

# REPLICATION (SYNTHETIC ASSET) TRANSACTIONS AND MANDATORILY CONVERTIBLE SECURITIES

LR013

## *Basis of Factors*

A replication (synthetic asset) transaction is a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income-generation transaction shall not be considered a replication (synthetic asset) transaction. All replication transactions must be reviewed and approved by the NAIC Securities Valuation Office and assigned an RSAT number. The transactions are disclosed in Schedule DB, Part FC.

A replication (synthetic asset) transaction increases the insurer's exposure to one type of asset, the replicated (synthetic) asset, and may reduce the insurer's exposure to the asset risk associated with the cash market components of the transaction. Both effects are captured and quantified in the worksheet for replication transactions.

For the purposes of this worksheet, a mandatorily convertible security is a security that is mandatorily convertible at prices different from the market prices at the time of conversion. Such securities are classified on the annual statement by ignoring the conversion feature. This worksheet adjusts the RBC requirement upward if the security that results from the conversion is more risky than the original security.

## *Specific Instructions for Application of Formula*

This worksheet should contain a line for each replicated (synthetic) asset and each cash instrument component of all replication (synthetic asset) transactions undertaken by the insurer. It should also contain a line for each mandatorily convertible security and a line for the security that will result from the conversion. The assets should be sorted first by RSAT number, next by type (replicated assets, then cash instruments) and finally by CUSIP.

### Column (1)

The RSAT number for each transaction should be that used in Schedule DB, Part FC, Section 1. Leave this column blank for mandatorily convertible securities.

### Column (2)

Enter an R (for replicated asset) if the line describes one of the replicated (synthetic) assets, a CW (for cash instrument with RBC credit) if the line describes one of the cash instruments constituting the transaction and the transaction either (1) is a swap of prospectively determined interest rates, or (2) eliminates the asset risk associated with the cash instrument, and a CN (for cash instrument with no RBC credit) if the line describes one of the cash instruments constituting the transaction and the transaction does not eliminate the insurer's exposure to the asset risk associated with the instrument. Enter an MC for a mandatorily convertible security and an MCC for the security that will result from the conversion.

### Column (3)

Show the CUSIP for all cash instruments that are securities, all mandatorily convertible securities and all securities that will result from a mandatory conversion.

### Column (4)

Give the description of the replicated (synthetic) asset(s) or cash instruments as found on Schedule DB, Part FC, Section 1. Leave blank for mandatorily convertible securities.

Column (5)  
Give the NAIC designation or other description that will best identify the asset risk class of the asset. For replications (synthetic assets), this is contained in columns 3 or ~~124~~ of Schedule DB, Part ~~FC~~, Section 1.

Column (6)  
Give the book/adjusted carrying value of the asset. For replications (synthetic assets), this is contained in columns ~~4 or 105~~, 10 or 15 of Schedule DB, Part ~~FC~~, Section 1.

Column (7)  
For replicated (synthetic) assets and for the securities that will result from the conversion of a mandatorily convertible security, multiply the risk-based capital factor appropriate to the asset class of the replicated (synthetic) asset times the book/adjusted carrying value contained in Column (6). For cash instrument components that qualify for an RBC credit and for mandatorily convertible securities, the amount contained in this column is the product of:

- (a) the risk-based capital factor appropriate to the asset class of the cash instrument or mandatorily convertible security, but not higher than the average risk-based capital factor for the replicated (synthetic) asset(s) or the securities that result from the conversion of the mandatorily convertible security, times
- (b) the book/adjusted carrying value contained in Column (6), times
- (c) -1

For other cash instrument components, this column should contain zero.