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MORTGAGE BANKERS ASSOCIATION

May 21, 2021

Philip A. Barlow, FSA, MAAA  
Chair, Life Risk-Based Capital (E) Working Group  
National Association of Insurance Commissioners  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106-2197

RE: Proposed Modifications to RBC Calculations for Real Estate

Dear Mr. Barlow and Working Group Members:

The Mortgage Bankers Association<sup>1</sup> respectfully submits this letter of support for the modified proposal to update the risk-based capital (RBC) calculation for real estate, which was proposed by the American Council of Life Insurers (ACLI) and which this Working Group exposed on April 7, 2021.

First, we want to recognize the considerable and thoughtful engagement of the Chair and the members of the Working Group. This proposal has been in the works for some time, and the Working Group has put in the time and attention necessary to bring it forward to a decision.

As for the proposal, we believe that it is a vast improvement over the current state, and is both reasonable and appropriately conservative, as we describe below.

**Schedule A: Equity investments in real estate**

The current C-1 factor for real estate investments reported on Schedule A is 15%. Because there was little data available on the performance of real estate assets at the time of adoption in 2000, the current C-1 factor is based on a suggested relationship between common stock and real estate volatility described by Ennis and Burik (1991).<sup>2</sup>

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Its membership of over 1,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, more than 70 life insurance companies engaged in real estate finance, and others in the mortgage lending field. For additional information, visit MBA's website: [www.mba.org](http://www.mba.org).

<sup>2</sup> Richard M. Ennis & Paul Burik, *Pension Fund Real Estate Investment Under a Simple Equilibrium Pricing Model*, The Financial Analysts Journal (May-June 1991).

In contrast, the proposal is based on analysis of historical real estate investment performance data from the NCREIF Property Index (NPI), supplemented by further data from FRC/Kelleher to extend the series through earlier years of 1961-1977. The results of the analysis of historical data suggest a far C-1 smaller factor, as low as 9.5%, would be more than appropriate to cushion against potential losses, while maintaining a safe and efficient lending market. Therefore, MBA supports the proposed factor of 11% as a reasonable and conservative application of the results of that analysis.

### **Schedule BA: Indirect equity investments in real estate**

The current C-1 factor for Schedule BA real estate assets is 23%. This factor is based on an implicit assumption that the *indirect* real estate investments (e.g., through structures such as LLCs) reported on Schedule BA are on average about 50% riskier than *direct* real estate investments reported on Schedule A.

It has become clear that the current 50% risk add-on does not accurately reflect the marginal additional risks. For example, the Jeffrey Fisher<sup>3</sup> study cited in the ACLI submission found that the performance of real estate held through joint ventures was consistent with and perhaps even slightly better than wholly owned real estate. As the ACLI submission notes, real estate investments are typically executed through corporate structures such as LLCs specifically to reduce or mitigate risks. In fact, treating Schedule BA real estate investments on a par with Schedule B real estate investments would be consistent with prior NAIC action reclassifying certain wholly owned single-asset LLCs as Schedule A assets, recognizing that the LLC structure does not itself produce additional risk.

For the reasons above, MBA supports the proposed C-1 factor of 13 percent for Schedule BA real estate (applying a multiplier of about 1.18 vs. the current multiplier of 1.5) assets as reasonable and conservative.

### **RBC Adjustment for Real Estate Encumbrances**

The proposal would update the treatment of encumbrances to incorporate the proposed revised C-1 factor for Schedule A real estate investments (as the Working Group may adopt) and the revised commercial mortgage factor adopted in 2012. Our understanding that this is essentially a technical update to the treatment of encumbrances that is necessary to conform it changes in the

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<sup>3</sup> Jeffrey Fisher is *Professor Emeritus of Finance & Real Estate*, Indiana University Kelly School of Business; *Visting Professor*, Johns Hopkins Carey School of Business; and a Research and Educational Consultant to the National Council of Real Estate Investment Fiduciaries (NCREIF).

treatment of the two components of that treatment (i.e., treatment of mortgages and of real estate investments). Accordingly, MBA supports the proposed change.

### **Adjustment for Unrealized Capital Gains/Losses**

Under Statutory Accounting, a commercial property is accounted for at depreciated cost. As a result, over time, there will tend to be an increasing gap between the accounting value of a property on an insurer's balance sheet and the property's fair value. For example, a property could have a fair value of \$150 and a depreciated cost of \$100. ACLI's proposed market value adjustment is a novel approach to capturing the impacts those unrealized gains or losses have on an insurer's effective capital cushion against insolvency.

We have reviewed the Statutory Accounting Principles Working Group (SAPWG) Response to the Life Real Estate Proposal adopted on May 20, 2021, and we recognize the practical considerations the SAPWG raises. In light of those considerations, we recommend continued exploration of this and other possible approaches to recognizing the capital-like character of unrealized gains and losses on real estate investments.

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Again, we appreciate the considerable time and attention the Chair and members of this Working Group have devoted to this proposal, and to the many other matters the Working Group has addressed over the past year and is currently addressing. We hope that these comments will be helpful as the Working Group considers these proposals.

Respectfully,

A handwritten signature in black ink, appearing to read 'Mike Flood', written in a cursive style.

Mike Flood  
Senior Vice President  
Commercial/Multifamily Policy and Member Engagement