NAIC Group Capital Calculation Post Field Testing Staff Input

May 19, 2020

Key Decisions

- Scope of Application and Calibration
- Grouping and De-stacking of Financial and Non-financial Subsidiaries
- Treatment of Financial Entities without Regulatory Capital Requirements
- Treatment of Non-insurance / Non-financial Entities
  - Schedules A and BA
- Allowance for Capital Instruments as Additional Capital
- XXX / AXXX
- Choice of Scalars
- Applying Sensitivity Analysis

Scope of Application (Instructions pages 6-8, 15-16)

- Unchanged: Starting Point is the Ultimate Controlling Party and all Entities Within the Group (Schedule Y) in Alignment with the HCA
- Staff supports the following:
  - A consistent set of principles for establishing the scope of application of the GCC ratio based on evaluation of all entities within the group
- Working with the lead-state regulator a reduction or limit on the scope of entities to be included may be accomplished in most instances via request by the Group to exclude certain non-financial entities that do not pose material risk
  - The lead-State may accept the request for all or some entities while rejecting it for others
  - In some cases of large decentralized groups a reduction in scope of application up front may be requested
    - It is preferable that the regulatory evaluation of such requests is based on established guidance (Examples include materiality of risk; structural separation; no history of cross subsidies, or other criteria supporting regulatory judgement)
    - Group requests for reducing the scope of application of the base GCC should be based on defined criteria documented and applied by the Group
    - Rationale for lead-State acceptance of the request should be documented with information on excluded entities made available upon request of the regulator

Scope (cont.) and Calibration Level

- Scope – Cont.
  - Collecting information on criteria and rationale are important to support future improvements to the Base GCC
  - No single suggestion for a threshold for materiality had consensus from the field test volunteers
- Suggested Base Calibration Level:
  - All RBC filers capital calculations will be Included in the Base GCC ratio at 300% x ACL RBC (Trend Test Level)
  - Capital calculations for all entities that are subject to scaling based on RBC levels will use the trend test RBC Level

Grouping and De-Stacking (Instructions Pages 14-15)

- Unchanged: Continue to Allow Grouping of Financial Entities without a Regulatory Capital Requirement Using Current Criteria
  - Same business type
  - Same accounting basis
- Suggested Change: Allow grouping for Non-insurance / Non-financial Entities Not Owned by RBC Filers or Financial Entities with a Regulatory Capital Requirement for those Entities
- Suggested Change: Do Not Require De-Stacking of Non-insurance / Non-financial Entities Owned by Either RBC Filers or Financial Entities with a Regulatory Capital Requirement that Includes a Capital Charge
- Suggested Change: Use RBC of UCP Mutual Insurer at 300% x ACL RBC Calibration with Only Financial Affiliates De-stacked
  - If no financial entities in the group, then TAC and RBC of top mutual is all that is required in the Inventory Tab
  - Data for other schedules still required for each grouping or entity as applicable

Capital Calculation For Financial Entities

(Instructions pages 9, 29-30)

- Staff Suggestion is That all Financial Entities within the Larger Group should be Included in the GCC
  - Subject to further discussion / discretion based on the breadth of definition of a financial entity

- Suggested Changes: Options for Financial Entities Without Regulatory Capital Requirements Reduced to 2
  - Retain Basel op risk type charge applied to 3 years average gross revenue
    - Current charge is 12% but Basel moving to 15%
  - Option: Scaled version of the charge based on Average RBC ratios
    - Currently 4%, but could increase to close to 5% based on 15% full Basel charge
  - Suggested Change: Consider treating all financial entities without regulatory the same (incl. asset managers)
    - Decision on full vs. scaled charge may be dependent on the breadth of entity types that are classified as financial entities
  - Impact: Minor since field test Base Ratio used 12% and Tested scaled charge with scaled version also tested

Capital Calculation For Non-Financial Entities (Page 30)

- Suggested Change: Capital Charges for Non-insurance / Non-financial Entities Reduced to 2 Approaches (one in Base GCC and another for information)
  - Consider applying a 7% equity charge (based on average post covariance charge on this entity type in RBC) or tailor the equity factor by insurer type
  - Alternate Option: Apply a 3 - 5% risk charge to reporting year gross revenue or tailor the factor by industry type
    - Note: The two alternatives above only apply to non-financial entities not owned by RBC filers or by financial entities with a regulatory capital requirement
    - Impact: The equity charge is lower than what was used in the field test base ratio and the revenue charge is not significantly different from what was tested
  - Suggested Change: Consider treating all non-insurance / non-financial entities the same
    - Option: Apply either the equity or revenue charge based on the nature of the non-financial entity operating activities

- Non-operating Hold Cos:
  - Suggested Change: Apply same equity charge used for other non-insurance / non-financial entities (7% or tailored)
  - Discuss positive value only vs. netting (also consider for non-financial entities)
  - Impact: More than the zero-value used in field test base ratio, but less than alternative equity charge of 22.5% applied in field test. Netting decreases the impact further.

Capital Instruments (Instructions pages 35-37)

- Suggested Change: All Capital Instruments to be Reported in this Tab and Adjusted for GCC Allowance Purposes
  - No longer reported in Schedule 1
- Suggested Change: Include Allowance for Additional Capital in Base GCC Adjusted for any Double Counting
  - Exception: No allowance should be calculated where the lead-State accepts a GCC submission that excludes the UCP issuer of the debt
  - Question: Should HC values reported be adjusted for debt allowance for purposes of a capital calculation?
- Two Step Approach
  - Step 1 - Down-streamed comparison (Similar to what was used in field test)
    1. Tracked based on criteria (New - Criteria to be Suggested)
    2. Total paid–in and contributed capital and surplus from insurer annual statements (New item in Template)
    3. Larger of two items above is carried into step 1

Capital Instruments – Cont. (Instructions page 37)

- Two Step Approach
  - Step 2 - Proxy Allowance (Recommended selection from field test Options)
    1. Qualifying Senior Debt @ 30% x (Total Adjusted Carrying Value from Inventory B + Outstanding Senior and Hybrid Debt)
    2. Qualifying Hybrid Debt @15% x (Total Adjusted Carrying Value from Inventory B + Outstanding Senior and Hybrid Debt)
- Larger of Step 1 or Step 2 Becomes Additional Capital Allowance (Subject to Max = 100% of Outstanding Senior and Hybrid Debt – Same as field test)
- Suggested Limits on Allowance:
  - Overall additional allowance can be no more than 50% of total adjusted carrying value in Inventory B (field test applied limit of 100%)
- Impact: Of 24 Volunteers that Reported Senior and / or Hybrid Debt, 6 Could Not Include 100% of Their Qualifying Debt as Additional Capital.
  - 3 of the 6 could not include more than 10% of their outstanding senior and hybrid debt (11% - 27%)

Capital Instruments – Cont. (Instructions Page 37)

- Suggested Criteria for Down-streamed tracked
  - Evidence of infusion of proceeds
  - Description of the method used for tracking the proceeds
  - Explanation of excess over what is reported as paid-in and contributed capital and surplus
  - Default is paid-in and contributed capital and surplus
- Based on Impact Analysis staff suggests that the Working Group Consider Replacing the Down-streamed Option Altogether in Favor of Defining Paid-in Capital and Surplus as Structurally Subordinated Down-streamed Debt in Step 1
- No allowance for debt Classified as “Other”
  - Description provided in Capital Instruments Tab Tab
  - Other debt may be included in Sensitivity Analysis @ 15% x (Total Adjusted Carrying Value from Inventory B + Outstanding Senior, Hybrid and Other Debt)
  - Use information collected to determine if qualifying criteria can be established.

XXX / AXXX Assets and Liabilities

- Suggested Change: Provisionally Exclude Sensitivity Analysis for XXX / AXXX Captives from the GCC Template upon referral to an E Committee Group or Subgroup for Further Risk Assessment / Data Collection Associated with Implementation of Economic Reserves and Recognition of non-SAP assets as available capital
  - With particular focus on review of grandfathered XXX/ AXXX captives
- Sensitivity Analysis (Based on Field Test Method 3) to be Removed from the GCC Template Once the Appropriate E Committee Group or Subgroup is Identified and an Agenda is Adopted

Scalars (Instructions pared to reflect the selected method)

- Suggested Change: Apply Pure Relative Ratio Option at 300% RBC Calibration in Base GCC for Jurisdictions Where Data is Available
  - Separated UK from EU and added new jurisdictions
- Other Jurisdictions
  - Use 100% of the capital requirement at PCR level in Base GCC
- Treatment for regimes without capital requirements
  - For discussion: Suggestions during field test made to set calc capital of between 50% and 100% of available capital in Base GCC
- Continue to Explore Other Potential Methods for Scaling (in conjunction with similar work for ICS – AM)
- Impact: Any Current Scalar (except Japan) Increases the GCC Ratio Compared to the Base Ratio in the Field Test which used 100% Values
  - Any new options would need to be evaluated as to impact on the GCC ratio

Suggested Change: Sensitivity Analysis Tab Added

(Instructions pages 38-39)

- Sensitivity Analysis is Available on an Informational Only Basis to Assess the Capital Impact of Various Adjustments
- The Analysis will Not Impact the Base GCC Ratio
- Main Sensitivity Analyses include:
  - **XXX / AXXX adjustments**
    - **Sensitivity analysis will apply Method 3 from the field test**
  - **Permitted and prescribed practices**
    - **Sensitivity analysis excludes values for permitted and prescribed accounting practices along with associated capital charges**
  - **Foreign insurer capital requirements unscaled**
    - **Sensitivity analysis includes all jurisdictions at 100% PCR requirement**
  - **Alternative calculated capital**
    - **Financial entities without a regulatory capital requirement**
    - **Non-financial entities**

Sensitivity Analysis – Cont. (Instructions pages 38, 39, 42)

- Type 2: To evaluate Data to Inform Potential Future Criteria:
  - **Excluded entities**
    - **Sensitivity analysis will exclude entities requested by the filer but not accepted by the lead-State**
  - **Additional capital allowance for capital instruments classified as "Other"**
    - **Sensitivity analysis will include an additional allowance for capital instruments designated as "Other"**
  - **Other regulator discretion**
    - **This will allow Regulators to adjust valuation for intragroup transactions where there is a question as to appropriate reserve, investment or other valuations compared to statutory accounting values**

Other Information (Instructions Pages 43-44)

- Material Risk Definition Applied by Lead-State to Approve Reduced Scope of Application
- Intangible Assets
- Currency Adjustments
- Methodology for Tracking Down-streamed Debt (if Down-streamed Debt Category is Retained

Suggested Changes: Schedule 1 (Instructions pages 17-21)

- Instructions
  - Added entity categories to the entity type chart
  - Clarify required entries in Schedule 1B, Column 16 (Treatment for RBC purposes)
  - Eliminate most alternative capital calculation options used in the field test and underlying data
  - Clarify entity categories, particularly for regulated vs. non-regulated financial entities and affiliate entity types
- Data Removed
  - Financial strength ratings
  - Assumed and ceded premiums
  - Debt (all debt moved to Capital Instruments Tab)
  - Intergroup capital maintenance agreements , contracts and guarantees (moved to Other Information Tab)
  - Most field test capital calculation options for financial and non-financial entities along with supporting data (few remaining moved to inventory Tab)
- Data Added
  - Surplus / equity reconciliation
  - Dividends paid and received
  - Capital contributions paid and received
  - Intra-group reinsurance assumed and ceded
  - Other data needed to support new analytics tab

Suggested Changes: Inventory Tab (Instructions page 25)

- Instructions
  - Added charts to instructions regarding carrying values to be reported in Columns 1 and 2 of Inventory B and Inventory C (parent and local carrying values / capital calculations) **[Pages 23 & 31]**
  - Added examples for financial entities without a regulatory capital requirement and for non-financial entities
  - Added examples for financial vs. non-financial subsidiaries of insurance companies

- Template
  - Add column (+ instructions) for accounting adjustments (e.g. GAAP to SAP and or other regulatory adjustments
  - Add columns for revenue-based options (moved from Schedule 1)
  - Remove permitted and prescribed practices columns (moved to Sensitivity Analysis Tab)

Suggested Other Changes

- Attestation Added **[Instructions Page 11]**
- Analytics and Guidance to be Added **[Separate doc]**
  - Addresses use of GCC
  - Uses data collected in the template
  - Guidance and instructions to be reviewed concurrently with revised template / instructions
- Potential Changes to Informational Grouping Alternative and Instructions (Working with some IPS)