

Group Solvency Issues (EX) Working Group
Group Capital Assessment Proposal

For U.S. Compliance with the International Association of Insurance
Supervisors (IAIS) Insurance Core Principles (ICP) on Group Capital and
To Observe Financial Sector Assessment Program Recommendations

Introduction

In the wake of the financial crisis, it became clear that U.S. state insurance regulators needed to be able to assess the holding company's financial condition, as a whole, and its impact on an insurer within the holding company system. Specifically, during the 2009 International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP) of the United States (U.S.), there were recommendations that U.S. supervisors should expand assessment of the financial condition of the whole group of which a licensed insurance company is a member. Per the IMF, this assessment might involve quantitative techniques and practices in use internationally. Additionally, as defined in IAIS ICP 1, the IAIS Principles on Group-wide Supervision require that capital adequacy should be assessed on a group-wide basis. Fortunately, the IAIS recognizes numerous approaches to group capital assessment to meet compliance with the principle and standards. After considering various options during the NAIC 2010 winter National Meeting, the Group Solvency Issues (EX) Working Group agreed to utilize the Own Risk and Solvency Assessment to the means to provide confidential information to state insurance department regulators to regularly perform an analysis of the group's financial condition and risks via review of the holding company system's target capital position. The following document explains that proposed assessment.

NAIC Proposed Group Capital Assessment for ORSA

On an annual basis, all U.S. based insurance legal entities that are part of a insurance holding company system as defined by *NAIC's Insurance Holding Company System Regulatory Act (#440)*, must provide a group capital assessment within their confidential ORSA for the previous period year-end. This information will also be required upon regulator request throughout the year, if needed.

The holding company system may use a consolidated or aggregated approach for the group's capital assessment. However, if several U.S. insurance legal entities are within the same holding company system, then those affiliated U.S. insurers must agree to utilize the same approach.

Using a consolidated approach to group capital assessment, the insurance holding company system will be considered a single integrated entity for which a separate assessment is made for the group as a whole. Risks from non-insurance members, partially-owned entities and off-balance sheet activities of the group are considered and

require different assumptions in the calculations. Consolidated methods have the advantage that intra-group holdings wash out but the disadvantage that the group is not actually one single entity.

On an aggregation approach to group capital assessment, the holding company system can sum legal entity surpluses/deficits, requiring adjustment for intra-group holdings, or sum the legal entity capital requirements and available capital (“capital resources”). Aggregation approach has the advantage to measure companies as they legally exist, but require adjustment for cross-border/cross-sectoral calculations where different valuations and capital requirement methodologies exist. The approach might also provide insight into the capital position of non-regulated entities, where there is a lack of existing capital standards.

Specifically, as a minimum, the approach and assessment of group-wide capital adequacy should consider the following:

- Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.
- Take account of the level of leverage, if any, resulting from holding company debt.
- Clearly identify diversification credits and adequately address restrictions on the fungibility of capital within the holding company system, including the availability and transferability of surplus resources created by holding company system level diversification benefits.
- Reflect the affects of contagion risk, concentration risk and complexity risk in their group capital assessment.

Most importantly, the goal of the assessment is to provide an overall determination of capital needs (i.e. “target capital”) for the holding company system, based upon the nature, scale and complexity of risk within the group. Group capital should not be perceived as the minimum amount of capital before regulatory action will result (e.g. US risk-based capital for insurance legal entities); rather, it should be recognized that this is the capital needed within a holding company system to achieve the group’s business objectives.