NAIC National Association of Insurance Commissioners

Date: 7/7/20

LIFE RISK-BASED CAPITAL (E) WORKING GROUP

Friday, July 10, 2020
12:00 p.m. ET / 11:00 a.m. CT / 10:00 a.m. MT / 9:00 a.m. PT

ROLL CALL

Philip Barlow, Chair	District of Columbia	John Robinson	Minnesota
Steve Ostlund	Alabama	William Leung	Missouri
Perry Kupferman	California	Rhonda Ahrens	Nebraska
Deborah Batista	Colorado	Seong-min Eom	New Jersey
Wanchin Chou	Connecticut	Bill Carmello	New York
Gilbert Moreau	Florida	Andy Schallhorn	Oklahoma
Vincent Tsang	Illinois	Mike Boerner	Texas
		Tomasz Serbinowski	Utah

NAIC Support Staff: Dave Fleming

AGENDA

1. Continue Discussion of Industry Request for Risk-Based Capital Mortgage Reporting Guidance—*Philip Barlow (DC)* Attachments 1 & 2

2. Discuss Any Other Matters Brought Before the Working Group—*Philip Barlow (DC)*

3. Adjournment

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Attachment 1

Paul S. Graham III
SVP, Policy Development

Mike Flood
SVP, CMF, Policy & Member Engagement

July 7, 2020

Philip A. Barlow, FSA, MAAA
Chair, Life Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197
Re: Supplement to June 8, 2020 Request for Risk-Based Capital Reporting Guidance

Dear Mr. Barlow:

The Mortgage Bankers Associations (MBA)[1] and the American Council of Life Insurers (ACLI),[2] on behalf of our respective member insurers, respectfully submit to the Life Risk-Based Capital Working Group of the National Association of Insurance Commissioners (NAIC) this Supplement to our June 8, 2020 request for risk-based capital reporting guidance.

We appreciate the Working Group's approval on June 30, 2020 of our requested reporting guidance for Construction Loans and for Origination Date, Valuation Date, Property Value, and 90 Days Past Due.

We also appreciate the thoughtful feedback regulators provided in the Working Group's discussion of our requested reporting guidance on Net Operating Income and on Contemporaneous Property Values. In response to that feedback, our organizations convened a large working group of insurers to consider modifications of the reporting guidance we recommended for those two items.

The attached Supplement describes revised recommendations developed by that working group that we believe address the concerns raised by the regulators. We look forward to discussing these proposed recommendations on the Working Group call scheduled for July 10, 2020.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, 70 life insurance companies engaged in real estate finance, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org

[2] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States. Learn more at www.acli.com

We want to thank you and other regulators, and NAIC staff, for your considerable time and attention to this request. Please feel free to contact Bruce Oliver at boliver@mba.org or 202-557-2840 or Mike Monahan at mikemonahan@acli.com or 202-624-2324 for any additional information.

Sincerely,

Mike Flood

Paul Graham

Attachment: Supplement to June 8, 2020 Request for Risk-Based Capital Reporting Guidance

cc: Dave Fleming, NAIC Senior Insurance Reporting Analyst

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Supplement to June 8, 2020 letter to the Life Risk-Based Capital Working Group

Revised RBC Reporting Guidance Proposals

July 7, 2020

This document supplements the proposal submitted to the Life Risk-Based Capital Working Group of the National Association of Insurance Commissioners, submitted by the Mortgage Bankers Association and the American Council of Life Insurers on June 8, 2020, following up on the Working Group call of June 30, 2020.

I. NET OPERATING INCOME

Background

Net Operating Income (NOI) inputs are reported in items (14), (15), and (16), and those inputs are used to compute a Rolling Average NOI under item (36).

The Rolling Average NOI is weighted as follows:

- 50% of NOI at year-end of preceding year
- 30% of NOI at year-end of next preceding year
- 20% of NOI at year-end of next preceding year

As a result, 2020 NOI will be an input into reporting for 2021, 2022, and 2023 reporting, and will not to be an input into 2020 RBC reporting.

June 8 proposed reporting guidance

For 2020 NOI inputs used to compute rolling average NOI for 2021, 2022, and 2023 reporting, use the greater of:

- 2020 NOI; or
- 2019 NOI.

Revised proposed reporting guidance

For 2020 NOI inputs used to compute rolling average NOI for 2021, 2022, and 2023 reporting, use the greater of—

- 2020 NOI; or
- 85% of 2019 NOI.

Rationale

Industry recognizes that substituting 2019 NOI for properties whose NOIs have decreased could be viewed as ignoring the credit risk impact of temporary business shutdowns resulting from the COVID-19 pandemic.

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On the other hand, direct application of 2020 NOI for properties affected by temporary business shutdowns resulting from the COVID-19 pandemic would overstate the actual increase in the credit risk exposure presented by temporary impacts to properties.

Direct application of the 2020 NOI would also create disincentives for insurers to work prudently with borrowers. Lenders retain approval rights for many leasing actions, including forgiveness or reductions in rent, and granting approval of rent forgiveness or reductions directly reduces NOI.

The revised proposal is an effort to balance these competing concepts. It recognizes reductions in NOI, and so does not ignore the credit risk impact of the pandemic. At the same time, it also proposes an 85% floor on reductions from 2019 NOI. That floor reduces the likelihood of overstating the actual change in credit risk. It also reduces disincentives for insurers to approve rent concessions that would reduce NOI, but that also are in the best interests of the insurer, the borrower, the tenants, and the economy generally.

The revised proposal also reflects practical considerations. Specifically, it is supportable by readily available reports. NOI for most properties is reported only annually, typically three to four months after year-end. As a result, 2019 and 2020 NOI year-end values will be readily available for 2021 reporting. In contrast, information necessary to support a possible approach based on quarterly NOI would generally not be available at all, and information to support an approach based on 2021 NOI would generally not be available in time for timely 2021 year-end reporting.

The 85% floor was identified as reasonable because a 15% drop in NOI represents roughly three times the worst four-quarter decline in NCREIF NOI values over the past 20 years. From the NCREIF data, the largest four-quarter decline in NOI (across all property types) during the Global Financial Crisis was 3.15% in Q1 2010. During the 2001 Recession (which was harder on NOIs), there was a 5.91% four-quarter decline in 2003 Q3 – with an aggregate 11.5% decline between 2001 Q2 and 2004 Q1.

Moreover, a 15% reduction in NOI has been recognized to be substantial in another regulatory capital context. Specifically, the Federal Housing Finance Agency (FHFA) used a 15% reduction in NOI as a stress input to calibrate multifamily mortgage credit risk for Fannie Mae and Freddie Mac in its recently proposed risk-based capital regulations.

- See 85 Fed. Reg. 39274, 39322 (June 30, 2020) (“FHFA generally calibrated the base risk weights and risk multipliers for multifamily mortgage exposures to require credit risk capital sufficient to absorb the lifetime unexpected losses incurred on multifamily mortgage exposures experiencing a shock to property values similar to that observed during the 2008 financial crisis. … For the purpose of the proposed rule, the multifamily-specific stress scenario assumes an NOI decline of 15 percent ….”).

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While the FHFA used a 15% reduction for a somewhat different regulatory capital purpose, its use of a 15% reduction in NOI to calibrate the multifamily mortgage credit risk element of its proposed risk-based capital regulations does support identifying 85% of 2019 NOI (i.e., a 15% reduction in NOI) as a reasonable floor here.

II. CONTEMPORANEOUS PROPERTY VALUE

Background

Contemporaneous Property Value (40) is a field computed as: the Property Value (20) at the time the loan was originated, was revalued due to impairment underwriting, restructure, extension, or other re-writing; times that ratio (rounded to 4 decimal places) of the Price Index current to the Price Index at valuation (39).

The Price Index at Valuation is the value of the NCREIF Price Index on the last day of the calendar quarter that includes the date defined in (21) and (22). However, the "Price Index current" is not a defined or numbered input into risk-based capital reporting.

The Contemporaneous Property Value (40) becomes an input into the computation of RBC LTV. RBC LTV is computed as Total Loan Value (13) divided by the Contemporaneous Property Value (40), rounded to the nearest percent. RBC LTV is then a factor in determining the risk category (from CM1 to CM5) for any loan that is not 90 days or more overdue, which is then used to determine the risk-based capital requirement for the loan.

The Contemporaneous Property Value is the property value at origination, adjusted by applying the NCREIF Price Index. That value becomes an input into the computation of RBC LTV, which affects the classification of the loan.

June 8 proposed reporting guidance

As "Price Index current" input used to compute Property Value for 2020 year-end reporting, use:

- The 2019 NCREIF Price Index.

Revised proposed reporting guidance

As "Price Index current" input used to compute Property Value for 2020 year-end reporting, use:

- Use the average of:
    1. The year-end 2019 NCREIF Price Index; and
    2. The 2020 NCREIF Price Index.

Rationale

Industry recognized that substituting 2019 NCREIF Price Index could be viewed as ignoring the credit risk impact of temporary business shutdowns resulting from the COVID-19 pandemic.

On the other hand, direct application of 2020 NCREIF Price Index could introduce anomalous 2020 market activity and so could overstate the actual increase in the credit risk exposure presented by changes in the continuing value of those properties.

The revised proposal is an effort to balance these two competing concepts. It does so by recognizing that reductions in property values may occur in 2020, and so does not ignore the credit risk impact of the pandemic, but it also moderates the distortive effects of anomalous 2020 market activity by averaging the indexes for 2019 and 2020.

The information needed to implement this proposal would be readily available for 2020 reporting because the only additional information not already required for 2020 reporting would be the 2019 year-end NCREIF Price Index.

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