**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’s important for the lead state to do so with consideration of the existing knowledge of 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. Specific to that point, the lead state is responsible for determining if any of the entities in the holding company structure should be excluded from the calculation. 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 financial data of all entities within the holding company. Similar to exclusion from the calculation itself is data for cases in which subgroups of the larger group are completely excluded from the 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 their 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 with the group.

The holding company structure and activities should also be utilized by the lead state in determining how to evaluate the GCC ratio. More specifically, information on structure can impact the flow of capital and 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 a “financial” entity should be excluded.

While the GCC is intended to be used as an input into the GPS, where the expectation is that the GCC summary section is used to document a high-level summary of the analysts take away of the GCC, as well as the Strategic branded risk, since that is the area where capital measurement is reported. 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. From a high level, the following steps suggest in

* Procedure Step 1 suggests that a review of the components of the GCC is appropriate when either the GCC ratio is trending downward or the GCC ratio is below a predefined suggested threshold of 150% (equivalent to an RBC of 300% since that is the same threshold used in the sensitivity analysis in the GCC Template.
* 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.
* 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.
* Procedure Step 4 is similar in that it too utilizes detailed information on capital allocation patterns that are necessary to understand if there are negative trends in the GCC since these can become important if there are any issues that might require further distribution of capital across the entities.
* Procedure Steps 5: Depending upon the analysis performed in Steps 1-4, similar to legal entity analysis, there is likely a need to determine what steps the company is taking or plans to take to address the issues seen in the analysis of the GCC. The guidance provided in these procedures is not intended to be exhaustive, but rather should give the analyst a starting point in better evaluating 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 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 existing information on the group obtained from the Form F, ORSA, or any other source is certainly part of that judgement decision.

## Procedure Step 1-Evaluate 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.**

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|  | *Branded Risk* | *Benchmark* |
| 1. Is the GCC <150%? If “yes”, determine the most significant risk factors causing the result.
 | ST | <150% |
| 1. Has there been a decrease in the GCC ratio over last two years? If “yes”, determine the cause(s) of the decline.
 | ST | <-10% |
| 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. If the GCC <150%, has there been a change from prior year? If so, determine the cause(s) of the change. If the GCC was <150% in the prior years also, consider more carefully the causes.
 | ST | >10 pts or <-10 pts |
| 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”, the analyst should proceed with procedure step 2, evaluating decreases in total available capital and/or procedure step C, evaluating increases in leverage to determine the cause(s) of the negative trends.

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

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

Unlike step 1, the intent of the step 2 (and 3) is to determine the actual source of the negative issues. However, unless obvious from the information obtained in step 2, the analyst should proceed to step 5 to understand more fully the actions being taken by the group to address the issues identified in step 2. However, in some cases, it’s 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 are known to all of the regulators utilizing the GPS.

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|  | *Branded Risk* | *Benchmark* |
| 1. Review the GCC ratio 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 lead to 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 from 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 that 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 lossesoccured, but the likely near-term future 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, 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-Evaluate 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 the 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 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 writings or exposure (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.

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|  | *Branded Risk* | *Benchmark* |
| 1. Review the GCC ratio 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.
 | 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 to understand more fully the actions being taken by the group to address the issues identified in step 3. However, in some cases, it’s 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 are known to all of the regulators utilizing the GPS.

## Procedure Step 4-Evaluate 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 or the likely future needed capital allocation patterns. 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 need capital and which entities have capital that can be provided. 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, but rather a change in strategy (e.g., increased writings at one company over another). These trends can also assist in discussions with the group on 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 in this area and in some cases may provide greater detail.

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|  | *Branded Risk* | *Benchmark* |
| 1. Review the data from the GCC 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 it’s possible any of the insurance companies will be required 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 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 to reverse a single negative trend.**

Steps 5 is designed to assist a review of the insurance company’s plans for addressing any meaningful decreases in the GCC ratio or total available capital. The specific plans of the group may or may not fully address all the issues but 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, 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. Similar to other areas, where similar information is also disclosed in Form F, further information may already be known in this area.

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|  | *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 trends 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 into 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 takes 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 inadequate to 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 |