**Review of the Group Capital Calculation**

Consideration of the Insurance Holding Company System Structure

As the lead state begins to review the annual Group Capital Calculation filing for a particular group, it is important for the lead state to do so with consideration of the existing knowledge of both the organizational structure of the group, including changes in the structure from year to year, but more importantly the overall activities of each of the entities in the group which otherwise have the potential to transmit material risk to the insurers within the group. While the GCC will provide additional quantitative information on the entities in the group; the actual activities of the entities are also important in determining the scope of application of the GCC. The lead state is responsible for determining if any of the entities in the holding company structure should be excluded from the calculation, and therefore a smaller “scope of application” for the entities included in the GCC ratio. The filing includes a column for the group to propose what should be excluded as well as an additional column for the final determination made by the lead state. In general, the determination of scope of the application is suggested by the group but made in consultation and agreement with the lead state. This exercise should be undertaken in a manner that yields a clearly documented rationale for excluding entities or subgroups of the larger group. The *Group Capital Calculation Instructions* describes the basis for making this determination and the calculation itself is structured to facilitate this determination, with the inclusion in Schedule 1 of the calculation of financial data for all entities within the holding company. Similar to exclusion from the calculation itself is review of data for cases in which subgroups are completely excluded from the larger group, particularly with regard to Schedule 1; the rationale for the exclusion(s) should be provided in the GPS. The concept is that this Schedule 1 data should be utilized by the lead state in conjunction with its existing knowledge of the group and its activities (obtained from the Schedule Y, ORSA, Forms B/C, Form F, the non-insurance grid, etc.), and therefore likely material risks, to make this determination. To the extent the entities included in Schedule 1 differ from the analyst’s knowledge of the Group, further discussion and follow-up should be held with the group.

In the initial year(s) of a GCC filing, to help the analyst get comfortable with the Inventory and Schedule 1 process, consider the following:

* Gather appropriate background information for your group(s) (e.g., Group Profile Summary, ORSA, RBC Reports, Schedule Y)
* Determine that all Schedule Y entities are listed in schedule 1 or  in the schedule BA  list in the other information tab or that an entity’s omission is understood / explained
* Evaluate requests for exclusion of non-insurance/ non- financial entities w/o material risk to determine if you agree with exclusion.
* Confirm that all insurers and financial entities are de-stacked in the inventory tab.
* Determine if grouping has been properly applied.
* Evaluate level of risk assigned by filer to financial entities w/o regulatory capital requirements.
* Test check that the numbers reported in Schedule 1 and Inventory Tab look reasonable,  especially for the insurers.  A sample check should be sufficient.

The holding company structure and activities should also be utilized by the lead state in determining how to understand the GCC ratio. More specifically, information on structure can impact the flow of capital used by the group to make decisions on how to utilize resources among entities within the holding company structure. Therefore, understanding the following can assist in evaluating the flow of resources:

* Domestic insurance operations
* International insurance operations
* Banking or other financial services operations subject to regulatory capital requirements
* Financial and non-financial operations not subject to regulatory capital requirements\*

\*The GCC instructions provide examples of financial versus non-financial entities in this category. All financial entities should be included in the scope of application of the GCC. However, there can be a broad array of entities that could be considered financial. The lead state should document the rationale for cases in which it concludes that an entity that may be financial in nature can nonetheless be classified in the group’s GCC filing as “non-financial” and thus excluded from the scope of the group of the GCC.

The GCC is intended to be used as an input into the GPS. The expectation is that the GCC summary section will help to document a high-level summary of the analyst’s take away of the GCC, as well as the Strategic branded risk. The manner in which the analyst determines what else should be documented beyond the GCC Summary and the Strategic branded risk should be based upon the following steps, since these steps contemplate the previously mentioned concept that the existing evaluation of the financial condition should be used in evaluating the depth of review of the GCC.

In as much as the GCC is a new analytical tool for use by regulators and that it will take a number of years before there is both (1) sufficient data for any given group to provide the trend identification ultimately anticipated for the GCC; and (2) experience by regulators with its use. Analysts should be mindful that any stated threshold in the following procedures is for analysis purposes only and DOES NOT constitute a trigger for regulatory action. Rather, the stated threshold should be used as an opportunity for an analyst to understand issues and concerns that may be emerging and address them with the group, if needed. Nonetheless, the following procedure steps provide analysts with a framework to consider the GCC results in conjunction with other data and tools at their disposal, and to begin to gain and benefit from experience in utilizing the GCC as a new analytical tool.

* Procedure Step 1 suggests that a review of the components of the GCC is appropriate when the GCC ratio is trending downward.
* When Procedure Step 1 identifies the need to look further, Procedure Step 2 suggests from a high level determining the drivers of any decreases in the total available capital in the GCC. While there are numerous benefits of the GCC over consolidated approaches, the ability to drill down on the drivers is one of the more significant and is consistent with the states approach to not just looking at capital, but to the drivers of capital issues.
* When Procedure Step 1 identifies the need to look further, Procedure Step 3 suggests from a high level determining the driver of any increases in operating leverage, which is typically what drives insurance capital requirements up, be it asset risk/leverage or writings leverage. Similar to drivers of capital decreases, the GCC has detailed information on financial figures and ratios that can be used to isolate the issues.
* When either Procedure Step 2 or Step 3 identify the need to understand better, Procedure Step 4 is similar in that it too utilizes detailed information on capital allocation patterns used by the group over time that are necessary for the analyst to understand if there are any future negative trends in the GCC.
* When Procedure Steps 2, 3 and 4 identify the need to understand better, Procedure Steps 5, depending upon the analysis performed in previous Steps, is similar to legal entity analysis, where there is likely a need to determine what steps the group/company is already taking or plans to take in order to address the issues they feel are appropriate. The guidance provided in these procedures is not intended to be exhaustive, but rather should give the analyst a starting point in better understanding the various issues.
* If the analyst determines after completing any of the above procedures (steps), that no further work is deemed necessary to fully document their understanding of the material risks of the group observable from the GCC (as well as the required information to be included in all GPS from the GCC), this should be documented by the analyst in any workpapers deemed appropriate by the state and include the general reason, therefore. In making this determination, it should be reiterated these procedures are not intended to be used in a checklist manner and judgement based upon and existing understanding of the group and existing information on the group obtained from the Form F, ORSA, or any other source is certainly part of that decision.

## Procedure Step 1-Understand the Adequacy of Group Capital

1. **Determine if the group capital position presents a risk to the group and its insurance subsidiaries based upon its recent trends and/or current measures in the GCC ratio.**

|  |  |  |
| --- | --- | --- |
|  | *Branded Risk* | *Benchmark* |
|  |  |  |
| 1. Has there been a decrease in the GCC ratio over last two or more years? If “yes”, determine the cause(s) of the decline.
 | ST | 1. <-10% (this is not a point change)
 |
| 1. Has there been a decrease in the GCC Total Available Capital from prior year? If “yes”, determine the cause(s) of the decline.
 | ST | <-10% |
|  |  |  |
| 1. Has there been a negative trend in the GCC ratio over the past five years suggesting an overall pattern of declining capital?
 | ST | N/A |

If the answer to any of the above questions is “yes”, but it is obvious that either the negative trend is caused by something such as the allowable debt, or a change in a corporate tax rate, or some other non-indicator of negative trends, note as such but do not proceed to step 2. In addition, if it is obvious that the negative trend is clearly driven from one entity in the group, understand the cause and document as such but do not proceed to step 2. However, in all other cases if the answer to any of the above questions is “yes”, the analyst should proceed with procedure step 2, understanding decreases in total available capital and/or procedure step 3, understanding increases in leverage to determine the cause(s) of the negative trends.

## Procedures Step 2-Understand Decreases in Total Available Capital

1. **Determine the source(s) of decreases in the GCC ratio or the GCC Total Available Capital**

Recognizing that not all declines in capital ratios are necessarily “negative”, i.e., they may be the result of sound capital management and ERM to more efficiently utilize capital, approved changes in the scope of application, or changes in underlying authority requirements, the intent of step 2 (and step 3) is to determine the actual source of the negative issues. In most cases, this equates to pinpointing the legal entity(ies) driving any negative trends. However, unless obvious from the information obtained in step 2, the analyst should proceed to step 5, using an understanding of items in Procedure Step 4, to understand more fully the actions the group, or the legal entity(ies) driving the negative trends already being taken or planned to be taken by the group to address the issues identified in step 2 that the group believes is needed. However, the analyst may already have a deep understanding of any such plans, and as a result, in some cases, it is possible that no further follow-up with the group will be necessary and that the lead state should simply update the GPS to be certain the main understanding of the issues is known to all of the regulators utilizing the GPS.

|  |  |  |
| --- | --- | --- |
|  | *Branded Risk* | *Benchmark* |
| 1. Review the ratio of available capital to calculated capital from each of the reported entities and compare to the same ratio from the prior year. Determine which entities may have led to the negative trends.
 |  | <-10% |
| 1. If the change in the GCC is not driven from a legal entity, and instead the change in allowable debt, note as such.
 | ST | N/A |
| 1. Review the levels of profitability for each of the reported entities in the GCC in the current and prior years (as reported in the GCC) to determine if there are particular entities showing signs of decreasing profitability which may eventually lead to losses and future decreases in the GCC ratio or total available capital.
 | OP, PR/UW | <-10% |
| 1. For each of the reported entities showing either 1) a meaningful decrease in the GCC due to a decrease in the total available capital, or 2) negative profitability trends, request information that identifies the issues by inquiring of the legal entity regulator first or the group itself (e.g., non-insurance company), if applicable.
 | OP, PR/UW, ST | N/A |
| 1. If due to pricing or underwriting issues, understand if the issues are the result of known pricing policies that are currently being modified or if the business is in runoff, recently identified products where metrics can quantify the issues whether new product lines, or geographic or other concentrations, volume/growth business strain, or other issues. When considering pricing that is being modified, include those products for which the price is adjusted through crediting rates.
 | PR/UW | N/A |
| 1. If due to reserve issues, understand the reserve development trends, whether reserve and pricing adjustments have been made as well as changes in business strategy apart from those products.
 | RV, ST | N/A |
| 1. If due to market risk issues—i.e., capital losses—understand not only why the losses occurred, but the likely near-term impact given current and likely prospective economic conditions. Market issues include not only changes in equity prices, but also impact/exposure to interest rates and other rates such as foreign currency exchange rates or rates on various hedging products used by the group.
 | MK, CR | N/A |
| 1. If due to strategic issues such as planned growth, planned decline in writings or changes in the investment strategy, utilize the business plan from the Form F to better understand the anticipated changes and how the actual changes compare. Understanding the variance from the business plan is important in assessing the ongoing risk either in projected future profitability or in some cases the investments.
 | ST, PR/UW, OP | N/A |
| 1. If due to negative reputational issues, for example, have adversely impacted new business or retention of existing business, understand the issues more closely, whether potential ongoing changes in stock prices or financial strength ratings that may further impact market perception, or what the group is doing to address the potential future impact be it sales projections or access to the capital markets.
 | RP | N/A |
| 1. If due to credit losses, understand the current and future concentration in credit risks, be it investments, reinsurance, or other source of credit losses.
 | CR, MK | N/A |
| 1. If due to operational issues, such as extremely large catastrophe events, IT or cybersecurity events or relationships, understand the current and prospective impact.
 | OP, ST | N/A |
| 1. If due to legal losses, understand the underlying issues and degree of potential future legal losses.
 | LG | N/A |
| 1. If due to non-insurance reported entities in the group, understand the relationship of the non-insurance operations to the insurance entities and the potential impact to the insurance operations (i.e., intercompany agreements, services, capital needs, etc.).
 | ST, OP | N/A |

## Procedure Step 3-Understand Increases in Operating Leverage

1. **Determine the source(s) of any decreases in the GCC ratio due to increases in leverage**

Like step 2, the intent of step 3 is to determine the actual source of the negative issues. The difference between step 3 and step 2 is simply the types of issues. Step 2 is focused on issues that have resulted in negative capital trends. Step 3; however, is focused on the issues that impact the risk being measured in the GCC. In most cases that risk is from the insurers and either from the asset side or from the liability side where in both cases there has been an increase in such risk that has not been offset by a corresponding or equal increase in capital. In general, this is referred to as operating leverage, where this risk can manifest itself either through increased insurance writings (e.g., the ratio of premiums to capital or liabilities to capital), or through increased assets that also carry risk. The expectation is that other regulated entities also have capital requirements that increase as these different types of risks increase, similar to how the NAIC RBC considers different types of products and assets that carry more risk. However, it is possible to have increased leverage outside of the insurance companies through for example increased exposure, which can manifest itself through increased liabilities or through increased assets. However, similar to other items noted in this document, such increases do not necessary represent negative trends, rather simply things the analyst may need to further understand the drivers of such. In most cases, this equates to pinpointing the legal entity(ies) driving any negative trends. Similar to step 2, using an understanding of items in Procedure Step 4, to understand more fully the actions the group, or the legal entity(ies) driving the negative trends already being taken or planned to be taken by the group to address the issues identified in step 2 that the group believes is needed.

|  |  |  |
| --- | --- | --- |
|  | *Branded Risk* | *Benchmark* |
| 1. Review the ratio of available capital to calculated capital from each of the reported entities and compare to the same ratio from the prior year. Determine which entities may have led to the negative trends based upon corresponding increases in leverage (e.g., writings/capital ratios or liability to capital ratios).
 | MK, CR, RV, ST, OP, RP | <-10% |
| 1. Review the levels of operating leverage for each of the reported entities in the GCC as well as the same for the prior years as reported in the GCC to determine if there are particular entities showing signs of increasing operating leverage which may lead to future decreases in the GCC ratio or total available capital.
 | MK, CR, RV, ST, OP, RP | <-10% |
| 1. For each of the reported entities showing a meaningful decrease in the GCC due to an increase in operating leverage, request information that identifies the issues by inquiring first from the legal entity regulator or the group itself (e.g., non-insurance company), if applicable.
 | MK, CR, RV, ST, OP, RP | N/A |
| 1. If operating leverage has increased, consider if growth may have resulted from underpriced products or a change in underwriting. Specifically inquire to determine if pricing was reduced to increase sales, or whether the growth is in new product lines or new geographic focus where the group may not have expertise. When considering pricing being modified, include those products that the price is adjusted through crediting rates.
 | PR/UW, OP, ST | N/A |
| 1. If operating leverage has increased, consider if reserving risk has also increased, through potential underpricing that ultimately manifests itself into reserve adjustments. To do so, obtain current profitability information on the products leading to the increased leverage.
 | RV | N/A |
| 1. If operating leverage has increased, obtain current information on the asset mix to be certain that there is a corresponding decrease in riskier assets to mitigate the otherwise likely increase in market and credit risk.
 | CR, MK | N/A |

Unless obvious from the information obtained in step 3, the analyst should proceed to step 5, using understanding of items in Procedure 4, to understand more fully the actions being taken by the group, or the legal entity(ies) or planned to be taken by the or planned to be taken by the group to address the issues that the group believes is needed. However, in some cases, it is possible that no further follow up with the group will be necessary, and that the lead state should simply update the GPS to be certain issues are known to all of the regulators utilizing the GPS.

## Procedure Step 4-Understand the Capital Allocation Patterns

1. **Determine the capital allocation patterns to determine if some entities may put pressure on other legal entities.**

Steps 2 and 3 are critical in understanding the issues faced by the group and in identifying the source of negative trends; and while additional follow up with the group is expected, before proceeding to Step 5, the lead state should understand the historical capital allocation patterns taken by the group or the likely future needed capital allocation patterns that may be needed by the group if negative trends continue. The GCC includes data on historical capital allocation patterns (e.g., contributed capital received/paid or dividends received/paid), which help to illustrate which entities have historically needed more capital and which entities have capital that they have provided other entities in the group in the past. While these patterns do not necessarily repeat themselves from one period to the next, there is often consistency in terms of entities that need capital or have excess capital, which may or may not be driven by losses, or by a change in strategy (e.g., increased writings at one company over another) by the group. These trends can also assist in discussions with the group about where capital may come from as a result of a future unexpected material event. Where similar information is also disclosed in Form F, the detail in the GCC may confirm what is already known by the analyst in this area and in some cases may provide greater detail.

|  |  |  |
| --- | --- | --- |
|  | *Branded Risk* | *Benchmark* |
| 1. Review the underlying data from the GCC Analytics tab to determine the historical capital allocation patterns within the group and summarize the result of this analysis.
 | ST | N/A |
| 1. Using this data, as well as any recent information on net losses, or likely expected funding, determine if there may be an impact on the capital available to the insurance entities (either through the likelihood of higher dividends or through less capital being available for infusions and to fund future possible losses from other entities in the group and potentially become troubled themselves, regardless of the current capital in excess of RBC requirements.
 | OP, ST | N/A |

## Procedure Step 5-Consider the Need for Company Discussions for Reductions in Risk

1. **Determine the group’s plans for addressing source(s) of any meaningful decreases in the GCC ratio or total available capital. Please note, in some cases, the plan may be as simple as actions designed by the group to reverse a single negative trend.**

Steps 5 is designed to assist in understanding the group’s plans for addressing any meaningful decreases in the GCC ratio or total available capital that are not otherwise already planned by the group (i.e., that are not the results of capital management so as to efficiently utilize capital while still maintaining sufficient levels for Enterprise Risk Management needs). The specific plans of the group may or may not fully address all the issues but to the extent the group believes they have addressed what is needed, ultimately what is most important is that such information and the regulators plan for evaluating and monitoring the situation is known to the other regulators. There is a multitude of possibilities, and this guidance is not intended to address all of those. This includes the multitude of possibilities by the group and its legal entities and the ultimate results. This also includes the multitude of possibilities to be taken by the legal entity regulators of the legal entities, including the fact that in some cases some regulators may choose to put their legal entity into some type of supervision, conservation, or some other form of receivership (which , by necessity and intent, would presumably be done based upon existing legal entity authority and not the group’s GCC). Similar to other areas, where similar information is also disclosed in Form F, further information may already be known in this area.

|  |  |  |
| --- | --- | --- |
|  | *Branded Risk* | *Benchmark* |
| 1. Obtain a copy of the group’s most recent business plan and compare it to the prior year plan for variances. (See Additional Procedures below for additional follow-up analysis)
 | ST | N/A |
| 1. Request information from the group on how it intends to address the issues or negative trends (those that are not planned or due to approved changes to the GCC scope of application or the result of changes in underlying legal entity capital requirements) identified in Steps 1-3. More specifically, determine how the group intends to decrease risk, and by what means.
 | ST | N/A |
| 1. Based on information received in 5.b., determine the group’s capacity to reduce risks or raise additional capital.
 | ST | N/A |
| 1. Where the remaining capital is adequate, document the findings in the GPS (or another document) and make available to the supervisory college and or domestic states with the presumption no further action is deemed necessary.
 | ST | N/A |
| 1. Consider whether the collective information suggests that any of the U.S. legal entity regulators should deem the legal entity to be in a “Hazardous Financial Condition” and take appropriate action to address based upon the facts and circumstances and the provisions of the state’s law (similar to NAIC Model 385).
 | N/A | N/A |
| 1. Where appropriate, consider holding a meeting of the supervisory college or of all the domestic states to fully understand the group’s plans. Where appropriate, require the group to present its plans to the supervisory college or all the domestic states.
 | N/A | N/A |
| 1. Where appropriate, determine if the plans proposed by the group are considered inadequate by any of the legal entity regulators, and more specifically if any are considering taking action over their applicable legal entity. If this is the case, hold a meeting of the supervisory college or of all the domestic states to provide this information.
 | N/A | N/A |
| 1. Where appropriate, consider holding a broader meeting of all impacted jurisdictions in which the group is selling insurance. Where appropriate, require the group to present its plans to all such regulators and for the regulators to announce their plans.
 | N/A | N/A |