



Risk-Based Capital Newsletter

NAIC

National Association of Insurance Commissioners

Changes Made to the Deferred Tax Asset Sensitivity Test

Adopted at the Mar. 18, 2011, conference call of the Capital Adequacy (E) Task Force was a correction proposal to the deferred tax asset (DTA) sensitivity test.

New lines were added to LR033 Calculation of Total Adjusted Capital page to make adjustments for insurance subsidiaries and to eliminate the RBC charge for DTAs on the LR017 Off-Balance Sheet and Other Items page from Authorized Control Level RBC.

For 2012, the current SSAP No. 10R is expected to be replaced with new accounting guidance for DTA admission (likely called SSAP No. 101). Depending on what accounting guidance is decided upon by the Statutory Accounting Principles (E) Working Group, the current RBC sensitivity test and RBC charge for DTAs on the LR017 Off-Balance Sheet and Other Items page may be adjusted.

Non-U.S. Life Affiliates Proposal

Adopted at the Oct. 18, 2010 meeting of the Life Risk-Based Capital (E) Working Group was a non-U.S. life affiliates proposal.

Guidance was added to the instructions to eliminate the RBC charge for non-U.S. affiliates on the LR041 Details for Affiliated Investments page and instead eliminate the carrying value of the affiliates from Total Adjusted Capital.

What Risk-Based Capital Pages Should be Submitted?

For year-end 2011 Life RBC, submit hard copies of pages **LR001 through LR046** to any state that requests a hard copy in addition to the electronic filing. Starting with year-end 2007 RBC, a hard copy was not required to be submitted to the NAIC. But a PDF file representing the hard copy filing is part of the electronic filing.

If any actuarial certifications are required per the RBC instructions, those should be included as part of the hard copy filing. Starting with year-end 2008 RBC, the actuarial certifications were also part of the electronic RBC filing as PDF files similar to the annual statement actuarial opinion.

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.

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Derivatives Risk Mitigation Proposal

Adopted at the Jan. 6, 2011, conference call of the Life Risk-Based Capital (E) Working Group was a derivatives risk mitigation proposal. The proposal added two new pages to the Life RBC formula in addition to adjustment lines on the LR002 Bonds and LR005 Unaffiliated Preferred and Common Stock pages.

One-to-one credit default swaps for bonds and common stock will now be allowed an RBC credit. To account for the difference between insurers that have hedged the debt security to full maturity versus those with a mismatched position, the determination of the RBC credit shall be made in accordance with the following formula which limits the results to a fraction of the C-1 charge for the hedged asset:

$$\text{RBC Credit As \% of C1 Asset Charge} = \text{Min} \left(1, \frac{\text{Time to Maturity of CDS}}{\text{Time to Maturity of Bond}} \right) \times (94\% - 10\%) + 10\%$$

This formula accounts for mismatched maturities and provides a regulatory margin of safety within a range of 94%-10% of the C-1 asset charge.

In addition, a basket or index based derivative (e.g. CDX family of derivatives) with the same or very similar components as the portfolio may also receive RBC credit. For these hedges the risk reduction shall be measured based on the number of issuers common to the both the insurer's portfolio and the index/basket CDS. A minimum of 50% overlap of the derivative instrument notional amount and the book adjusted carrying value of the hedged bonds shall be required to qualify for any RBC credit. Examples of the new LR014 Hedged Asset Bond Schedule and LR015 Hedged Asset Common Stock Schedule can be found on the Life Risk-Based Capital (E) Working Group website:

http://www.naic.org/committees_e_capad_lrbc.htm

New Hedging Fair Value Adjustment Line

Adopted at the Jan. 6, 2011, conference call of the Life Risk-Based Capital (E) Working Group was a hedging fair value adjustment proposal. A new Line (5) Hedging Fair Value Adjustment was added to page LR033 Calculation of Total Adjusted Capital. The line was added in order to mitigate the effects of derivative accounting mismatches. An adjustment is required when all of the following conditions exist:

1. the bond is not carried at fair value, 2. the bond is hedged with a credit derivative and RBC is being reduced for the hedge, 3. the credit derivative is carried at fair value, and 4. the bond has never been written-down pursuant to the recording of an other-than-temporary impairment.

When these conditions exist, the adjustment shall never be less than zero and shall be based on any unrealized gain of the credit derivative, determined as the lesser of 1 or 2 below:

1. Book/Adjusted Carrying Value of the credit derivative from Schedule DB minus the sum of the Prior Year and Current Year Initial Cost of the credit derivative from Schedule DB,
2. The reduction in RBC arising from the hedge.

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