



MEMORANDUM

To: Financial Regulation Standards and Accreditation (F) Committee

From: Financial Condition (E) Committee

Date: March 8, 2021

Re: 2020 Revisions to *Insurance Holding Company System Regulatory Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450)

On Dec. 9, 2020, the NAIC Executive (EX) Committee and Plenary unanimously adopted revisions to the NAIC *Insurance Holding Company System Regulatory Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450). These revisions implemented a Group Capital Calculation (GCC) for the purpose of group solvency supervision and Liquidity Stress Test (LST) for macroprudential surveillance.

Please find attached, memorandums and proposed changes to the Accreditation (E) Committee as adopted by the Financial Condition (E) Committee related to these most recent changes to #440 and #450. Each of the memorandum's summarize the basis for recommending that certain provisions of these model changes become part of the Accreditation program as well as suggested timing. With respect to timing, consistent with action taken by the Financial Regulation Standards and Accreditation (F) Committee to use an expedited process in 2019 with respect to the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786) due to the "Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance" (Covered Agreement), we recommend a similar expedited process with respect to states who are a Group Wide Supervisor of a group with operations in the EU or UK. The attached provide further details on the specifics of such recommendations.

F Committee exposed the referral for a 1-year comment period beginning January 1, 2022 (pending approval by Plenary at the Fall National Meeting).

The exposure by F Committee differs from the original exposure in two ways:

- The proposed effective date for all states is January 1, 2026.
- The proposed significant elements for the group capital calculation were modified to allow commissioners to grant exemptions to groups meeting the qualifications set forth in Model #450 Section 21A and Section 21B without the requirement to file at least once.

Note: In conjunction with the motion, the F Committee strongly encourages all states with a group impacted by the Covered Agreement to adopt the group capital calculation revisions to Model #440 and Model #450 for those groups effective Nov. 7, 2022. The Committee also strongly encourages states with a group impacted by the liquidity stress test to adopt the relevant revisions to Model #440 as soon as possible.



MEMORANDUM

To: Financial Condition (E) Committee

From: Group Capital Calculation (E) Working Group

Date: February 25, 2021

Re: 2020 Revisions to *Insurance Holding Company System Regulatory Model Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450)

Executive Summary

On Dec. 9, 2020, the NAIC Executive (EX) Committee and Plenary unanimously adopted revisions to the NAIC *Insurance Holding Company System Regulatory Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450). These revisions implemented a Group Capital Calculation (GCC) for the purpose of group solvency supervision and Liquidity Stress Test (LST) for macroprudential surveillance. This memorandum makes recommendations with respect to the accreditation standards that this Working Group believes is appropriate with respect to only the GCC and expect the Financial Stability (EX) Task Force to make separate recommendations to the Committee with respect to the LST.

The GCC was developed as a result of discussions which began in 2015. The GCC is a natural extension of work state insurance regulators had begun, in part by lessons learned from the most recent financial crisis, to better understand an insurance group's financial risk profile for the purpose of enhancing policyholder protections. While state insurance regulators currently have the authority to obtain information regarding the capital positions of non-insurance affiliates, they do not have a consistent analytical framework for evaluating such information. The GCC is designed to address this shortcoming and will serve as an additional financial metric that will assist state insurance regulators in identifying risks that may emanate from a holding company system. The GCC, and related financial reporting, will provide comprehensive transparency to state insurance regulators, making risks more easily identifiable and quantifiable. For these reasons, the Working Group recommends adoption of #440 and #450 as accreditation standards for all states with the normal accreditation timeline, which would result in an effective date of January 1, 2026.

In addition, the GCC is intended to comply with the requirements under the "Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance" (Covered Agreement), which was signed on Sept. 22, 2017. On Dec. 18, 2018, a similar Covered Agreement was signed with the United Kingdom (UK). The GCC is intended to meet the requirement that the states have a "worldwide group capital calculation" in place by Nov. 7, 2022 in order to avoid the EU from imposing a group capital assessment or requirement at the level of the worldwide parent undertaking. Failure of any state to do so for any U.S. group operating in such jurisdiction raises the potential for any supervisor in the EU or UK to impose its own group capital calculation (e.g., Solvency II capital requirements) on that group and therefore all of the U.S. insurers within that group. Due to this agreement, the Working Group recommends that the accreditation standard become effective Nov. 7, 2022 for those states who are the Group Wide Supervisor of a group with operations in the EU or UK.

A statement and explanation of how the potential standard is directly related to solvency surveillance and why the proposal should be included in the standards:

The current *Insurance Holding Company Systems* accreditation standard requires that state law shall contain the significant elements from Model #440 and Model #450. These models have provided state insurance departments the framework for insurance group supervision since the early 1970s. Following the 2008 financial crisis, state regulators identified group supervision as an area where improvements could be made to the U.S. system. In December 2010, the NAIC adopted changes to the models enhancing the domestic legal structure under which holding companies are supervised. In December 2014, the NAIC adopted revisions to clarify legal authority and powers to act as a group-wide supervisor for internationally active insurance groups. These changes are newly required elements of the NAIC Accreditation Program and have been satisfactorily adopted by nearly all accredited U.S. jurisdictions. As discussed in the preceding paragraphs, the GCC was designed to enhance these same standards that were previously included as accreditation standards.

A statement as to why ultimate adoption by every jurisdiction may be desirable:

The Group Capital Calculation (E) Working Group believes that all states that are the lead state for a group subject to the GCC should be required to adopt the model revisions. The GCC is a tool intended to help protect the policyholders in all states from the risk that can emanate from outside the domestic insurer and will be an input into the Group Profile Summary (GPS). After an initial filing by all insurance groups, the GCC is required for all U.S. insurance groups with greater than \$1 billion in premium. The groups subject to the GCC are expected to have domestic insurers in most U.S. states. Therefore, it is recommended that that the new significant elements apply to all states.

A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date:

We are not currently aware of any states that have adopted the 2020 revisions to Model #440 and Model #450, although we have been advised that many states have begun their legislative processes for adoption of these revisions.

A statement as to the provisions needed to meet the minimum requirements of the standard. That is, whether a state would be required to have “substantially similar” language or rather a regulatory framework. If it is being proposed that “substantially similar” language be required, the referring committee, task force or working group shall recommend those items that should be considered significant elements:

The current accreditation standard for Model #440 and Model #450 requires state adoption on a substantially similar basis. Therefore, the Group Capital Calculation (E) Working Group supports the attached proposed significant elements (Attachment A) be adopted by NAIC-accredited jurisdictions in a “substantially similar” manner, as that term is defined in the Accreditation Interlineations of the NAIC Financial Regulation Standards and Accreditation Program. The Financial Regulation Standards and Accreditation (F) Committee should consider a waiver of procedure as provided for in the Accreditation Program Manual and expeditiously consider adoption of this standard. The Group Capital Calculation (E) Working Group recommends that the accreditation standard become effective Nov. 7, 2022, the end of the 60-month period contemplated under the Covered Agreement, with enforcement of the standard to commence Jan. 1, 2023. However, the Working Group is also supportive of the effective date being bifurcated to allow those states that are not the Group Wide Supervisor of a group with operations in the EU or UK to be subject to a later effective date in line with the normal accreditation timeline, which would result in an effective date of January 1, 2026.

There were also revisions made to Section 8 of Model #440 regarding Confidential Treatment. The Group Capital Calculation (E) Working Group strongly supports the use of language similar to that contained in Section 8G of Model #440. This language was considered very critical to the GCC as its very important that members of the insurance industry (or regulators) not be allowed to make the results of the GCC public in any way as they are designed as regulatory-only tools. Unlike RBC that has regulatory trigger points, the GCC does not, and the regulators of these groups believed it would be detrimental if these tools were used by insurers as a means to advertise their relative solvency strength.

An estimate of the cost for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it, if reasonably quantifiable:

The NAIC has not performed a cost/benefit analysis with respect to the 2020 revisions to Model #440 and Model #450, nor do we believe that the specific costs for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it are reasonably quantifiable. However, the possible exemptions allowed under Model #450 are specifically designed to consider the cost to complete the GCC by the insurance company and the benefits of the GCC to the lead-state commissioner. More specifically, all insurers are required to submit the GCC at least once, after which time the expectation is that the lead state commissioner will evaluate the added insight brought to the state from GCC; then, provided the group has premium less than \$1 billion, no international business, no risky non-regulated entities and no banks or similar capital regulated entities in the group, the lead state commissioner can exempt the group from filing in the future.

In addition, the construction of the GCC also considers cost of completion and specifically provides a principle-based approach where the insurance company can exclude non-risky affiliates from the calculation and also provides the insurance company to group the information of multiple non-insurance/non-regulated affiliates as a means to further reduce the burden of completion. In short, the GCC is only as complex as the insurance group has structured itself, and therefore the GCC already inherently considers the cost to comply.

6. Insurance Holding Company Systems

State law should contain the NAIC *Insurance Holding Company System Regulatory Act* (#440), or an act substantially similar, and the department should have adopted the NAIC *Insurance Holding Company System Model Regulation* (#450).

Insurance Holding Company Systems – continued

Changes to Existing

k. Filing requirements for the enterprise risk filing similar to those specified in Section 4L(1) of the Model #440?

New

- l. Filing requirements for the group capital calculation filing similar to those specified in Section 4L(2) of Model #440?
- i. The ultimate controlling person of every insurer subject to registration shall annually file a group capital calculation completed in accordance with the NAIC Group Capital Calculation Instructions as directed by the lead state commissioner similar to section 4L(2)?
 - ii. Provision for exempting an insurance holding company system that has only one insurer within its holding company structure, that only writes business [and is only licensed] in its domestic state and assumes no business from any other insurer, similar to 4L(2)(a)?
 - iii. Provision for exempting an insurance holding company system that is required to perform a group capital calculation specified by the U.S. Federal Reserve? If the Federal Reserve Board cannot share the calculation with the lead state commissioner, the insurance holding company system is not exempt from the GCC, similar to 4L(2)(b)?
 - iv. Provision for exempting an insurance holding company system whose non-U.S. group-wide supervisor is located within a Reciprocal Jurisdiction that recognizes the U.S. state regulatory approach to group supervision and group capital, similar to 4L(2)(c)?
 - v. Provision for exempting an insurance holding company system that provides information to the lead state that meets the requirements for accreditation under the NAIC financial standards and accreditation program and whose non-U.S. group-wide supervisor that is not in a Reciprocal Jurisdiction recognizes and accepts the GCC as the world-wide group capital assessment for U.S. insurance groups who operate in that jurisdiction, similar to 4L(2)(d)?
 - vi. Provision that gives the lead state the authority to require the GCC for U.S. operations of any non-U.S. based insurance holding company system where after any necessary consultation with other supervisors or officials, it is deemed appropriate by the lead state commissioner for prudential oversight and solvency monitoring purposes, similar to 4L(2)(e)?

Changes to Existing

cc. Provisions for protecting confidential information submitted to the commissioner, including provisions maintaining confidentiality for information shared with state, federal and international regulators similar to Section 8? If sharing confidential information with the NAIC and third-party consultants is permitted, appropriate confidentiality protections should be included.

New

- m. Provision prohibiting the making, publishing, disseminating, circulating or placing before the public in any way the group capital calculation and resulting group capital ratio under Section 4L(2) and/or the liquidity stress test along with its results and supporting disclosures required under Section 4L(3), by any insurer, broker, or other person engaged in any manner of the insurance business, except if the sole purpose of the announcement is to rebut a materially false statement, similar to Section 8G of Model #440?
- n. Filing requirements for the group capital calculation filing similar to those specified in Section 21 of Model #450?
- i. Provision that gives the lead state the authority to exempt the filing of the group capital calculation provided the criteria are similar to those allowed under Section 21A of Model #450?

The significant elements exposed by F Committee on Aug. 14, 2021 include a modification to element n.i and n.ii. Please see separate document containing the modified significant elements.

- ii. Provision that gives the lead state the authority to accept a limited group capital filing provided the criteria are similar to those allowed under Section 21B of Model #450? *See above comment regarding modifications.*
- iii. Provision that gives the lead state the authority to require the group capital calculation of any group that previously met an exemption or submitted a limited filing if any insurer in the holding company system either triggers an RBC action level event, is deemed in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer, similar to those allowed under Section 21C of Model #450?
- iv. Provision that sets forth the criteria for a jurisdiction to be included on the NAIC listing that “recognize and accept the group capital calculation” similar to that required under Section 21D and Section 21E of Model #450?



MEMORANDUM

To: Financial Condition (E) Committee

From: Financial Stability (E) Task Force

Date: February 22, 2021

Re: 2020 Revisions to *Insurance Holding Company System Regulatory Act* (#440)

Executive Summary

On Dec. 9, 2020, the NAIC Executive (EX) Committee and Plenary unanimously adopted revisions to the NAIC *Insurance Holding Company System Regulatory Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450). These revisions implemented a Group Capital Calculation (GCC) for the purpose of group solvency supervision and Liquidity Stress Test (LST) for macroprudential surveillance. This memorandum makes recommendations with respect to the accreditation standards that this Task Force believes is appropriate with respect to only the LST and expect the Group Capital Calculation (E) Working Group to make separate recommendations to the Committee with respect to the GCC.

Post-financial crisis, regulators from all financial sectors across the globe recognized the need for macroprudential surveillance and tools to address macroprudential risks. While the solvency framework established and managed by the Financial Condition (E) Committee thoroughly addresses legal entity insurers and insurance groups, there was no group with a macroprudential scope. This Task Force was created to fill this gap, and in 2017 was charged to “analyze existing post-financial crisis regulatory reforms for their application in identifying macroprudential trends, including identifying possible areas of improvement or gaps, and propose . . . enhancements and/or additions to further improve the ability of state insurance regulators and industry to address macroprudential impacts.” The Task Force created the NAIC Macroprudential Initiative (MPI) to focus its efforts in four key areas: liquidity risk, recovery and resolution, capital stress testing, and exposure concentrations. Liquidity risk was consistently recognized as a key macroprudential risk by federal and international regulatory agencies, and there were several attempts to assess potential market impacts emanating from a liquidity stress in the insurance sector. Many of these analyses relied heavily on anecdotal assumptions and observations from behaviors of other financial sectors.

In order to provide more evidence-based analyses, the Task Force decided to develop a LST for large life insurers that would aim to capture the impact on the broader financial markets of aggregate asset sales under a liquidity stress event. Unlike capital adequacy, which has risk-based capital as a standardized legal entity capital assessment tool and the newly created Group Capital Calculation to provide a capital analysis tool at the group level, there is no regulatory liquidity assessment or stress tool. The Task Force focused on large life insurers due to the long-term cash buildup involved in many life insurance contracts and the potential for large scale liquidation of assets, not because liquidity risk does not exist in other insurance segments. Thus, the primary goal of the LST is to provide quantitative as well as qualitative insights for macroprudential surveillance, such as identifying the amount of asset sales that could occur during a specific stress scenario; but it will also aid micro prudential regulation as well. Because this stress testing is complex and resource-intensive, a set of scope criteria were developed to identify life insurers with large balances of activities assumed to be highly correlated with liquidity risk; thus, many life insurers will not be subject to the LST.

A statement and explanation of how the potential standard is directly related to solvency surveillance and why the proposal should be included in the standards:

The current *Insurance Holding Company Systems* accreditation standard requires that state law shall contain the significant elements from Model #440 and Model #450. These models have provided state insurance departments the framework for insurance group supervision since the early 1970s. Following the 2008 financial crisis, state regulators identified group supervision as an area where improvements could be made to the U.S. system. In December 2010, the NAIC adopted changes to the models enhancing the domestic legal structure under which holding companies are supervised. In December 2014, the NAIC adopted revisions to clarify legal authority and powers to act as a group-wide supervisor for internationally active insurance groups. These changes are newly required elements of the NAIC Accreditation Program and have been satisfactorily adopted by nearly all accredited U.S. jurisdictions. As discussed in the preceding paragraphs, the LST was designed to enhance these same standards that were previously included as accreditation standards.

Macroprudential risks can directly impact regulated legal entity insurers and groups, and/or can emanate from or be amplified by these insurers and transmitted externally. The NAIC solvency surveillance framework must address macroprudential risks to ensure that the companies states regulate remain financially strong for the protection of policyholders, while serving as a stabilizing force to contribute to financial stability, including in stressed financial markets. The LST is the first new tool developed for the macroprudential program within the financial solvency framework.

A statement as to why ultimate adoption by every jurisdiction may be desirable:

The Financial Stability Task Force believes that all states that are the lead state for a group subject to the LST should be required to adopt the model revisions. The LST is a tool intended to help assess the impacts the life insurance industry can have on the broader financial markets in a time of stress. Ideally, the tool would have been required of all life insurance groups, but this was not possible due to the complexity and resources required to accomplish such liquidity stress testing. Thus, the LST uses a set of scope criteria to identify those life insurers with significant amounts in activities assumed to have high liquidity risk, thus representing the larger portion of the life insurance industry in terms of liquidity risk rather than representing the entire life insurance industry. If a scoped-in life insurance group was not subject to the LST because a state did not adopt the model revisions, this would significantly reduce the ability of the NAIC to represent the results as truly macroprudential and reflective of the majority of risks of the life insurance sector. Additionally, the LST results will be helpful to the lead states in their group supervision efforts as well.

Though not every state will be the lead state of a scoped-in group, the Task Force still believes the model revisions for the LST should be adopted in every state. It is fairly common for legal entity insurers to move from one group to another, impacting the group dynamics including the lead state determination, and each state should have the LST in their statutes to ensure they will be prepared for any future appointment as lead state. Also, even without legal entities changing groups, business acquisition and operational changes within existing groups might subject a previously excluded group to the LST. Therefore, it is recommended that that the new significant elements apply to all states.

A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date:

We are not currently aware of any states that have adopted the 2020 revisions to Model #440, although we have been advised that many states have begun their legislative processes for adoption of these revisions.

A statement as to the provisions needed to meet the minimum requirements of the standard. That is, whether a state would be required to have “substantially similar” language or rather a regulatory framework. If it is being proposed that “substantially similar” language be required, the referring committee, task force or working group shall recommend those items that should be considered significant elements:

The current accreditation standard for Model #440 and Model #450 requires state adoption on a substantially similar basis. Therefore, the Financial Stability (E) Task Force supports the attached proposed significant elements (Attached) be adopted by NAIC-accredited jurisdictions in a “substantially similar” manner, as that term is defined in the Accreditation Interlineations of the NAIC Financial Regulation Standards and Accreditation Program. The Financial Regulation Standards and Accreditation (F) Committee should consider a waiver of procedure as provided for in the Accreditation Program Manual and expeditiously consider adoption of this standard. The Financial Stability (E) Task Force recommends that the accreditation standard become effective Nov. 7, 2022, concurrent with the Group Capital Calculation revisions to the model, with enforcement of the standard to commence Jan. 1, 2023.

There were also revisions made to Section 8 of Model #440 regarding Confidential Treatment. The Financial Stability (E) Task Force strongly supports the use of language similar to that contained in Section 8G of Model #440. This language was considered very critical to the LST as its very important that members of the insurance industry (or regulators) not be allowed to make the results of the LST public in any way as they are designed as regulatory-only tools using complex assumptions for potential future stress events and the results could easily be misinterpreted and misrepresented by other users, causing true financial harm to the insurers.

An estimate of the cost for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it, if reasonably quantifiable:

The NAIC has not performed a cost/benefit analysis with respect to the 2020 revisions to Model #440, nor do we believe that the specific costs for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it are reasonably quantifiable. However, the LST scope criteria selects the larger, more complex life insurers, and all of these already perform some form of internal liquidity stress tests. While there are regulatory requirements for inputs and outputs, truly significant costs are avoided by using their existing internal stress testing systems instead of specifying a regulatory model.

6. Insurance Holding Company Systems

State law should contain the NAIC *Insurance Holding Company System Regulatory Act* (#440), or an act substantially similar.

Insurance Holding Company Systems – continued

Changes to Existing

- k. Additions to the filing requirements for the enterprise risk filing specified in Section 4L(1) of the Model #440 (see next item).

New

- c. Define “NAIC Liquidity Stress Test Framework” similar to that in Section 1K?
- d. Define “Scope Criteria” similar to that in Section 1M?
- l. Filing requirements for the liquidity stress test filing similar to those specified in Section 4L(3) of Model #440:
- i. The ultimate controlling person of every insurer subject to registration and also scoped into the NAIC Liquidity Stress Test Framework shall file the results of a specific year’s Liquidity Stress Test to the lead state insurance commissioner of the insurance holding company system as determined by the procedures within the *Financial Analysis Handbook* similar to Section 4L(3)?
 - ii. Insurers meeting at least one threshold of the Scope Criteria for a specific data year are scoped into that year’s NAIC Liquidity Stress Test Framework unless the lead state, after consultation with the NAIC Financial Stability Task Force or its successor, determines the insurer should not be scoped into the Framework for that data year similar to Section 4L(3)(a)? Insurers that do not trigger at least one threshold of the Scope Criteria are considered scoped out of the NAIC Liquidity Stress Test Framework for the specified data year, unless the lead state insurance commissioner, in consultation with the NAIC Financial Stability Task Force or its successor, determines the insurer should be scoped into the Framework for that data year?
 - iii. Provision requiring compliance with the NAIC Liquidity Stress Test Framework’s instructions and reporting templates for the specific data year and any lead state insurance commissioner determinations in consultation with the Financial Stability Task Force or its successor, provided within the Framework similar to Section 4L(3)(b)?

Changes to Existing

- cc. Provisions for protecting confidential information submitted to the commissioner, including provisions maintaining confidentiality for information shared with state, federal and international regulators similar to Section 8? If sharing confidential information with the NAIC and third-party consultants is permitted, appropriate confidentiality protections should be included.
- m. Provision prohibiting the making, publishing, disseminating, circulating or placing before the public in any way the group capital calculation and resulting group capital ratio under Section 4L(2) and/or the liquidity stress test along with its results and supporting disclosures required under Section 4L(3), by any insurer, broker, or other person engaged in any manner of the insurance business, except if the sole purpose of the announcement is to rebut a materially false statement, similar to Section 8G of Model #440?