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	[ ] Investment RBC (E) Working Group	[ ] Operational Risk (E) Subgroup
[ ] C3 Phase II/ AG43 (E/A) Subgroup	[ ] P/C RBC (E) Working Group	[ ] Longevity Risk (A/E) Subgroup

	DATE: January 21, 2021	**FOR NAIC USE ONLY**
CONTACT PERSON:	Steve Clayburn	Agenda Item # 2021-01-L
TELEPHONE:	(202) 624-2197	Year 2021
EMAIL ADDRESS:	steveclayburn@acli.com	**DISPOSITION**
ON BEHALF OF:	American Council of Life Insurers (ACLI)	[x] ADOPTED 4-29-21 - CADTF
NAME:	Steve Clayburn	[ ] REJECTED
TITLE:	Senior Actuary, Health Insurance & Reinsurance	[ ] DEFERRED TO
AFFILIATION:	ACLI	[ ] REFERRED TO OTHER NAIC GROUP
ADDRESS:		[ ] EXPOSED
		[ ] OTHER (SPECIFY)

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

[ ] Health RBC Blanks	[ ] Property/Casualty RBC Blanks	[X] Life and Fraternal RBC Instructions
[ ] Health RBC Instructions	[ ] Property/Casualty RBC Instructions	[X] Life and Fraternal RBC Blanks
[ ] OTHER ____________________________		

DESCRIPTION OF CHANGE(S)

To update the RBC calculation for Real Estate to reflect updated experience and analysis since RBC was first developed. The factors and instructions included are not final, with the exception of the structure which is included and presented in Figure 7, and will be addressed with a separate proposal.

REASON OR JUSTIFICATION FOR CHANGE **

When RBC was developed, there was limited experience on the default and loss for commercial real estate. Since then data sources have been compiled and tracked in the industry, and can now be accessed to provide more meaningful analysis and information for development of capital standards.

Additional Staff Comments:

4-29-21 cgb The Capital Adequacy Task Force adopted the proposal on 4/29/21.

**** This section must be completed on all forms.** **Revised 2-2019**

1. REAL ESTATE

LR007

Basis of Factors

~~Companies that have developed their own risk-based capital factors for real estate have used a range of factors from 5 percent to 20 percent. One study indicated real estate volatility is about 60 percent of common stock, suggesting a factor in the range of 18 percent. Assuming a full tax effect for losses, a pre-tax factor of 15 percent was chosen. Foreclosed real estate would carry a somewhat higher risk at 23 percent pre-tax. Schedule BA real estate also has a 23 percent factor pre-tax because of the additional risks inherent in owning real estate through a partnership. The pre-tax factors were developed by dividing the post-tax factor by 0.65 (0.65 is calculated by taking 1.0 less 0.35). The pre-tax factors are not changing for 2018 due to tax reform.~~ The base factor for equity real estate of **[10%]** was developed by adding a margin for conservatism to the results of an analysis of real estate performance over the period of 1978 – 2012. The analysis was conducted by a group of life insurance company real estate investment professionals coordinated by the ACLI. The data used was a national database of real property owned by investment fiduciaries and supplemented by data on real estate backing mortgage securities. The analysis is documented in a report to the NAIC dated April 9, 2017. In addition to modifying the factor for company owned and investment real estate, this updated factor will also be used for real estate acquired in satisfaction of debt (Foreclosed real estate) and for assets with the characteristics of real held estate (partnership or other structure) reported on Schedule BA. Foreclosed real estate is recognized in the statutory statements as having acquisition cost equal to market value at time of foreclosure. Schedule BA real estate was originally given a higher factor under a presumption that it was more highly levered. Analysis has shown these assets to have experience very similar to directly held and will therefore use the same factor.

While the experience analysis was done based on analysis of fair value impacts, Real Estate is reported at depreciated cost in the Statutory statements. Therefore, beginning in 2021 an adjustment is made to the factor to partially account for the difference between fair value and statutory carrying value on a property by property basis. The adjustment is defined as

Adj Factor = *RE Factor*(1 – [factor] * (MV-BVg)/BVg)}*

factor is [2/3]

The resulting adjusted RBC factor is subject to a minimum of zero. In the RBC calculation, see Figure 7, fair value is taken from Schedule A Column 10 plus encumbrances, or from Schedule BA column 11 plus encumbrances, respectively, while BVg is the net Book Adjusted Carrying Value plus the encumbrance.

Encumbrances have been included in the real estate base since the value of the property is held net of the encumbrance, but the entire value is subject to loss ~~would include encumbrances~~. Encumbrances receive ~~a~~the base real estate factor of [10%] reduced by the average factor for commercial mortgages of 1.75~~2~~ percent pre-tax. In the past this was computed as a base factor applied to the net real estate value plus a separate factor applied to the amount of the encumbrance. Beginning in 2021, the equivalent result will be obtained by applying a base factor to the gross statutory value of the property, and a credit provided for the amount of the encumbrance. ~~for real estate encumbrances not in foreclosure and 20 percent pre-tax for real estate encumbrances in foreclosure and encumbrances on Schedule BA real estate.~~

The final RBC amount is subject to a minimum of the Baa bond factor (1.30%) applied to the BACV, and a maximum of 45% of the BACV.

~~All references to involuntary reserves as it relates to real estate were removed to comply with the codification of statutory accounting principles.~~

Specific Instructions for Application of the Formula

Column (1)
Calculations are done on an individual property or joint venture basis in the worksheets and then the summary amounts are entered in this column for each class of real estate investment. Refer to the real estate calculation worksheet (Figure 7) for how the individual property or joint venture calculations are completed.

Line (1) should equal Page 2, Column 3, Line 4.1.
Line (2) should equal Page 2, inside amount, Line 4.1.
Line (4) should equal AVR Equity Component Column 1 Line 20.
Line (5) should equal AVR Equity Component Column 3 Line 20.
Line (7) should equal AVR Equity Component Column 1 Line 19.
Line (8) should equal AVR Equity Component Column 3 Line 19.
Line (14) should equal Schedule BA, Part 1, Column 12, Line ~~1799999~~ 2199999 plus Line ~~1899999~~2299999, in part.
Line (15) should equal Schedule BA, Part 1, Column 12, Line 1799999 plus Line 1899999, in part.
Line (17) should equal AVR Equity Component Column 1 Line 75.
Line (18) should equal AVR Equity Component Column 1 Line 76.
Line (19) should equal AVR Equity Component Column 1 Line 77.
Line (20) should equal AVR Equity Component Column 1 Line 78.
Line (21) should equal AVR Equity Component Column 1 Line 79.

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

Column (2)
The average factor column is calculated as Column (3) divided by Column (1).

Column (3)
Summary amounts are entered for Column (3) based on calculations done on an individual property or joint venture basis. Refer to Column (8) of the real estate calculation worksheet (Figure 7).

Line (17)
Guaranteed federal low-income housing tax credit (LIHTC) investments are to be included in Line (17). There must be an all-inclusive guarantee from an ARO-rated entity that guarantees the yield on the investment.

Line (18)
Non-guaranteed federal LIHTC investments with the following risk mitigation factors are to be included in Line (18):

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.

Line (19)
State LIHTC investments that at a minimum meet the federal requirements for guaranteed LIHTC investments.

Line (20)
State LIHTC investments that at a minimum meet the federal requirements for non-guaranteed LIHTC investments.

Line (21)
State and federal LIHTC investments that do not meet the requirements of lines (17) through (20) would be reported on Line (21).

(Figure 7)

Real Estate Worksheet

Fair value adjustment factor [*factor*]

	(1)	(2)	(3)	(4)	(5~~4~~)	(6~~5~~)	(7)	(8~~6~~)	(9~~7~~)	(10~~8~~)
	Description	Book/Adjusted Carrying Value	Encumbrances	Fair Value	~~Book/Adjusted Carrying Value~~Base Factor	Encumbrance~~s~~ credit Factor	Adjusted RBC Factor&	Gross RBC ~~Book/Adjusted Carrying Value~~ Requirement‡	Encumbrances ~~Requirement§~~ Credit	RBC Requirement*
	Company Occupied Real Estate									
~~(1)~~	All Properties Without Encumbrances†		XXX		0.10~~5~~0	XXX			XXX	
(1)										
(2)										
	All Properties With Encumbrances:									
(3~~2~~)					0.10~~5~~0	0.0175~~120~~				
(4~~3~~)					0.10~~5~~0	0.0175~~0.120~~				
(199)	Total Company Occupied Real Estate									
	Foreclosed Real Estate									
~~(1)~~	All Properties Without Encumbrances†~~All Properties Without Encumbrances‡~~		XXX		0.10~~23~~0	XXX			XXX	
(1)										
(2)										
	All Properties With Encumbrances:~~All Properties With Encumbrances:~~									
(3)~~(2)~~					0.10~~23~~0	0.0175~~0.200~~				
(4)~~(3)~~					0.10~~23~~0	0.0175~~0.200~~				
(299)	Total Foreclosed Real Estate									
	Investment Real Estate									
~~(1)~~	All Properties Without Encumbrances†~~All Properties Without Encumbrances‡~~		XXX		0.10~~15~~0	XXX			XXX	
(1)										
(2)										
	All Properties With Encumbrances:~~All Properties With Encumbrances:~~									

(3)~~(2)~~				0.10~~15~~0	0.0175~~0.120~~			
(4)~~(3)~~				0.10~~15~~0	0.0175~~0.120~~			
(399)	Total Investment Real Estate							
(499)	Total Real Estate (Line (199) + Line (299) + Line (399))							
	Schedule BA Assets with characteristics of Real Estate							
~~(1)~~	All Assets Without Encumbrances† ~~All Joint Ventures w/o Encumbrances‡~~		XXX	0.10~~23~~0	XXX		XXX	
(1)								
(2)								
	All Assets With Encumbrances:~~All Properties With Encumbrances:~~							
(3)~~(2)~~				0.10~~23~~0	0.0175~~0.200~~			
(4)~~(3)~~				0.10~~23~~0	0.0175~~0.200~~			
(899)	Total Schedule BA Real Estate							

Note that column (2) is the book/adjusted carrying value net of any encumbrances, while column (4) is the fair value of the property not reduced for any encumbrances.

† For each category, each property ~~Line (1) should also exclude properties or joint ventures that have a negative book/adjusted carrying value. These~~ should be listed individually, including those for which there is no encumbrance.

& Column (7) is Column (5) times (1-(*factor*) * (Column (4) – (Column (2) + Column (3))) / (Column (2) + Column (3))), but not less than zero.

‡ Column (8~~6~~) is calculated as (Column (2) plus Column (3)) multiplied by Column (7~~4~~).

§ Column (9~~7~~) is calculated as Column (3) multiplied by Column (6~~5~~).

* Column (10~~8~~) is calculated as ~~the sum of~~ Column (8~~6~~) minus~~plus~~ Column (9~~7~~), but not less than ~~zero or more than Column (2).~~1.3% nor more than 45% of column (2), and not less than zero.