March 11, 2021

Philip Barlow
Chair
Life Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners (NAIC)

Dear Philip,

On behalf of the American Academy of Actuaries'[1] C1 Work Group (C1WG), we present to the Life Risk-Based Capital (E) Working Group updated base bond factors and a companion portfolio adjustment formula to reflect corporate tax rates enacted by the Tax Cuts and Jobs Act of 2017 for the Life Risk-Based Capital (LRBC) formula. The C1WG's most recent recommendation on updated bond factors was provided to the NAIC's Investment Risk-Based Capital Working Group on October 10, 2017.[2] No other changes have been made to the October 17, 2017, recommendation.

As we have done in previous reports to the NAIC, we are providing direct model output for the base factors. As is the case with the current capital requirements for bonds, we recommend capping the base factor for the lowest-quality bond desi(e)- 20tion at 30%. Note that this approach caps the capital requirement for bonds at the base factor for unaffiliated common stock. In addition to capping the factor, we have not rounded any of the factors, as was done for the current bond factors.

## A. UPDATED BASE FACTORS

The table below shows updated bond factors using a 21% corporate tax rate and the factors recommended in October 2017. These factors are used in the first step in calculating the basic capital requirements for bonds. These factors have been established at the statistical safety level specified by regulators. These factors in combination with the portfolio adjustment are expected to establish required capital at the 96th percentile over a 10-year time horizon. The assumptions used in developing these factors are based on expected loss given default experience for a portfolio of bonds that is representative of a typical life insurer's bond portfolio.

In the development of the capital requirements for credit risk, recall that the tax rate affects the net loss flowing through statutory surplus. The factor is based on a discounted after-tax cash flows. As such, an after-tax discount is used in the calculation. In the October 2017 recommendation, the after-tax cash flows were discounted at 3.25%. The updated bond factors are based on after-tax cash flows discounted at

1850 M Street NW Suite 300 Washington, DC 20036 Telephone 202 223 8196 Facsimile 202 872 1948 www.actuary.org

1850 MStreet

The representative bond portfolio used in developing the base factors contained 824 issuers. As per the October 2017 recommended portfolio adjustment, the updated portfolio adjustment is neutral or approximately equal to 1.0 of an average portfolio (i.e., a portfolio with the same number of bonds as

1850 M Street NW Suite 300 Washington, DC 20036 Telephone 202 223 8196 Facsimile 202 872 1948 www.actuary.org

for bonds, exclusive of the impact of increased requirements from the tax change, increase the capital requirements for credit risk approximately 15-20% for the industry, on average. Updated assumptions might indicate that capital requirements should be increased further. We understand the desire to now adopt factors that move the capital requirements closer to the desired statistical level but encourage regulators to consider more frequent reviews of the assumptions and the resulting factors.

We appreciate your consideration of this update. Please contact Nancy Bennett, seni6 ( r)6.9 (e)-8gl-4.6 (i)6.2 (n)-3.9 ( )

1850 M Street NW Suite 300 Washington, DC 20036 Telephone 202 223 8196 Facsimile 202 872 1948 www.actuary.org