# CAPITAL ADEQUACY (E) TASK FORCE


Capital Adequacy (E) Task Force September 22, 2009, Minutes
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Capital Adequacy (E) Task Force
Washington, DC
September 22, 2009

The Capital Adequacy (E) Task Force met in Washington, DC, Sept. 22, 2009. The following Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Jim L. Ridling represented by Richard Ford and Sheila Travis (AL); Steve Poizner represented by Ron Dahlquist, Perry Kupferman and Kim Hudson (CA); Thomas R. Sullivan represented by Richard Marcks (CT); Karen Weldin-Stewart represented by Al Franz (DE); Kevin McCarty represented by Al Willis (FL); Sandy Praeger represented by Ken Abitz (KS); Glenn Wilson represented by Blaine Shepherd (MN); Mary Jo Hudson represented by Dale Bruggeman and Mary Miller (OH); Joel Ario represented by Steve Johnson (PA); Scott H. Richardson represented by Leslie Jones (SC); Kent Michie represented by Jake Garn (UT); Mike Kreidler represented by Patrick McNaughton (WA); and Sean Dilweg represented by Peter Medley (WI). Also participating were: Anne Kelly and Matti Peltonen (NY).

1. Release for Comment Property and Health Term Asset-Backed Securities Loan Facility (TALF) Proposal

Mr. Felice said the proposal would be guidance for year-end 2009 and an instructional change for year-end 2010. To ensure that everyone was all right with the proposal for property and health, he said he thought the proposal should be released for comment before adoption. Mr. Ford made a motion to release the Property and Health RBC Term Asset-Backed Securities Loan Facility (TALF) proposal for a comment period of 30 days. Mr. Shepherd seconded the motion. The motion passed unanimously.

2. Discuss the Residential Mortgage-Backed Securities Proposal

Mr. Felice said a proposal had been released for comment by the Valuation of Securities Task Force. The issue is driven by the impact of rating agency actions so it will be overseen by the Valuation of Securities Task Force, but it will still need to be monitored by the Capital Adequacy Task Force.

Mr. Peltonen said the NAIC had been working with the American Council of Life Insurers (ACLI) on a proposal for several months. The original ACLI proposal was to notch up the ratings to a higher NAIC designation for downgraded residential mortgage-backed securities (RMBS), but it was expanded to include all RMBS securities. An analytical firm could be hired to analyze the risks of the securities using agreed-upon assumptions. Using an analytical firm provides a better risk-based mapping of the instruments to NAIC designations than the current rating agency methodology. That approach would have the advantage of having control over the process. Currently there are wide discrepancies between rating agencies on the ratings of the same securities.

Joe Celentano (Pacific Life representing the American Council of Life Insurers—ACLI) said the proposal was created because of the significant impact of securities rating downgrades on RBC. The rating agency methodology did not distinguish between the total loss for the security and the first dollar of loss. The proposal was not a matter of capital relief but of having the correct RBC calculations. He said he felt the proposal was prudent and warranted.

Mr. Felice said Mr. Medley had brought up an issue regarding the RBC ratios described in the proposal. Mr. Medley said the RBC percentages used were different from what regulators normally use when thinking of RBC percentages. The RBC percentages should be doubled to get to what regulators normally use. He said the issue did not affect the proposal but might affect regulators' interpretation of the proposal. Mr. Felice said the drop in the RBC ratio would still be significant to companies, as it might affect the company financial strength rating which could in turn impact the ability of the company to conduct business.

3. Discuss the American Academy of Actuaries (AAA) Life RBC C-3 Phase 3 Proposal

Mr. Felice said the AAA was drafting instructions based on an updated AAA report released in September. Potentially, the C-3 Phase 3 proposal could be moved forward to the Task Force at the Winter National Meeting. Mr. Shepherd said the AAA had asked the Life Risk-Based Capital Working Group whether to incorporate the C-3 Phase II and C-3 Phase III guidance as appendices in the RBC instructions, rather than referencing a document posted on the Web site, as was currently done.

 

4. Discuss the Long-Term Mortgage Experience Adjustment Proposal

Mr. Felice said a temporary fix had been made to the mortgage experience adjustment factor calculation for 2009. He said the ACLI was working on a long-term proposal and hoped to complete it for the Life Risk-Based Capital Working Group shortly. He said he would need to see the long-term proposal before considering whether to adjust or extend the 2009 temporary change in the mortgage experience adjustment factor calculation for 2010.

5. Discuss the 2010 Derivatives Collateral Proposal

Mr. Felice said a correction of the 2009 life RBC formula was made for the derivatives collateral calculation. A 2010 proposal had been released for comment, and an issue had been found with double counting the cash collateral. An updated proposal would eventually be coming to the Task Force for consideration. Mr. Shepherd added that a Life Risk-Based Capital Working Group conference call would be scheduled to discuss the issue.

6. Discuss the ACLI Derivatives Risk Mitigation Proposal

Mr. Felice said the ACLI was working on a derivatives risk mitigation proposal. The proposal currently includes three different scenarios for derivative use that would be eligible for C-1 risk mitigation. There was wide agreement on the first scenario, where the derivative directly hedged the risk. While work on the other scenarios would continue to move forward, he suggested that the focus should be placed on the first scenario in order to implement a change for year-end 2010 life RBC.

7. Discuss the Property RBC Two-Year Lines

Ms. Kelly said a proposal to expand the Schedule P two-year lines to 10 years of data had been released for comment, and two comment letters were received. One concern was whether the company could sign the jurat page if the electronic filing did not match the hard copy filing. She said additional data was included for other items on the electronic filing, so it probably was not an issue, but it could be discussed further when the Working Group holds a conference call to address the comments received.

8. Discuss P&C RBC Catastrophe Risk Proposal

Ms. Kelly said a conference call had been held for regulators to brainstorm ideas of where the NAIC might go regarding catastrophe risk. She said the call had been helpful, and a call of the Catastrophe Risk Subgroup of the Property Risk-Based Capital Working Group might be held soon.

9. Adopt the 2010 Task Force Charges

Mr. Felice said the 2010 Task Force charges had been drafted based on the previous year's charges with the dates updated. Mr. Willis made a motion to adopt the 2010 Task Force charges (Attachment One). Mr. Ford seconded the motion. The motion passed unanimously.

10. Update regarding the C-3 Phase II Results Subgroup

Dan Swanson (NAIC) said several conference calls had been held since the Summer National Meeting. Memorandums for two companies had been reviewed and follow-up questions for the companies had been drafted. A conference call to address a third company would be scheduled. Mr. Felice said the work should continue so that hopefully a report would be made to the Task Force for the Winter National Meeting.

11. Discuss the 2010 Task Force Procedures

Mr. Felice said changes would be needed to Task Force procedures when the NAIC goes to the three-meeting per year schedule. Currently RBC blanks changes need to be completed in December, with instructions and factor changes by June. His suggestion was to keep the December and June deadlines and handle proposals by a conference call if needed. Mr. Johnson said the Blanks Working Group had recently updated their procedures, and those should be reviewed. Mr. Garn said proposals needed to be adopted by the last national meeting, but if it was the prerogative of the Property Risk-Based Capital Working Group, any important proposals could be adopted by conference call in June. Mr. Felice said he thought it would be best to retain the December and June dates. He said the new procedures would need to be adopted at the Winter National Meeting.

12. Update Regarding the Life and Health Actuarial Task Force / Capital Adequacy Task Force Joint Subgroup and Other Task Force Subgroups

Mr. Swanson said a conference call of the LHATF/CADTF Joint Subgroup had been held Aug. 12. The Subgroup discussed an AAA-provided document that compared several different principle-based approaches, including C-3 Phase II, Phase III and VM-20. Mr. Felice said a new chair was needed for the subgroup, the Solvency Modernization Subgroup and the Investments Subgroup.

13. Referral from the NAIC Officers Regarding Fraternal RBC

Mr. Felice said a letter had been received from the NAIC officers referring fraternal RBC issues to the Task Force. The Task Force would need to consider whether there was agreement to develop a model act or model act changes for fraternal RBC. Mr. Ford made a motion to develop a model law request form for fraternal RBC. Mr. Garn seconded the motion. The motion passed unanimously.

Mr. Johnson said review of the fraternal RBC instructions would also be needed. Mr. Swanson said any changes made for Life RBC were automatically made to the Fraternal RBC as well. However, there would be updates needed to the formula if action were to be taken as a result of the fraternal RBC calculation. Mr. Shepherd asked whether the fraternal RBC would be addressed by the Task Force or the Life Risk-Based Capital Working Group. Mr. Felice said he was concerned that the Working Group had quite a bit on its agenda already. He said the Task Force would address the issue for now, most likely starting with a review of the life RBC formula to determine what may not apply to fraternals. Mr. Willis made a motion to review the fraternal RBC instructions and formula for any changes that were needed. Mr. Shepherd seconded the motion. The motion passed unanimously.

14. Adopt Interim Conference Call Minutes

Mr. Shepherd made a motion to adopt the Sept. 10 and July 7 Task Force conference call minutes (Attachments Two and Three). Mr. Ford seconded the motion. The motion passed unanimously.

15. Adopt the Working Group and Subgroup Conference Call Minutes

Mr. Willis made a motion to adopt the Sept. 21 Life Risk-Based Capital Working Group meeting minutes (Attachment Four), the July 6 Property Risk-Based Capital Working Group conference call minutes (Attachment Five) and the July 6 Health Risk-Based Capital Working Group conference call minutes (Attachment Six). Mr. Shepherd seconded the motion. The motion passed unanimously.

16. Any Other Matters

Mr. Johnson said he would like to have added to the Task Force agenda for the Winter National Meeting whether to make the Risk-Based Capital for Health Organizations Model Act an accreditation standard. Mr. Felice asked when the Financial Accreditation (F) Committee would address the issue. Mr. Johnson said F Committee would address the issue at the 2010 Spring National Meeting, which is why he wanted the Task Force to address the issue at the Winter National Meeting. Mr. Johnson said he would still like to see the level of the Life RBC Trend Test raised from 250% to 300% in order to make the level consistent with other business types. He said he would also like to see a higher charge for state deposits, as the assets were illiquid.

Mr. Felice said the Joint Executive (EX) Committee/Plenary would consider adoption of the trend test changes to the Risk-Based Capital (RBC) for Health Organization Model Act (#315) at the Fall National Meeting. Mr. Johnson said making the property RBC trend test changes to the Risk-Based Capital (RBC) for Insurers Model Act (#312) an accreditation standard would also be considered by Jt. Executive/Plenary as well. Mr. Felice said quite a few RBC-related issues were being discussed related to the financial crises. Re-REMICs and parental guarantees were two issues discussed at the Statutory Accounting Working Group and Emerging Issues Working Group that would affect RBC.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

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# 2010 CHARGES

Draft: 9/17/09

**CAPITAL ADEQUACY (E) TASK FORCE**

The mission of the Capital Adequacy (E) Task Force is to evaluate and recommend appropriate refinements to capital requirements for all types of insurers.

**Ongoing Support of NAIC Programs, Products or Services:**

1. Evaluate refinements to the existing NAIC risk-based capital formulas implemented in 2009. Forward final version of the structure of the 2010 life, P&C and health RBC formulas to Financial Condition (E) Committee by June 2010.—*Essential*

2. Consider proposals for structural changes to the RBC formulas (including proposals related to a principle-based RBC approach) submitted by the working groups/subgroups. Proposed structural changes to the 2011 formulas that are received by the 2010 Fall National Meeting will be considered for adoption by the Task Force, and adopted changes will be forwarded to Financial Condition (E) Committee by March 2011.—*Essential*

3. Review the effectiveness of the NAIC's RBC policies and procedures as they affect the accuracy, audit ability, timeliness of reporting access to RBC results, and comparability between the RBC formulas. Report on data quality problems in the 2009 RBC filings at the summer and fall meetings.—*Essential*

4. Monitor changes in accounting and reporting requirements resulting from the adoption and continuing maintenance of the revised *Accounting Practices and Procedures Manual* to ensure that model laws, publications, formulas, analysis tools, etc., supported by the Task Force continue to meet regulatory objectives.—*Essential*

5. Evaluate emerging "risk" issues for referral to the risk-based capital working groups/subgroups for certain issues involving more than one RBC formula. Monitor emerging and existing risks relative to their consistent or divergent treatment in the three RBC formulas.—*Essential*

6. Conduct a regulatory review of the 2007, 2008 and 2009 RBC filings and associated company records in order to assess the impact resulting from implementation of the principle-based changes to the life RBC formula. Monitor implementation and impact of the adopted changes, as well as provide responses to the Principles-Based Reserving (EX) Working Group, regarding how the proposed expansion to the principle-based approach affects all of the RBC formulas. Also develop and review disclosure-documentation and governance protocols to be used by regulators and companies.—*Essential*

7. Upon notice that a security has been placed under regulatory review, the chair of Capital Adequacy Task Force, or his or her representative, will be deemed a member of the Invested Asset (E) Working Group of the Valuation of Securities (E) Task Force. The chair, or his or her representative, is charged with contributing the perspective and expertise of the regulatory group to the development of NAIC regulatory guidance for the security under review.— *Essential*

***Sponsors for 2010 Charges***
*(Except as noted, I support all charges)*

Staff Support: Dan Swanson

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Draft: 9/15/09

Capital Adequacy (E) Task Force
Conference Call
September 10, 2009

The Capital Adequacy (E) Task Force met via conference call Sept. 10, 2009. The following Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Jim L. Ridling represented by Richard Ford (AL); Steve Poizner represented by Ron Dahlquist (CA); Kevin McCarty represented by Al Willis and Kerry Krantz (FL); Glenn Wilson represented by Blaine Shepherd (MN); Mary Jo Hudson represented by Dale Bruggeman (OH); Kent Michie represented by Jake Garn (UT); and Sean Dilweg represented by Peter Medley (WI).

1. Consider Adoption of the Life Risk-Based Capital (RBC) Term Asset-Backed Securities Loan Facility (TALF) Proposal

Mr. Felice said a proposal for the TALF program had been released for comment by the Task Force. The Life RBC calculation has a 1.3% pre-tax and 1% after-tax charge for a number of off-balance sheet items and non-controlled assets. The proposal was an instructional change to eliminate off-balance sheet charge for TALF assets pledged as collateral. The TALF program was money being loaned by the federal government to foster issuance of asset-backed securities. If the value of the assets declined, the assets held as collateral could be surrendered to the government and the loan would be forgiven.

No comments or questions had been received on the RBC proposal itself. A couple of questions had been received on an accounting issue related to whether the assets would be shown gross or net of the liability for the loan. A Form B on the issue had been drafted and would be discussed at the Emerging Accounting Issues Working Group meeting during Fall National Meeting of the. Mr. Felice's opinion was that gross reporting was more appropriate. Mr. Shepherd agreed that gross reporting was the better approach. He asked whether the Task Force would need to monitor what action the Emerging Accounting Issues Working Group took. Robin Marcotte (NAIC) said the initial staff recommendation in the Form B was to have gross reporting. Mr. Felice said that, if net reporting was chosen by the Emerging Issues Working Group, then the Task Force might need to consider again the appropriateness of the RBC change.

Mr. Felice said Life RBC had been the starting point for the proposal, but there was no reason why the proposal could not also be applied to P/C and health RBC. He asked whether NAIC staff could prepare P/C and health proposals to be included with the Task Force materials for the Fall National Meeting, where the proposals could be considered for adoption. Dan Swanson (NAIC) said the proposals would be included as part of the Task Force materials for the Fall National Meeting.

Mr. Ford made a motion to adopt the Life RBC TALF proposal (Attachment Two-A) for year-end 2010 and as optional guidance for year-end 2009. Mr. Garn seconded the motion. The motion passed unanimously.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

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## OFF-BALANCE SHEET ITEMS

LR015

*Basis of Factors*

The potential for risk exists in off-balance sheet items. For items other than derivative instruments, a 1.3 percent factor was chosen on a judgment basis. The 1.3 percent pre-tax factor will differentiate between the companies that have small and large exposures to this risk. Since there is no firm actuarial basis for assigning the 1.3 percent pre-tax factor to these risks, off-balance sheet items are included in the sensitivity analysis using a factor of 3 percent, and leases are added as an additional off-balance sheet item. For securities lending programs, a reduced charge may apply to certain programs that meet the criteria as outlined below.

For derivative instruments, the book/adjusted carrying value exposure net of collateral (the balance sheet exposure) is included under miscellaneous C-1o risks. Because collars, swaps, forwards and futures can have book/adjusted carrying values that are positive, zero or negative, the potential exposure to default by the counterparty or exchange for these instruments cannot be measured by the book/adjusted carrying values. Schedule DB, therefore, includes a calculation of the potential exposure that is based on the March 1987 research paper "Potential Credit Exposure on Interest Rate and Foreign Exchange Rate Related Instruments," supporting the 1988 Bank of International Settlements framework for banks. The off-balance sheet exposure (Schedule DB, Part E, Section 1, Column 11) will measure this potential exposure for risk-based capital purposes. The factors applied to the derivatives off-balance sheet exposure are the same as those applied to bonds.

*Specific Instructions for Application of the Formula*

<u>Column (2)</u>
Assets directly funding guaranteed separate accounts or synthetic GIC contracts should be excluded from the noncontrolled assets computation.

<u>Line (1)</u>
Securities lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.
2. Written operational procedures to monitor and control the risks associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:
   a. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.
   b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.
   c. Approved borrower lists and loan limits to allow for adequate diversification.
   d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross currency loans).
   e. Daily mark-to-market of lent securities and obtaining additional collateral needed to ensure that collateral at all times exceeds the value of the loans to maintain margin of 102% of market.
   f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.
3. A binding securities lending agreement (standard "Master Lending Agreement" from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.
4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-rated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

Collateral included in General Interrogatories, Part 1, Line 22.5 of the annual statement should be included on Line (1).

Line (2)
Collateral from all other securities lending programs should be reported General Interrogatories, Part 1, Line 22.6 and included in Line (2).

Lines (3) through (11)
Noncontrolled assets are the amount of all assets not exclusively under the control of the company, or assets that have been sold or transferred subject to a put option contract currently in force. For Line (7) include assets pledged as collateral reported in the General Interrogatories Part 1 Line 23.25 other than assets related to the Federal Reserve's Term Asset Loan Facility (TALF).

Lines (13) through (20)
The off-balance sheet exposure for derivative instruments reported on Schedule DB, Part E, Section 1, Column 11, Lines 0199999 through 0799999 are brought into each individual SVO rating class.

Line (21)
Guarantees for affiliates include guarantees for the benefit of an affiliate that result in a material† contingent exposure of the company's assets to liability.

Line (23)
The exposure amount for long-term leases is the annual rental amount of all leases that could have a material† financial effect. If the rent expense is shared with affiliates, it should be allocated by company.

† The definition of "material" exposure or financial effect is the same as for annual statement disclosure requirements.

## OFF-BALANCE SHEET COLLATERAL

LR016

*Basis of Factors*

Security lending programs are required to maintain collateral. Some entities post the collateral supporting security lending programs on their financial statements, and incur C-1 risk charges on those assets. Other entities have collateral that is not recorded on their financial statements. While not recorded on the financial statements of the company, such collateral has risks that are not otherwise captured in the RBC formula.

The collateral in these accounts is maintained by a third-party (typically a bank or other agent). The collateral agent maintains on behalf of the company detail asset listings of the collateral assets, and this data is the source for preparation of this schedule. The company should maintain such asset listings, at a minimum CUSIP, market value, book/carrying value, and maturity date. The asset risk charges are derived from existing RBC factors for bonds, preferred and common stocks, other invested assets, and invested assets not otherwise classified (aggregate write-ins).

*Specific Instructions for Application of the Formula*

Off-balance sheet collateral included in General Interrogatories, Part 1, Lines 20.5 and 20.6 of the annual statement should agree with Line (19).

<u>Lines (1) through (8) – Bonds</u>
Bond factors are described on page LR002 Bonds.

<u>Line (9) through (15) – Preferred Stocks</u>
Preferred stock factors are described on page LR005 Unaffiliated Preferred and Common Stock.

<u>Line (16) – Common Stock</u>
Preferred stock factors are described on page LR005 Unaffiliated Preferred and Common Stock.

<u>Line (17) – Schedule BA – Other Invested Assets</u>
Other invested assets factors are described on page LR008 Other Long Term Assets.

<u>Line (18) – Aggregate Write-ins for Other Invested Assets</u>
Aggregate write-ins for other invested assets factor are described on page LR012 Miscellaneous Assets.

Company Name | Confidential when Completed | NAIC Company Code

**OFF-BALANCE SHEET ITEMS**

| | | Annual Statement Source | (1) Statement Value | (2) Less Noncontrolled Assets Funding Guaranteed Separate Accounts or Synthetic GIC's | (3) Subtotal | | Factor | | (4) RBC Requirement |
|---|---|---|---|---|---|---|---|---|---|
| | Noncontrolled Assets | | | | | | | | |
| (1) | Loaned to Others - Conforming Securities Lending Program | General Interrogatories Part 1 Line 22.5 | | | | X | 0.002 | = | |
| (2) | Loaned to Others - Securities Lending Programs - Other | General Interrogatories Part 1 Line 22.6 | | | | X | 0.013 | = | |
| (3) | Subject to Repurchase Agreements | General Interrogatories Part 1 Line 23.21 | | | | X | 0.013 | = | |
| (4) | Subject to Reverse Repurchase Agreements | General Interrogatories Part 1 Line 23.22 | | | | X | 0.013 | = | |
| (5) | Subject to Dollar Repurchase Agreements | General Interrogatories Part 1 Line 23.23 | | | | X | 0.013 | = | |
| (6) | Subject to Reverse Dollar Repurchase Agreements | General Interrogatories Part 1 Line 23.24 | | | | X | 0.013 | = | |
| (7) | Pledged as Collateral | ~~General Interrogatories Part 1 Line 23.25~~ **Company Records** | | | | X | 0.013 | = | |
| (8) | Assets Placed Under Option Agreements | General Interrogatories Part 1 Line 23.26 | | | | X | 0.013 | = | |
| (9) | Letter Stock or Other Securities Restricted | General Interrogatories Part 1 Line 23.27 | | | | X | 0.013 | = | |
| (10) | On Deposit with State or Other Regulatory Body | General Interrogatories Part 1 Line 23.28 | | | | X | 0.013 | = | |
| (11) | Other | General Interrogatories Part 1 Line 23.29 | | | | X | 0.013 | = | |
| (12) | Total Noncontrolled Assets | Sum of Lines (1) through (11) | | | | | | | |
| | Derivative Instruments | | | | | | | | |
| (13) | Exchange Traded | Schedule DB Part E Section 1 Column 11, Line 0199999 | | | | X | 0.004 | = | |
| (14) | Off-Balance Sheet Exposure Class 1 | Schedule DB Part E Section 1 Column 11, Line 0299999 | | | | X | 0.004 | = | |
| (15) | Off-Balance Sheet Exposure Class 2 | Schedule DB Part E Section 1 Column 11, Line 0399999 | | | | X | 0.013 | = | |
| (16) | Off-Balance Sheet Exposure Class 3 | Schedule DB Part E Section 1 Column 11, Line 0499999 | | | | X | 0.046 | = | |
| (17) | Off-Balance Sheet Exposure Class 4 | Schedule DB Part E Section 1 Column 11, Line 0599999 | | | | X | 0.100 | = | |
| (18) | Off-Balance Sheet Exposure Class 5 | Schedule DB Part E Section 1 Column 11, Line 0699999 | | | | X | 0.230 | = | |
| (19) | Off-Balance Sheet Exposure Class 6 | Schedule DB Part E Section 1 Column 11, Line 0799999 | | | | X | 0.300 | = | |
| (20) | Total Derivative Instruments Off-Balance Sheet Exposure | Sum of Lines (13) through (19) | | | | | | | |
| (21) | Guarantees for Affiliates | Notes to Financial Statements Number 10E | | | | X | 0.013 | = | |
| (22) | Contingent Liabilities | Notes to Financial Statements Number 14A1 | | | | X | 0.013 | = | |
| (23) | Long Term Leases | Notes to Financial Statements Number 15A2a1 | | | | X | 0.000 | = | |
| (24) | Total Off-Balance Sheet Items (pre-MODCO/Funds Withheld) | Lines (12) + (20) + (21) + (22) + (23) | | | | | | | |
| (25) | Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements | Company Records (enter a pre-tax amount) | | | | | | | |
| (26) | Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements | Company Records (enter a pre-tax amount) | | | | | | | |
| (27) | Total Off-Balance Sheet Items (including MODCO/Funds Withheld.) | Lines (24) - (25) + (26) | | | | | | | |

Denotes items that must be manually entered on the filing software.

 

## MISCELLANEOUS OFF-BALANCE SHEET ITEMS PR013

| | | Annual Statement Source | (1) Statement Value | Factor | (2) RBC Requirement |
|---|---|---|---|---|---|
| (1) | Non-controlled Assets | General Interrogatories Part 1 L22.5 | 0 | 0.002 | 0 |
| (2) | Non-controlled Assets | General Interrogatories Part 1 L22.6 | 0 | 0.010 | 0 |
| (3) | Non-controlled Assets | General Interrogatories Part 1 L23.21 | 0 | 0.010 | 0 |
| (4) | Non-controlled Assets | General Interrogatories Part 1 L23.22 | 0 | 0.010 | 0 |
| (5) | Non-controlled Assets | General Interrogatories Part 1 L23.23 | 0 | 0.010 | 0 |
| (6) | Non-controlled Assets | General Interrogatories Part 1 L23.24 | 0 | 0.010 | 0 |
| (7) | Non-controlled Assets | ~~General Interrogatories Part 1 L23.25~~ **Company Records** | 0 | 0.010 | 0 |
| (8) | Non-controlled Assets | General Interrogatories Part 1 L23.26 | 0 | 0.010 | 0 |
| (9) | Non-controlled Assets | General Interrogatories Part 1 L23.27 | 0 | 0.010 | 0 |
| (10) | Non-controlled Assets | General Interrogatories Part 1 L23.28 | 0 | 0.010 | 0 |
| (11) | Non-controlled Assets | General Interrogatories Part 1 L23.29 | 0 | 0.010 | 0 |
| (12) | Total Non-controlled Assets | Sum of L(1) through L(11) | 0 | | 0 |
| (13) | Guarantees for Affiliates | Notes to Financial Statements Item 10e | 0 | 0.010 | 0 |
| (14) | Contingent Liabilities | Notes to Financial Statements Item 14a1 + Item 26a Amount 2 Unrecorded Loss Contingencies | 0 | 0.010 | 0 |
| (15) | Total Miscellaneous Off Balance Sheet Items=L(12)+L(13)+L(14) | | 0 | | 0 |

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**OFF-BALANCE SHEET RISK (See instructions for explanation)**

| | | Annual Statement Source | (1) Bk/Adj Carrying Value | Factor | (2) RBC Requirement |
|---|---|---|---|---|---|
| (1) | Loaned to Others - Conforming Securities Lending Program | General Interrogatories Part 1 Line 22.5 | | 0.002 | |
| (2) | Loaned to Others - Securities Lending Programs - Other | General Interrogatories Part 1 Line 22.6 | | 0.010 | |
| (3) | Subject to Repurchase Agreements | General Interrogatories Part 1 Line 23.21 | | 0.010 | |
| (4) | Subject to Reverse Repurchase Agreements | General Interrogatories Part 1 Line 23.22 | | 0.010 | |
| (5) | Subject to Dollar Repurchase Agreements | General Interrogatories Part 1 Line 23.23 | | 0.010 | |
| (6) | Subject to Reverse Dollar Repurchase Agreements | General Interrogatories Part 1 Line 23.24 | | 0.010 | |
| (7) | Pledged as Collateral | ~~General Interrogatories Part 1 Line 23.25~~ **Company Records** | | 0.010 | |
| (8) | Assets Placed Under Option Agreements | General Interrogatories Part 1 Line 23.26 | | 0.010 | |
| (9) | Letter Stock or Other Securities Restricted | General Interrogatories Part 1 Line 23.27 | | 0.010 | |
| (10) | On Deposit with State or Other Regulatory Body | General Interrogatories Part 1 Line 23.28 | | 0.010 | |
| (11) | Other | General Interrogatories Part 1 Line 23.29 | | 0.010 | |
| (12) | Total Noncontrolled Assets | Sum of Lines (1) through (11) | | | |
| (13) | Guarantees for Affiliates | Notes to Financial Statements 10E | | 0.010 | |
| (14) | Contingent Liabilities | Notes to Financial Statements 14A(1) | | 0.010 | |
| (15) | Total Miscellaneous Off-Balance Sheet Items | L(12) + L(13) + L(14) | | | |

Denotes items that must be manually entered on filing software.

Draft: 9/2/09

Capital Adequacy (E) Task Force
Conference Call
July 7, 2009

The Capital Adequacy (E) Task Force met via conference call July 7, 2009. The following Task Force members participated: Kermitt Brooks, Chair, represented by Lou Felice (NY); Jim L. Ridling represented by Steve Ostlund (AL); Steve Poizner represented by Sheldon Summers and Kim Hudson (CA); Thomas R. Sullivan represented by Richard Marcks (CT); Kevin McCarty represented by Al Willis (FL); Sandy Praeger represented by Larry Bruning (KS); Glenn Wilson represented by Blaine Shepherd (MN); Steven M. Goldman represented by Russell Jones (NJ); Mary Jo Hudson represented by Dale Bruggeman (OH); Joel Ario represented by Steve Johnson (PA); Kent Michie represented by Jake Garn (UT); Mike Kreidler represented by Chase Davis (WA); and Sean Dilweg represented by Peter Medley (WI).

1. Discuss the Term Asset-Backed Securities Loan Facility (TALF) Proposal

Mr. Felice discussed the Federal Reserve's TALF program, explaining that the federal government was loaning money to companies that buy asset-backed securities and then pledge those securities or similar securities as collateral. On average, the government would loan approximately 90% of the value of the securities. Therefore, if the security does not perform, the company would be at risk for approximately 10% of the value of asset. If the company decides not to keep the loan from the government, the company would surrender to the government those securities held as collateral and the loan would be considered satisfied. In the RBC formula, there is a 1.3% factor for securities not under the control of the company. The purpose of the proposal was to eliminate that RBC charge for the TALF assets.

Mr. Felice said it was too late to make the change for the 2009 RBC instructions so, if adopted, the proposal would likely be used as guidance for year-end 2009. The Task Force could also consider whether to make the proposed changes for year-end 2010 or whether some other change might be made for 2010. Mr. Summers asked what risk the additional 1.3% charge was covering. Mr. Felice said his understanding was that it was because the securities were not under control of the company, but that should be mitigated by allowing the loan to go back to the government. Mr. Summers asked whether there was a particular expectation of loss that the 1.3% was taking into effect, adding that he would like to have a better understanding of the factors themselves to see whether it might be applied. Mr. Felice said he would try to find more background information regarding the 1.3% factor.

Mr. Ostlund made a motion to release the TALF proposal for a comment period of 30 days. Mr. Shepherd seconded the motion. The motion passed unanimously. Mr. Felice said a conference call of the Task Force would be held after the exposure period was over.

2. Adopt the Life RBC 2009 Derivatives Collateral Proposal

Mr. Felice asked whether the derivatives collateral proposal was something the Life Risk-Based Capital Working Group was hoping to get implemented for year-end 2009 RBC. Dan Swanson (NAIC) said the proposal was adopted by the Working Group with a year-end 2009 implementation. Mr. Felice asked how the proposal was different from the guidance adopted for year-end 2008 RBC. Mr. Swanson said the main difference was related to how the collateral was reported. For the year-end 2008 guidance, the collateral could be reported on the lines for classes 1 through 6, where this proposal had all collateral reported on the class 1 line.

The reasoning for the change was that, according to the definition of acceptable collateral in the Schedule DB instructions, all of the collateral would be class 1. During the Working Group's conference call, some editorial changes were made to the proposal to have the line descriptions revert back to the current reference so the amounts are pulled directly from the Asset Valuation Reserve Default Component page. Mr. Felice asked if any of the collateral amounts reported last year were for classes 2 through 6. Mr. Swanson said no collateral amounts had been reported for classes 2 through 6, as far as he could tell. Mr. Ostlund made a motion to adopt the derivatives collateral proposal (Attachment Three-A). Mr. Bruning seconded the motion. The motion passed unanimously.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

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## MISCELLANEOUS ASSETS
LR012

*Basis of Factors*

Lines (1) through (3.5)
The pre-tax factor for cash is 0.4 percent. It is recognized that there is a small risk related to possible insolvency of the bank where cash deposits are held. The 0.4 percent pre-tax factor, equivalent to a Class 1 bond, reflects the short-term nature of this risk.

The short-term investments to be included here are those not reflected elsewhere in the formula. Commercial paper, repurchase agreements, collateralized mortgage obligations (CMOs), mortgage participation certificates (MPCs), interest-only and principal-only certificates (IOs and POs), and equipment trust certificates should be included in appropriate bond classifications (Class 1 through Class 6) on LR002 Bonds and should be excluded from short-term investments. The 0.4 percent pre-tax factor is equal to the factor for cash.

Lines (4) through (7)
Premium notes, receivables for securities and write-ins for invested assets are generally a small proportion of total portfolio value. A pre-tax factor of 6.8 percent is consistent with other risk-based capital formulas studied by the working group. The charge for derivatives is determined in lines (8) through (15), therefore the total~~gross~~ amount of derivatives included in Line 6.1 (from line 9, page 2) should~~may~~ be ~~excluded~~ included on Line 6.2 resulting in line 6.3 including no derivative amounts. ~~, rather than the amount of derivatives net of collateral that appears on Line 33, Column 1, of the Asset Valuation Reserve Default Component, may be used for year-end 2008Line 6.2.~~

Lines (8) through (15)
Derivative instrument book/adjusted carrying value exposure net of acceptable collateral held on the balance sheet from Schedule DB Part E Section 1 Column 6 Line 089999, for each SVO rating class, is subject to the bond RBC factor for that category to reflect the amount held on the balance sheet exposed to loss upon default of the Over the Counter (OTC) counterparty or exchange. Acceptable collateral is subject to an RBC charge at the same level as ~~Type~~Class 1 Bonds. For 2009 the collateral should be reported in line (9) From Schedule DB Part E Section 1 Column 3 Line 0899999. "Acceptable collateral" means cash, cash equivalents, securities issued or guaranteed by the United States or Canadian governments or their government–sponsored enterprises, publicly traded obligations rated 1 by the SVO, government money market mutual funds, and such other items as may be defined as acceptable collateral in the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*. ~~NOTE: For year-end 2008, derivatives instrument book / adjusted carrying value should be gross of collateral if a gross amount is used in Line 6.2, unless the insurance company is reporting acceptable collateral on theirits balance sheet and has unrestricted access to the assetscollateral in the event of counterparty non-performance.~~

**MISCELLANEOUS ASSETS**

| | | Annual Statement Source | (1) Book / Adjusted Carrying Value | Factor | 2009 Proposal (2) RBC Requirement |
|---|---|---|---|---|---|
| | Miscellaneous | | | | |
| (1) | Cash | Page 2 Line 5, inside amount 1 | | X 0.004 = | |
| (2.1) | Cash Equivalents | Page 2 Line 5, inside amount 2 | | | |
| (2.2) | Less Cash Equivalent Bonds Already Included with Page LR002 Bonds | Schedule E Part 2 Column 6 Line 6099999, in part | | | |
| (2.3) | Net Cash Equivalents | Line (2.1) - Line (2.2) | | X 0.004 = | |
| (3.1) | Short-Term Investments | Page 2 Line 5, inside amount 3 | | | |
| (3.2) | Less Short-Term Bonds | Schedule DA Part 1 Column 7 Line 6099999 | | | |
| (3.3) | Less Exempt Money Market Funds | Schedule DA Part 1 Column 7 Line 7999999 | | | |
| (3.4) | Less Class One Money Market Funds | Schedule DA Part 1 Column 7 Line 8099999 | | | |
| (3.5) | Net Short-Term Investments | Lines (3.1) - (3.2) - (3.3) - (3.4) | | X 0.004 = | |
| (4) | Premium Notes | Page 2 Line 6 first inside amount | | X 0.068 = | |
| (5) | Receivable for Securities | Page 2 Column 3 Line 8 | | X 0.068 = | |
| (6.1) | Aggregate Write-ins for Invested Assets | Page 2 Column 3 Line 9 | | | |
| (6.2) | Less Derivative Instruments | **Page 2 Column 3 Line 9, Derivatives reported as part of total** | | | |
| (6.3) | Net Write-ins for Invested Assets | Line (6.1) - Line (6.2) | | X 0.068 = | |
| (7) | Total Miscellaneous Excluding Derivative Instruments | Lines (1) + (2.3) + (3.5) + (4) + (5) + (6.3) | | | |
| | Derivative Instruments | | | | |
| (8) | Exchange Traded | Asset Valuation Reserve Default Component Column 1 Line 26 | | X 0.004 = | |
| (9) | Over the Counter Class 1 **plus collateral** | Asset Valuation Reserve Default Component Column 1 Line 27 **plus Schedule DB Part E Section 1 Column 3 Line 0899999** | | X 0.004 = | |
| (10) | Over the Counter Class 2 | Asset Valuation Reserve Default Component Column 1 Line 28 | | X 0.013 = | |
| (11) | Over the Counter Class 3 | Asset Valuation Reserve Default Component Column 1 Line 29 | | X 0.046 = | |
| (12) | Over the Counter Class 4 | Asset Valuation Reserve Default Component Column 1 Line 30 | | X 0.100 = | |
| (13) | Over the Counter Class 5 | Asset Valuation Reserve Default Component Column 1 Line 31 | | X 0.230 = | |
| (14) | Over the Counter Class 6 | Asset Valuation Reserve Default Component Column 1 Line 32 | | X 0.300 = | |
| (15) | Total Derivative Instruments ~~(Column (1) should equal Asset Valuation Reserve Default Component Column 1 Line 33)~~ | Sum of Lines (8) through (14) | | | |
| (16) | Total Miscellaneous Assets (pre-MODCO/Funds Withheld) | Lines (7) + (15) | | | |
| (17) | Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements | Company Records (enter a pre-tax amount) | | | |
| (18) | Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements | Company Records (enter a pre-tax amount) | | | |
| (19) | Total Miscellaneous Assets (including MODCO/Funds Withheld.) | Lines (16) - (17) + (18) | | | |

Denotes items that must be manually entered on the filing software.

Draft: 9/29/09

Life Risk-Based Capital (E) Working Group
Washington, DC
September 21, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Washington, DC, Sept. 21, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steven Ostlund (AL); Perry Kupferman (CA); Larry Bruning (KS); Blaine Shepherd (MN); Fred Andersen (NY); and Mike Boerner (TX).

1. Release for Comment the AAA C-3 Phase 3 Proposal

Mr. Barlow said a new American Academy of Actuaries (AAA) C-3 Phase 3 report was released in September. Peter Boyko (Manulife, representing the AAA) said some minor clarifications to the report were made. The changes included updating the scope language to indicate that the approach applied to individual and group life, and adding a numerical example for the development of discount rates. He said the Society of Actuaries (SOA) research project materials were reviewed for changing the 4% threshold for the stochastic exclusion test and no basis was found for updating the percentage.

The Reinsurance Subgroup of the Life and Health Actuarial Task Force provided verbiage changes for the report, which were not yet incorporated. Mr. Barlow asked how soon the language might be added. Mr. Boyko said an AAA work group call would be held in a couple weeks. He noted that the updates were minor wording changes to be consistent with VM-20.

Mr. Barlow summarized the issues that were still outstanding for the proposal. Comments were made that the documentation requirements were too onerous. He asked for further feedback regarding the documentation and whether it was still a concern. He said the stochastic exclusion test was still an open issue both to modify the percentage used and whether it was too complicated. Mr. Boyko said the SOA results came out as expected regarding the percentage issue and the SOA feedback indicated that it was not a particularly difficult calculation. Mr. Barlow said a conference call of the Working Group regarding the SOA report was planned so that the issue could be discussed further.

Mr. Barlow said another outstanding issue to decide was whether to 1) use the total asset requirement (TAR) less reserves; 2) TAR less a consistently calculated reserve amount; or 3) use a shocked reserve amount, as New York suggested. Mr. Barlow asked whether the issue was a concern with the principle-based approach as a whole, or for just C-3 Phase 3. Mr. Andersen said it was a concern more for C-3 Phase 2, but would be a concern for any calculation using a TAR. He said he felt all of the C-3 phases should be kept consistent and that, perhaps, the issue could be addressed in the future.

Mr. Barlow said another outstanding issue was the scenario generator. He said that whatever was decided by the Life and Health Actuarial Task Force regarding the generator should be fine, as long as the decision was timely. Mr. Andersen said a conference call would be held early in the fourth quarter, where it is hoped that a decision might be made.

Mr. Boyko said the C-3 Phase 3 instructions were being drafted as an appendix to the Life RBC instructions, rather than having the instructions refer to a separate report posted on the Web site. He asked whether it would be all right to combine the C-3 Phase 2 and C-3 Phase 3 instructions to reduce the overlap in the instructions. No objections were heard. Mr. Barlow said that any Working Group members interested in working with the AAA on the instructions should contact Mr. Boyko.

Mr. Ostlund made a motion to release the September 2009 AAA report for a comment period of 30 days. Mr. Shepherd seconded the motion. The motion passed unanimously.

2. Discuss the ACLI Long-Term Mortgage Calculation

John Bruins (American Council of Life Insurers—ACLI) said the ACLI was still trying to work out some of the details of the proposal. He said the ACLI hoped to have a proposal soon. Mr. Barlow said a proposal would be needed by December to be implemented for 2010. Mr. Felice said he did not want to move on a short-term fix for the existing calculation, if it were needed, at least until a long-term proposal was available for review.

 

3. Discuss the ACLI Derivatives Collateral Proposal

Mr. Bruins said an issue had been found with the derivatives collateral proposal released for comment, where the RBC charge was double-counted. He said he wanted the Working Group to consider eliminating the double-counting for the cash collateral. Mr. Barlow said the proposal could be addressed on a future conference call, because he wanted to make sure there was time for everyone to review the addition of the new lines in the proposal.

4. Discuss the ACLI Derivatives Risk Mitigation Proposal

Walter Givler (Northwestern Mutual, representing the ACLI) said the ACLI was working on the RBC instructions associated with the proposal. He said that once all the issues were documented, the changes would be incorporated into a new ACLI report. Mr. Felice said there was still a good deal of concern with the more complicated hedging scenarios. He suggested the ACLI might want to split out the direct hedging proposal in order to get something adopted for year-end. Mr. Givler said he would take the suggestion regarding making the proposal more modular back to the ACLI group.

5. Adopt Interim Conference Call Minutes

Mr. Ostlund made a motion to adopt the Aug. 27 (Attachment Four-A), Aug. 26 (Attachment Four-B), July 16 (Attachment Four-C), July 1 (Attachment Four-D) and June 26 (Attachment Four-E) Life Risk-Based Capital Working Group conference call minutes. Mr. Shepherd seconded the motion. The motion passed unanimously.

6. Any Other Matters

Mr. Barlow said an issue regarding residential mortgage-backed securities that would affect Life RBC would be discussed by the Capital Adequacy Task Force at the Fall National Meeting.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 9/2/09

Life Risk-Based Capital (E) Working Group
Conference Call
August 27, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Aug. 27, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Tomoko Stock (CA); Blaine Shepherd (MN); Fred Andersen and Dennis Lauzon (NY); and Al Sekac (TX).

1. Discuss the American Council of Life Insurers (ACLI) Follow-up to the July 16 Conference Call

Walter Givler (Northwestern Mutual) said a report dated May 1 had been submitted following a referral to this Working Group from the Derivatives Market Study Group of the Valuations of Securities Task Force. Follow-up comments were drafted for the May 27 and July 16 Working Group conference calls.

Mr. Givler said the follow-up comments to the July 16 conference call would be discussed first. The first issue was related to bonds being written down. He explained that credit deterioration can cause the bond to be considered for being written down, which causes a realized loss. At the same time, he said, the value of the hedging instrument can increase; therefore, if hedge accounting is used, the gain would be realized when sold or matured.

Mr. Barlow asked if a reduction could be taken for a derivative that did not meet SSAP No. 86 requirements for hedge accounting. Mr. Givler said risk reduction would still occur, even if companies had derivatives that might not qualify for hedge accounting. Because it is expensive to maintain hedge accounting, this proposal aims to give credit for all hedges, whether or not the derivative qualifies for hedge accounting.

Mr. Lauzon asked about bonds accounted for at amortized cost that had been written down, and whether there might be a disconnect between the write-down and the derivative. Mr. Givler said that could occur, then asked Mr. Lauzon whether he was concerned about mismatches. Mr. Lauzon said he was concerned about a double-credit for the hedges. Mr. Givler said he would take the issue back to the ACLI derivatives group for further consideration and to draft some sample scenarios. Mr. Barlow said this Working Group could not change the accounting, but could limit the RBC credit taken.

Mr. Givler said the next issue was who would rate the tranches for the advanced hedging program example. He said it would be whomever the NAIC authorizes to perform the rating, adding that the Rating Agency Working Group was working on the issue.

2. Discuss the ACLI Follow-up to the May 27 Conference Call

Mr. Givler said he would take the five issues in opposite order from the document. Issue #5 was related to whether the VACARVM methodology for hedging was appropriate to use. He said a maximum of a 70% credit was allowed for a clearly defined hedging strategy. The ACLI proposal was not for future hedges, but only those on the books. Mr. Carmello said he would withdraw his concern and question.

Mr. Givler said issue #4 was the “file-and-use” approach for the advanced category of hedges. He said the file-and-use proposal could be withdrawn if it was a concern, and the instructions could require substantial documentation of hedging strategies instead. Mr. Barlow asked if a change to the ACLI report would be required. Mr. Givler said that would be the case. Mr. Barlow asked whether the issue was something that should be discussed with the Valuation of Securities Task Force. Mr. Givler said he would contact Matti Peltonen (NY) to discuss further.

Mr. Givler said that issue #3 was regarding counterparty risk. Chris Johnson (MetLife) said the issue was whether the RBC captured the counterparty risk on pages LR012 Miscellaneous Assets and LR015 Off-Balance Sheet Risk. Mr. Givler said that the counterparty risk was not included in the proposal because it was reflected elsewhere. Mr. Barlow said that made sense, but that it would be helpful if all of the transactions were in one place. Niraj Patel (Genworth Financial) said it would overly complicate the proposal.

Mr. Givler said that issue #2 was related to the liquidity of the instruments. He said the market for credit default swaps was going through changes that would reduce counterparty risk and increase transparency, to include the use of a centralized clearing platform, as well as additional collateral or margin that is posted on a timely basis. Now, credit default swaps trade more like bonds being purchased at a premium or discount. He added that all major institutions had agreed to follow a certain protocol, so that more transparency would be provided in the case of a credit event — and that his protocol would assist with liquidity and counterparty risk.

Mr. Givler said issue #1 was related to maturity of the instrument being longer than the term of the credit derivative. The derivative credit might perhaps be less where the derivative term was shorter than for a derivative that matched the term of the bond. Ed Toy (NAIC) will follow up on this issue, and the Working Group will discuss it further at a later date.

Mr. Givler said a separate ACLI group was working on RBC instructions and an implementation spreadsheet. Mr. Barlow asked whether those items would be available for the Fall National Meeting. Mr. Givler said he was not sure whether that would be possible. Mr. Barlow said he understood the outstanding issues to be issue #1 and issue #4, as well as the example on double-counting the derivative credit. In order to implement the calculation for 2009 year-end, the proposal would need to be completed and released for comment by the end of September.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 8/27/09

Life Risk-Based Capital (E) Working Group
Conference Call
August 26, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Aug. 26, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Sheldon Summers (CA); Blaine Shepherd (MN); Bill Carmello (NY); and Mike Boerner (TX). Also participating was: Fred Andersen (NY).

1. Review American Academy of Actuaries' Responses to C-3 Phase 3 Comment Letters

Mr. Barlow said a new report on C-3 Phase 3 had been provided by the American Academy of Actuaries (AAA). Peter Boyko (Manulife) representing the AAA said a brief summary document had been prepared. The purpose of the document was to provide clarifications to issues raised in the C-3 Phase 3 comment letters received. He said the references to the working reserve would be removed from stochastic exclusion test section of the C-3 Phase 3 report as a result of the Unum comment in order to avoid confusion. The AAA planned to submit a new C-3 Phase 3 report for the Fall National Meeting. He did not consider any of the changes being made to the report to be material.

Mr. Boyko said there had been several requests for additional guidance. It was felt that these requests would be better handled in an actuarial standard of practice, so those issues were referred. For comments regarding the work effort to complete the calculations, it was still felt the work done for asset adequacy analysis could be leveraged for this project. Items such as the stochastic exclusion test and the alternative amount were also intended to facilitate the work effort. Differences between Valuation Manual (VM-20) and C-3 Phase 3 were considered appropriate. Changes had been made to the March AAA report as a result of the comparison document that had been prepared. Mr. Boyko said he thought consistency was important, but not so much as to require principle-based reserves to be calculated for all in-force business.

The AAA had concerns about the suggestion to eliminate the stochastic exclusion test. Mr. Boyko said it was not thought to be the appropriate direction to take. There were also concerns about the suggestion to have a minimum amount applied to the stochastic testing; that was also thought to be inappropriate, because there would be no benefit to companies for the modeling and it would add costs. It was suggested that companies would be in a better position to understand their own risks, and that is what should be encouraged by regulators. The benefit for splitting out interest rate risk and market risk in the covariance formula had been included for consistency with C-3 Phase 2. It was not felt to be a material issue to the calculation.

Mr. Boyko said allowing the modeling to be done six-months' prior rather than 3 months as for reserves was felt to be appropriate due to the difference in scope. An adjustment would be made to the results to make the amount applicable to year-end. Mr. Boerner asked how the adjustment would be calculated. Mr. Boyko said the company would make use of existing analysis of economic movements. The company would subsequently re-run the data to test the accuracy of the adjustment after year-end.

2. Discuss Draft Actuarial Standard of Practice for C-3 Phase 3

Bob Meilander (Northwestern Mutual) said that a task force of the Actuarial Standards Board had started work on an actuarial standard of practice (ASOP) for principle-based reserving, because capital standards appeared more likely to be finished before reserves attention was shifted to C-3 Phase 3. A discussion draft of the ASOP has been released to the public, but the ASOP language has not been approved or reviewed by the Actuarial Standards Board. The ASOP will not be finalized until after the C-3 Phase 3 calculation has been completed.

Mr. Barlow asked whether actuaries were required to comply with an ASOP. Mr. Meilander said that they do. Mr. Barlow said regulators should look for the ASOP to assist in having things completed in an appropriate manner. Mr. Meilander said that ASOPs rarely specify doing something in a particular way; for the most part, ASOPs provide guidance regarding which types of disclosures to make. Mr. Ostlund said that ASOPs usually have a disclosure where the actuary would justify departure from actuarial standards. He asked whether the current draft had that disclosure. Mr. Meilander said that disclosure was included in Section 4.1 of the draft.

3. Discuss Issues and Further Steps for the C-3 Phase 3 Proposal

Mr. Barlow said he wanted to discuss the status of the C-3 Phase 3 proposal, as well as any outstanding issues regarding the proposal — of which he had identified a few. He said the stochastic exclusion test and alternative amount had a minimum amount of 0.5%, which was the current factor-based calculation; however, the stochastically modeled amount currently had no minimum amount. Mr. Carmello said he would like to keep the minimum floor as an item to discuss.

Mr. Barlow said comments had indicated the stochastic exclusion test was too complicated. He said he would like to receive specific examples of exactly how it was too complicated. He said the Society of Actuaries (SOA) has modeling results that might help with the stochastic exclusion test. Mr. Boyko said the SOA modeling was complete or near completion — and would help regulators discern whether the 4% level chosen was valid for the stochastic exclusion test. He said that an SOA webcast on the modeling would be held Sept. 2, and the modeling information would be available around that same time. Karen Rudolph (Milliman) said the SOA would show partial modeling results during the webcast, with more detailed information available about two weeks after that. Mr. Ostlund asked about small company data. Ms. Rudolph said both small and large companies had submitted data. Mr. Barlow suggested that a conference call of the Working Group might be held after the data became available to review the data in detail.

Mr. Barlow said that more than one method could be used to calculate the capital amount: 1) total asset requirement (TAR) less statutory reserves; or 2) TAR less an actuarially calculated reserve amount. Mr. Summers suggested taking the total capital plus the reserves, because sometimes the capital requirement is increased when the reserves are reduced. Another reason for concern was that only a portion of the reserves for new business would be calculated using a principle-based valuation method. Mr. Carmello said he had seen companies increased their reserves or transfer the business off-shore, rather than increase the capital amount. He added that, in Europe, capital is calculated by “shocking: the reserve so there is enough capital to cover losses and stay solvent. Mr. Barlow said that using TAR less an actuarially consistent reserve (rather than actual reserves) might address some of the current issues.

Mr. Barlow said the issue of the scenario generator was still outstanding. He said he was not clear whether there was a big difference between capital and reserves; the question would be whether to limit the scenarios to NAIC-approved scenarios. Mr. Barlow asked whether the Economic Scenarios Subgroup of the Life and Health Actuarial Task Force would issue a report soon. Mr. Andersen said that time had been allocated at the Fall National meeting to discuss this issue, and that the Subgroup would likely present their recommendations following that meeting. Mr. Barlow said that several comments had been received regarding the documentation being onerous, but the comments were not more specific than that. He said he would like to receive specific suggestions on how to reduce the documentation required.

For C-3 Phase 2, the AAA report was referenced in the instructions. Mr. Barlow said he would like to have the C-3 Phase 3 guidance included in the instructions. He said the AAA was forming a work group to address the C-3 phase 3 instructions, and that a regulator would be needed to participate in that group. He asked any regulator interested in becoming a member of the AAA group to contact him.

Mr. Barlow said that comments regarding C-3 Phase 3 should be sent to Mr. Barlow and Dan Swanson (NAIC). He said another Working Group conference call regarding derivatives risk mitigation was scheduled for Aug. 27. Continuing discussion of C-3 Phase 3 would occur at the Working Group’s meeting during the Fall National Meeting.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 9/2/09

Life Risk-Based Capital (E) Working Group
Conference Call
July 16, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call July 16, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Sheldon Summers (CA); Blaine Shepherd (MN); Dennis Lauzon (NY); and Mike Boerner (TX).

1. Discuss the American Council of Life Insurers (ACLI) Derivatives Risk Mitigation Proposal

Walter Givler (Northwestern Mutual) said he would take up the discussion from a previous Working Group conference call. For this call, he would start with the advanced example. The ACLI recommendation was that the RBC credit should be proportional to the risk reduction. For intermediate hedges with a many-to-many relationship, there would need to be a more than 50% match of the risk before a credit was allowed. For advanced hedges, there was a specialized assessment of the risk reduction.

Niraj Patel (Genworth Financial) said the Blanks Working Group had approved Schedule DB changes that would capture data on hedge effectiveness. Mr. Shepherd asked when the anticipated effective date of the Blanks proposal was. Mr. Givler said it would be first quarter 2010. Mr. Patel said the advanced category was non-linear; i.e., the risk mitigation was not 100%, so there would not be a 100% reduction of RBC. Similar to securitizations, the risk to insurers was reduced, and protection would be bought for losses above a certain amount. The tranche could then be rated by the Securities Valuation Office (SVO), a rating agency or the insurance company itself.

Mr. Lauzon said there had been problems with rating securitizations, and he was not sure who had the expertise to rate tranches. Mr. Givler said that was a valid point; i.e., whether it would be better to have the SVO, a rating agency or some other group perform the rating. Mr. Patel said that, similar to asset-backed securities, the rating might go up or down depending on the performance. Mr. Givler said they would need to be re-rated year-in and year-out, and not just at inception. Mr. Shepherd said that how the rating would be conducted and who would be responsible for it would be significant to implementation. Mr. Givler noted that other NAIC groups were looking at ratings — and, to the extent that those groups make changes, that approach could be adopted.

Mr. Lauzon said that if the company was not doing hedge accounting, the derivative could be marked to market — in which case, the RBC charge for the asset would be based on amortized cost and the derivative would be at market — and he was concerned a mismatch might occur. Mr. Givler said he could provide an example of how the proposal would work. Mr. Lauzon said he would like to see what would happen for NAIC class 5 securities. Mr. Lauzon said he was also concerned about duration mismatch. Mr. Givler said this was the first issue in the discussion document, adding that there were different factors to take into consideration and quite a lot of time was spent on that question. Mr. Lauzon said he would like to see further discussion regarding the hedging becoming more expensive, because a similar issue had been seen with letters of credit; i.e., that duration mismatch can cause problems. Mr. Patel said the credit default swap market was liquid and, if someone needed to roll a contract, it would be easy to do at the five-year point — as it was rare for a hedging contract to go beyond five years. Mr. Barlow asked if there had been issues recently with the market. Mr. Patel said there was time to extend a contract, if needed.

Mr. Barlow asked if the mismatch issue was applicable to all three derivative types. Mr. Givler said that, with the exception of item 4 for VACARVM, all of the five issues discussed related to all of the three derivative categories. Mr. Barlow said a conference call would be scheduled to discuss the regulators' concerns further. As long as issues were still being discussed, he said, there was no benefit to releasing the proposal for comment at this time.

2. Release for Comment the 2010 Derivatives Collateral Proposal

Mr. Barlow said a derivatives collateral proposal for 2010 had been drafted that was essentially the same as the proposal adopted for 2009. The collateral would be separated out on a different line in the 2010 proposal — but, other than that, there were no substantive changes. Mr. Shepherd made a motion to release the derivatives collateral proposal for a comment period of 60 days. Mr. Boerner seconded the motion. The motion passed unanimously.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 9/2/09

Life Risk-Based Capital (E) Working Group
Conference Call
July 1, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call July 1, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Sheldon Summers (CA); Blaine Shepherd (MN); Frank Horn (NY); and Steve Neil and Al Sekac (TX).

1. Consider Adoption of the 2009 American Council of Life Insurers (ACLI) Derivatives Collateral Proposal

Mr. Barlow said a proposal regarding derivatives collateral had been presented to the Working Group at the Summer National Meeting, where the proposal was released for comment. A slight modification was made to the 2008 guidance that had been adopted to include all of the collateral on the line for class 1 assets. No comment letters were received on the proposal. One comment from NAIC staff had indicated the references for the lines where the collateral was not included could continue to use the current references to the Asset Valuation Reserve page.

John Bruins (ACLI) said the suggested change would be consistent with the proposed references and would not result in different amounts being reported. Mr. Horn asked whether there was any collateral that would not be class 1. Mr. Barlow indicated that, by definition, the collateral would be class 1. Mr. Ostlund made a motion to adopt the derivatives collateral proposal with the suggested changes. Mr. Shepherd seconded the motion. The motion was passed unanimously.

Mr. Bruins said a long-term 2010 proposal for derivatives collateral might also be released for comment. Mr. Barlow said he thought a Schedule DB proposal had been adopted by the Blanks Working Group, and that the proposal should be reviewed for any changes needed. Mr. Barlow said the long-term derivatives collateral proposal would be added to the agenda for the next Working Group conference call.

2. Consider Adoption of the 2009 Life Risk-Based Capital Formula and Instructions

Mr. Barlow said the draft 2009 life RBC formula pages and instructions did not include the derivatives collateral proposal that was just adopted. In addition, the Working Group members had not had a long period of time to review the instructions. Mr. Barlow said the Working Group could go ahead and make a motion to adopt the instructions now or take more time to review the instructions and have an e-mail vote. Mr. Ostlund asked when the instructions needed to be adopted. Dan Swanson (NAIC) said the RBC instructions needed to be sent to vendors by July 10. Mr. Shepherd said he had a few minor changes that he would contact NAIC staff about separately.

Mr. Ostlund made a motion to adopt the 2009 life RBC instructions and formula, with the derivatives collateral changes implemented. Mr. Neil seconded the motion. The motion passed unanimously.

3. Any Other Matters

Mr. Barlow said the Capital Adequacy Task Force would be holding a conference call to discuss the Term Asset Loan Facility proposal. Mr. Summers asked how the 1.3% factor for non-controlled assets and 0.4% class 1 factor for bonds had been determined. Mr. Swanson said his understanding was that the 1.3% factor for off-balance sheet items had not been determined in a scientific manner. Mr. Swanson said he thought the 0.4% class 1 bond factor had been determined by using a study of bond default data. He said there was some documentation available from when the life RBC formula was first developed that he could provide Mr. Summers.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 9/3/09

Life Risk-Based Capital (E) Working Group
Conference Call
June 26, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call June 26, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Sheldon Summers (CA); Blaine Shepherd (MN); Dennis Lauzon (NY); and Mike Boerner (TX). Also participating was: Kerry Krantz (FL).

1. Review Comment Letters Received on the American Academy of Actuaries (AAA) C-3 Phase III Proposal

Mr. Barlow said 12 comment letters had been received on the C-3 Phase III proposal released for comment. At the Summer National Meeting, the Working Group decided to not pursue a year-end 2009 implementation, which should address some of the comments received. He said he wanted the Working Group to complete work on the proposal as quickly as possible for a year-end 2010 implementation to give companies sufficient time to implement the proposal.

Bill Schwegler (AEGON) said AEGON has grave concerns and believes the proposal is "fundamentally and fatally" flawed. He said the proposal is not consistent with the current U.S. solvency regime, and that using a static factor was not perfect but that it was characteristic of the entire RBC formula. He said he favored a modeling approach when a factor-based approach was inadequate, but that evidence had not been provided that showed the current factor-based approach was inadequate. He added that the benefit of measurement of the risks as provided by the proposal does not justify the costs. He also had concerns with the working reserve amount, the market value issue and with margins for prudence. He said the proposal would be burdensome, costly and resource intensive. In addition, he said the stochastic exclusion test and alternative amount provided limited relief to companies, and there were alternatives that would be more appropriate. In summary, he said the proposal was damaging to companies, regulators and consumers. Mr. Lauzon asked about the effects of accounting mismatches and the use of market value. Mr. Schwegler said the modeling procedures produced punitive results when market value was used instead of book value. Mr. Barlow asked whether that was an issue with cash flow testing. Mr. Schwegler said the cash flow testing was different because it was a pass/fail calculation.

John Bruins (American Council of Life Insurers—ACLI) said the C-3 Phase III proposal was complex, with a host of areas on which to comment. He said the ACLI did not have a total consensus on concerns, as companies were raising more issues every day; therefore, the implementation delay of one year was appreciated. One concern regarding the proposal was related to the mix of book value and market value. He said the Working Group should consider having a multi-year phase-in of the proposal, as it would be a difficult process for most companies, and a year might not be long enough for companies to implement the proposal. Mr. Bruins said another issue was having a finite number of scenarios, and the proposal should use targeted subsets of scenarios and should recognize some level of materiality. In addition, he said that the documentation requirements were too extensive and needed to be streamlined. Overall, he said, the current factor-based approach was 4% of the total RBC requirement, and this calculation would not impact solvency for most companies.

Mr. Barlow said he was concerned with the selective use of concerns for different proposals, whether the RBC was being used for regulatory purposes or for non-regulatory purposes. Paul Graham (ACLI) said he thought the concern was the magnitude of the work effort. Mr. Barlow asked whether the effort was bigger or different from C-3 Phase II. Mr. Graham said C-3 Phase II was limited in the products it affected and there was a clear impact on the capital requirements. In comparison, he said C-3 Phase III would have a smaller impact on capital requirements and would probably entail more effort by the companies.

Bill Olbert (UNUM) said his biggest concern had been the year-end 2009 implementation. However, he said he still had some technical questions regarding the proposal; specifically, a number of questions on exactly how the stochastic exclusion test would work. He said UNUM's life business is a small portion of the company's overall business. As such, he wondered whether his company would need to do the stochastic testing, and said he believed there should be a materiality test — because having another actuarial memorandum to complete would be a lot of work for the small-dollar amount of life business his company has. Mr. Lauzon said he understood that a lot of work would need to be done, and asked whether the work would need to be done for principle-based reserves anyway. Mr. Olbert said there would be more time to prepare for principle-based reserves, and that his company was planning to have resources in place for the calculations. Mr. Bruins said there was overlap between the reserves and capital calculations for new business with interest mismatch, but that would not be the case for in-force business, and the NAIC would need to coordinate the modeling proposals in order for them to be consistent.

Bob Meilander (Northwestern Mutual) said one concern was with the reserve margins, because smaller or larger margins would affect the overall result, and even small changes in assumptions could lead to a large impact. He said that changing the mortality margin from 3% to 5% had affected the results, and that adding equities to the investment mix had produced some nonsensical results.

In addition, Mr. Meiland said that the starting asset amount had a noticeable impact to the RBC result. He said he also was concerned with the work effort, as the stochastic exclusion test was an important element of the proposal. He said he was concerned with the ability to audit the results and the potential expense of an audit. He said he also was concerned with the consistency with other RBC results, noting that there were several areas where there would be unintended consequences of the proposal. These included calculating a near-zero RBC amount, pro-cyclicality of the RBC results, the impact of equities and the sensitivity of results to assumptions. For those reasons, he said he felt the C-3 Phase III proposal was "fatally flawed" and not ready for implementation. Mr. Ostlund asked about a statement made in the comments summary. He asked what circumstances had changed in the past two years. Mr. Meilander said that, in the current economic climate, capital was much harder to come by than two years ago.

Mark Birdsall (Security National Life, representing the National Alliance of Life Companies—NALC) said testing of the stochastic exclusion test had been limited so far, and there was concern the stochastic exclusion test 4% threshold was inappropriate. Based on limited testing, he said it appeared that the threshold for new business for reserves and in-force business for capital would be significantly different — and there would be a possibility that the thresholds would need to be different for principle-based reserves vs. RBC. He noted that the stochastic exclusion test allows the company to use cash-flow testing assumptions and experience, but the current proposal requires extra work to set assumptions that might be reduced, in addition to the documentation requirements. He said he would like to use anticipated experience assumptions, rather than prudent estimate assumptions. He also said he thought the margins should be aggregate, rather than at an assumption-by-assumption level. If principle-based reserving was not implemented, he said it would not make sense to implement the capital calculation.

Pam Hutchins (Government Personnel Mutual Life) said she thought the 4% threshold for the stochastic exclusion test was too low — that 6% might be a good starting point, but something somewhat higher was needed. Mr. Barlow said he hoped some "real world" information would become available to set the proper level. Mr. Ostlund asked whether smaller companies would be willing to pay a penalty to use a factor-based approach. Ms. Hutchins said she believed that would be the case.

Arnold Dicke (AADicke LLC) said he wrote his comment letter from the perspective of an in-force policyholder. Because these are not ordinary times, he said that C-3 might be more important than in the past — especially as there could soon be an environment with significantly rising interest rates. From a policyholder perspective, it would be equally bad if the RBC was understated or overstated. Mr. Dicke then outlined his five-point proposal: 1) Require a factor-based and a stochastic approach be completed, so the impact could be judged; 2) Set the stochastic exclusion test at 6% or higher; 3) Require a materiality test for closed blocks of business; 4) Implement a five-year phase-in period for the stochastic calculation and the stochastic exclusion test; and 5) All the commissioner to require adoption of the new basis for companies.

Mr. Lauzon said New York was concerned with whether it made sense that a block of business that was fluctuating 4% would only have to hold a 0.5% reserve — adding that the concern would be greater if the 4% level was raised. Mr. Dicke said the original idea for the stochastic exclusion test was to try to find a way to carve out less risky policies for business that did not have material tail risk; i.e., the 4% number is not meaningful. Mr. Barlow said that a product with a 4% result would be riskier than a product with the result of 1%. As such, he said it would be a valid issue to consider whether more variation was needed in the 0.5% factor. He said another issue was related to negative interest maintenance reserve (IMR), as inclusion of a negative IMR lowers starting assets. If negative IMR is offsetting positive IMR, he said it should reduce the amount of assets. Another item in the comment letter indicated that an example with numbers might help in understanding the discount rate methodology.

2. Discuss Issues Raised in the C-3 Phase III Comment Letters

Mr. Barlow asked Mr. Boyko for initial thoughts from the AAA regarding the comments. Mr. Boyko said there was a fundamental issue regarding the use of the total asset requirement (TAR) in defining the risk metric. He noted that conditional tail expectation (CTE) 90 has been used since September 2006 and, therefore, he was surprised that it was being questioned at this point. He said the AAA would need direction from the Working Group, because if CTE 90 is rejected, then he is not sure the AAA would be able to address the other concerns. In addition, he said the AAA work group tried as best they could to address the concerns raised regarding complexity and excessive documentation through simplification methods. In doing so, the AAA work group did not consider addressing a materiality test, but he said it would be consistent with the other simplification methods employed.

Mr. Boyko said that other principle-based approaches were reviewed to see if they required excessive documentation, but the work group did not feel that it could reject previous direction from the Working Group in regard to those items already being required. However, he said, there were potential efficiencies that could be considered, and direction from the Working Group on that issue would be appreciated. Regarding the initial 4% baseline threshold for the stochastic exclusion test, he said there was not much data available — but the Society of Actuaries is working on a research project that will cover 15 blocks of business, which might provide some useful insight as to what the correct percentage might be. Underlying the stochastic exclusion test using cash flow assumptions was allowed, and he said the SOA decided to use anticipated experience rather than prudent estimates, so that the margins chosen did not influence the results. He said he would take to the AAA work group the issue New York brought up regarding the stochastic exclusion test.

Mr. Barlow said there were some common concerns in the comment letters, one of which was related to getting odd results when a non-principle-based reserve was subtracted from a principle-based TAR. Mr. Boyko said another possibility was considered, where an adjustment would be made to the reserves to make them consistent with a CTE 65 level; however, it was decided that would be too big of a change to the current principle-based approach. Mr. Schwegler gave an example where the RBC ratio would be adjusted. Mr. Barlow said he was aware of the RBC ratio concern, which was part of having a TAR approach, and he wondered whether there were other concerns regarding the approach. Paul Graham (ACLI) said one concern was that when the reserve is not principle-based, the choice of the margin has a huge effect on the results. Mr. Barlow said it was an issue where there could be more discussion and further review.

Mr. Barlow said a simple example of the market value accounting issue might help. Mr. Schwegler said he would try to provide an example. Mr. Barlow said he would like to see more work done on the stochastic exclusion test; i.e., rather than having a flat factor, he said they should consider adjusting the factor based on the information available. He added that he would like to get more information about things that they might be considering to simplify methods, such as reducing the number of scenarios run. Mr. Boyko said he would contact the AAA Model Efficiency Work Group to see if they might be able to provide more information. He said companies would already have the ability to run a reduced scenario set in context of the alternative amount. Mr. Barlow said some things might need to be better identified.

Mr. Ostlund asked if the AAA could address small companies. Mr. Barlow asked whether he was referring to small companies or small blocks of business — because the calculation would still be needed for a small company writing a risky line of business. Mr. Ostlund said he thought the materiality should be addressed. Mr. Shepherd said a similar discussion had been held for C-3 Phase I and he agreed with Mr. Barlow's comments. Mr. Barlow said another call regarding C-3 Phase III was scheduled for July 29. He said he thought the comment letter had been extremely helpful and would make for a better end-result.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Property and Casualty Risk-Based Capital (E) Working Group
Conference Call
July 6, 2009

The Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call July 6, 2009. The following Working Group members participated: Anne Kelly, Chair (NY); Ron Dahlquist (CA); Ray Spudeck (FL); Dale Bruggeman (OH); Jennifer Wu (TX); and Peter Medley (WI).

1. Adopt the 2009 P&C RBC Forecasting Kit

Ms. Kelly informed the group that the updated P&C risk based capital (RBC) report and instructions are reviewed and adopted by this Working Group each year. She added that there were a few changes made in 2009, most of which were driven by the inclusion of the new hybrid securities lines. Ms. Kelly also indicated that the second phase of the new underlying risk charges was adopted through an e-mail vote. Another major change for the 2009 RBC publication was the update of the underlwriting risk charges. Ms. Kelly said the last update was the insertion of the long-term care RBC requirement into R4 and R5 of the Calculation of Total RBC After Covariance page. She stated that this item had been overlooked previously and should be included in the covariance calculation. Mr. Dahlquist made a motion to adopt the 2009 P&C RBC Forecasting Kit. Mr. Bruggeman's seconded the motion and it passed unanimously.

2. Update from the Catastrophe Risk Subgroup

Ms. Kelly suggested that having a joint conference call between the Casualty Actuarial and Statistical (C) Task Force and the Catastrophe Reserve (C) Working Group would be more effective in developing a constructive proposal without duplication of efforts. Mr. Dahlquist agreed and said a conference call would be scheduled.

3. Discuss the Schedule P, Two-year Lines Expansion to 10 years

Ms. Kelly presented a blanks proposal to require 10 years of data (electronically only) on Schedule P, Parts 1, 2 and 3. She said that the proposal might help ensure better quality of data. Ralph Blanchard (Travelers) expressed concerns about the possibility of triggering a tax penalty, even if the data was filed in an electronic format. Whether there was a penalty would depend on which data would be used for *Best's Aggregates & Averages*. Mr. Blanchard asked if there had been any attempt to clean up the data. Ms. Kelly said cleaning up the data would be difficult, but that it might be possible to screen for all zeros. She stated that the Working Group would need to gather more comments from the industry regarding this proposal before proceeding. Mr. Bruggeman made a motion to release, for a comment period of 60 days, the proposal for the the expansion of the Schedule P, from two years to 10 years of data. Mr. Medley seconded the motion and it passed unanimously.

Having no further business, the Property and Casualty Risk-Based Capital (E) Working Group adjourned.

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Health Risk-Based Capital (E) Working Group
Conference Call
July 6, 2009

The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call July 6, 2009. The following Working Group members participated: Dennis Julnes, Chair (WA); Steve Ostlund (AL); Julia Philips (MN); and JoBeth Stephenson (TX). Also participating were: Dan Keating, Richard Tan and Al Willis (FL); Mary Pesce (NJ); Alan Furan (OH); and Richard Hinkle (WI).

1. Adopt the 2009 Health RBC Forecasting Kit

Mr. Julnes informed the group that the updated health risk-based capital (RBC) report and instructions is reviewed and adopted by this Working Group each year, and he added that there were a few changes made in 2009. Eva Yeung (NAIC) stated that there were three major updates for the 2009 health RBC materials, one of which was for hybrid securities. Ms. Yeung said that, starting Jan. 1, 2009, hybrid securities moved to a new line on the annual statement Schedule D, Part 1. This change would affect several pages of the Health RBC formula, such as XR007, XR009 and XR022. Ms. Yeung also indicated that another update was for Stand-Alone Medicare Part D Prescription Drug Coverage factors. The new factors were adopted during the June 14 meeting of the Capital Adequacy Task Force. A major change was made to the XR014 Medicare Part D supplemental benefit factor. The new factor will be phased in over a two-year period, starting with a 21% factor for year-end 2009 and a 34% factor for year-end 2010. The last major update for the 2009 publication was the implementation of the Trend Test, which was added to the health RBC calculation. The RBC for Health Organizations Model Act (#315) is in the process of being modified for the Health Trend Test. Ms. Philips made a motion to adopt the updated 2009 Health RBC Forecasting Kit. With Mr. Ostlund's second, the motion was unanimously adopted.

2. Updates from American Academy of Actuaries (AAA)

Kevin Russell (American Academy of Actuaries—AAA) said that its Healthcare Receivables Working Group had been formed recently. Mr. Russell added that some of the members in the working group believed that the treatment of each type of the receivable should be handled differently, due to various kinds of risks. He anticipated that the healthcare receivables would increase dramatically if the U.S. Congress passes the Medicaid Prescription Drug Rebate Equalization Act. Mr. Russell further stated that the initial data had been received and is being reviewed by the group. The data should help determine the impact of any potential changes in healthcare receivable factors and the RBC after covariance. Mr. Russell also said that the AAA welcomes comments from interested parties. Crystal Brown (NAIC) indicated that, based on the Health RBC Working Group agenda, this issue was scheduled to be implemented by year-end 2010 or later.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.

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