

Capital Adequacy (E) Task Force

RBC Proposal Form

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|---|---|--|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input checked="" type="checkbox"/> Op Risk RBC (E) Subgroup |
| <input type="checkbox"/> C3 Phase II/ AG43 (E/A) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Stress Testing (E) Subgroup |

<p style="text-align: right;">DATE: <u>10/12/2017</u></p> <p>CONTACT PERSON: <u>Lou Felice</u></p> <p>TELEPHONE: <u>212-386-1956</u></p> <p>EMAIL ADDRESS: <u>lfelice@naic.org</u></p> <p>ON BEHALF OF: <u>Operational Risk (E) Subgroup</u></p> <p>NAME: <u>Alan Seeley</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>New Mexico Office of the Super of Ins</u></p> <p>ADDRESS: _____</p>	<p style="text-align: center;"><u>FOR NAIC USE ONLY</u></p> <hr/> <p>Agenda Item # <u>2017-16-O</u></p> <p>Year <u>2018</u></p> <hr/> <p style="text-align: center;"><u>DISPOSITION</u></p> <p><input checked="" type="checkbox"/> ADOPTED 4/30/2018 _____</p> <p><input type="checkbox"/> REJECTED _____</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input checked="" type="checkbox"/> EXPOSED _____</p> <p><input type="checkbox"/> OTHER (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|--|---|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life RBC Instructions |
| <input checked="" type="checkbox"/> Fraternal RBC Blanks | <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions |
| <input checked="" type="checkbox"/> Life RBC Blanks | <input type="checkbox"/> Fraternal RBC Instructions | <input type="checkbox"/> OTHER _____ |

DESCRIPTION OF CHANGE(S)

Life / Fraternal RBC: Add new line 69; renumber subsequent existing lines and line references on page LR031 accordingly; and edit source in renumbered line 70.

P&C RBC: Add new lines 75 and 76 on Page PR032; renumber subsequent existing lines and line references accordingly;

Health RBC: Add new lines 39 and 40 on Page XR025; renumber subsequent existing lines and line references accordingly; and revise the line references on renumbered lines 41 and 42.

REASON OR JUSTIFICATION FOR CHANGE **

Adjustment to the adopted 2017 RBC structural changes to revise the “add-on” methodology for basic operational risk in accordance with direction from the Capital Adequacy (E) Task Force.

Additional Staff Comments:

- Refer to Proposal 2016-13-0 for prior history on basic operational activity.
- Exposed 10/16/16 for 45 days (November 30, 2017)
- Adopted by Subgroup on 1/25/18 as exposed including 3% Factor for 2018
- Exposed associated instructional revisions on 1/25/18 for 30 Days (February 26, 2018)
- Re-exposed for 30 days effective 2/27/18 due to error (March 29, 2018)
- Adopted instructional revisions for 2018 RBC formulas on 4/12/18 as exposed with minor editorial changes
- 4/30/2018 Capital Adequacy Task Force adopted with editorial changes to the P/C line references.

** This section must be completed on all forms.

Revised 11-2013

AFFILIATED STOCKS
XR002–XR004

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↑  **Detail Eliminated To Conserve Space**  ↓
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Affiliates that are Subject to RBC

The risk-based capital requirement for the reporting company for those subsidiaries that are subject to a risk-based capital requirement is based on the Total Risk-Based Capital After Covariance of the subsidiary, prorated for the percent of ownership of that subsidiary. **For purposes of Affiliate Risk all references to Total Risk-Based Capital After Covariance of the subsidiary or affiliate means:**

- For a Health subsidiary RBC filing, Total Risk-Based Capital After Covariance before Basic Operational Risk (XR025, Line (37));
- For a P/C subsidiary RBC filing, Total Risk-Based Capital After Covariance before Basic Operational Risk (PR032, Line (73)); and
- For a Life subsidiary RBC filing, the sum of
 - (a) Total Risk-Based Capital After Covariance before Basic Operational Risk (LR031, Line (67)); and
 - (b) Primary Security shortfalls for all cessions covered by Actuarial Guideline XLVIII (AG 48), multiplied by two (LR031, Line (701)).

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COVARIANCE CALCULATION
XR024–XR025

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↑  **Detail Eliminated To Conserve Space**  ↓
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Operational Risk:

Operational risk is defined as the risk of financial loss resulting from operational events, such as the inadequacy or failure of internal systems, personnel, procedures or controls, as well as external events. Operational risk includes legal risk but excludes reputational risk and risk arising from strategic decisions. Operational risk has been identified as a risk that should be explicitly addressed in the RBC formulas. The Operational Risk charge is intended to account for operational risks that are not already reflected in existing risk categories.

An operational risk charge will be reported on Line 38 using a percentage of RBC or “add-on” approach that will apply a risk factor of 30.00% to the amount reported in Line (37) - RBC after Covariance Before Operational Risk reported on page XR025. A further reduction to the operational risk charge equal to the sum of the C-4a offset amounts reported included by the direct Life RBC filing insurance subsidiaries on their respective (Page LR031, Lines (63 + 69)), adjusted for the percentage of ownership in the direct life insurance subsidiary, will be reported on Page XR025 in Line (39), and the net Basic Operational Risk charge will be reported in Line (40), but not to produce a charge that is less than zero.

| **Total RBC After Covariance including Operational Risk will be reported in Line (~~4139~~) as the sum of lines (37) and (~~4038~~).**

Authorized Control Level RBC is computed from the RBC after Covariance and is set at 50 percent of RBC after Covariance including Operational Risk.

Company Action Level RBC is 200 percent of Authorized Control Level RBC. Regulatory Action Level RBC is 150 percent of Authorized Control Level RBC. Mandatory Control Level RBC is 70 percent of Authorized Control Level RBC.

AFFILIATED INVESTMENTS

LR042, LR043 and LR044

Detail Eliminated To Conserve Space

Insurance and Investment Subsidiaries that are Subject to a Look-Through Risk-Based Capital Calculation

The risk-based capital requirement for the reporting company for those insurance subsidiaries that are subject to a risk-based capital requirement is based on the Total Risk-Based Capital After Covariance of the subsidiary, prorated for the percent of ownership of that subsidiary. (Note: For life and investment subsidiaries, the Total Risk-Based Capital After Covariance and the Company Action Level Risk-Based Capital are identical.) **For purposes of Affiliate Risk all references to Total Risk-Based Capital After Covariance of the subsidiary or affiliate means:**

- For a Health subsidiary RBC filing, Total Risk-Based Capital After Covariance before Basic Operational Risk (XR025, Line (37));
- For a P/C subsidiary RBC filing, Total Risk-Based Capital After Covariance before Basic Operational Risk (PR032, Line (73)); and
- For a Life subsidiary RBC filing, the sum of
 - (a) Total Risk-Based Capital After Covariance before Basic Operational Risk (LR031, Line (67)); and
 - (b) Primary Security shortfalls for all cessions covered by Actuarial Guideline XLVIII (AG 48) multiplied by two (LR031, Line (719)).

Detail Eliminated To Conserve Space

CALCULATION OF AUTHORIZED CONTROL LEVEL RISK-BASED CAPITAL

LR031

Detail Eliminated To Conserve Space

Operational Risk:

Operational risk is defined as the risk of financial loss resulting from operational events, such as the inadequacy or failure of internal systems, personnel, procedures or controls, as well as external events. Operational risk includes legal risk but excludes reputational risk and risk arising from strategic decisions. Operational risk has been identified as a risk that should be explicitly addressed in the RBC formulas. The Operational Risk charge is intended to account for operational risks that are not already reflected in existing risk categories.

A Gross Operational Risk charge will be reported on Line 68 using a percentage of RBC or “add-on” approach that will apply a risk factor of **30.00%** to the amount reported in Line (67) – Total RBC after Covariance Before Operational Risk reported on page LR031. The result will represent an **initial value floor level** of operational risk. Because the current C-4a risk charge is assumed to include some operational risk, a company’s C-4a – Post Tax reported on Line (63) is offset against operational risk ~~but not to produce a result that is less than zero.~~ **A further reduction to the operational risk charge equal to the sum of the C-4a offset amounts**

~~included~~ reported by direct Life RBC filing insurance subsidiaries ~~on their respective~~ (Page LR031, Lines (63 + 69)), adjusted for the percentage of ownership in the direct life insurance subsidiary, will be reported on Page LR031 in Line (69)

Net Operational risk after C-4a offset is reported on Line (7069), but not less than zero.

Total RBC After Covariance including Operational Risk will be reported in Line (724) as the sum of lines (67), (7069) and (710) - Primary Security Shortfall Calculated in Accordance With Actuarial Guideline XLVIII as described below.

Authorized Control Level Risk-Based Capital is 50 percent of the sum of items A plus B plus C where:

”A” equals C-0 plus the C-4a risk-based capital and the square root of the sum of the C-1o and C-3a risk-based capital squared, the C-1cs and C-3c risk-based capital squared, the C-2 risk-based capital squared, the C-3b risk-based capital squared and the C-4b risk-based capital squared as reported on Line (67) and,

”B” equals the amount of operational risk after C-4a offset as reported on Line (7069) and C” equals the greater of zero and the amount of Primary Security shortfalls for all cessions covered by Actuarial Guideline XLVIII (AG 48) multiplied by two on Line (710).

**AFFILIATED STOCKS AND BONDS
PR003 – PR005**



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Insurance Affiliates that are Subject to RBC

For purposes of Affiliate Risk all references to Total Risk-Based Capital After Covariance of the subsidiary or affiliate means:

- For a Health subsidiary RBC filing, Total Risk-Based Capital After Covariance before Basic Operational Risk (XR025, Line (37));
- For a P/C subsidiary RBC filing, Total Risk-Based Capital After Covariance before Basic Operational Risk (PR032, Line (73)); and
- For a Life subsidiary RBC filing, the sum of

(a) Total Risk-Based Capital After Covariance before Basic Operational Risk (LR031, Line (67)); and

(b) Primary Security shortfalls for all cessions covered by Actuarial Guideline XLVIII (AG 48) multiplied by two (LR031, Line (7071)); ~~multiplied by two.~~



Detail Eliminated To Conserve Space



PR030 - PR032 - Computation of Total Risk-Based Capital After Covariance

Detail Eliminated To Conserve Space

To compute the Total RBC After Covariance **Before Basic Operational Risk on Line (7368)**, the following formula is used:

$$R0 + \text{SQRT}(R1^2 + R2^2 + R3^2 + R4^2 + R5^2 + Rcat^2) = \text{Total RBC After Covariance Before Basic Operational Risk}$$

Operational Risk:

Operational risk is defined as the risk of financial loss resulting from operational events, such as the inadequacy or failure of internal systems, personnel, procedures or controls, as well as external events. Operational risk includes legal risk but excludes reputational risk and risk arising from strategic decisions. Operational risk has been identified as a risk that should be explicitly addressed in the RBC formulas. The Operational Risk charge shall account for operational risks that are not determined to be already reflected in existing risk categories.

An operational risk charge will be reported on Page PR032 in Lines (7469) and (74A) using an percentage of RBC or “add-on” approach that will apply a risk factor of 03.000% to Line (7368) - RBC after Covariance Before Basic Operational Risk, and Line (73A) RBC after Covariance with Proposed Reinsurance Recoverable Charge Before Basic Operational Risk respectively. **A further reduction to the operational risk charge equal to the sum of C-4a offset amounts reported included by direct Life RBC filing insurance subsidiaries on their Page LR031, Lines (63) + (69), adjusted for the percentage of ownership in the direct life insurance subsidiary, will be reported in Line 70, and the net Basic Operational Risk charge will be reported on Page PR032 in Line (71), but not to produce a charge that is less than zero.**

Total RBC After Covariance including Basic Operational Risk will be reported in Line (7572) as the sum of lines (73689) and (7471).

~~Total RBC with Proposed Reinsurance Recoverable Charge After Covariance including Basic Operational Risk will be reported in Line (75A) as the sum of lines (73A) and (74A).~~

The Authorized Control Level RBC, which is reported in the Five-Year Historical Exhibit on Line 29 along with Total Adjusted Capital, is one-half of the Total RBC After Covariance including Operational Risk.