New RBC capital factors will affect insurer investment policy: AM Best

By Editorial Staff *Thu, Nov 4, 2021*

A new Best's Special Report, "Navigating the New NAIC Risk-Based Capital Factors," states that insurance companies likely will see increased required capital for bonds.

A new set of **risk-based capital** (RBC) factors taking effect in 2021 could temper allocations to lower-rated bonds by insurers looking to capture higher yields according to an AM Best report.

The National Association of Insurance Commissioners' (NAIC) RBC factors will be changing for 2021 filings, and with the change to 20 designations from six, lower-rated bonds will now have much higher RBC factors compared with the prior factors.

A new Best's Special Report, "Navigating the New NAIC Risk-Based Capital Factors," states that insurance companies likely will see increased required capital for bonds. Life/health insurers would see an increase in gross required capital for bonds of approximately $7.2 billion, or an increase of more than 18%, compared with prior RBC factors.

The property/casualty industry's required capital for bonds is expected to nearly double from the prior class-based structure as a result of the new factors. The health industry required capital for bonds is expected to increase almost two and a half times over prior levels.

According to the report, while the increased property/casualty and health RBC for bonds is much higher on a percentage basis than that of the life/health RBC, the impact on RBC ratios should be minimal since most property/casualty and health risks are concentrated on premium and reserve risks.

Additionally, for life/health and property/casualty companies, a modified diversification factor offsets the higher overall bond risk required capital. The new formulas lower the threshold for companies to receive diversification credit. These changes will help smaller companies, as well as larger companies, which will receive even greater diversification benefits.

The NAIC also has implemented a reduction of real estate factors for 2021 filings by life/health companies. With reduced RBC charges for real estate, in particular BA real estate, AM Best expects higher allocations to this asset category going forward.

Life/health insurers also will see new longevity risk factors applied to annuity reserves held for life contingent payments. This could slow activity in the pension risk transfer market, although the impact of the RBC change depends on the company's balance of mortality risk and longevity risk.