



Risk-Based Capital Newsletter

NAIC

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National Association of Insurance Commissioners

Trusted Collateral for Authorized Reinsurers

At the June 1, 2008, meeting of the Capital Adequacy Task Force, a proposal was adopted to modify the instructions for page LR014 Reinsurance.

The proposal would allow a credit to page LR014 Reinsurance Line (15) for trusted collateral supporting authorized reinsurance.

Underlined and highlighted below are changes made to the LR014 Reinsurance instructions:

Basis of Factors

There is a risk associated with recoverability of amounts from reinsurers. The risk is deemed comparable to that represented by bonds between risk classes 1 and 2 and is assigned a pre-tax factor of 0.8 percent. To avoid an overstatement of risk-based capital, the formula gives a 0.8 percent pre-tax credit for reinsurance with non-authorized companies, for reinsurance among affiliated companies, for reinsurance with funds withheld or reinsurance with authorized reinsurers that is supported by equivalent trusted collateral that meets the requirements stipulated in Appendix A-785 (Credit for Reinsurance), where there have been regular bona fide withdrawals from such trusted collateral to pay claims or recover payments of claims during the calendar year covered by the RBC report, and for reinsurance involving policy loans. Withdrawals from trusted collateral that are less than the amounts due the ceding company shall be deemed to not be bona fide withdrawals.

What RBC Pages Should be Submitted?

For year-end 2008 Life RBC, submit hard copies of pages **LR001 through LR044** to any state that requests a hard copy in addition to the electronic filing. Starting with year-end 2007 RBC, a hard copy was not required to be submitted to the NAIC.

If any actuarial certifications are required per the RBC instructions, those should be included as part of the hard copy filing. Starting with year-end 2008 RBC, the actuarial certifications will also be part of the electronic RBC filing as PDF files similar to the annual statement actuarial opinion.

Other pages, such as the mortgage and real estate worksheets, do not need to be submitted, but still need to be retained by the company as documentation.

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Changes made to RBC for Securities Lending Agreements

At the Dec. 3, 2007, meeting of the Capital Adequacy (E) Task Force, changes for securities lending were adopted for the 2008 life RBC formula and instructions.

A new line was added to page LR015 Off-Balance Sheet Items to split out qualifying securities lending programs. The qualifying programs will receive a smaller pre-tax RBC factor of 0.2%. Programs that are not qualifying will still receive a 1.3% pre-tax factor.

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 rated 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.

In addition to the LR015 changes, a new page was added called LR016 Off-Balance Sheet Collateral. Collateral for securities lending agreements that is accounted for off-balance sheet will now receive an RBC charge as if it were accounted for on the balance sheet.

The off-balance sheet collateral will receive a similar RBC charge to the on-balance sheet assets. So, the new page will have lines for bonds, preferred stock, common stock, Schedule BA assets and other invested assets. The RBC factors will generally be the same as used elsewhere. For example, the LR016 bond factors will be the same as the bond factors used on page LR002.

Hybrid Securities Notching for Risk-Based Capital

The short-term solution of notching certain hybrid securities implemented by Hybrid RBC (E) Working Group for year-end 2006 will continue to be in effect until 1/1/2009.

So, the notching would still be in effect for year-end 2008 RBC but not year-end 2009.

Starting 1/1/2009, hybrid securities will be moved to a new line on Schedule D Part 1 and the notching will no longer be in effect. The hybrid annual statement note disclosure will also be eliminated at the same time.

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Address correspondence to: Dan Swanson, Life RBC
Newsletter, NAIC, 2301 McGee Street, Suite 800, Kansas
City, MO 64108-2604. Phone: (816) 783-8412. E-mail:
Dswanson@naic.org

Address corrections requested. Please mail the old address
label with the correction to: NAIC Publications Department,
2301 McGee, Suite 800, Kansas City, MO 64108-2604.
Phone: (816) 783-8300. Fax: (816) 460-7593

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