



Risk-Based Capital – New Tendencies

Capital Basado en Riesgo – Nuevas Tendencias

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Presentation Overview

- History of Risk-Based Capital (RBC)
- Brief Overview of RBC Formulas
- RBC Statistics
- Solvency Modernization Initiative (SMI)



History of Risk-Based Capital

- 1989, RBC concept began
- September 1990, Examination Oversight Task Force of NAIC determined RBC requirements were preferable to minimum capital and surplus requirements
- December 1990, NAIC formed two RBC working groups (one life and one property & casualty)



History of Risk-Based Capital (Continued)

- 1991 and 1992, NAIC distributed RBC survey to insurers
- Life RBC formula finalized in 1993
- P/C RBC formula finalized in 1994
- Implemented RBC standards for health organizations in 1998



History of Risk-Based Capital (Continued)

- Annual modifications to the RBC formulas subsequent to initial implementation
- Used modeling approach where a factor-based approach inadequate to capture all risks



History of Risk Based Capital (Continued)

RBC intended to provide a Capital Adequacy Standard that:

- Is uniform among the states
- Provides regulatory authority for timely action
- A calculation of minimum capital required and not a target or ideal level of capital
- Reflects unique risks inherent in operating an insurance company
- Is easy to understand and calculate
- Can be verified or extracted from the statutory annual statement



History of Risk Based Capital (Continued)

We did NOT intend RBC to be:

- An early warning device
- Designed to prevent insolvency
- Designed to detect fraud/mismanagement
- A stand-alone tool for solvency monitoring
- Designed to fit every scenario and capture every possible risk of a specific company
- A rating mechanism



Overview of NAIC RBC Formulas

RBC is just one part of the NAIC solvency framework:

- RBC
- Financial Analysis and Reporting
- Examinations
- Statutory Accounting
- Reserve Requirements
- Regulatory Control of Transactions/Activities
- Governance / Risk Assessment



Overview of NAIC RBC Formulas (Cont.)

The *Four Year Historical Data Page* of the Statutory Financial Statement includes 2 Results:

- Total Adjusted Capital
(a calculation of the total actual capital held)
- Authorized Control Level RBC
(a calculation of the minimum capital that insurers should hold to avoid regulatory control)



Overview of NAIC RBC Formulas (Cont.)

Generic Risk Components – Authorized Control Level RBC:

- Asset Risks
 - Affiliated Investment Risk
 - Credit Risk
 - Other
- Underwriting/Insurance Risk
- Other Types of Risk (Varies by Formula)
 - Business Risk (Life & Health)
 - Interest Rate and Market Risk (Life)



Overview of NAIC RBC Formulas (Cont.)

RBC Action/Control Level Ratios:

- Company Action Level
= 200% of Authorized Control Level RBC
- Regulatory Action Level
= 150% of Authorized Control Level RBC
- Authorized Control Level RBC
= 50% of RBC after Covariance Adjustment
- Mandatory Control Level
= 70% of Authorized Control Level RBC



Overview of NAIC RBC Formulas (Cont.)

An RBC corrective action plan should have:

- Conditions that contributed to the RBC Action Level Event
- Corrective actions proposals expected to result in the elimination of the RBC Action Level Event
- Insurer's projected financial results for 4 succeeding years
- Key assumptions impacting the insurer's projections
- Evaluation of the quality of insurer's business and potential associated problems



Overview of NAIC RBC Formulas (Cont.)

When a jurisdiction enacts the RBC Model Act into law, it provides regulators with legal authority to intervene based upon the RBC Ratio:

- RBC Model Act 312 for Life and P/C RBC:
 - 51 of 56 Jurisdictions for Life RBC Model
 - 51 of 56 Jurisdictions for P/C RBC Model
(As of July 2010)
- RBC Model Act 315 for Health RBC:
 - 37 of 56 Jurisdictions for Health RBC Model (As of April 2010)



STATISTICS – All Companies Filing RBC

	2007	2008	2009	2010
No Action	4,195	4,148	4,118	4,021
Company	40	63	53	32
Regulatory	28	27	22	20
Authorized	15	15	14	8
Mandatory	39	51	44	37
Total	4,317	4,304	4,251	4,118
% at an Action Level	2.83%	3.62%	3.13%	2.36%



STATISTICS – All Companies Filing RBC

Aggreg. RBC	2010	2009	2008	2007
Total Adjusted Capital	1,197,236	1,109,950	992,036	1,103,237
Auth. Control Level RBC	165,567	159,773	154,050	162,677

Amounts reported in millions

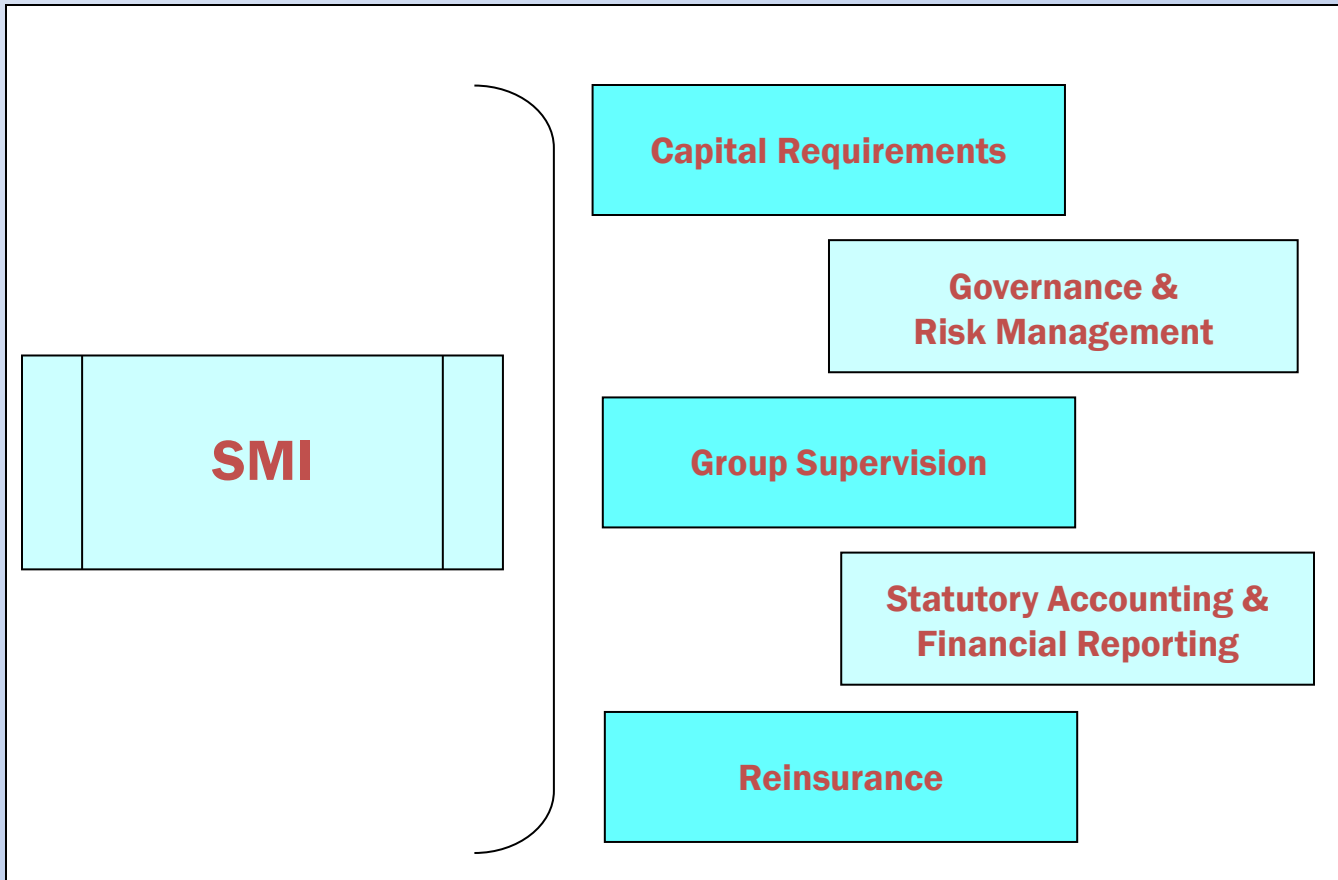


Solvency Modernization Initiative (SMI)

- 1. Describe the U.S. system based on a coherent set of principles**
- 2. Examine international developments and their potential use in U.S. insurance regulation.**
 - U.S. implementation of Basel II international capital framework for banks
 - IAIS Solvency work
 - Solvency proposals in other jurisdictions including Australia, Canada, Switzerland and the EU Solvency II
 - International Accounting Standards Board (IASB) development of International Accounting Standards
- 3. Critically review the entire U.S. solvency regulation framework**
 - Evaluate and retain requirements that are working well and add, modify or delete requirements as needed



SMI Focus Areas



SMI Road Map

- Complete all major policy decisions by the end of 2012;
- NAIC committees then proceed with implementation as may be appropriate.
- SMI initial activities already completed include:
 - Documentation of the current U.S. Insurance Financial Solvency Framework and Core Principles
 - Study of international solvency systems to formulate new ideas for consideration in the U.S.



Solvency Modernization Initiative (Cont.)

Why include RBC in the Solvency Modernization Initiative?

- 20 years since we first developed the RBC formulas
- Appropriate time for a comprehensive review of the RBC formula calibration, factors, methodology and risks captured
- Consider changes to insurance products, investments and experience since original RBC development



Solvency Modernization Initiative (Cont.)

Capital Requirements

Priority issues of the SMI RBC Subgroup:

- Identification of the calibration strategy for the risk-based capital formulas
- Improvements to RBC formulas, including implementation of missing risk charges
- Improvements to RBC correlation/covariance methodology



Solvency Modernization Initiative (Cont.)

Governance and Risk Management

- The revised risk-focused surveillance approach already includes a review of certain corporate governance activities
- Developed and released 20 high-level corporate governance principles for comment
- Belief that ORSA (“Own Risk and Solvency Assessment”) would have regulatory added value as companies integrate their risk management processes into their solvency assessment



Solvency Modernization Initiative (Cont.)

Group Supervision

- Group capital assessment through an “Own Risk and Solvency Assessment” (ORSA)
- NAIC E Committee adoption of Revised Holding Company Model Act (#440) and Regulation (#450)
- New Enterprise Risk Management Form F-Statement regarding material risks within the insurance holding company system that could pose enterprise risk to the insurer
- Will not pursue legal entity RBC adjustments or a group capital calculation



Solvency Modernization Initiative (Cont.)

Statutory Accounting and Financial Reporting

- Document the purpose of statutory accounting in the U.S. insurance solvency regulation framework
- Develop a policy position and recommendation regarding International Financial Reporting Standards (IFRS) and its potential use in the U.S. insurance solvency regulation framework
- Develop a policy position recommendation to address the regulatory impacts of non-regulatory uses of statutory financial statements



Solvency Modernization Initiative (Cont.)

Reinsurance

- The NAIC adopted the Reinsurance Regulatory Modernization Framework proposal in 2008
- The Framework recommended implementation through enabling federal legislation, but we were unable to procure congressional support
- Some states (NY, NJ, FL, IN, LA, TX) are moving forward with individual state-based reinsurance collateral reduction reforms
- Considering changes to the Credit for Reinsurance Model Law and related accreditation requirements





Questions???