

Capital Adequacy (E) Task Force

RBC Proposal Form

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|---|--|--|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input checked="" 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"/> SMI RBC (E) Subgroup |
| <input type="checkbox"/> C3 Phase II/ AG43 (E/A) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Stress Testing (E) Subgroup |

<p style="text-align: right;">DATE: <u>08/31/2020</u></p> <p>CONTACT PERSON: <u>Crystal Brown</u></p> <p>TELEPHONE: <u>816-783-8146</u></p> <p>EMAIL ADDRESS: <u>cbrown@naic.org</u></p> <p>ON BEHALF OF: <u>Health RBC (E) Working Group</u></p> <p>NAME: <u>Steve Drutz</u></p> <p>TITLE: <u>Chief Financial Analyst/Chair</u></p> <p>AFFILIATION: <u>WA Office of Insurance Commissioner</u></p> <p>ADDRESS: <u>5000 Capitol Blvd SE</u> <u>Tumwater, WA 98501</u></p>	<p style="text-align: center;"><u>FOR NAIC USE ONLY</u></p> <p>Agenda Item # <u>2020-07-H</u></p> <p>Year <u>2021</u></p> <p style="text-align: center;"><u>DISPOSITION</u></p> <p><input type="checkbox"/> ADOPTED _____</p> <p><input type="checkbox"/> REJECTED _____</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input checked="" type="checkbox"/> EXPOSED <u>Exposed until Oct. 12</u></p> <p><input type="checkbox"/> OTHER (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

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

DESCRIPTION OF CHANGE(S)

Split the Bonds and Misc. Fixed Income Assets into separate pages (Page XR007 and XR008).

REASON OR JUSTIFICATION FOR CHANGE **

Currently the Bonds and Misc. Fixed Income Assets are included on page XR007 of the Health RBC formula. With the implementation of the 20 bond designations and the electronic only tables, the Bonds and Misc. Fixed Income Assets were split between two tabs in the excel file for use of the electronic only tables and ease of printing. However, for increased transparency and system requirements, it is suggested that these pages be split into separate page numbers beginning with year-2021. Bonds would remain on page XR007 and Misc. Fixed Income Assets would move to page XR008. All remaining page numbers and references to the page numbers would be incorporated into the Blank an instructions.

Additional Staff Comments:

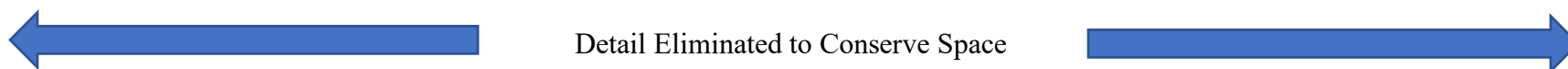
9-11-20 cgb The Health RBC WG exposed the proposal for 30 days with comments due back on Oct. 12.

** This section must be completed on all forms.

Revised 11-2013

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Detail Eliminated to Conserve Space

FIXED INCOME ASSETS XR007 AND XR008

The RBC requirement for fixed income assets is largely driven by the default risk on those assets. There are two major subcategories: Bonds and Miscellaneous. Bonds are obligations issued by business units, governmental units, and certain nonprofit units, having a fixed schedule for one or more future payments of money. This definition includes commercial paper, negotiable certificates of deposit, repurchase agreements, and equipment trust certificates. Miscellaneous fixed income assets are other assets with fixed repayments schedules, such as mortgages and collateral loans.

BONDS

The bond factors are based on cash flow modeling using historically adjusted default rates for each bond category. For each of 2,000 trials, annual economic conditions were generated for the ten-year modeling period. Each bond of a 400-bond portfolio was annually tested for default (based on a “roll of the dice”) where the default probability varies by designation category and that year’s economic environment. When a default takes place, the actual loss considers the expected principal loss by category, the time until the sale actually occurs, and the assumed tax consequences. Only default risk is recognized in the RBC factors because, under statutory accounting, bonds are generally carried at their amortized value on the statutory annual statement, so changes in the market value of the bonds following swings in interest rates do not, as a general rule, affect the capital and surplus of the regulated entities unless the bonds are actually sold. The accounting for reporting entities can be substantially different from other regulated entities, but the RBC formula continues to recognize only default risk.

There is no RBC requirement for bonds guaranteed by the full faith and credit of the United States because there is virtually no default risk associated with these securities.

The factor for NAIC 06 bonds recognizes that the book/adjusted carrying value of these bonds reflects a loss of value upon default by being marked to market.

The book/adjusted carrying value of all bonds and related fixed income investments should be reported in Column (1). The bonds are split into seven different risk classifications. These risk classifications are based on the NAIC designations assigned. For long-term bonds, these classifications are found on Lines 11.1 through 11.6 less the hybrids Lines 7.1 through 7.6 of Schedule D, Part 1A, Section 1 of the annual statement.

Enter the book/adjusted carrying value of the bonds, by NAIC designation category, in Column (1). The RBC requirement will be automatically calculated in Column (2).

MISCELLANEOUS FIXED INCOME ASSETS

The factor for cash is 0.3 percent. It is recognized that there is a small risk related to possible insolvency of the bank where cash deposits are held. This factor, equivalent to an unaffiliated NAIC 01 bond, reflects the short-term nature of this risk. The required risk-based capital for cash will not be less than zero, even if the company's cash position is negative.

The Short-Term Investments to be included in this section are those short-term investments not reflected elsewhere in the formula. The 0.3 percent factor is equal to the factor for cash. The amount entered here should equal the total short-term investments found in Schedule DA, Part 1, Column 7, Line 8399999 less bonds that are contained in Schedule D, Part 1A, Section 1.

Collateral loans and mortgage loans are generally a small portion of the total portfolio value. A factor of 5 percent is consistent with other risk-based capital formulas studied by the working group.

The book adjusted carrying value of NAIC 01 and 02 Working Capital Finance Investments, Lines (23) and (24), should equal the Notes to Financial Statement, Lines 5M(01a) and 5M(01b), Column 3 of the annual statement.

Other Long-Term Invested Assets are those that are listed in Schedule BA and are somewhat more speculative and risky than most other investments. Therefore, a 20 percent factor is consistent with other risk-based capital formulas studied by the working group.

Low income housing tax credit investments are reported in Column (1) in accordance with *SSAP No. 93—Low Income Housing Tax Credit Property Investments*.

Federal Guaranteed Low-Income Housing Tax Credit (LIHTC) investments are to be included in Line (26). There must be an all-inclusive guarantee from an ARO-rated entity that guarantees the yield on the investment.

Federal Non-Guaranteed LIHTC investments with the following risk mitigation factors are to be included in Line (27):

- a) A level of leverage below 50 percent. For a LIHTC Fund, the level of leverage is measured at the fund level.
- b) There is a tax credit guarantee agreement from general partner or managing member. This agreement requires the general partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For an LIHTC fund, a tax credit guarantee is required from the developers of the lower-tier LIHTC properties to the upper-tier partnership.

State Guaranteed LIHTC investments that at a minimum meet the federal requirements for guaranteed LIHTC investments are to be included in Line (28).

State Non-Guaranteed LIHTC investments that at a minimum meet the federal requirements for non-guaranteed LIHTC investments are to be included on Line (29).

All Other LIHTC investments, state and federal LIHTC investments that do not meet the requirements of Lines (27) through (30) would be reported on Line (30).



Detail Eliminated to Conserve Space



FIXED INCOME ASSETS

BONDS

	Electronic Only Tables Source	(1A) Book/Adjusted Carrying Value	Annual Statement Source: Sch D Pt 1A Sn 1	(1) Book/Adjusted Carrying Value	Factor	(2) RBC Requirement
(1) NAIC 1.A - U.S. Government -Direct and Guaranteed and NAIC U.S. Direct Obligations/Full Faith and Credit Exempt Money Market Funds List	Table A Column (4) Line (1)	0	Column 7, Line 1.1	0	0.0000	0
(2) NAIC Designation Category 1.A Bonds	Table A Column (4) Line (2)	0				
(3) NAIC Designation Category 1.B Bonds	Table A Column (4) Line (3)	0				
(4) NAIC Designation Category 1.C Bonds	Table A Column (4) Line (4)	0				
(5) NAIC Designation Category 1.D Bonds	Table A Column (4) Line (5)	0				
(6) NAIC Designation Category 1.E Bonds	Table A Column (4) Line (6)	0				
(7) NAIC Designation Category 1.F Bonds	Table A Column (4) Line (7)	0				
(8) NAIC Designation Category 1.G Bonds	Table A Column (4) Line (8)	0				
(9) Total NAIC 01 Bonds	Sum of Lines (1) through (8)	0	Column 7, Lines 11.1 - 7.1	0		
(9A) Total Other NAIC 01 Bonds	Table A Column (4) Line (9)	0	Lines (9) - (1)	0	0.0030	0
(10) NAIC Designation Category 2.A Bonds	Table A Column (4) Line (10)	0				
(11) NAIC Designation Category 2.B Bonds	Table A Column (4) Line (11)	0				
(12) NAIC Designation Category 2.C Bonds	Table A Column (4) Line (12)	0				
(13) Total NAIC 02 Bonds	Sum of Lines (10) through (12)	0	Column 7, Lines 11.2 - 7.2	0	0.0100	0
(14) NAIC Designation Category 3.A Bonds	Table A Column (4) Line (13)	0				
(15) NAIC Designation Category 3.B Bonds	Table A Column (4) Line (14)	0				
(16) NAIC Designation Category 3.C Bonds	Table A Column (4) Line (15)	0				
(17) Total NAIC 03 Bonds	Sum of Lines (14) through (16)	0	Column 7, Lines 11.3 - 7.3	0	0.0200	0
(18) NAIC Designation Category 4.A Bonds	Table A Column (4) Line (16)	0				
(19) NAIC Designation Category 4.B Bonds	Table A Column (4) Line (17)	0				
(20) NAIC Designation Category 4.C Bonds	Table A Column (4) Line (18)	0				
(21) Total NAIC 04 Bonds	Sum of Lines (18) through (20)	0	Column 7, Lines 11.4 - 7.4	0	0.0450	0
(22) NAIC Designation Category 5.A Bonds	Table A Column (4) Line (19)	0				
(23) NAIC Designation Category 5.B Bonds	Table A Column (4) Line (20)	0				
(24) NAIC Designation Category 5.C Bonds	Table A Column (4) Line (21)	0				
(25) Total NAIC 05 Bonds	Sum of Lines (22) through (24)	0	Column 7, Lines 11.5 - 7.5	0	0.1000	0
(26) Total NAIC 06 Bonds	Table A Column (4) Line (21)	0	Column 7, Lines 11.6 - 7.6	0	0.3000	0
(27) Total Bonds RBC = Lines (1) + (9A) + (13) + (17) + (21) + (25) + (26)						0

Page Number XR007

- Denotes items will be used for internal analysis to determine the future RBC charge and will not be reflected in the RBC calculation.
- Denotes items that must be manually entered on filing software.

FIXED INCOME ASSETS

MISCELLANEOUS FIXED INCOME ASSETS

	<u>Annual Statement Source</u>	(1) <u>Bk/Adj Carrying Value</u>	<u>Factor</u>	(2) <u>RBC Requirement</u>
(28) Cash	Page 2, Line 5, inside amount 1		0.0030	
(29) Cash Equivalents	Page 2, Line 5, inside amount 2			
(30) Less: Cash Equivalent, Bonds included in Schedule D, Part 1A	Schedule E, Part 2, Column 7, Line 8399999, in part			
(31) Less: Exempt Money Market Mutual Funds*	Schedule E, Part 2, Column 7, Line 8599999			
(32) Net Cash Equivalents	Line (29) - (30) - (31)		0.0030	
(33) Short-Term Investments	Page 2, Line 5, inside amount 3			
(34) Short-Term Bonds *	Schedule DA, Part 1, Column 7, Line 8399999			
(35) Total Other Short-Term Investments	Lines (33) - (34)		0.0030	
(36) Mortgage Loans - First Liens	Page 2, Column 3, Line 3.1		0.0500	
(37) Mortgage Loans - Other Than First Liens	Page 2, Column 3, Line 3.2		0.0500	
(38) Receivable for Securities	Page 2, Column 3, Line 9		0.0250	
(39) Aggregate Write-Ins for Invested Assets	Page 2, Column 3, Line 11		0.0500	
(40) Collateral Loans	Included in Page 2, Column 3, Line 8		0.0500	
(41) NAIC 01 Working Capital Finance Investments	Notes to Financial Statement 5M(01a), Column 3		0.0038	
(42) NAIC 02 Working Capital Finance Investments	Notes to Financial Statement 5M(01b), Column 3		0.0125	
(43) Other Long-Term Invested Assets Excluding Collateral Loans and Working Capital Finance Investments	Included in Page 2, Column 3, Line 8		0.2000	
(44) Federal Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3599999 + 3699999		0.0014	
(45) Federal Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3799999 + 3899999		0.0260	
(46) State Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3999999 + 4099999		0.0014	
(47) State Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 4199999 + 4299999		0.0260	
(48) All Other Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 4399999 + 4499999		0.1500	
(49) Total Other Long-Term Invested Assets (Page 2, Column 3, Line 8)	Lines (40) + (41) + (42) + (43) + (44) + (45) + (46) + (47) + (48)			
(50) Derivatives	Page 2, Column 3, Line 7		0.0500	
(51) Total Fixed Income Assets RBC	XR007 Line (27) + Lines (28) + (32) + (35) + (36) + (37) + (38) + (39) + (49) + (50)			

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Denotes items that must be manually entered on filing software.

* These bonds appear in Schedule D Part 1A Section 1 and are already recognized in the Bond portion of the formula.