<u>Revisions to the GCC Instructions not in the Materials for the November 17 Group Capital Calculation (E) Working Group Call</u>

The following three changes to the instructions were presented during the 11-17-20 call but were not in the version of the instructions included in the materials for that call. The working group adopted the instructions with the changes and they are included in the version that has been posted to the GCC WG webpage in the Related Documents tab and distributed as part of the materials for the Financial Condition E Committee session on December 8, 2020 at the Virtual NAIC Fall National Meeting:

1. **<u>Page 6, Paragraph 9</u>**

The original marked language has been deleted and the ACLI suggested language inserted:

<u>9.</u> **<u>Financial Entity:</u>** A non-insurance entity that engages in or facilitates financial intermediary operations (e.g., accepting deposits, granting of credits, or making loans, managing, or holding investments, etc.). Such entities may or may not be subject to specified regulatory capital requirements of other sectoral supervisory authorities. For purposes of the GCC, entities that are not regulated by an insurance or banking authority (e.g. FINRA or the SEC) will be considered as not subject to a specified regulatory capital requirement. The primary examples of financial entities are commercial banks, intermediation banks, investment banks, saving banks, credit unions, savings and loan institutions, swap dealers, and the portion of special purpose and collective investment entities (e.g., investment companies, private funds, commodity pools, and mutual funds) that represents the Broader Group's aggregate ownership in such entities, whether or not any member of the Broader Group is involved in that entity's management responsibilities (e.g., via investment advisory or broker/dealer duties) for those entities. For purposes of this definition, a subsidiary of an insurance company whose predominant purpose is to manage or hold investments or act as a broker / dealer for those investments on behalf of the insurance company and its affiliated insurance (greater than 90% of all such investment subsidiaries' assets under management or held are owned by or for the benefit of these insurance affiliates) should NOT be considered a Financial Entity. ~~However, in the case of collective investment entities (e.g., investment companies, private funds, commodity pools, and mutual funds) the 90% will be measured in the aggregate for all affiliated entities within each subtype (e.g., investment companies, private funds, commodity pools, and mutual funds).~~ <u>In the case where an insurer sets up multiple subsidiaries for this purpose, the 90% may be measured in the aggregate for all such entities. Similarly, in the case of collective investment pools (e.g. private funds, commodity pools, and mutual funds) the 90% may be measured individually, or in the aggregate for each subtype (e.g., private funds, commodity pools, and mutual funds).</u> In addition, other financial entities without a regulatory capital requirement include those which are predominantly engaged in activities that depending on the nature of the transaction and the specific circumstances, could create financial risks through the offering of products or transactions outside the group such as a mortgage, other credit offering, or a derivative.

Commented [FL1]: ACLI proposed language replaced existing language.

2. Page 34, Paragraph 70

69. Debt issued by US led groups:

- Surplus Notes – Report the outstanding value of all surplus notes in Column 8 whether issued to purchasers within or outside the group. The outstanding value of Surplus notes issued to entities outside the group and that is already recognized by State regulators and reported 100% as capital in the carrying value of U.S insurer issuers in Section B of the **inventory tab and will not be included in the additional capital allowance.** Surplus notes issued within the group generally result in double counting and will not be included in the additional capital allowance. See instructions below.

- Subordinated Senior Debt (and Hybrid Debt e.g., debt issuances that receive an amount of equity credit from rating agencies) issued – The outstanding value will be reported in Column 8. Recognition for structurally subordinated debt will be allowed to increase available capital. For purposes of qualifying for recognition as additional capital, both of the following criteria must be met:

  a. The instrument has a fixed term (a minimum of five years at the date of issue or refinance, including any call options other than make whole provisions[1]). However, if the instrument is callable within the first five years from the date of issue any such call is at the option of the issuer only (the instrument is not retractable by the holder) AND it is management's intent that the called instrument ~~must~~ will be replaced in full before or at redemption by a new issuance of the same or higher quality instrument.

  b. Supervisory review or approval is required for any ordinary or extraordinary dividend or distribution from any insurance subsidiary to fund the repurchase or redemption of the instrument. Supervisory approval of ordinary dividends is met if the supervisor has in place supervisory controls over distributions, including the ability for the supervisor to limit, defer and/or disallow the payment of any distributions should it find that the insurer is presently, or may potentially become, financially distressed. There shall be no expectation, either implied or through the terms of the instrument, that such approval will be granted without supervisory review.

Note: A Y/N column has been added to the Input 3 Cap Instruments Tab to reported if the instrument is subject to a call provision (including "make whole"). In addition, analysis guidance may also be added in the FAHB for the lead-State to potentially request additional information.

[1] NAIC staff have been informed that make whole provisions are a form of a call feature that can be exercised by the issuer at any time; that they nonetheless are most frequently utilized near the end of the term of the instrument, generally In connection with refinancing; and that the cost to the issuer to exercise the make whole provision and associated financial reporting impacts, combined with the very low interest rate environment, make it much less likely that such provisions will be triggered, particularly within five years of issuance. Staff will continue its research, and assuming these observations are confirmed, the referenced criteria will continue to scope out make whole provisions.

3. Page 37, Paragraph 71 (Instructions for Column 13)

- [Column 13] Regulatory Approval – Respond "Y" or "N" as to whether instrument is subject to a call provision in the first 5 years AND it is management's intent to replace the called instrument in full before or at redemption by a new issuance of the same or higher quality instrument.