Kansas Insurance Department
Sandy Praeger, Commissioner of Insurance

RISK-BASED CAPITAL

Purpose

Kansas' Risk-Based Capital (RBC) laws operate as an early warning system that gives the Department clear legal authority to intervene with an insurer when the insurer triggers one of four "action levels" specified by law. RBC alerts the Department to undercapitalized companies while there is still time for the Department to react quickly and effectively to avoid insolvencies and to ensure such companies are able to pay policyholders' claims. Kansas' RBC laws are based on uniform laws adopted by the NAIC and are an accreditation standard.

Background

Risk-Based Capital is a method of measuring the minimum amount of capital appropriate for a company to support its overall business operations in consideration of its size and certain risk factors. RBC limits the amount of risk a company can assume. It requires a company with a higher amount of risk to hold a higher amount of capital. Capital provides a cushion to a company against insolvency. RBC is intended to be a minimum regulatory capital standard and not necessarily the full amount of capital that an insurer would want to hold to meet its safety and competitive objectives. In addition, RBC is not designed to be used as a stand-alone tool in determining financial solvency or stability of an insurance company; rather it is one of multiple tools available to the Department.

Before RBC was created, regulators used fixed capital standards as a primary tool for monitoring the financial solvency of insurance companies. Under fixed capital standards, owners are required to supply the same minimum amount of capital, regardless of the financial condition of the company. The requirements required by the states ranged from $500,000 to $6 million and was dependent upon the state and the line of business that an insurance carrier wrote. Companies had to meet these minimum capital and surplus requirements in order to be licensed and write business in the state. As insurance companies changed and grew, fixed capital standards were no longer effective in providing a sufficient cushion for many insurers.

RBC laws were developed in the early 1990s driven by a string of large-company insolvencies that occurred in the late 1980s and early 1990s. RBC is now a standard regulatory tool nationwide. Kanas adopted its first RBC laws in 1994.

How RBC works

RBC regulation has two main components: (1) the risk-based capital formula that establishes a hypothetical minimum capital level that is compared to a company's actual capital level; and (2) a risk-based capital laws that grants authority to the Department to take specific actions based on a company's level of impairment.

House Insurance
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Attachment # 1

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Consumer Hotline
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Website
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Formula –

The Risk Based Capital Formula was developed to establish a minimum capital requirement based on the types of risks a company assumes. Separate RBC models have been developed for each of the primary insurance types: Life, Property/Casualty, Health and Fraternal. This reflects the differences in the economic environments facing these companies.

The risk factors for the RBC formulas focus on three major areas: 1) Asset Risk; 2) Underwriting Risk; and 3) Other Risk. The emphasis on these risks differs from one formula to the next. As a generic formula, every single risk exposure of a company is not necessarily captured in the formula. The formula focuses on the material risks that are common for the particular insurance type. For example, interest rate risk is included in the Life RBC formula because the risk of losses due to changes in interest rate levels is a material risk for many life insurance products.

Authority –

Under the Kansas' RBC laws, the Department is authorized and mandated to take preventive and corrective measures that vary depending on the level of deficiency in the company's RBC. These preventive and corrective measures are designed to provide for early intervention to correct problems before insolvencies become inevitable, thereby minimizing the number and adverse impact of insolvencies.

The RBC formula generates the minimum amount of capital that a company is required to maintain to avoid regulatory action. There are four levels of action that a company can trigger under the formula: company action, regulatory action, authorized control, and mandatory control levels. Each RBC level requires some particular action on the part of the Department, the company, or both. For example, an insurer that breaches the Company Action Level must produce a plan to restore its RBC levels. This could include adding capital, purchasing reinsurance, reducing the amount of insurance it writes, or pursuing a merger or acquisition.