

Potential Impacts of Proposed Risk-Based Capital Factors

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The National Association of Insurance Commissioners (NAIC) regularly updates its regulations. In 2020, the NAIC proposed a more granular set of designations for bonds. The proposed regulations expanded the number of designations from 6 to 20. These proposed designations align closely with the ratings provided by nationally recognized statistical ratings organizations, such as S&P Global Ratings (see Exhibit 1). The proposed expanded factors also add more transparency to the varying degrees of risk within insurers' fixed income securities.

However, the NAIC did not update the risk-based capital (RBC) factors for the proposed designations. Thus, while companies reported the proposed NAIC designations in their 2020 Schedule D filings, the RBC factors remained the same as those in the existing system. The RBC factors will remain the same until the NAIC completes its impact study and releases the final RBC factors for the proposed designations.

Exhibit 1: Existing and Proposed NAIC Designations and RBC Factors

NAIC BOND DESIGNATIONS		S&P GLOBAL RATING	LIFE RBC FACTORS (%)		P&C RBC FACTORS (%)	
EXISTING	PROPOSED		EXISTING	PROPOSED	EXISTING	PROPOSED
Exempt Obligations			0.00	0.00	0.00	0.00
Non-Exempt U.S. Government Agency Bonds			0.39	0.16	0.30	0.30
1	1.A	AAA		0.16		0.20
	1.B	AA+		0.27		0.40
	1.C	AA		0.42		0.60
	1.D	AA-	0.39	0.52	0.30	0.80
	1.E	A+		0.66		1.00
	1.F	A		0.82		1.30
	1.G	A-		1.02		1.50
2	2.A	BBB+		1.26		1.80
	2.B	BBB	1.26	1.52	1.00	2.10
	2.C	BBB-		2.17		2.50
3	3.A	BB+		3.15		5.50
	3.B	BB	4.46	4.54	2.00	6.00
	3.C	BB-		6.02		6.60
4	4.A	B+		7.39		7.10
	4.B	B	9.70	9.54	4.50	7.70
	4.C	B-		12.43		8.70
5	5.A	CCC+		16.94		9.80
	5.B	CCC	22.31	23.80	10.00	10.90
	5.C	CCC-		30.00		12.00
6	6	CC+ or lower	30.00	30.00	30.00	30.00

Source: National Association of Insurance Commissioners. Data as of Dec. 31, 2020. Table is provided for illustrative purposes.

When released, the proposed RBC factors will vary for Life and non-Life insurers due to the different statutory and tax accounting treatments. Separate NAIC RBC Working Groups have been working to finalize and assess the RBC factors for their respective segments. A draft set of proposed factors has been released, but the NAIC has yet to formally adopt them (see Appendix). The NAIC plans to implement the proposed RBC factors for 2021 RBC filings.

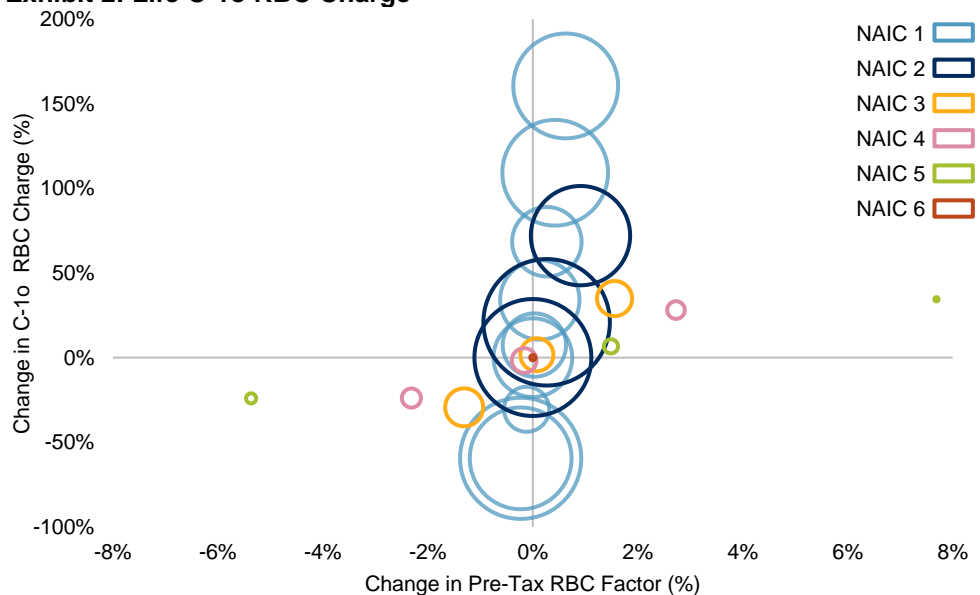
In 2020, the NAIC proposed a more granular set of designations for bonds, expanding from 6 to 20.

Using S&P Global Market Intelligence’s RBC templates, we assessed the potential impact of the proposed RBC risk factors on the insurance industry. We analyzed the impact of the proposed factors on the asset-level capital charge (R1 for Property & Casualty [P&C] and C-1o for Life) and at the authorized control level (ACL).¹

The Life industry has been the primary focus of the 20-designation project, given the contribution bond risk to Life insurers’ overall RBC profile. Within individual designations, the impact of the proposed factors would be broad. The reduction in AAA/Fannie/Freddie RBC charge would lower the industry level charge by 60%. At the other end, the increase in the NAIC 1.G factor would increase this capital charge by 160% (see Exhibit 2). Overall, the after-tax C-1o charge would only increase by 11.25%—from USD 55.6 billion to USD 61.9 billion. However, the ACL ratio would decrease by 37.3%—from 970.89% to 933.59%. Although the overall impact on industry-level RBC ratios is not material, scenarios at the individual company level could cause the changes to be more than superficial in certain instances.

The NAIC has yet to update the risk-based capital factors, though a draft set of proposed factors has been released.

Exhibit 2: Life C-1o RBC Charge



Within individual designations, the impact of the proposed factors on the Life industry would be broad.

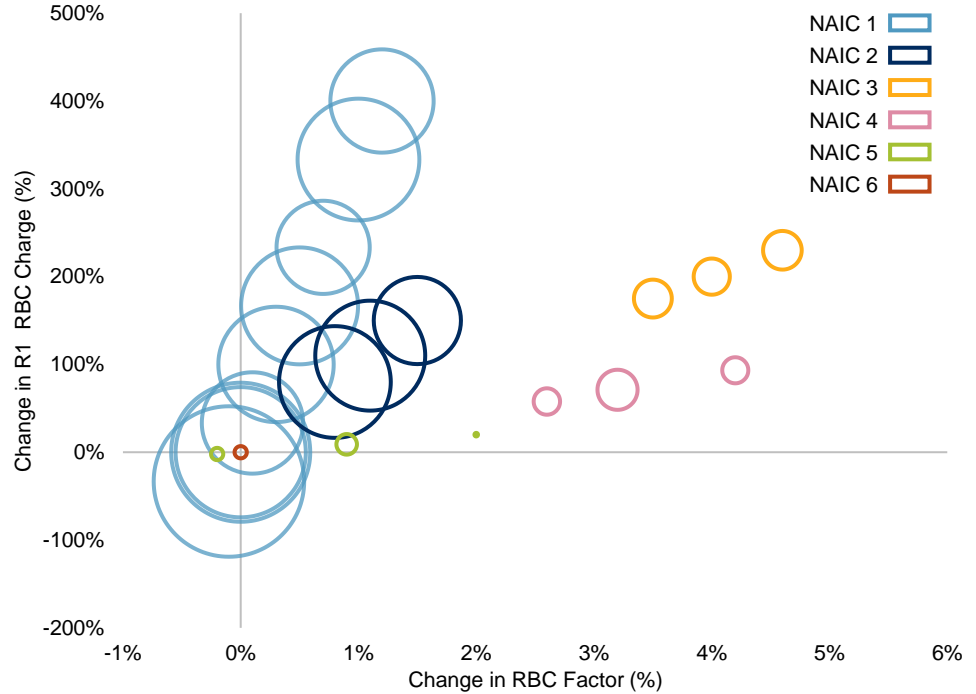
Source: NAIC and S&P Global Market Intelligence. Data as of Dec. 31, 2020. Bubble size is proportional to asset allocation. Chart provided for illustrative purposes.

¹ For this analysis, we assumed all other RBC calculations and values remained the same.

For P&C insurers, the potential change in the RBC factors would have a much smaller impact because investment risk, as a percentage of the total RBC, would be lower than that of Life insurers. At an industry level, the proposed RBC factors would increase the R1 charge 81.4%, from USD 8.8 billion to USD 15.8 billion. The potential impact on individual designations would vary substantially—ranging from -33% to 400% (see Exhibit 3). In contrast to the Life industry, a larger increase in R1 capital charge would only decrease the ACL ratio by 1.23%, from 786.17% to 784.94%.

For P&C insurers, the potential change in RBC factors would have a much smaller impact...

Exhibit 3: P&C R1 RBC Charge



Source: NAIC and S&P Global Market Intelligence. Data as of Dec. 31, 2020. Bubble size is proportional to asset allocation. Chart is provided for illustrative purposes.

...because investment risks would be lower than that of Life insurers.

Obviously, individual company results could vary, but the insurance industry remains comfortably capitalized and the proposed RBC factors are likely to have minimal impact on the ACL ratio.

Individual insurance companies must analyze their bond portfolios well ahead of the implementation of the proposed RBC factors. Insurance companies that are well capitalized and are not sensitive to marginal changes in their RBC ratio may take this opportunity to understand the proposed NAIC designation framework and make changes to their bond portfolios to generate higher yields. To estimate the impact, we modeled the impact of moving 1% of assets from A- (the lowest NAIC 1 category) to various other NAIC categories. Relative to existing RBC factors, the proposed RBC factors are more punitive for P&C companies. However, because of the difference in RBC formulas, the impact would be more meaningful for Life companies (see Exhibits 4 and 5).

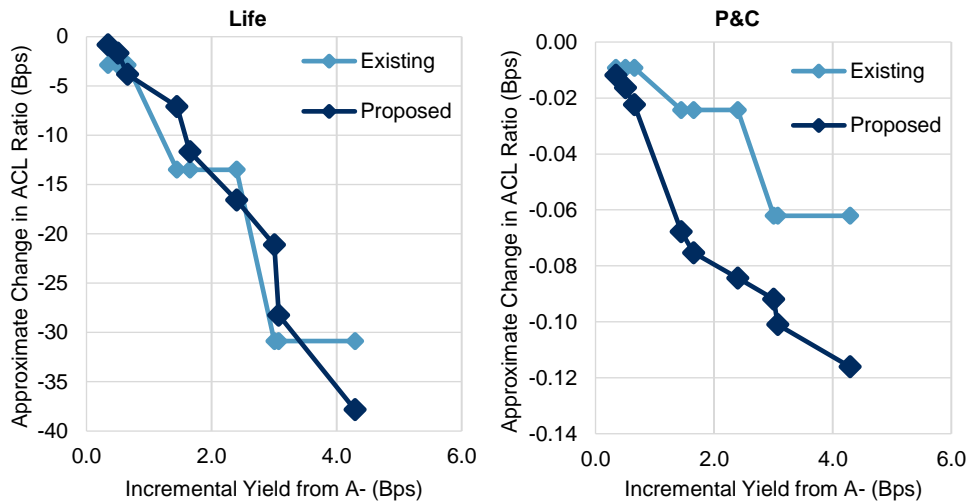
Insurers may take this opportunity to understand the proposed NAIC designation framework and make changes to their bond portfolios to generate higher yields.

Exhibit 4: Yield-to-Worst by Rating²

S&P GLOBAL RATING	YIELD-TO-WORST (%)	CHANGE FROM A- (%)
A-	1.39	-
BBB+	1.73	0.34
BBB	1.89	0.50
BBB-	2.04	0.66
BB+	2.83	1.45
BB	3.04	1.65
BB-	3.78	2.40
B+	4.39	3.01
B	4.46	3.07
B-	5.68	4.29

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2020. Table is provided for illustrative purposes.

Exhibit 5: Impact to ACL



The S&P Global Market Intelligence RBC templates may help insurance companies assess the potential impact of the proposed factors on their risk-based capital.

Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2020. Charts are provided for illustrative purposes.

The S&P Global Market Intelligence RBC templates may help insurance companies assess the potential impact of the proposed factors on their risk-based capital. The 2020 RBC models now include NAIC designation analysis, which calculates the RBC for bonds based on existing and proposed RBC factors to provide risk-based capital for any selected company or for the overall industry.

² A- represented by the S&P U.S. Investment Grade Corporate Bond A Index; BBB+, BBB, BBB- represented by the S&P U.S. Investment Grade Corporate Bond BBB Index; and BB+ and below represented by the [S&P U.S. High Yield Corporate Bond Index](#).

APPENDIX

For more information on the proposed NAIC RBC factors, please see:

- **Life:** <https://content.naic.org/sites/default/files/inline-files/2021-11-L%20Life%20Bond%20Factors%20%28ACLI%29.pdf>
- **P&C:** <https://content.naic.org/sites/default/files/inline-files/Joint%20Academy%20July%2030%2C%202018%20Bond%20Report.pdf>

For more information on the S&P Global Market Intelligence RBC templates,³ please see:

- **Life:** <https://www.snl.com/InteractiveX/file.aspx?DoNotRedirectTo3=1&id=408756782&KeyFileFormat=26&reqFrom=SNL3&KeyProductLinkType=2>
- **P&C:** <https://www.snl.com/InteractiveX/file.aspx?DoNotRedirectTo3=1&id=408256465&KeyFileFormat=26&reqFrom=SNL3&KeyProductLinkType=2>

³ Please contact your S&P Global representative or insurance_info@spglobal.com to access the RBC templates.

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