

Capital Adequacy (E) Task Force

RBC Proposal Form

- | | | |
|---|---|--|
| <input checked="" 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 type="checkbox"/> Operational Risk (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 |

DATE: <u>March 2, 2018</u>	FOR NAIC USE ONLY
CONTACT PERSON: <u>Ralph Blanchard</u>	Agenda Item # <u>2018-05-CA</u>
TELEPHONE: <u>860-277-9975</u>	Year <u>2019</u>
EMAIL ADDRESS: <u>rblancha@travelers.com</u>	DISPOSITION
ON BEHALF OF: _____	<input checked="" type="checkbox"/> ADOPTED <u>6/28/18</u>
NAME: <u>Ralph Blanchard</u>	<input type="checkbox"/> REJECTED _____
TITLE: <u>VP & Actuary</u>	<input type="checkbox"/> DEFERRED TO _____
AFFILIATION: <u>The Travelers Companies, Inc.</u>	<input type="checkbox"/> REFERRED TO OTHER NAIC GROUP
ADDRESS: <u>One Tower Square – PB06-A</u>	<input checked="" type="checkbox"/> EXPOSED Due 5/31
<u>Hartford, CT 06183</u>	<input type="checkbox"/> OTHER (SPECIFY) _____

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

DESCRIPTION OF CHANGE(S)

Change the label in RBC filings for the “0” term in the RBC formula (e.g., R0) to be more accurate and to prevent confusion and misunderstanding. The current label is “Asset Risk – Subsidiary Insurance Companies”. The proposed label is “Subsidiary Insurance Companies and Misc. Off-Balance Sheet”

REASON OR JUSTIFICATION FOR CHANGE **

The current label describes these charges as “Asset Risk”. The more detailed labels describe them (using R0 as an example) as “Subsidiary Insurance Companies”. Neither of these labels are fully accurate and in some cases they are materially misleading.

The actual items that are part of this charge include insurance affiliates and items labeled “Misc Off-Balance Sheet” items that include contingent liabilities. For US insurance affiliates the charge is based on a look-through to the affiliate’s RBC result. For P&C and Health affiliates that charge is dominated by premium risks and (for P&C) reserving risks, frequently with invested assets or other asset charges being a minor or immaterial contributor. Hence for many P&C and Health insurers the R0 and H0 terms actually represent premium, reserving and contingent liability risks and not asset risk.

The current label of “asset risk” has led at times to a mischaracterization of the industry’s exposure to asset risk vs. liability risk, due to inclusion of the entire “0” category in asset risk. Such an analysis is materially incorrect and potentially materially misleading when evaluating the source of industry risk and therefore where to focus risk mitigation/regulation efforts. This change also has no impact on any formula values, formula structures or RBC results. It just corrects an unfortunately misleading label. (This label correction would be made in both the RBC filing forms and the instructions that point to them, a one line change in each.)

Additional Staff Comments:

- 6/4/18 No comments received during exposure period.
 6/28/18 The Capital Adequacy (E) Task Force adopted the proposal.

** This section must be completed on all forms.

Revised 11-2013

NAIC Health Risk-Based Capital Report

INTRODUCTION

Risk-based capital (RBC) is a method of measuring the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. It provides an elastic means of setting the capital requirement in which the degree of risk taken by the insurer is the primary determinant. The five major categories of risks involved are:

~~Insurance Asset Risk—Affiliates With RBC and Misc. Other~~ H-0 This is the risk from declining value of insurance subsidiaries as well as risk from off-balance sheet and other misc. accounts (e.g., DTAs) of assets' default for certain affiliated investments.

Asset Risk – Other	H-1	This is the risk of assets' default of principal and interest or fluctuation in market value.
Underwriting Risk	H-2	This is the risk of underestimating liabilities from business already written or inadequately pricing business to be written in the coming year.
Credit Risk	H-3	This is the risk of recovering receivable amounts from creditors.
Business Risk	H-4	This is the risk of general business.

A company's risk-based capital is calculated by applying factors to various asset, premium and reserve items. The factor is higher for those items with greater underlying risk and lower for less risky items. The adequacy of a company's actual capital can then be measured by a comparison to its risk-based capital as determined by the formula.

Risk-based capital standards will be used by regulators to set in motion appropriate regulatory actions relating to insurers that show indications of weak or deteriorating conditions. It also provides an additional standard for minimum capital requirements that companies should meet to avoid being placed in rehabilitation or liquidation.

COVARIANCE CALCULATION XR024–XR025

The purpose of the Health RBC formula is to estimate the minimum risk-based capital required to absorb losses that can be caused by a series of catastrophic financial events. However, it is extremely unlikely that all such losses will occur simultaneously. The covariance formula adjusts the combined effect of the H0, H1, H2, H3, and H4 risks so that the combination of risks is less than the sum of the parts. Statistically, this assumes that the H1, H2, H3 and H4 risks are uncorrelated. The H0 risk of subsidiaries is added to the total under the assumption that the risk of the subsidiaries is highly correlated with the risk of the parent, so that if the parent were to experience severe financial distress, the subsidiaries would also be adversely affected.

The components of the RBC after Covariance Formula are:

- H0 — ~~Asset Risk~~ — Affiliates with RBC
- H1 – Asset Risk – Other
- H2 – Underwriting Risk
- H3 – Credit Risk
- H4 – Business Risk

The covariance formula is applied before adding operational risk on Line (37) on XR025:

RBC after Covariance Before Operational Risk = Square Root of $(H1^2 + H2^2 + H3^2 + H4^2) + H0$

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 0.00% to the amount reported in Line (37) - RBC after Covariance Before Operational Risk reported on page XR025.

Total RBC After Covariance including Operational Risk will be reported in Line (39) as the sum of lines (37) and (38).

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.

NAIC Life Risk-Based Capital Report

Introduction

Risk-based capital (RBC) is a method of measuring the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. It provides an elastic means of setting the capital requirement in which the degree of risk taken by the insurer is the primary determinant. The five major categories of risks involved are:

Insurance Asset Risk Affiliates and Misc. Other	C-0	This is the risk <u>from declining value of insurance subsidiaries as well as risk from off-balance sheet and other misc. accounts (e.g., DTAs) of assets' default for certain affiliated investments.</u>
Asset Risk - Other	C-1	This is the risk of assets' default of principal and interest or fluctuation in fair value.
Insurance Risk	C-2	This is the risk of underestimating liabilities from business already written or inadequately pricing business to be written in the coming year.
Interest Rate Risk, Health Credit Risk and Market Risk	C-3	This is the risk of losses due to changes in interest rate levels and the risk that health benefits prepaid to providers become the obligation of the health insurer once again, and risk of losses due to changes in market levels associated with variable products with guarantees.
Business Risk	C-4	This is the risk of general business.

A company's risk-based capital is calculated by applying factors to various asset, premium, claim, expense and reserve items. The factor is higher for those items with greater underlying risk and lower for less risky items. The adequacy of a company's actual capital can then be measured by a comparison to its risk-based capital as determined by the formula.

Risk-based capital standards will be used by regulators to set in motion appropriate regulatory actions relating to insurers that show indications of weak or deteriorating conditions. It also provides an additional standard for minimum capital requirements that companies should meet to avoid being placed in rehabilitation or liquidation.

Calculation of Total Risk-Based Capital After Covariance PR030 R0-R1

(1)

R0—Asset Risk - Subsidiary Insurance Companies and Misc. Other Amounts		PRBC O&I Reference	RBC Amount
(1)	Affiliated US P&C Insurers - Directly Owned	PR004 L(1)C(5)	0
(2)	Affiliated US P&C Insurers - Indirectly Owned	PR004 L(4)C(5)	0
(3)	Affiliated US Life Insurers - Directly Owned	PR004 L(2)C(5)	0
(4)	Affiliated US Life Insurers - Indirectly Owned	PR004 L(5)C(5)	0
(5)	Affiliated US Health Insurer - Directly Owned	PR004 L(3)C(5)	0
(6)	Affiliated US Health Insurer - Indirectly Owned	PR004 L(6)C(5)	0
(7)	Affiliated Alien Insurers - Directly Owned	PR004 L(8)C(5)	0
(8)	Affiliated Alien Insurers - Indirectly Owned	PR004 L(9)C(5)	0
(9)	Misc Off-Balance Sheet - Non-controlled Assets	PR014 L(15) C(3)	0
(10)	Misc Off-Balance Sheet - Guarantees for Affiliates	PR014 L(16) C(3)	0
(11)	Misc Off-Balance Sheet - Contingent Liabilities	PR014 L(17) C(3)	0
(12)	Misc Off-Balance Sheet - SSAP No.101 Par. 11A DTA	PR014 L(19) C(3)	0
(13)	Misc Off-Balance Sheet - SSAP No.101 Par. 11B DTA	PR014 L(20) C(3)	0
(14)	Total R0	L(1)+L(2)+L(3)+L(4)+L(5)+L(6)+L(7)+L(8)+L(9)+L(10)+L(11)+L(12)+L(13)	0

CALCULATION OF AUTHORIZED CONTROL LEVEL RISK-BASED CAPITAL

	<u>Source</u>	(1) RBC <u>Requirement</u>
<u>Asset Risk—Insurance Affiliated and Misc. Other Amounts (C-0)</u>		
(1) Affiliated US Property-Casualty Insurers Directly Owned	LR042 Summary for Affiliated Investments Column (4) Line (1)	_____
(2) Affiliated US Life Insurers Directly Owned	LR042 Summary for Affiliated Investments Column (4) Line (2)	_____
(3) Affiliated US Health Insurers Directly and Indirectly Owned	LR042 Summary for Affiliated Investments Column (4) Line (3)	_____
(4) Affiliated US Property-Casualty Insurers Indirectly Owned	LR042 Summary for Affiliated Investments Column (4) Line (4)	_____
(5) Affiliated US Life Insurers Indirectly Owned	LR042 Summary for Affiliated Investments Column (4) Line (5)	_____
(6) Affiliated Alien Life Insurers - Canadian	LR042 Summary for Affiliated Investments Column (4) Line (8)	_____
(7) Affiliated Alien Life Insurers - All Others	LR042 Summary for Affiliated Investments Column (4) Line (9)	_____
(8) Off-Balance Sheet and Other Items	LR017 Off-Balance Sheet and Other Items Column (5) Line (34)	_____
(9) Total (C-0) - Pre-Tax	Sum of Lines (1) through (8)	_____
(10) (C-0) Tax Effect	LR030 Calculation of Tax Effect for Life Risk-Based Capital Column (2) Line (120)	_____
(11) Net (C-0) - Post-Tax	Line (9) - Line (10)	=====