John Bruins

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January 22, 2010

Mr. Philip Barlow
Chair, Life Risk Based Capital Working Group
Deputy Commissioner
Dept of Insurance Securities & Banking
810 First Street NE Suite 701
Washington, DC 20002

Re Comments on NAIC Instructions for proposed C-3 Phase III

Dear Philip:

The American Council of Life Insurers (ACLI) is pleased to provide the following comments regarding the NAIC instructions for proposed C-3 Phase III. The ACLI represents 340 member companies operating in the United States, of which 332 are legal reserve life insurance companies, and eight are fraternal benefit societies. These 340 member companies account for 93 percent of total assets, 93 percent of the life insurance premiums, and 94 percent of annuity considerations in the United States.

Our detailed comments, which are provided in Attachment 1, are intended to serve as a preliminary technical review of the proposed instructions. Our review of Section 5.E. of Appendix 3 is not yet complete, and we plan to submit more detailed comments within the next 30 days. We will also separately provide comments on Appendix 2, which is related to the C-3 Phase II methodology for variable annuities. It is also possible that our ongoing review of this proposal or the ongoing changes at LHATF to VM20 will surface additional issues that merit comment.

We would like to highlight several items:

- We do not believe that the calculations provide an appropriate offset for C-1 risk charges for equities other than public common stocks (i.e. the C-1cs offset) that are modeled stochastically. We believe that this is an oversight and are proposing a correction.
- In our October 2009 letter, we advocated establishing a “safe harbor” minimum number of stochastic scenarios in order to avoid the circularity of needing to run additional scenarios to demonstrate that one has run a sufficient number of scenarios. We continue to believe that such a “safe harbor” is essential and are proposing language to implement this.
- We are proposing re-writes of selected portions of Appendix 3. We have included these proposals as Attachments 2-4.
    - Attachment 2: We have re-written Section 2.I.7 to correct for the C-1 offset issue.

- Attachment 3: We are proposing a new Section 2.O (and moving the existing 2.O to 2.P) in order to clarify the handling of prior period calculations.
- Attachment 4: We are proposing streamlining the description of the Stochastic Exclusion Test scenarios. This section seems to have much more detail than needed and is confusing as a result.

- We are recommending removal of the description of and references to a "principle-based" approach. The proposed calculation is a hybrid of company modeling and factors, and we are not persuaded that the "principle-based" term is necessary within Appendix 3.
- We are recommending that references to proposed reserve standards be eliminated.
- We recommend moving all relevant materials to the NAIC website and eliminating references to the Academy website. In recommending the placement of the scenario generator and similar items on the NAIC website, we are assuming that they will continue to remain freely available to companies.

During the course of our review, we noted one change (the definition of Business Segment) between the document that was included in the December 2009 Life RBC meeting materials and the document that was formally exposed. We request further information about changes that were made and may provide additional comments on the basis of these changes.

ACLI supports application of the proposed Phase III methodology to a limited product scope comprising fixed interest universal life policies with secondary guarantees, after the following eight tasks are completed:

1. The attached comments need to be addressed and reflected in the instructions, as appropriate.
2. If approved by regulators, changes to the RBC instructions will be needed to reflect the proposed product scope limitation and/or materiality test. ACLI will be pleased to assist in this work.
3. The scenario generator needs to be determined. It is not possible for our member companies to determine the impact of the Phase III proposal on their regulatory capital requirements without a decision on this item.
4. The proposed interest rate calibration criteria need to be evaluated under a variety of different economic environments. Although it is possible that this evaluation has been performed using the Academy's proposed generator, the work cannot be completed until a there is a decision on the generator.
5. Scenario reduction techniques need to be permitted. Such techniques approximately replicate the characteristics of a large number of scenarios with a smaller number of scenarios. This is a critical item for industry from a workload, cost, and execution standpoint.
6. Additional guidance on margins needs to be provided, including the development of measures of appropriate aggregate margins. We understand that the Academy is doing work on margins for principle-based reserves, and it is possible that such work would be useful for this project.
7. A legal review of the proposal needs to occur. Industry legal experts will be performing such a review, and we request a review from NAIC legal staff as well.
8. A "feedback loop" needs to be established whereby a defined process exists for regulators to examine Phase III results and for industry to provide input. ACLI's support for the limited scope of C-3 Phase III is based in part for the need for a "proof of concept": we are not persuaded that the methodology produces meaningful and appropriate results. Accordingly, we believe that a

process and timetable for regulators to evaluate the methodology and results—with input from industry—should be established before the proposal is adopted.

Attachment 1

ACLI Technical Review of Proposed C-3 Phase III Instructions

#	Document	Page(s)	Section(s)	Question, Comment, or Recommendation
1	LR025	9 10		The instructions include detailed language regarding the amounts included on lines (35) and (37) for life insurance, but not for variable annuities. We recommend a consistent approach.
2	App. 3	1	Intro	The introduction describes the methodology as a "principle based approach" to the determination

- Prior definition: “A group of assets associated with a group of policies that are modeled together to project future Accumulated Deficiencies. This grouping will generally follow the company’s asset segmentation plan, investment strategies, or approach used to allocate investment income for statutory purposes.”
- Current definition: “A group of assets associated with a group of policies that are modeled together to project future Accumulated Deficiencies.” grouping

Amount”

				suggest leaving this to a practice note.
34	App. 3	16	2.G.5	The language could be clearer. We suggest the following: Valuation of Projected Assets. ~~The~~ Projected values of ~~projected~~ Starting Assets shall be determined in a manner consistent with their values at the start of the projection, i.e. their values should be determined in the same way that they are determined for the statutory annual statement. For reinvestment assets, the values shall be determined in a manner consistent with the values of assets at the start of the projection that have similar investment characteristics.
35	App. 3	17	2.G.9	The requirements for a Clearly Defined Hedging Strategy should be expanded to encompass hedging of interest rate guarantees.
36	App. 3	18	2.H.1	It is not clear what a "risk based calculation" is (2nd paragraph after b.). Is this intended to be a reference to the Scenario Amount?
37	App. 3	20	2.I.2	"Material Tail Risk" is a defined term and should be capitalized.
38	App. 3	20	2.I.5	The language refers only to projections performed "for each policy in force on their

				Attachment 2 for our proposed correction.
44	App. 3	24	2.I.7	Does "re determined RBC value" refer to the TAR, the C 3a and C 3c risk charges, the CAL RBC the RBC ratio, or something else? Similarly, what does the 5 percent mean? (Parallel language on page 39 makes it seem like it should refer to the CAL RBC.) See Attachment 3 for our proposed clarification.
45	App. 3	24; 39	2.J.4; 6.C	It is unclear why there is an inconsistency between these two sections. Section 2.J.4 requires that the policies to which the Alternative Amount is applied to have been subject to asset adequacy testing. Section 6.C appears to require that policy reserves be adequate on a

69	App. 3	45	7.E.3.d	We recommend changing “generally acceptable actuarial standards” to “Actuarial Standards of Practice as promulgated by the Actuarial Standards Board.”

Attachment 3

ACLI Proposed New Section 2.O

O. Adjustments of prior period amounts

1. The actuary may elect to base the Stochastic Amount projections on asset and policy inforce data that have an "as of" date prior to the Valuation Date, but in no event earlier than six months before the Valuation Date, provided that the Stochastic Amount so calculated is adjusted to the Valuation Date in a manner that

Attachment 4

ACLI Proposed Revision of Section 6.F

Section 6.F

F. Stochastic Exclusion Test Scenarios

The Stochastic Exclusion Test is based on the sixteen test scenarios described in this subsection. The specific interest rate and equity return rate paths representing each test scenario may be downloaded from the [TBD] .

The test scenarios are defined in terms of 90 percentile random shocks in various directions over various periods of time. The test scenarios are as follows:

1. Test Scenario 1 – Pop up, high equity – Interest rate shocks that maintain the cumulative shock at the 90% level; equity returns that maintain the cumulative equity return at the 90% level.

2. Test Scenario 2 – Pop up, low equity – Interest rate shocks that maintain the cumulative shock at the 90% level; equity returns that maintain the cumulative equity return at the 10% level.

3. Test Scenario 3 – Pop down, high equity – Interest rate shocks that maintain the cumulative shock at the 10% level; equity returns that maintain the cumulative equity return at the 90% level.

4. Test Scenario 4 – Pop down, low equity – Interest rate shocks that maintain the cumulative shock at the 10% level; equity returns that maintain the cumulative equity return at the 10% level.

5.

9. Test Scenario 9 – Base scenario – All shocks are zero.

10. Test Scenario 10 – Inverted yield curves – Zero shocks to long term rates and equities. Shocks to the spread between short and long rates that are consistently in the same direction for each three-year period. The shocks for the first three-year period are in the direction of reducing the spread (usually causing an inverted yield curve). Shocks for each subsequent three year period alternate in direction. The cumulative shock for each 3-year period is at either the 90% level or the 10% level (alternating).

11. Test Scenario 11 – Volatile equity returns – Zero shocks to interest rates. Shocks to equity returns that are consistently in the same direction for each two-year period, and then switch directions. The cumulative shock for each two –year period is at either the 90% level or the 10% level (alternating).

12. Test Scenario 12 – Moderately adverse shock – Uniform downward shocks each month for 20 years, sufficient to get down to the 80% point on the distribution of 20 year shocks. After 20 years, shocks are at a level that keeps the cumulative shock at the 80% level (or the 20% level, depending on how you look at it).

13. Test Scenario 13 – Delayed pop up, high equity – Interest rate shocks that are zero for the first 10 years, followed by 10 years of shocks each 1.414 times those in the first 10 years of Scenario 1. This gives the same 20-year cumulative shock as scenario 1 but all the shock is concentrated in the second 10 years. After 20 years, the same as scenario 1. Equity returns that maintain the cumulative equity return at the 90% level.

14. Test Scenario 14 – Delayed pop up, low equity – Interest rate shocks that are zero for the first 10 years, followed by 10 years of shocks each 1.414 times those in the first 10 years of Scenario 2. This gives the same 20-year cumulative shock as scenario 2 but all the shock is concentrated in the second 10 years. After 20 years, the same as scenario 1. Equity returns that maintain the cumulative equity return at the 10% level.

15. Test Scenario 15 – Delayed pop down, high equity - Interest rate shocks that are zero for the first 10 years, followed by 10 years of shocks each 1.414 times those in the first 10 years of Scenario 3. This gives the same 20-year cumulative shock as scenario 3 but all the shock is concentrated in the second 10 years. After 20 years, the same as scenario 3. Equity returns that maintain the cumulative equity return at the 90% level.

16. Test Scenario 16 – Delayed pop down, low equity – Interest rate shocks that are zero for the first 10 years, followed by 10 years of shocks each 1.414 times those in the first 10 years of Scenario 4. This gives the same 20-year cumulative shock as scenario 4 but all the shock is concentrated in the second 10 years. After 20 years, the same as scenario 4. Equity returns that maintain the cumulative equity return at the 10% level.