

June 7, 2010

To: Lou Felice, Chair of the Capital Adequacy (E) Task Force

From: Director Christina Urias, Chair of the Solvency Modernization Initiative (EX) Task Force

Subject: SMI's RBC Proposals

Dear Lou Felice:

The Solvency Modernization Initiative (EX) Task Force and its Working Groups have been critically reviewing our U.S. financial regulatory system in the Solvency Modernization Initiative (SMI). We have agreed that our risk-based capital (RBC) requirements should continue to be a component in the legal framework of U.S. solvency regulation in order to maintain a floor for triggering regulatory intervention. We also noted that it has been a number of years since RBC was first created in the 1990s and that, while we have made updates over the years, it is time for a holistic evaluation of the RBC formulas, factors, and methodology.

The SMI Task Force is seeking your Task Force's advice on the scope of changes for RBC within the SMI, as well as a proposed timeline for implementation. The following provides some items for consideration. Would you please let us know if you agree with these suggestions, whether there are additional RBC issues that should be addressed in the SMI, and what deadlines should be attached to each part of the project:

- (1) Selection of the calibration ("safety") level and time horizon for the RBC, recognizing that the RBC is designed to identify weakly capitalized companies rather than to mirror a company's economic target capital calculations.
- (2) Identification of missing risks (e.g. P&C Catastrophe risk, operational risk) in the RBC formula and creation of risk charges for those missing risks.
- (3) Modification to the formula: asset categories, current factors, modeling where factor-based approaches are not sufficient to capture the identified risk, and covariance.
- (4) Development of modeling requirements and regulatory approval processes where the modeling requirements are principles-based.
- (5) Re-evaluation of the thresholds for the action and control levels.
- (6) Recalibration of the RBC.
- (7) Completion of impact studies.

In determining deadlines, please aim for full utilization of the NAIC's new Distinguished Scholar who will be dedicated to the RBC modernization project for one year starting in July.

Your Task Force might find the background information contained in the *Consultation Paper on Regulatory Capital Requirements and Overarching Accounting/Valuation Issues for the Solvency Modernization Initiative* (http://www.naic.org/documents/committees_ex_isftf_1003_capital_req.doc) helpful while investigating the details.

Thank you for your assistance in this priority NAIC initiative.

Director Christina Urias

cc: Solvency Modernization Initiative (EX) Task Force
Kris DeFrain, NAIC
Dan Swanson, NAIC

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EXECUTIVE OFFICE	444 N. Capital Street, NW, Suite 701	Washington, DC 20001-1509	p 202.471.3990	f 616.460.7493
CENTRAL OFFICE	2301 McGee Street, Suite 800	Kansas City, MO 64108-2652	p 816.842.3600	f 816.783.8175
SECURITIES VALUATION OFFICE	48 Wall Street, 6th Floor	New York, NY 10005-2906	p 212.398.9000	f 212.362.4207