

NAIC Group Capital Calculation Recommendation

Adopted by the ComFrame Development and Analysis (G) Working Group – Oct. 30, 2015

Adopted by the International Insurance Relations (G) Committee – Nov. 19, 2015

BACKGROUND

State insurance regulators currently perform group analysis on all U.S. insurance groups, including assessing the risks and financial position of the insurance holding company system based on currently available information; however, they do not have the benefit of a consolidated statutory accounting system and financial statements to assist them in these efforts. A consistent method of calculating group capital for typical group risks would provide a very useful tool for state financial regulators to utilize in their group assessment work. A group capital calculation could serve as a baseline quantitative measure to be used by regulators in conjunction with group-specific risks and stresses identified in ORSA filings as well as risks identified in Form F filings that may not be captured in legal entity RBC filings. A group capital calculation would thus be another valuable tool to complement our legal entity focused solvency assessments.

During the course of several open meetings and exposure periods, the ComFrame Development and Analysis (G) Working Group (CDAWG) has considered a discussion draft which included three high level methodologies for the group capital calculation: an RBC aggregation approach, a Statutory Accounting Principles (SAP) consolidated approach, and a Generally Accepted Accounting Principles (GAAP) consolidated approach. On September 11, 2015, the CDAWG members unanimously approved a motion to move forward with developing a recommendation for a group capital calculation and directed attention to deciding on an appropriate high level methodology for the recommendation.

At a CDAWG meeting on September 24, 2015, pros and cons for each methodology were discussed, and a consensus quickly developed in support of using an RBC aggregation approach if a group capital calculation were to be developed. The CDAWG unanimously approved a motion to develop a concept paper that proposes the RBC aggregation method for a group capital calculation in its recommendation to NAIC Executive/Plenary.

RECOMMENDATION

To continue the NAIC’s work on developing regulatory tools for insurance group capital assessment and oversight, the CDAWG recommends the NAIC Executive/Plenary adopt the following charge for the Financial Condition (E) Committee:

“Construct a U.S. group capital calculation using an RBC aggregation methodology; liaise as necessary with the ComFrame Development and Analysis (G) Working Group on international capital developments and consider group capital developments by the Federal Reserve Board, both of which may help inform the construction of a U.S. group capital calculation.”

The RBC aggregation approach would build on existing legal entity capital requirements where they exist rather than developing replacement/additional standards. In selecting this approach, it was recognized as satisfying regulatory needs while at the same time having the advantages of being less burdensome and costly to regulators and industry, respecting other jurisdictions’ existing capital regimes, and likely being the quickest approach to develop and implement. In order to capture the risks associated with the entire group, including the insurance holding company, RBC calculations would need to be developed in those instances where no RBC calculations currently exist.

While there are clear benefits to this approach, there are also challenges and key decisions that will need to be addressed by the (E) Committee. Those that are already apparent include:

1. **Scope and scalability:** The presumption is that the approach would cover all legal entities within the group, including the holding company. A determination would need to be made as to whether such a

calculation would apply if the group capital calculation did not add regulatory value for a certain size or type(s) of groups.

2. **Method for Including Non-RBC Filers and Non-insurance Entities:** A decision will need to be made on how to aggregate the legal entity capital requirements from other jurisdictions as well as what to do with legal entities that have no existing capital requirements. Below are some examples of potential options:

Legal Entity Insurers Not Subject to RBC

- Utilize existing jurisdictional RBC requirements. This has some practical advantages, but would require a conclusion about the adequacy and consistency of the jurisdictional requirement with RBC. Alternatively, potential adjustments may be considered to achieve greater consistency before aggregation. This approach would also require removal of any portion of that entity that is already included within an RBC filing in order to avoid double counting of risks.
- Utilize a flat factor for the capital of, or the ownership interest in the non-U.S. insurers. For example, a factor of 50% of the ownership interest is used in the Property/Casualty RBC formula for directly owned alien insurers.
- Apply the U.S. RBC formula to non-U.S. insurers. This would involve additional work to consider how non-U.S. products align with U.S. products in RBC.

Non-insurance Entities

- Utilize existing sectoral requirements for other financial entities (e.g., Basel III for banking entities) and decide on an approach for non-financial entities.
- Apply existing U.S. RBC treatment for all non-insurers not already included in a U.S. insurer's RBC calculation. While this would make use of existing RBC calculations, it would require consideration of any differences in RBC treatment for these entities between Life/P&C/Health formulas.

Any of these options may require the collection of additional data from the U.S. insurance groups.

3. **Going vs. Gone Concern:** U.S. RBC is based on conservative statutory accounting which is somewhat more consistent with a gone concern view of financial strength than is the case for other accounting regimes. Regulators would need to determine whether the group capital calculation should target a similarly conservative view or whether greater emphasis should be placed on a going concern view. If more of a going concern view is desired, consideration needs to be given as to what potential adjustments would be appropriate to the RBC factors and/or calibration or whether the application of stresses could be useful for these purposes.
4. **Treatment of Subordinated Debt:** Though typically a liability of the entity holding the debt, contractually subordinated debt can sometimes be a form of capital. Surplus notes are an example of this in statutory accounting, which is applicable to insurance legal entities. In addition, there is also the concept of structural subordination which limits the ability of a holding company's debtors from accessing the assets of its subsidiary legal entity insurers. Regulators will need to determine whether and to what extent a holding company's senior debt will be counted as a component of available group capital.
5. **Eliminations to Avoid Double Counting and Other Adjustments:** Since each legal entity would be aggregated, ownership in subsidiary, controlled and affiliated (SCA) companies will need to be reviewed for potential elimination. Depending on decisions made in developing the RBC aggregation group capital calculation, other SCA transactions may need to be considered for adjustment as well. Similarly, when aggregating available capital for each legal entity, eliminations and adjustments will need to be considered.
6. **Stress Testing:** Consideration should be given to how stress testing could be used to complement a group capital calculation.

It is worth noting that in addition to this concept being a useful group supervision tool, CDAWG members believe the lessons learned and information garnered from the NAIC developing and implementing a group capital calculation will be useful in our continuing efforts on group capital standards work. For instance, at the domestic level, this may be useful with respect to the Federal Reserve Board's work on developing group capital requirements for the various domestic insurance groups for which it has regulatory authority. At the international level, the CDAWG has been reviewing and contributing to International Association of Insurance Supervisors (IAIS) discussions regarding the development of group capital requirements for internationally active insurance groups (IAIGs), including a global insurance capital standard (ICS). Last fall, CDAWG members began exploring potential approaches rooted in the national system of state-based insurance regulation that could provide a basis for compatibility with IAIS proposals. In recognition of the relevance of a group capital view for state insurance regulators, CDAWG paused this work and determined that state insurance regulators should first consider establishing a group capital calculation as an additional regulatory tool for US group supervision. Thus the group capital calculation is *not* intended to be an ICS, but nevertheless should help inform such discussions and developments.