



A M E R I C A N A C A D E M Y A C T U A R I E S

**American Academy of Actuaries' C3 Life and Annuity Capital Work Group
Comments Regarding Proposed C3 Phase 3 Scope Limitation**

Presented to the National Association

This document has been prepared by the American Academies of Actuaries C3 Life and Annuities Capital Work Group (C3WG) in response to the American Council of Life Insurers (ACLI) C-3 Phase 3 scope proposal modified by the Life Risk Based Capital (E) Working Group and released for comment on the Jan. 13, 2010, conference call of the Working Group.

As proposed by the ACLI, the C-3 Phase 3 (C3P3) methodology would apply only to fixed interest universal life insurance policies that contain secondary guarantees (ULSG) that extend beyond the fifth policy anniversary.

The C3WG strongly believes that a risk-based determination of C-3 capital requirements that includes all life insurance products is far superior to a product-based inclusion/exclusion approach. The issue of the practicality of comprehensive stochastic modeling is addressed by the Stochastic Exclusion Test and the Alternative Amount option.

Fundamentally, minimum C-3 capital requirements should be based on the risk exposures created for the company by the product and its management, not solely based on product type. The risks for the company depend not only on the nature of the liability, but also on the supporting assets, and the investment and risk management strategies. In that context, using the length of secondary guarantee period to qualify for exclusion from the C3P3 requirements ignores many more critical items that place a company's capital at risk.

In developing our proposal, the C3WG formulated a process that is commensurate with the degree of risk. In that context, the Stochastic Exclusion Test serves as a filter, identifying blocks of business with material tail risk and that need to be measured by stochastic modeling. The C-3 required capital for those blocks identified as not having material tail risk would continue to be determined according to the existing C-3 factor basis. Further, to lessen the burden where stochastic modeling might be required, the Alternative Amount option is provided as a possible simplification tool, facilitating the use of existing risk management processes.

Any methodology for establishing C-3 capital requirements should be based on the company's aggregate portfolio of retained risks, where the methodology establishes capital requirements based on the combined effect of a company's business decisions – product, investment, and risk management strategies. Any methodology based on a portion of a company's risks has the potential for manipulation and unintended results.

Limitation of scope to a product or group of products creates a number of issues.

- Allocation Issues

As stated in the ACLI proposal, scope limitation depends upon practitioners determining whether each specific contract satisfies the defined product scope and then artificially dividing the supporting asset portfolio in order to carry out the

The scope limitation needlessly introduces complexities and may result in a distorted picture of the risks for the block as a whole. To the extent that regulators are sympathetic to industry concerns with the time and effort involved to set up a risk-based model for C3 capital requirements, the C3WG suggests that the scope limitation apply for one year with no scope limitation thereafter.

In summary, C3WG strongly believes that a risk-based determination of C-3 capital requirements that includes all life insurance products is far superior to a product-based inclusion/exclusion approach for the above reasons. The issue of the practicality of comprehensive stochastic modeling is addressed by the Stochastic Exclusion Test and the Alternative Amount option.