Life Company RBC

MBA advocates reduced risk-based capital for equity investments in real estate.

BACKGROUND
Life insurance companies are subject to regulation by state insurance regulators. That regulatory framework includes Risk-Based Capital (RBC) standards. RBC standards specify the minimum amount of capital a life company must hold on its balance sheet for various categories of business activities.

State insurance regulators' RBC standards generally are identical to model standards established by the National Association of Insurance Commissioners (NAIC). Therefore, MBA actively works with the NAIC to foster risk-based capital rules that appropriately enable life companies to continue to be a stable source of capital for commercial real estate.

REAL ESTATE INVESTMENTS PROPOSAL
MBA is currently working with the NAIC and its Investment (E) Risk-Based Capital Working Group to secure a reduction for the RBC charge for life company holdings of equity real estate. Briefly, the proposal is to modify the life insurer risk-based capital treatment of real estate investments as follows:

- **Schedule A real estate assets.** The current C-1 factor of 15% is based on 60% of the common stock factor, adjusted for taxes. The proposal is based on historical experience as to real estate assets and would reduce the C-1 factor to a lower level, e.g., 10%.

- **Schedule BA real estate assets.** The current C-1 factor of 23% is based on the C-1 factor for Schedule A real estate assets, multiplied by 150%. The proposal would reduce that multiplier to 100% (and would incorporate proposed changes to the C-1 factor for Schedule A real estate assets).

- **Encumbrances.** The current methodology for encumbrances incorporates risk-based capital treatments for (1) real estate assets and (2) commercial mortgages. The proposal would not change the methodology, but would update its application to reflect the proposed changes to the C-1 factor for Schedule A real estate assets, and the risk-based capital treatment of commercial mortgages adopted in 2013.

- **Market-value adjustment.** Currently, no amount of unrealized gains is recognized for risk-based capital purposes. The proposal would recognize some proportion (2/3) of unrealized gains to reflect the impacts of market value vs. book value on the ability to absorb loss.

While the specifics as to each element of the proposal remain to be determined, there seems to be general agreement on key points, e.g., that a lower capital charge for equity real estate is appropriate; that a methodology based on historical experience is an improvement over one based on common stock; and that a market value adjustment can be justified from a risk perspective.
MBA continues to advocate that the Investment (E) Risk-Based Capital Working Group adopt these changes.

**PRIOR CHANGE TO RBC FOR MORTGAGES: MEAF REPLACEMENT**

In 2013, after a concerted five-year effort, NAIC adopted the replacement for the Mortgage Experience Adjustment Factor (MEAF) Risk-Based Capital (RBC) approach that had previously applied. The new framework specifies RBC requirements for each loan in a life company’s commercial and multifamily real estate loan portfolio, based upon (1) the loan’s debt service coverage ratio (DSCR) and (2) its loan to value ratio (LTVR). As shown in the table below, the framework has seven RBC categories: five for performing loans, one for loans past due, and one for loans in default.

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>RBC</th>
</tr>
</thead>
<tbody>
<tr>
<td>CM1</td>
<td>Performing</td>
<td>0.90%</td>
</tr>
<tr>
<td>CM2</td>
<td>Performing</td>
<td>1.75%</td>
</tr>
<tr>
<td>CM3</td>
<td>Performing</td>
<td>3.00%</td>
</tr>
<tr>
<td>CM4</td>
<td>Performing</td>
<td>5.00%</td>
</tr>
<tr>
<td>CM5</td>
<td>Performing</td>
<td>7.50%</td>
</tr>
<tr>
<td>CM6</td>
<td>Loans 90 days past due but not in foreclosure</td>
<td>18.00%</td>
</tr>
<tr>
<td>CM7</td>
<td>Loans in process of foreclosure</td>
<td>23.00%</td>
</tr>
</tbody>
</table>

MBA will monitor development that could affect risk-based capital treatment for mortgages in life companies’ portfolios.

*March 2019*