31 of the materials distributed for 6/10/2006 Life RBC Working Group meeting: http://www.naic.org/documents/committees_e_cap_ad_lrbc_0606_advance.pdf

Dividend Adjustment to Total Adjusted Capital (TAC)

At the June 10, 2006, meeting of the Life Risk-Based Capital Working Group, instructions were added to LR030 Calculation of TAC for Lines (3) and (4) for dividends.

In general, a credit to TAC for dividends will not be allowed to either company when a block is reinsured. However, in situations involving experience rated refunds or other special features, an actuary would apply professional judgment to determine the appropriate amount of the TAC credit for the ceding company.

The following two questions should be considered concerning business that is reinsured:

1. Does the company have "total control" over the dividend decision?
2. Does the full benefit of any future ability to change the dividend scale flow to the company?

A “no” answer to the first of these questions will eliminate the company's ability to take credit for the dividend provision related to the policies reinsured. A “no” answer to the second will indicate that the credit might be limited and that actuarial judgment should be used to determine the amount of the credit.

Considerations for determining the credit include:

- The degree to which the block is reinsured.
- The provisions of the reinsurance agreement regarding the sharing of dividend payments.
- Any provisions for sharing costs in the reinsurance agreement.
- Any other relevant provisions of the reinsurance agreement.

Where actuarial judgment is used to determine the credit, the factor can range between zero and 50%. For year-end 2006, the Lines (3) and (4) factor will not be adjustable. The statement value used in LR030 Column (1) will need to be adjusted to get the correct RBC Requirement.

An actuarial certification is required to be filed with the RBC report when actuarial judgment is used to determine the credit.

New Medicare Part D Prescription Drug Coverage Calculations

A proposal to add RBC calculations for Medicare Part D prescription drug coverage was adopted at the Dec. 3, 2005, meeting and the Feb. 22, 2006, conference call of the Capital Adequacy (E) Task Force.

The RBC proposal was done in conjunction with the accounting and annual statement treatment. INT 05-05 addressed the Medicare Part D accounting treatment. A Medicare Part D supplement was added to the annual statement blank along with changes to the annual statement instructions.

LR016 Health Premiums

Four new lines were added to 2006 RBC LR016 Health Premiums for Medicare Part D prescription drug coverage:

LR016 Health Premiums	Factor
Medicare Part D Coverage - Individual	Calculated on LR017
Supplemental benefits within Part D Coverage - Individual	0.120
Medicare Part D Coverage - Group	Calculated on LR017
Supplemental benefits within Part D Coverage - Group	0.120

LR017 Underwriting Risk – Experience Fluctuation Risk

A new column for Medicare Part D Prescription drug coverage was added to page LR017 Underwriting Risk – Experience Fluctuation Risk.

The alternate risk charge is calculated as the greater of 150,000 or 6 times the maximum individual risk.

The underwriting factors are 0.141 for the first 25 million of premium and 0.109 for premiums above 25 million. Premiums are multiplied by the claims ratio and the weighted average underwriting factor.

LR019 Underwriting Risk – Managed Care Credit

A managed care credit is calculated for LR017 line (12). A new column and new lines were added to page LR019 for the Medicare Part D prescription drug coverage:

LR019 Claims Category	Factor
Category 0 - No Federal Reinsurance or Risk Corridor Protection	XXX
Category 1 - Federal Reinsurance but no Risk Corridor Protection	XXX
Category 2a - No Federal Reinsurance but Risk Corridor Protection	0.500
Category 3a - Federal Reinsurance and Risk Corridor Protection apply	0.650

New Medicare Part D Prescription Drug Coverage Calculations (Continued)

The resulting weighted average factor for the two lines will be subtracted from one and carried forward to LR017 Column (4) Line (12).

Sample Calculation

Assumptions:

- Total Premium – \$50 million.
- Total Claims – \$5 million.
- Maximum Individual Risk – \$20,000.
- All claims are in category 3a – federal reinsurance and risk-corridor protection.

Claims Ratio:

5,000,000 claims / 50,000,000 premiums
= 0.10 claims ratio

Underwriting Factor:

25,000,000 x 0.141 = 3,525,000
 25,000,000 x 0.109 = 2,725,000
 Total 6,250,000
 6,250,000 / 50,000,000 = 0.125 underwriting factor

Managed Care Discount:

5,000,000 claims x 0.65 managed care factor
 = 3,250,000 weighted claims
 3,250,000 weighted claims / 5,000,000 total claims
 = 0.65 weighted average managed care discount
 1.0 – 0.65 = 0.35 managed care discount adjustment factor

Alternate Risk Charge:

6 x 20,000 maximum individual risk = 120,000
 120,000 is less than 150,000 so the alternate risk charge is 120,000.

Sample Calculation (Continued)

RBC Charge:

50,000,000 total premium
 x 0.10 claims ratio
 x 0.125 underwriting factor
 = 625,000 base underwriting risk RBC charge
 x 0.35 managed care discount
 = 218,750 base RBC after managed care discount

The 218,750 base RBC is greater than the 120,000 alternate risk charge. So, the total RBC charge reported on page LR017 Column (4) Line (18) would be \$218,750.

Workers' Compensation Carve-Out Factors

Workers' compensation carve-out business factors were changed for page LR018 Underwriting Risk – Other Lines (4), (5) and (6.3). This is due to the factors for the calculation being phased in over a three-year period as follows:

	2004 Factors	2005 Factors	2006 Factors
Line (4) Net Premiums Written	0.121	0.243	0.364
Line (5) Claim Liability and Reserve	0.116	0.231	0.347
Line(6.3) Unaffiliated Reinsurance Recoverables	0.020	0.040	0.060

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