NAIC NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Draft date: 6/9/23

GROUP CAPITAL CALCULATION (E) WORKING GROUP
Tuesday, June 13, 2023
3:00 – 4:00 p.m. ET / 2:00 – 3:00 p.m. CT / 1:00 – 2:00 p.m. MT / 12:00 – 1:00 p.m. PT

ROLL CALL

John Rehagen, Chair	Missouri	Lindsay Crawford	Nebraska
Susan Bernard/Michelle Lo	California	David Wolf	New Jersey
John Loughran	Connecticut	Bob Kasinow	New York
Philip Barlow	District of Columbia	Dale Bruggeman/Tim Biler	Ohio
Ray Spudeck	Florida	Doug Hartz	Oregon
Susan Berry	Illinois	Diana Sherman	Pennsylvania
Roy Eft	Indiana	Trey Hancock	Tennessee
Kevin Clark	Iowa	Jamie Walker	Texas
John Turchi/Christopher Joyce	Massachusetts	Doug Stolte/David Smith	Virginia
Judy Weaver	Michigan	Amy Malm	Wisconsin
Barbara Carey	Minnesota		

NAIC Support Staff: Jane Ren/Dan Daveline

AGENDA

1. Receive and Consider Exposure of the Proposed Scalar for the 2023 Group Capital Calculation (GCC)—*Jennifer McAdam (American Council of Life Insurers—ACLI) and Martin Mair (MetLife)* — Attachment 1

2. Discuss Any Other Matters Brought Before the Working Group—*John Rehagen (MO)*

3. Adjournment

ACLI GCC Scalar Proposal

June 2023

ACLI Proposal and Projected Support

The primary GCC calculation currently relies on placeholder scalars, which convert non-US available and required capital figures into an RBC equivalent on a 1:1 basis. Other scalar methodologies are reported on a sensitivity basis.

ACLI has pointed out significant shortcomings of placeholder scalars and has proposed that Excess Relative Ratio (ERR) scalars would generate superior GCC figures for regulators and industry.

ACLI has solicited consultant bids to facilitate a potential transition from placeholder scalars to ERR scalars during 2023 for the Life and Health sectors. This project has two major components:

1. Identify data sources for solvency ratios and regulatory intervention levels by jurisdiction

2. Work with NAIC to develop appropriate methodologies for generating ERR scalars over time (use of moving averages, dealing with jurisdictional solvency regime change, identifying representative insurers, etc.)

ACLI and six individual insurers have agreed to fund the total $300,000 consultant cost to engage Oliver Wyman and Lou Felice to help NAIC transition to ERR scalars during 2023.

Executive Summary

Replacing placeholder scalars with ERR will appropriately recognize non-U.S. business in the GCC formula

Credible approaches – Prob. of Negative Outcomes (PNO), Pure & Excess Ratio - produce directionally similar scalars

Excess Ratio approach has two critical advantages relative to other ratio-based approaches:

1. Excess Ratio best recognizes *cross-jurisdictional differences in required reserves*
2. Excess Ratio best reflects *capital management practices of prudent global insurers*

ERR Scalar Benefits for US Insurers

Replacing placeholder scalars with ERR scalars provides multiple benefits for US insurers:

1. Unlike placeholder scalars, ERR scalars can be designed to adjust immediately to solvency regime changes, avoiding uneconomic GCC volatility through time

2. Since ERR scalars recognize cross-jurisdictional differences in required reserves, ERR scalars produce GCC figures most accurately aligned with RBC – facilitating insurers' most efficient allocation of capital

3. By helping select representative insurers in each jurisdiction, industry can improve the accuracy of each jurisdictional scalar

4. By providing input into scalar update methodologies, insurers can align future GCC figures with their internal forecasts

5. ERR scalars can also be leveraged for IAIS comparability purposes – to convert GCC into ICS-equivalent figures

Improving GCC Accuracy

Replacing the existing approach with ERR scalars will improve GCC accuracy and avoid the following potential criticisms of current placeholder:

- No justification for assuming available & required capital is equivalent globally
- Placeholder scalar penalizes insurers in the many jurisdictions with Solvency II-like regimes

Credible scalars are ***directionally consistent*** converting overseas capital to RBC

- Japan SMR is discounted heavily when converted to RBC equivalent
- Conversely, Solvency II-like ratios are increased upon conversion to RBC

Different scalar approaches use similar underlying data (regulatory intervention points, industry average ratios) across risk-sensitive jurisdictions, resulting in roughly similar scalar estimates

Unique Advantages of Excess Ratio Approach

Excess Ratio methodology best recognizes differences in required reserves across jurisdictions

- JGAAP reserves are very stringent, balanced by lower required capital
- Jurisdictions with Solvency II-like regimes often have relatively low reserve requirements, balanced by higher required capital

Excess Ratio preserves insurers' excess capital and aligns with prudent insurers' solvency management:

1. Ongoing Competitiveness: Manage local solvency ratio within range of industry average to ensure ability to sell new products

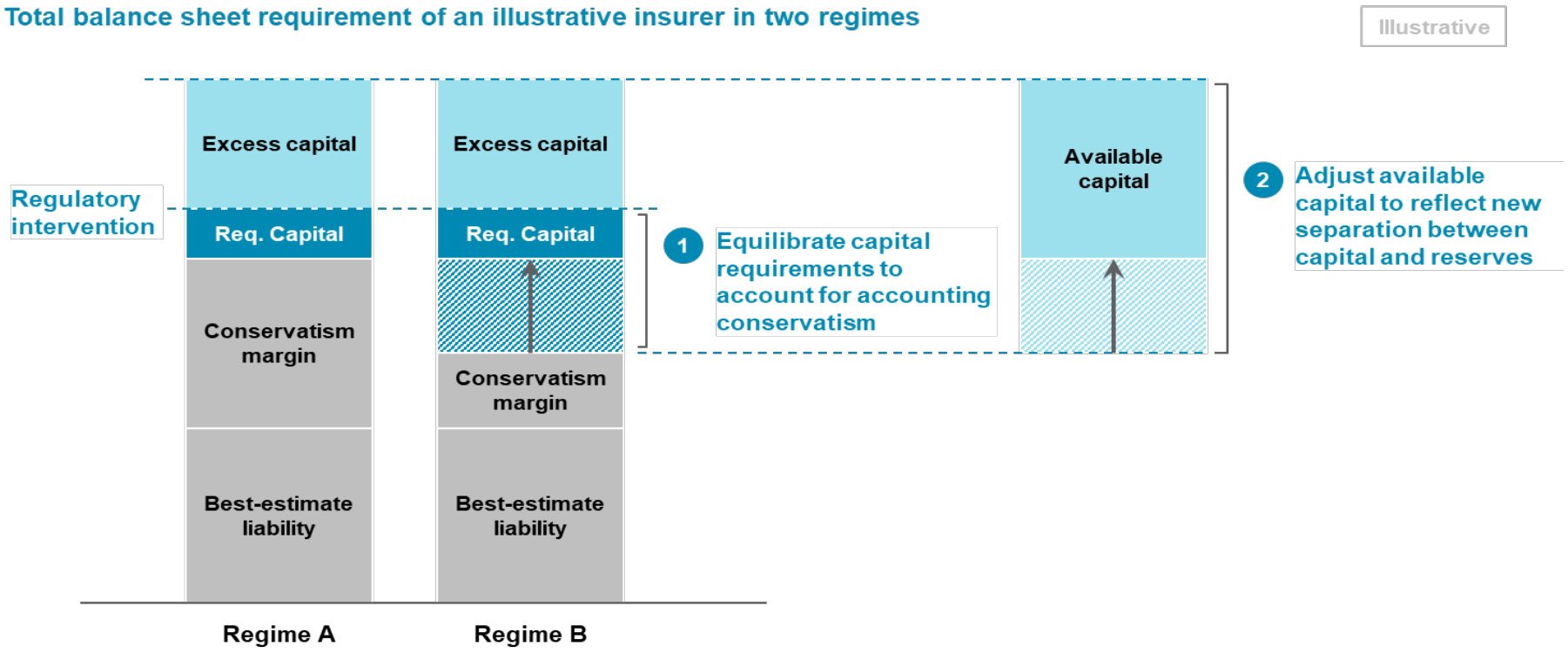
2. Independence Under Stress: Manage local solvency to remain independent of regulatory intervention during the inevitable periods of market stress

Appendix 1: Excess Ratio Scalars in GCC Template

	Life	Non-Life	Health
Canada	15%	28%	
Bermuda	44%	44%	
Japan	101%	121%	72%
Solvency II (EU)	31%	47%	
Solvency II (UK)	31%	47%	
Australia	30%	30%	30%
Switzerland	16%	56%	
Hong Kong	100%	100%	
Singapore	100%	100%	100%
Chinese Taipei	100%	100%	100%
South Africa	100%	100%	100%
Mexico	100%	100%	
China	100%	100%	
South Korea	100%	100%	

Appendix 2: How does the Excess Relative Ratio Adjust for Key Differences?

The Excess Relative Ratio scalar is a total balance sheet-based approach that recognizes different accounting conservatism levels to equilibrate capital requirements:

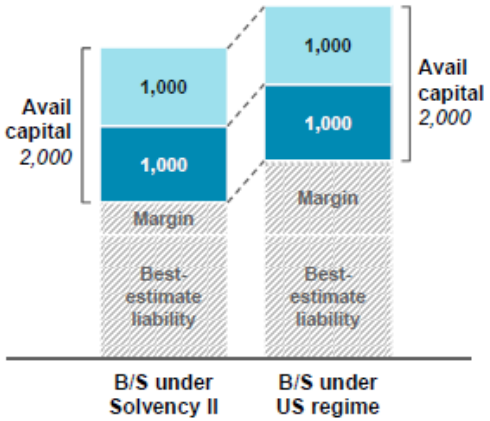


1. Also accounts for differences in asset valuation and admissibility rules (e.g., for intangible assets). For instance, assets admitted under Regime B but not Regime A may be considered a "contra-liability" in Regime B that is subsequently removed when raising Regime B's conservatism margin to equilibrate Regime B and Regime A.

Appendix 3: Distinguishing Between Alternative Scalar Approaches

1 Placeholder Approach – 1.0

Scalar = 1.0x



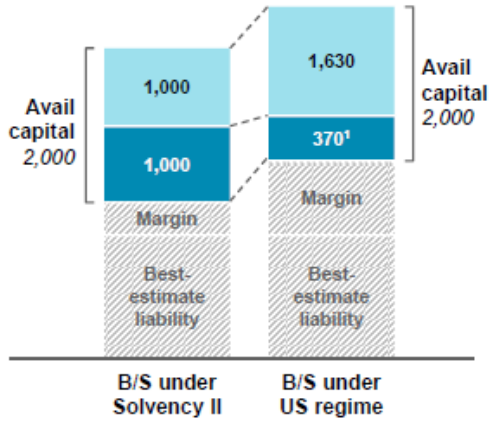
Resultant capital ratios

200% → 200%

- Restating the entity's balance sheet to US creates net increase in total assets, as available capital stays the same
- Scaled capital ratio unrealistically low

2 The Pure Relative Ratio Approach (aka "Operating Ratio" approach)

Scalar = .37x



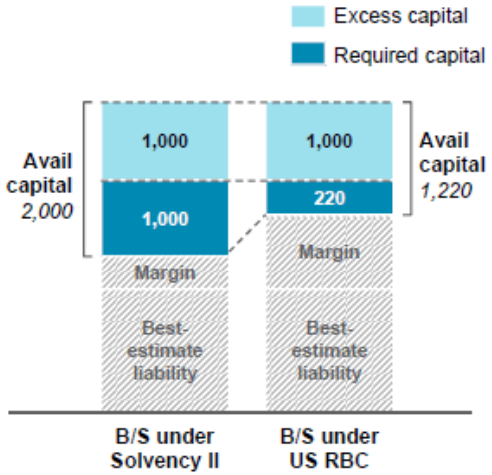
Resultant capital ratios

200% → 541%

- Restating the entity's balance sheet to US creates net increase in total assets, as available capital stays the same
- Scaled capital ratio in-line with US insurers, but with larger cushion of "excess capital"

3 The Excess Relative Ratio Approach (aka "total balance sheet approach")

Scalar = .22x



Resultant capital ratios

200% → 555%

- No net increase in assets from restating the entity's balance sheet to US
- Scaled capital ratio in-line with US insurers, with comparable level of "excess capital"

1. Scalar = 100% SII SCR / 100% RBC CAL (applied to required capital)
2. Scalar = 191% SII SCR / 518% RBC CAL (applied to required capital)
3. See previous slide for scalar calibration and application details

Appendix 4: Sample Demonstration of Excess Scalar

A US-based life insurer has significant operations in both Europe (Solvency II) and Japan. In each jurisdiction, the insurer has an industry-average solvency ratio.

How are excess scalars developed, and what is the insurer's GCC ratio?

	Assumptions	US	SII	Japan
(a)	Industry Avg Ratio (%)	400%	200%	800%
(b)	First Regulatory Intervention (%)	100%	100%	200%
(c)	Current Available Capital ($)	$400	$200	$400
(d)	Available Capital at Intervention ($)	$100	$100	$100
(e)	Required Capital ($)	$100	$100	$50
$\frac{(a)-(b)}{(b)}$ = (f)	Excess Ratio	**300%**	**100%**	**300%**
$\frac{(f)\ Country}{(f)\ US}$ = (g)	Excess Scalar[1]	**N/A**	**0.333**	**1.00**

[1]Actual excess scalars listed on GCC Template (slide 6) are **0.31 (SII)** and **1.01 (Japan)**

Appendix 5: Applying Excess Scalars to SII and Japan

Country scaled capital example

Excess scalars are first applied to required capital

		SII	Japan
(a)	Available Capital at Intervention	$100	$100
(b)	Scalar	0.333	1.00
(a) X (b) = (c)	Scaled Required Capital	$33	$100
(c) – (a) = (d)	Required Capital Difference	($67)	$0

Available Capital is adjusted by the change in required capital

		SII	Japan
(e)	Current Available Capital	$200	$400
(d)	Required Capital Difference	($67)	$0
(e) – (d)	Scaled Available Capital	$133	$400

Group capital aggregation example

	US	SII	Japan	GROUP
Scaled Available Capital	$400	$133	$400	$933
Scaled Required Capital	$100	$33	$100	$233
Solvency Ratio	*400%*	*400%*	*400%*	*400%*

Appendix 6: Sample Methodological Issues in Generating Scalars

A robust framework for generating scalars should address issues including:

1. How long of an historical time series is required (e.g., 5-year rolling average)?
2. What minimum percentage of the industry should be included in the average?
3. What circumstances justify excluding certain companies from the calculation (e.g., outlier ratios or ratings, very different business model, not representative of IAIG's)?
4. How should jurisdictional scalars adjust when there is a regulatory regime change?
5. Should there be a minimum trigger for year-over-year changes in scalars? Excluding a change in solvency regime, should scalars generally be static for a period of time and revised every few years?
6. What outcomes suggest that a particular scalar is not appropriate?