

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 checked="" 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"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>1/22/2024</u></p> <p>CONTACT PERSON: <u>Brian Bayerle</u></p> <p>TELEPHONE: <u>(202) 624-2169</u></p> <p>EMAIL ADDRESS: <u>BrianBayerle@acli.com</u></p> <p>ON BEHALF OF: <u>ACLI</u></p> <p>NAME: <u>Brian Bayerle</u></p> <p>TITLE: <u>Chief Life Actuary</u></p> <p>AFFILIATION: <u>ACLI</u></p> <p>ADDRESS: <u>101 Constitution Ave, NW Suite 700</u> <u>Washington, DC 20001</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-03-L</u> Year _____</p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

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

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

Summary: Life Risk-Based Capital (RBC) currently has a C-0 charge for Repurchase Agreements (repo) advances of 1.26% computed on LR017. ACLI proposes a reduction of the repo charge to 0.2% for programs that meet “conforming program criteria” through the General Interrogatories, including identification of a reinvestment pool funded by conforming repo programs; General Interrogatories will be updated as part of this proposal. This reduced charge will apply to footnote 5 F (7) ending balance for collateral received under secured borrowing (or the conforming amount as determined by the instructions). The overcollateralized amount (the difference in statement balances for the above-mentioned footnote 5 F (7) ending balance for collateral received under secured borrowing net of the statement balance for Footnote 5 F (5) defining the fair value ending balance for securities sold under repurchase secured borrowing) would receive C-1 RBC factor for bonds rated BBB; this would only apply to counterparties rated BBB or higher. All other repo programs that do not meet the conforming programing criteria or where the counterparty is rated BB or lower would continue to receive the current 1.26% charge.

Rationales for change: Approval of this proposal would align capital charges and disclosure requirements between conforming securities lending programs and conforming repo programs, incentivizing insurers to diversify sources of short-term funding. Enhanced disclosure for conforming repo programs would improve regulatory oversight, while RBC alignment would help insurers reduce interconnectedness with Primary Dealers and the idiosyncratic risk associated with bank balance sheet management, particularly during periods of financial stress.

Background:

Repurchase agreements and securities lending transactions are similar forms of short-term collateralized funding for life insurers. Counterparties are a key difference between these two funding structures. While Primary Dealers act as intermediaries for securities lending transactions, repo is generally executed directly with end-counterparties, such as money market funds. When risk-based capital (RBC) standards were developed, both securities lending and repurchase agreements were assigned C-0 RBC factors of 1.26%. Around 2006, the NAIC revised the C-0 RBC factor for “conforming” securities lending programs to 0.2%:

- To qualify for a “conforming” securities lending program, insurers must attest that their program conforms to appropriate operational and investment risk guidelines and that the collateral margin applied to transactions is within the industry standard. The primary “conforming” requirement is to identify a dedicated reinvestment portfolio to match the securities lending liability.
- Adjusting RBC requirements for smaller “repo” programs was left for a later date.

Since the Great Financial Crisis, regulators and market participants have worked towards reducing the interconnectedness of funding through both regulation and risk management practices. A core tenant of these efforts has been to reduce concentration risk, both in single counterparty and source. Reliance on Primary Dealers in the securities lending market has exposed insurers to the idiosyncratic risks that drive bank balance sheet availability, particularly under stress. The expansion of funding sources to include repo counterparties would enhance overall liquidity for Securities Lenders, increase stability in secured funding markets during times of stress and diversify loan exposures, collectively reducing systematic risk. Alignment of RBC charges would support this enhancement.

ACLI Proposal

The ACLI proposal for conforming repo programs mirrors existing RBC for conforming securities lending:

1. Establish “conforming program criteria” for repo, similar to securities lending. Reporting insurers must attest that they have dedicated reinvestment assets to support the repo liability and enhance their statutory reporting so that regulators can validate these attestations.
2. Proposed RBC for conforming repo programs is the sum of:
 - 0.20% charge for repo assets, plus
 - Additional RBC applied to insurer’s net uncollateralized counterparty exposure (typically 2% of funding amount). To be conservative, the C-1 RBC charge for bonds rated BBB is applied to the insurer’s net counterparty exposure. Counterparts rated lower than BBB would not qualify for a conforming repo program.

Additional Staff Comments:

**** This section must be completed on all forms.**

Revised 11-2023

OFF-BALANCE SHEET AND OTHER ITEMS

		(1)	(2)	(3)	(4)	(5)	(6)
		Statement Value	Less Noncontrolled Assets Funding Guaranteed Separate Accounts, Synthetic GIC's and Certain FHLB Liabilities	Subtotal	Factor	RBC Requirement	Yes/No Response
		Annual Statement Source					
Noncontrolled Assets							
(1)	(1)	Loaned to Others - Conforming Securities Lending Program	General Interrogatories Part 1 Line 25.04		X 0.0020	=	
(2)	(2)	Loaned to Others - Securities Lending Programs - Other	General Interrogatories Part 1 Line 25.05		X 0.0126	=	
(3)	(3)	Loaned to Others - Conforming Repurchase Agreement Program Collateral	General Interrogatories Part 1 Line 25.06	\$	X 0.0020	=	
(4)	(4)	Loaned to Others - Conforming Repurchase Agreement Program Overcollateralization	General Interrogatories Part 1 Line 25.07	\$	X 0.0126	=	
(5)	(5)	Loaned to Others - Repurchase Agreement Programs - Other	General Interrogatories Part 1 Line 25.08		X 0.0126	=	
(6)	(6)	Subject to Reverse Repurchase Agreements	General Interrogatories Part 1 Line 26.21		X 0.0126	=	
(7)	(7)	Subject to Dollar Repurchase Agreements	General Interrogatories Part 1 Line 26.22		X 0.0126	=	
(8)	(8)	Subject to Reverse Dollar Repurchase Agreements	General Interrogatories Part 1 Line 26.23		X 0.0126	=	
(9)	(9)	Placed Under Option Agreements	General Interrogatories Part 1 Line 26.24		X 0.0126	=	
(10)	(10)	Letter Stock or Other Securities Restricted as to sale - excluding FHLB Capital Stock	General Interrogatories Part 1 Line 26.25		X 0.0126	=	
(11)	(11)	FHLB Capital Stock	General Interrogatories Part 1 Line 26.26		X 0.0126	=	
(12)	(12)	On Deposit with States	General Interrogatories Part 1 Line 26.27		X 0.0126	=	
(13)	(13)	On Deposit with Other Regulatory Bodies	General Interrogatories Part 1 Line 26.28		X 0.0126	=	
(14.1)	(14.1)	Pledged as Collateral - excluding Collateral Pledged to an FHLB	General Interrogatories Part 1 Line 26.29		X 0.0126	=	
(14.2)	(14.2)	Less Derivative Collateral Pledged	General Interrogatories Part 1 Line 26.30		X 0.0039	=	
(14.3)	(14.3)	Pledged as Collateral - excluding Collateral Pledged to an FHLB Less Derivatives Collateral Pledged	Schedule DB Part D Section 2 Column 7, Line 0199999999 Line (15.1) - (15.2)		X 0.0126	=	
(15)	(15)	Pledged as Collateral to FHLB - including Assets Backing Funding Agreements	General Interrogatories Part 1 Line 26.31		X #	=	
(16)	(16)	Other	General Interrogatories Part 1 Line 26.32		X 0.0126	=	
(17)	(17)	Total Noncontrolled Assets	Sum of Lines (1) through (13) Plus Lines (14.2) through (16)				
Derivative Instruments							
(18)	(18)	Exchange Traded and Centrally Cleared	Schedule DB Part D Section 1 Column 12, Line 0999999999, in part		X 0.0039	=	
(19)	(19)	Off-Balance Sheet Exposure NAIC 1	Schedule DB Part D Section 1 Column 12, Line 0999999999, in part		X 0.0039	=	
(20)	(20)	Off-Balance Sheet Exposure NAIC 2	Schedule DB Part D Section 1 Column 12, Line 0999999999, in part		X 0.0126	=	
(21)	(21)	Off-Balance Sheet Exposure NAIC 3	Schedule DB Part D Section 1 Column 12, Line 0999999999, in part		X 0.0446	=	
(22)	(22)	Off-Balance Sheet Exposure NAIC 4	Schedule DB Part D Section 1 Column 12, Line 0999999999, in part		X 0.0970	=	
(23)	(23)	Off-Balance Sheet Exposure NAIC 5	Schedule DB Part D Section 1 Column 12, Line 0999999999, in part		X 0.2231	=	
(24)	(24)	Off-Balance Sheet Exposure NAIC 6	Schedule DB Part D Section 1 Column 12, Line 0999999999, in part		X 0.3000	=	
(25)	(25)	Total Derivative Instruments Off-Balance Sheet Exposure	Sum of Lines (18) through (24)				
(26)	(26)	Guarantees for Affiliates	Notes to Financial Statements Number 14A3c1		X 0.0126	=	
(27)	(27)	Contingent Liabilities	Notes to Financial Statements Number 14A1		X 0.0126	=	
(28)	(28)	Long Term Leases	Notes to Financial Statements Number 15A2a1		X 0.0000	=	
(29)	(29)	Total Off-Balance Sheet Items (pre-MODCO/Funds Withheld)	Lines (17) + (25) + (26) + (27) + (28)				
(30)	(30)	Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)				
(31)	(31)	Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)				
(32)	(32)	Total Off-Balance Sheet Items (including MODCO/Funds Withheld.)	Lines (29) - (30) + (31)				
Other Items							
(33)	(33)	Is the entity responsible for filing the U.S. Federal income tax return for the reporting insurer a regulated insurance company?	"Yes", "No" or "N/A" in Column (6)				
(34)	(34)	SSAP No. 101 Paragraph 11a Deferred Tax Assets	Notes to Financial Statements Item 9A2(a)		X ‡	=	
(35)	(35)	SSAP No. 101 Paragraph 11b Deferred Tax Assets	Notes to Financial Statements Item 9A2(b)		X 0.0100	=	
(36)	(36)	Total Off-Balance Sheet and Other Items	Line (32) + Line (34) + Line (35)				

† For Column (2) Line (16), include assets pledged as collateral other than assets related to the Federal Reserve's Term Asset Loan Facility (TALF). For Column (2) include excess assets held by a FHLB but not associated with a FHLB advance (i.e. assets above the required collateral amount and therefore

‡ If Line (35) Column (6) is "Yes", then the factor is 0.005. If Line (35) Column (6) is "No", then the factor is 0.010. If Line (35) Column (6) is "N/A", then the factor is 0.000.

In most instances, apply a factor based on the NAIC ratings category equivalent to an unsecured debt obligation of the FHLB. A higher factor applies if FHLB funded advance liabilities associated with spread-lending activities exceed 5% of total net admitted assets. This higher factor shall equal the factor

§ For Column (1), lines (3) and (4), values are based on Cash and Fair Value amounts.

Denotes items that must be manually entered on the filing software.

OFF-BALANCE SHEET AND OTHER ITEMS

LR017

Basis of Factors

The potential for risk exists in off-balance sheet items. For items other than derivative instruments, a 1.26 percent factor was chosen on a judgment basis. The 1.26 percent pre-tax factor will differentiate between the companies that have small and large exposures to this risk. Since there is no firm actuarial basis for assigning the 1.26 percent pre-tax factor to these risks, off-balance sheet items are included in the sensitivity analysis using a factor of 3 percent, and leases are added as an additional off-balance sheet item. For securities lending programs, a reduced charge may apply to certain programs that meet the criteria as outlined below.

For assets pledged as collateral on funded Federal Home Loan Bank (FHLB) liabilities included in the C3 Phase 1 Cash Flow Testing, the C3 calculation already provides adequate provision for potential risks up to the Statement Value of the associated FHLB liabilities tested therein. For any excess of assets pledged as collateral above this Statement Value (FHLB liabilities included in C3 Phase 1 Cash Flow Testing) the potential exposure is proportionate to the credit risk assessed for the FHLB counterparty, making the bond factor associated with the NAIC designation assigned to the FHLB an appropriate risk provision. For FHLB advances that are not subject to the C3 Phase 1 Cash Flow Testing, the full amount of pledged collateral supporting those advances shall receive a C-0 RBC factor based on the credit standing of the FHLB. Excess assets held by a FHLB but not associated with a FHLB advance (i.e. assets above the required collateral amount and therefore available to be recalled by the insurer), do not present non-controlled asset risk and should be excluded.

Collateral supporting certain FHLB funding agreement activities might be subject to a higher non-controlled asset charge. If the amount of FHLB funded liabilities associated with funding agreement activities is greater than 5% of the company's total net admitted assets, the full amount of pledged collateral supporting FHLB funding agreements in excess of this 5% will receive a higher factor equal to the factor for an NAIC 2 Corporate Bond asset factor.

For derivative instruments, the book/adjusted carrying value exposure net of collateral (the balance sheet exposure) is included under miscellaneous C-1o risks. Because collars, swaps, forwards and futures can have book/adjusted carrying values that are positive, zero or negative, the potential exposure to default by the counterparty or exchange for these instruments cannot be measured by the book/adjusted carrying values. Schedule DB, therefore, includes a calculation of the potential exposure that is based on the March 1987 research paper "Potential Credit Exposure on Interest Rate and Foreign Exchange Rate Related Instruments," supporting the 1988 Bank of International Settlements framework for banks. The off-balance sheet exposure (Schedule DB, Part D, Section 1, Column 12) will measure this potential exposure for risk-based capital purposes. The factors applied to the derivatives off-balance sheet exposure are the same as those applied to bonds.

Specific Instructions for Application of the Formula

Column (2)

Assets directly funding guaranteed separate accounts or synthetic GIC contracts should be excluded from the noncontrolled assets computation.

Line (1)

Securities lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.
2. Written operational procedures to monitor and control the risks associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:
 - a. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.
 - b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.
 - c. Approved borrower lists and loan limits to allow for adequate diversification.
 - d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross currency loans).
 - e. Daily mark-to-market of lent securities and obtaining additional collateral needed to ensure that collateral at all times exceeds the value of the loans to maintain margin

of 102% of market.

- f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.
3. A binding securities lending agreement (standard “Master Lending Agreement” from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.
4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-designated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

Collateral included in General Interrogatories, Part 1, Line 24.04 of the annual statement should be included on Line (1).

Line (2)

Collateral from all other securities lending programs should be reported General Interrogatories, Part 1, Line 24.05 and included in Line (2).

Line (3) through (4)

Insurers may also engage in repurchase transactions which are eligible for lower off-balance sheet charges. The off-balance sheet charges are comprised of two items. The amount of collateral received in the repurchase transaction, subject to the elements specified under Line (2) below, will be assigned a .002 factor. The overcollateralization amount, more specifically the difference between the collateral sold and collateral received, will receive the Bonds - NAIC Designation Category 2.A factor.

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Repurchase programs (similar in nature to Securities Lending) that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in repurchase agreements and how cash collateral received will be invested.
2. Written operational procedures to monitor and control the risks associated with securities lending/repurchase agreements. Safeguards to be addressed should, at a minimum, provide assurance of the following:
 - a. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.
 - b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.
 - c. Approved borrower lists and loan limits to allow for adequate diversification.
 - d. Holding collateral with margin percentages in line with industry standards for repurchase transactions.
 - e. Daily mark-to-market of sold securities and obtaining additional collateral needed to ensure that collateral at all times is in line with the value of the loans to maintain the appropriate margin.
 - f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.
 - g. Counterparty credit rating of BBB or higher

3. A binding repurchase agreement (standard “Master Repurchase Agreement” from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.

4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-designated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

Line (5)

Collateral from all other repurchase programs should be included in Line (5).

Lines (36) through (147)

Noncontrolled assets are the amount of all assets not exclusively under the control of the company, or assets that have been sold or transferred subject to a put option contract currently in force. For Line (12.1) and (13) include assets pledged as collateral reported in the General Interrogatories Part 1 Line 25.30 and 25.31 other than assets related to the Federal Reserve's Term Asset Loan Facility (TALF). For Line (12.2), include all collateral pledged, both cash and securities, to derivative counterparties and/or central clearinghouses for initial margin and variation margin. In addition, include securities collateral pledged as initial margin for futures. Line (12.2) should agree to Schedule DB Part D Section 2 Column 7, Line 0199999. Line (12.3) should equal Line (12.1) minus Line (12.2). For Line (13) column 2 include excess assets held by a FHLB but not associated with a FHLB advance (i.e. assets above the required collateral amount and therefore available to be recalled by the insurer). For Line (13) column 2 also include an amount equal to the lessor of Statement Value of FHLB liabilities subject to C3P1 Cash Flow Testing or 5% of total net admitted assets. For Line (13) column (4), the Factor will be manually input. In most instances, the Factor will be based on the NAIC ratings category equivalent to an unsecured debt obligation of the FHLB. A higher factor applies if FHLB funded advance liabilities associated with funding agreement activities exceed 5% of total net admitted assets. If the higher factor is applicable, the Factor for column 4 is calculated as a blended factor prorated such that collateral in column 3 supporting FHLB funding agreement liabilities in excess of the limit is subject to the factor for an NAIC 2 corporate bond (Line 14 Column 4). All other collateral in column 3 is subject to the factor based on the NAIC ratings category equivalent to an unsecured debt obligation of the FHLB.

Lines (196) through (2326)

The off-balance sheet exposure for derivative instruments reported on Schedule DB, Part D, Section 1, Column 12, Lines 0199999 through 0899999. Off-balance sheet exposure is reported for aggregate exchange traded derivatives, OTC – bilateral derivatives aggregated by counterparty brought into each individual NAIC designation 1-6, and aggregated centrally cleared derivatives. For 2015, derivative balances subject to central clearing are to be included in Line (16) regardless of the category they are included in for Schedule DB, Part D, Section 1.

Line (247)

Guarantees for affiliates include guarantees for the benefit of an affiliate that result in a material[†] contingent exposure of the company's assets to liability.

Line (296)

The exposure amount for long-term leases is the annual rental amount of all leases that could have a material[†] financial effect. If the rent expense is shared with affiliates, it should be allocated by company.

Line (344)

“Yes” means the entity which files the US Federal income tax return which includes the reporting entity is a regulated insurance company (including where the reporting entity is the direct filer of the tax return). “No” means the entity which files the US Federal income tax return which includes the reporting entity is not a regulated insurance company (e.g. a non-insurance entity or holding company makes the filing). “N/A” means the entity is exempt from filing a US federal income tax return; lines (32) and (33) should be zero in this case.

Lines (325) and (336)

These lines are not applicable to Fraternal Benefit Societies.

Apply a one-percent (1%) charge in the RBC formula, placed outside of the covariance adjustment, to admitted adjusted gross deferred tax assets (DTAs) as described in SSAP No. 101, paragraphs 11a and 11b (lesser of paragraph 11b(i) and 11b(ii)). For the period for which the paragraph 11a component is determined, the charge is reduced to one-half percent (0.5%) when the insurance company either filed its own separate Federal income tax return or it was included in a consolidated Federal income tax of which the common parent is an insurance company. The source for the DTA amounts to use in the calculation is found in the Annual Statement, Notes to Financial Statements, Note 9, Part A, Section 2, Admission Calculation Components for SSAP No. 101. Paragraph 11a is found in Section 2, subpart (a), Paragraph 11b is found in Section 2, subpart (b).

[†] The definition of “material” exposure or financial effect is the same as for annual statement disclosure requirements.