S&P Insurer Risk-Based Capital Model Updates

S&P RBC model updates

Who this impacts:
U.S. insurance companies (life, health, P&C)

Timeline:
Implemented in Q4 2023

Description:

S&P has published comprehensive changes to their risk-based capital adequacy model for insurance companies following a two-year collaborative process.

- This is expected to impact around 30% of companies, with only 10% expected to undergo rating changes
- This will result in significant changes to operational capital parameters
- Primary implications to investment capital include:
    - Refinement of interest rate risk components
    - Expanded credit risk categories
    - Increased equity risk charges
    - Larger potential diversification benefits

Investment implication:
Structured securities under more scrutiny, BBB and below investment grade bonds and loans may be more attractive from a capital perspective

Key observations

- In general, **confidence levels used to calibrate risk charges have increased**, leading to more stringent capital requirements for insurance companies

- Refined interest rate risk methodology components:

1. **Interest rate stress** assumptions broken out by country. For U.S. and European investors, interest rate risk charges likely to increase
2. **Duration mismatch** assumptions may penalize insurers with larger asset–liability management mismatches

Expanded **credit risk recovery categories** for bonds and loans by sector, apply larger capital penalty to “riskier” asset groups (i.e., structured securities)

- Category 1: government bonds, senior secured, infrastructure, covered bonds
- Category 2: senior unsecured bonds and loans
- Category 3: subordinated bonds and loans
- Category 4: structured finance

- Charges for equity risk will generally increase, particularly impacting U.S. and European insurers

- Greater diversification allowances across operations and investments may reduce ultimate capital requirements

- Provision to penalize bonds lacking an S&P rating was removed, but remains on the table for possible reconsideration in the future

Source: National Association of Insurance Commissioners, 2024.