**MEMORANDUM**

TO: Judith L. French (OH), Chair of the Capital Adequacy (E ) Task Force

FROM: John Rehagen (MO), Chair of the Group Capital Calculation (E) Working Group

DATE: TBD, 2021

RE: Group Capital Calculation Treatment Regarding Certain Subsidiaries

As you may know, the Group Capital Calculation (GCC) utilizes an aggregation methodology where it accumulates the available capital and required capital of a group’s subsidiaries and affiliates. More specifically, as it relates to insurance subsidiaries, it accumulates the available capital and company action level RBC from the RBC formula for U.S. insurers and utilizes the same methodology for non-U.S. insurers. In doing so, it also does not require insurance groups to “de-stack” non-insurance and non-financial subsidiaries reporting directly or indirectly from the parent insurance company’s available capital and company action level RBC.

This decision to not require de-stacking of non-insurance and non-financial subsidiaries was largely done as a means to respect existing regulatory authority. However, it was also done as a means to address another point made by some regulators and some interested parties during the development of the GCC, which is that the GCC and RBC should treat similar assets similarly. In fact, it was for this reason that the factors used by the GCC as it relates to non-financial entities are based upon a similar result that an insurance group would obtain if it were held by a U.S. insurance company. However, its also to this point of desired consistency between the GCC and RBC that we recommend the Task Force to consider at some point in the future if a change should be made to RBC regarding the treatment of insurance company subsidiaries and financial entities within RBC.

**Insurance Company Subsidiaries (Directly and Indirectly Owned) Required Capital**

U.S. insurance subsidiaries-Report the capital required by RBC at the Company Action Level (consistent with today).

U.S. Non-RBC insurance subsidiaries-For those insurance that do not have an RBC formula, the minimum capital per state law should be used. This specifically includes mortgage guaranty insurers, financial guaranty insurers, and other companies that do not have an RBC (e.g., HMOs regulated by the California Department of Managed Care).

Title Insurance Companies-Use 200% of the required level of reserves carried by the insurance company.

Non-U.S. insurance subsidiaries-Use the local capital requirement as specified by the regulator in that jurisdiction at a Prescribed Capital Requirement (PCR) level. The following provides more specific guidance on what meets the definition for the identified jurisdictions:

European Union-Use the Solvency II Solvency Capital Requirement (SCR) as the PCR.

Australia-Use the target capital as set by the insurer/group in accordance with APRA requirements. Effectively, this would be “Target capital under ICAAP.” PCR is not a set multiple of MCR.

Bermuda-Use the “Enhanced Capital Requirement” (ECR) which is the legal entity PCR for medium and large commercial insurers and is calibrated to Tail VaR at 99% confidence level over a one-year time horizon.

Hong Kong-Under the current rule-based capital regime, if applied similar to the concept of PCR, the regime’s PCR would be 150% of MCR for life insurers and 200% of MCR for non-life insurers.

Japan-Use the solvency margin ratio of 200%.

Korea-Use 100% of risk-based solvency margin ratio.

Singapore-Use 120% of total risk requirement (i.e., capital requirement).

China Taipei-Use 200% of RBC ratio.

Canada life-Use “100% of the LICAT Base Solvency Buffer.” The carrying value should include surplus allowances and eligible deposits.

Canada P/C-Use the MCT capital requirement at the target level.

South Africa-Use 100% of the SAM SCR.

**Non-Insurance Financial Entities Subject to a Specified Regulatory Capital Requirement**

Banks and other depository institutions–Use the unscaled minimum required by their regulator. For U.S. banks, that is the Office of the Comptroller of the Currency (OCC) Tier 1 or other applicable capital requirement. This is understood to be consistent with how the Federal Reserve Board would apply its Building Block Approach.

Other-Any other financial entity that is determined to be subject to a specified regulatory capital requirement will bring that requirement in the GCC at the first level of regulator intervention (if applicable).

**Non-Insurance Financial Entities NOT Subject to a Specified Regulatory Capital Requirement**

Asset Managers, Registered Investment Advisors and All other Financial Entities-Use the capital calculation specified below based the level of risk assigned to the entity by applying the material risk principles defined below. However, asset managers and investment affiliates (not qualifying to be treated as non-financial entities as defined below) will be reported at either medium or high risk. In certain cases, these entities may be subject to a layer of regulation (e.g., SEC or FINRA) but are not generally subject to a specified capital requirement.

High Risk: 10% x 3-year average revenue

Medium Risk: 5.0% x 3-year average revenue

Low Risk: 2.5% x 3-year average revenue

**Financial Entity**: 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., the U.S. Securities and Exchange Commission (SEC) or the Financial Industry Regulatory Authority (FINRA)] 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. 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).

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.

**Material Risk**: Risk that is of a magnitude that could adversely impact such thatthe ability to pay policyholder claims or make other policy related payments (e.g., policy loan requests or annuity distributions) may be impacted.

To determine whether an entity poses material risk, the totality of the facts and circumstances must be considered. The determination of whether risk posed by an entity is material requires analysis of various aspects pertaining to the subject entity. A number of items as listed below should be considered in making such a determination, to the extent they apply.

Caution is necessary, however. The fact that one or more of these items may apply does not necessarily indicate risk to the Insurance Group is, or is not, material. The insurer should be able to support its determination of material risk if requested by the regulator. This should not be used as a checklist or as a scorecard. Rather, the list is intended to illuminate relevant facts and circumstances about a subject entity, the risk it poses, how the insurer might be exposed to that risk and means to mitigate that risk.

Primary Considerations:

* Past experience (i.e., the extent to which risk from the entity has impacted the insurer over prior years/cycles).
* The existence of intragroup cross-support mechanisms (as defined below) between the entity and the insurer.
* The means by which risk can be transmitted, i.e., the existence of sufficient capital within the entity itself to absorb losses under stress.
* The degree of risk correlation or diversification between the subject entity and the other entities owned by the insurer (e.g., where risks of one or more entities are potentially offset (or exacerbated) by risks of other entities) and whether the corporate structure or agreements allow for the benefits of such diversification to protect the insurer.
* The existence and relative strength or effectiveness of structural safeguards that could minimize the transmission of risk.

Other Considerations (*if primary considerations suggest exclusion may be reasonable, these can be used to further support exclusions*):

* The activities of the entity and the degree of losses that the entity could pose to the insurer under the current economic environment or economic outlook.

The guidance above recognizes that there are diverse structures and business models of insurers that make it impracticable to apply a one-size-fits-all checklist that would work for materiality determinations. Strict or formulaic quantitative measures based on size of the entity, or its operations of a non-insurance affiliate are an insufficient proxy for materiality of risk to the insurance operations.