

Capital Adequacy (E) Task Force RBC Proposal Form

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| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Operational Risk (E) Subgroup |
| <input type="checkbox"/> C3 Phase II/ AG43 (E/A) Subgroup | <input checked="" type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |

DATE: <u>8/5/2019</u>	<u>FOR NAIC USE ONLY</u>
CONTACT PERSON: <u>Eva Yeung</u> TELEPHONE: <u>816-783-8407</u> EMAIL ADDRESS: <u>eyeung@naic.org</u> ON BEHALF OF: <u>P/C RBC (E) Working Group</u> NAME: <u>Tom Botsko</u> TITLE: <u>Chair</u> AFFILIATION: <u>Ohio Department of Insurance</u> ADDRESS: <u>50 W. Town Street, Third Floor – Suite 300</u> <u>Columbus, OH 43215</u>	Agenda Item # <u>2019-11-P</u> Year <u>2020</u> <b style="text-align: center;"><u>DISPOSITION</u> <input checked="" type="checkbox"/> ADOPTED <u>12-8-19</u> <input type="checkbox"/> REJECTED _____ <input type="checkbox"/> DEFERRED TO _____ <input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____ <input checked="" type="checkbox"/> EXPOSED <u>8-4-19</u> <input type="checkbox"/> OTHER (SPECIFY) _____

IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|--|--|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Instructions | <input checked="" type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION OF CHANGE(S)

The proposed changes clarify the reinsurance recoverable from individual syndicates of Lloyds' of London that are covered under the Lloyd's Central Fund may utilize the lowest financial strength group rating received from an approved rating agency.

REASON OR JUSTIFICATION FOR CHANGE **

Upon review of 2018 Schedule F Part 3 filings, it has been observed that many filers reported reinsurance recoverable amounts due from Lloyd's of London Syndicates as being NAIC 6-Unrated; and therefore, subject to the highest credit risk charge.

Additional Staff Comments:

- 8-3-19 The PCRBCWG exposed for comment until 9-3-19
 11-8-19 This proposal has been adopted at the Joint Catastrophe Risk Subgroup and Property/Casualty Risk-Based Capital Working Group conference call on Nov. 8.
 12-8-19 cgb The Capital Adequacy Task Force adopted the proposal at the Fall National Meeting on 12/8/19.

** This section must be completed on all forms.

Revised 2-2019

PR012 - Credit Risk for Receivables

Reinsurance Recoverables

The calculation of the credit risk charge for reinsurance recoverables is detailed in Schedule F Part 3 Columns 28 through 36 of the Property/Casualty Annual Statement. This calculation is performed at the transaction level and those results are then summed to determine the charge. Reinsurance balances receivable on reinsurance ceded to non-affiliated companies (excluding certain pools) and to alien affiliates are subject to the credit risk-based capital charge. The following types of cessions are exempt from this charge:

- Cessions to State Mandated Involuntary Pools and Associations or to Federal Insurance Programs.
- This category includes all federal insurance programs [e.g., National Flood Insurance Program (NFIP), Federal Crop Insurance Corporation (FCIC), etc., all state mandated residual market mechanisms and the National Council on Compensation Insurance (NCCI)].
- Cessions to U.S. Parents, Subsidiaries and Affiliates.

The categories above are automatically excluded from the data that is calculated in Schedule F Part 3 of the Annual Statement.

Since the Annual Statement requires the collectability of reinsurance balances be considered via the reinsurance penalty, the appropriate balances must be offset by any liability that has been established for this purpose. The amount from Page 3, Line 16 should be allocated to the appropriate (re)insurers listed on Schedule F. The total amount recoverable from reinsurers less any applicable reinsurance penalty is multiplied by 120% to stress the recoverable balance. The total of reinsurance payable and/or funds held amounts (not in excess of the stressed recoverable) are applied as offsets to arrive at the stressed net recoverable.

Since there are different reinsurance credit risk factors for collateralized and uncollateralized reinsurance recoverables, the stressed net recoverable should be offset by any available collateral, such as letters of credit, multiple beneficiary trusts, and single beneficiary trusts and other allowable offsets (not in excess of the stressed net recoverable). The collateralized amounts are derived from Schedule F Part 3 Column 32 and the uncollateralized amounts are derived from Column 33.

The risk-based capital for the various credits (including collateral offsets where applicable) taken for reinsurance may not be less than zero even if the amount reported or the amount net of offsets is negative.

The factor for reinsurance recoverables (paid and unpaid less any applicable reinsurance penalty) due from a particular reinsurer is determined based on that reinsurer's financial strength rating assigned on a legal entity basis.

For the purpose of the credit risk-based capital charge, the equivalent rating category assigned will correspond to current financial strength rating received from an approved rating agency as outlined in the table below. Ratings shall be based on interactive communication between the rating agency and the assuming insurer and shall not be based solely on publicly available information. If the reinsurer is unauthorized and does not have at least one financial strength rating, it should be assigned the "Vulnerable 6 or Unrated Unauthorized" equivalent rating. If the reinsurer is authorized and does not have at least one financial strength rating, it should be assigned the "Unrated Authorized Reinsurers" equivalent rating. Amounts recoverable from unrated voluntary pools should be assigned the "Secure 3" equivalent rating. An authorized association including incorporated and individual unincorporated underwriters or a member thereof **(e.g. individual authorized syndicates of Lloyds' of London that are backed by the Central Fund)** may utilize the lowest financial strength group rating received from an approved rating agency. The table below shows the R3 reinsurer equivalent rating categories and corresponding factors for A.M. Best, Standard and Poor's, Moody's and Fitch ratings.



Detail Eliminated To Conserve Space



Proposed Guidance Statement:

Upon review of 2018 Schedule F Part 3 filings, it has been observed that many filers reported reinsurance recoverable amounts due from Lloyd's of London Syndicates as being NAIC 6-Unrated; and therefore subject to the highest credit risk charge.

However, the RBC Instructions for PR012 - Credit Risk for Receivables provides that: "An authorized association including incorporated and individual unincorporated underwriters or a member thereof may utilize the lowest financial strength group rating received from an approved rating agency." This instruction is applicable to reinsurance recoverable from individual syndicates of Lloyds' of London that are covered under the Lloyd's Central Fund; and are therefore eligible to be treated as rated for the purposes of PR012 and the R3 Credit Risk component of RBC. This treatment is consistent with the NAIC Credit for Reinsurance Model Law and Regulation concerning applicable NAIC ratings designations for the purpose of determining reduced collateral requirements.