# Capital Adequacy (E) Task Force

## RBC Proposal Form

☐ Capital Adequacy (E) Task Force ☐ Health RBC (E) Working Group ☒ Life RBC (E) Working Group
☐ Catastrophe Risk (E) Subgroup ☐ P/C RBC (E) Working Group ☐ Longevity Risk (A/E) Subgroup
☐ Variable Annuities Capital. & Reserve (E/A) Subgroup ☐ Economic Scenarios (E/A) Subgroup ☐ RBC Investment Risk & Evaluation (E) Working Group

**DATE:** **2/13/2025**

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**ON BEHALF OF:** **American Council of Life Insurers**

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Agenda Item # 2025-05-L
Year 2025

**DISPOSITION**

**ADOPTED:**
☐ TASK FORCE (TF) ______
☐ WORKING GROUP (WG) ______
☐ SUBGROUP (SG) ______
**EXPOSED:**
☐ TASK FORCE (TF) ______
☐ WORKING GROUP (WG) ______
☐ SUBGROUP (SG) ______
**REJECTED:**
☐ TF ☐ WG ☐ SG ______
**OTHER:**
☐ DEFERRED TO ______
☐ REFERRED TO OTHER NAIC GROUP
☐ (SPECIFY) ______

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

☐ Health RBC Blanks ☐ Property/Casualty RBC Blanks ☐ Life and Fraternal RBC Blanks
☐ Health RBC Instructions ☐ Property/Casualty RBC Instructions ☒ Life and Fraternal RBC Instructions
☐ Health RBC Formula ☐ Property/Casualty RBC Formula ☐ Life and Fraternal RBC Formula
☐ OTHER ______

**DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)**

As a result of the NAIC Principles-Based Bond Project, some assets are moving from Schedule D to Schedule BA. Though there are other implications, ACLI members have identified what seems to be an ambiguous Schedule BA fixed income asset concentration charge. Asset concentration (LR010) generally intends to double the risk-based capital pretax factor of the ten largest asset exposures, excluding lower risk categories. There is a maximum overall (basic formula plus asset concentration) pretax factor of 45%.

An Overview of RBC treatment of fixed income assets can be found below:

| RBC Treatment of Fixed Income Assets | | |
|---|---|---|
| Annual Statement | Schedule D | Schedule BA |
| C-1 RBC Section | LR002 | LR008 |
| C-1 Structure | 20-classes | 6-classes |
| C-1 Reflects Bond Size Factor Adjustment | Yes | No |
| Asset Concentration Structure | 20-classes | Ambiguous |

However, we have noticed that LR010 excludes specific blanks for Schedule BA fixed income assets. Under current instructions, potential options for Schedule BA fixed income assets on LR010 include a 20-class Bond Section or Other Schedule BA Assets.

For example, please find below an illustration of a rated 2.A fixed-income asset moving from Schedule D to Schedule BA:

| Asset Concentration Treatment | (a) Basic Formula Sch. BA (6-class) | (b) Asset Concentration LR010 | (c = a + b) Overall C-1 | (c / a) Overall C-1 / Basic Formula |
|---|---|---|---|---|
| 20-class Bond Section | 1.26% | 1.261% | 2.521% | 200% |
| Other Schedule BA Assets | 1.26% | 15% | 16.26% | 1290% |

As potential remediations to address these ambiguities, ACLI is proposing changes to LR010 instructions as illustrated.

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**Additional Staff Comments:**

Staff Note: With effect from 2025 Annual Statement filings, the following schedule BA investments (collectively "SVO-designated non-bond debt securities") are added to AVR Equity line 22 through 28, thereby being afforded a base charge of C-1 **Bond factors** (NAIC 1-6) on RBC LR008, which is ultimately categorized as **C-1o** risk component.
However, the current LR010 asset concentration instruction does not provide explicit guidance for these investments.

ACLI proposal seeks to clarify LR010 instruction such that these "SVO-designated non-bond debt securities" can obtain asset concentration factor treatment akin to bonds in LR002, i.e., **C-1o** risk component (Option 1). Option 1 will put the investments' RBC treatment almost the same pre and post – Principle-Based Bond Definition adoption.

Alternatively, these investments will be assessed an asset concentration factor of 15% for Other Schedule BA Assets, which will ultimately be categorized as **C-1o** risk component as well. (Option 2). Option 2 will be a hybrid approach wherein the base factor are NAIC-designation-driven whereas asset concentration factor is flat at 15%.

| Schedule BA | Description |
|---|---|
| Line 0199999 | Debt Securities That Do Not Qualify as Bonds - Debt Securities That Do Not Reflect a Creditor Relationship in Substance - NAIC Designation Assigned by the Securities Valuation Office (SVO) - Unaffiliated |
| Line 0299999 | Debt Securities That Do Not Qualify as Bonds - Debt Securities That Do Not Reflect a Creditor Relationship in Substance - NAIC Designation Assigned by the Securities Valuation Office (SVO) - Affiliated |
| Line 0599999 | Debt Securities That Do Not Qualify as Bonds - Debt Securities That Lack Substantive Credit Enhancement-NAIC Designation Assigned by the Securities Valuation Office (SVO) - Unaffiliated |
| Line 0699999 | Debt Securities That Do Not Qualify as Bonds - Debt Securities That Lack Substantive Credit Enhancement - NAIC Designation Assigned by the Securities Valuation Office (SVO) - Affiliated |
| Line 0999999 | Debt Securities That Do Not Qualify as Bonds - Debt Securities That Do Not Qualify as Bonds Solely Due to a Lack of Meaningful Cash Flows - NAIC Designation Assigned by the Securities Valuation Office (SVO) - Unaffiliated |
| Line 1099999 | Debt Securities That Do Not Qualify as Bonds - Debt Securities That Do Not Qualify as Bonds Solely Due to a Lack of Meaningful Cash Flows - NAIC Designation Assigned by the Securities Valuation Office (SVO) - Affiliated |

**Note that similar investments that are <u>NOT</u> designated by the SVO are afforded 30% base charge and treated as Other schedule BA Assets (15%) for asset concentration factor purposes and thus <u>is outside of the scope</u> of this proposal.**

NAIC Staff look to the Working Group to determine how to clarify the LR010 Asset Concentration Factor instruction and/or blanks to capture these specific asset types. To ensure accurate determination among Option 1, Option 2 or any other options, NAIC staff recommend that the LRBCWG refer the proposal to SAPWG for review with a request for comments.

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**** This section must be completed on all forms.** **Revised 2-2023**

# ASSET CONCENTRATION FACTOR
# LR010

*Basis of Factors*

The purpose of the concentration factor is to reflect the additional risk of high concentrations in single exposures (represented by an individual issuer of a security or a holder of a mortgage, etc.) The concentration factor doubles the risk-based capital pre-tax factor (with a maximum of 45% pre-tax) of the 10 largest asset exposures excluding various low-risk categories or categories that already have a maximum factor. Since the risk-based capital of the assets included in the concentration factor has already been counted once in the basic formula, the asset concentration factor only serves to add in the additional risk-based capital required. The calculation is completed on a consolidated basis; however, the concentration factor is reduced by amounts already included in the concentration factors of subsidiaries to avoid double-counting.

*Specific Instructions for Application of the Formula*

The 10 largest asset exposures should be developed by consolidating the assets of the parent with the assets of the company's insurance and investment subsidiaries. The concentration factor component on any asset already reflected in the subsidiary's RBC for the concentration factor should be deducted from Column (4). This consolidation process affects higher tiered companies only. Companies on the lowest tier of the organizational chart will prepare the asset concentration on a "stand alone" basis.

The 10 largest exposures should exclude the following: affiliated and non-affiliated common stock, affiliated preferred stock, home office properties, policy loans, bonds for which AVR and RBC are zero, NAIC 1 bonds, NAIC 1 unaffiliated preferred stock, ~~**NAIC 1 Hybrids,**~~ CM 1 Commercial and Farm Mortgages and any other asset categories with RBC factors less than 0.8% post-tax (this includes residential mortgages in good standing, insured or guaranteed mortgages, cash and short-term investments).

In determining the assets subject to the concentration factor for both C-1o and C-1cs, the ceding company should exclude any asset whose performance inures primarily (>50%) to one reinsurer under modified coinsurance or funds withheld arrangements. The reinsurer should include 100% of such asset. Any asset where no one reinsurer receives more than 50% of its performance should remain with the ceding company.

Assets should be aggregated by issuer before determining the 10 largest exposures. Aggregations should be done separately for bonds, **including applicable Other Invested Assets with Underlying Characteristics of Bonds that are reported in Line 22 through 28 of Asset Valuation Reserve (AVR) Equity and Other Invested Asset Component table,** and preferred stock (the first six digits of the CUSIP number can be used as a starting point) (please note that the same issuer may have more than one unique series of the first six digits of the CUSIP), mortgages and real estate. Securities held within Schedule BA **joint ventures**, partnerships, **limited liability and other fund structures** should be aggregated by issuer as if the securities are held directly. Likewise, where joint venture real estate is mortgaged by the insurer, both the mortgage and the joint venture real estate should be considered as part of a single exposure. Tenant exposure is not included. For bonds and unaffiliated preferred stock, aggregations should be done first for classes 2 through 6. After the 10 largest issuer exposures are chosen, any NAIC 1 bonds~~,~~ **or** NAIC 1 unaffiliated preferred stock, ~~**or NAIC 1 Hybrids**~~, from any of these issuers should be included before doubling the risk-based capital. For some companies, following the above steps may generate less than 10 "issuer" exposures. These companies should list all available exposures.

Replicated assets other than synthetically created indices should be included in the asset concentration calculation in the same manner as other assets.

The book/adjusted carrying value of each asset is listed in Column (2).

The RBC factor will correspond to the risk-based capital category of the asset reported previously in the formula before application of the size factor for bonds. **Consistent with the aggregation noted above, applicable Other Invested Assets with Underlying Characteristics of Bonds receive the same RBC factor as bonds. To get the proper Asset Type for investments within the '*Other Invested Assets with Underlying Characteristics of Bonds*' AVR category, use the NAIC Designation and NAIC Designation Modifier from the '*NAIC Designation, NAIC Designation Modifier and SVO Administrative Symbol*' column as reported on Schedule BA – Part 1.** The RBC filing software automatically allows for an overall 45% RBC cap.

Detail Eliminated to Conserve Space