AGENDA

1. Consider Adoption of its July 21, June 2 and May 19 Minutes — Commissioner David Altmaier (FL) Attachments 1a, 1b and 1c

2. Consider Comments Received on an Exposed Revised Template & Instructions — Lou Felice (NAIC) Attachment 2
   a. Summary of Comments
   b. Combined comment Letters — Attachment 3

3. Discuss Any Other Matters Brought Before the Working Group — Commissioner David Altmaier (FL)

4. Adjournment
Group Capital Calculation (E) Working Group
Conference Call
July 21, 2020

The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met via conference call July 21, 2020. The following Working Group members participated: David Altmaier, Chair (FL); Kathy Belfi, Vice Chair (CT); Kim Hudson (CA); Philip Barlow (DC); Carrie Mears, Mike Yanacheak and Kim Cross (IA); Shannon Whalen (IL); Roy Eft (IN); Christopher Joyce (MA); Judy Weaver (MI); Fred Anderson (MN); John Rehagen (MO); Jackie Obusek (NC); Justin Schrader and Lindsay Crawford (NE); Dave Wolf (NJ); Edward Kiffel and Bob Kasinow (NY); Dale Bruggeman (OH); Joe DiMemmo (PA); Trey Hancock (TN); Doug Slape and Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Discussed Further Modifications to Exposed Exemptions

Commissioner Altmaier stated his appreciation for the comments received (Attachment B-1) on the Working Group’s previously exposed proposed changes to the Insurance Holding Company System Regulatory Act (#440). He said that NAIC staff had developed a revised Model #440, which incorporates changes to address many of the comments, and that this conference call will be specifically focused on those comments that either did not have specific language or would represent a change from the Working Group’s previously developed intent. He stated those comments for which the Working Group believed further changes should be made would be incorporated in the revised Model #440 and re-exposed. He asked Dan Daveline (NAIC) to summarize each of the comments along with a recommendation disposition, and then allow the Working Group to decide on each.

   a. Specificity of Exemptions

Mr. Daveline said that Texas recommended in its comment that the Working Group consider giving the insurance commissioner the authority to provide exemptions by rule and moving some of the more detailed exemptions that may be adjusted in the future into a regulation. He said the exemption criteria, and in particular those where commissioner discretion is allowed, is very detailed and that moving such to a model regulation seemed reasonable. Ms. Walker said how the request would be particularly helpful in this time of regulatory fatigue, particularly knowing that some of these changes would require quick adoption, especially in her state where the legislature does not meet annually. Commissioner Altmaier stated he does not oppose the movement of some of the items highlighted and shared some of the concerns of Texas. Mr. Hudson noted how this was consistent with other models and said that California is not opposed to the change. No Working Group members disagreed with the change.

   b. Additional Discretion to Waive Schedule 1

Mr. Daveline said that this comment relates to a request for the insurance commissioner to be able to waive the Schedule 1 filing if he or she does not believe it provided value. Mr. Daveline noted that NAIC staff appreciated that with some small groups, the Schedule 1 may not provide the state insurance regulator the value desired, and for that reason proposed language that could be used in the revised Model #440 to provide this discretion. Commissioner Altmaier asked Jonathan Rodgers (National Association of Mutual Insurance Companies—NAMIC) if the proposed resolution addressed their issue. Mr. Rodgers stated the language seemed reasonable but added that he would like to consider the language more closely during the comment period. However, he said he believes it was positive toward addressing their comment. No Working Group members disagreed with the change.

   c. Development of a Process for Recognizing and Accepting the GCC by Another Jurisdiction

Mr. Daveline said that the comments on this issue were extensive. He noted that NAIC staff agreed with the concept of the comment and more specifically the need to develop a process and an NAIC Working Group responsible for maintaining a list of jurisdictions deemed to have recognized and accepted the group capital calculation (GCC), although there was no specific action that needed to be taken at this time. Mariana Gomez-Vock (American Council of Life Insurers—ACLI) emphasized the need for a transparent process in terms of how decisions are made and asked if this issue would be fleshed out in the regulation. Commissioner Altmaier stated he appreciates the need for such a process and referenced the work done on reinsurance as a possible blueprint to follow for consistency sake. No Working Group members disagreed.
d. Initial Filing of the GCC

Mr. Daveline said that the comment seemed to question the need for an initial filing of the GCC before the insurance commissioner has the discretion to exempt a group going forward. He noted that he believes the Working Group’s rational for the initial filing to suggest obtaining one filing would enable the state insurance regulator to better assess on an individual company basis whether the calculation would provide information that was of value, thus making it more easy for the state insurance regulator to more confidently exempt the group going forward. Tom Finnell (America’s Health Insurance Plans—AHIP) stated he was seeking clarity and having received that, AHIP has no further comments. No Working Group members were opposed to not making any further changes for this issue.

e. Exemption for Non-U.S. Groups

Mr. Daveline said he believes one of the comments was addressed through incorporation of proposed language from another commenter that was incorporated into the revised Model #440. Jeff Johnson (John Hancock) stated the language incorporated into a revised Model #440 aligns with the concepts John Hancock was attempting to address and at this point, they have no further comments. No Working Group members were opposed to not making any further changes for this issue.

f. Broad Definition of Financial Entity

Mr. Daveline said this comment was focused on the broad definition of a financial entity within the GCC instructions. He noted, however, that the exemption limitation is very narrow and only applies to financial entities that are subject to a specified regulatory capital framework. He stated NAIC staff did not suggest incorporating further specificity and did not believe any further changes were needed. Mr. Finnell stated the concern was that the broad definition may somehow prevent a group from availing themselves of an exemption, but after looking at the language further along with the description, he said AHIP had no further comments at this time. No Working Group members were opposed to not making any further changes for this issue.

g. Limit Sharing of the GCC Information

Mr. Daveline said this was an informal comment made during the course of communicating with various parties on the confidentiality language. He said the comment suggested the GCC could only be shared with members of a supervisory college. Mr. Daveline said that while he is not certain the GCC itself will actually be shared by the lead state with other domestic states, information from the GCC definition will through the Group Profile Summary. As a result, the suggestion to limit the sharing seems problematic, and he noted that NAIC staff believe existing state confidentiality language around the examination and analysis process should be sufficient for such sharing. Commissioner Altmaier reinforced that while the Working Group is very supportive of confidentiality protections, this does seem to be too limiting. Michael Gugig (Transamerica), representing the Coalition, stated the Coalition appreciates the points and have no further comments on this issue. No Working Group members were opposed to not making any further changes for this issue.

h. Expand Exemptions

Mr. Daveline said this comment suggested adding an additional exemption for companies with premium thresholds of $100 million. He said the current exemptions already allow groups of this size to be exempted if further conditions are met, and also noted NAIC staff had some concern with further modifications that could create a conflict with the covered agreement. Mr. Rodgers stated that given the previous additional flexibility added, he has no further comments given that seemed to address the very small mutual insurance companies that this comment was also directed at. No Working Group members were opposed to not making any further changes for this issue.

i. Confidentiality Language

Mr. Daveline said this issue was related to a very small part of the confidentiality language at the end originally developed by the Coalition. He said he believes the existing language that described the GCC as a regulatory tool for assessing group risk is accurate, even though he appreciates the fact that the tool is then used to evaluate the impact on the insurer. Mr. Rodgers noted NAMIC believed it was another tool to be used for evaluating solvency on the insurers’ risk given legal entity regulation is what drives the GCC but stated he had no further points. No Working Group members were opposed to not making any further changes for this issue.
j. **Commissioner Authority for Further Exemptions**

Stephen Broadie (American Property Casualty Insurance Association—APCIA) said the APCIA recommends the Working Group incorporate more broad discretion for unique circumstances similar to language in the *Risk Management and Own Risk and Solvency Assessment Model Act (#505)*. He mentioned an example where there was one insurer above the $1 billion premium threshold, but only had one other affiliate that had de minimis business. Mr. Daveline noted NAIC staff were concerned about a potential conflict with the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” (EU Covered Agreement). Mr. Finnell noted AHIP’s position is different from ACPIA’s but could be used as regulatory guidance in further considering exemptions under the specific thresholds. No Working Group members expressed an interest in considering incorporation of the language from Model #505. However, Commissioner Altmaier stated he is willing to further consider the comments and, to the extent agreeable, consider further changes to the revised proposed Model #440.

k. **Deleting Language from Section 8 That Applies to Rest of Model #440**

Mr. Daveline said that during the course of communicating with various interested parties in the interim on the confidentiality language, it was noted that some parties recommended deletion of language that already pertains to other aspects of Model #440 and how NAIC staff had always sought out not making any changes to the existing confidentiality protections. Therefore, NAIC staff recommended no further changes as suggested by some that may remove such protections. He noted that this did not mean some of the language could not be applied specifically to the GCC and that perhaps such consideration could be given by parties in the forthcoming re-exposure of Model #440. Mr. Ridgeway agreed with Mr. Daveline’s characterization of the process under which NAIC staff worked with various parties to try to simplify the confidentiality language where “less is more” when it comes to state legislatures that would be asked to consider the model. He described how Model #505 had become the gold standard in terms of confidentiality protections and that the NAIC would be wise to consider some of those same provisions for other sections. He stated during the re-exposure, he would continue to review the language and work with NAIC staff to continue to improve. No Working Group members disagreed with making no changes.

l. **Reciprocity Issue**

Mr. Daveline directed the Working Group to language proposed by Reinsurance Group of America (RGA), which was exposed since it incorporates the aspect of reciprocity as discussed during the Working Group’s June 2 conference call. He said that the proposed language modifies the language dealing with exemptions for non-U.S. groups by specifying those exemptions shall not apply if the non-U.S. groupwide supervisor requires subgroup reporting. He indicated the Working Group has discussed subgroup reporting in the past and that it was not intended for the GCC in that it would not provide value. However, this language indicates subgroup reporting only comes into play if the non-U.S. group reporting requires subgroup reporting.

Michael Demuth (Allianz) stated Allianz is supportive of efforts to reduce regulatory burden. However, he said the proposal has a series of practical issues that Allianz believes should be taken into consideration before making a final decision since it could create practical and legal challenges, which could create problems both for Allianz and the entire industry.

Mr. Broadie stated the APCIA had two goals: 1) It strongly believes each insurance group should be subject to only one GCC and that should be a parent level and none should be applied at the subgroup level; and 2) it strongly supports reciprocity and the concept of mutual recognition and a level playing field. He stated the APCIA does not support the language and if it was included in the model, language would have to be developed for clarity. He stated the NAIC can develop a transparent process for determination if reciprocity does not exist at the subgroup level and should include coordination with international colleagues with the intent of supporting mutual recognition to get to a place that each group is only submitting one GCC, whether a U.S. group or non-U.S. group.

Matthew Wulf (Swiss Reinsurance Group) stated Swiss Reinsurance Group believes these questions of reciprocity should be asked and discussed with state insurance regulators. He said they understand the goal of the GCC and the insurance capital standard (ICS) and that there are broader goals. He noted there is a great deal more that needs to be laid out and determined but should not be included due to the legislative fatigue. He said he is not sure what the current proposed language means. He said this does not apply to troubled companies and that there are so many reasons why this is not practical and is too cumbersome.

Joseph Sieverling (Reinsurance Association of America—RAA) agreed with the previous commenters on the practical concerns. He said the RAA supports one group capital at the group level, but one thing that is unclear are the facts on the ground—whether many, or some or lot, or one jurisdiction actually report subgroup reporting for U.S. groups. Ultimately, he
said it comes down to the supervisory purpose, and there really is no supervisory purpose of subgroup reporting. He said putting subgroup reporting into the model to try to get reciprocity is just the wrong way to approach this issue.

Ms. Gomez-Vock said the ACLI worked very hard with its members to try to reach an agreement that was actually unanimously agreed upon. She said this includes one group capital at the group level and that subgroup regulation is undesirable. However, the ACLI ultimately came back with supporting the reciprocity provision as long as it is supported by a transparent process and equitable to insurers in all jurisdictions. She said this issue went all the way up to the chief executive officers (CEOs), where it was still unanimously supported.

Ian Adamczyk (Prudential Financial) said Prudential Financial fully supports the concept of mutual recognition across supervisory regimes, but as internationally active insurance groups (IAIGs), that should include recognition and accepting the GCC as part of that support. He stated this should be included in the model act because: 1) it would further the objective of mutual recognition; 2) it is an overarching concept that sets an expectation; and 3) it would help promote consistency across the states. He stated Prudential Financial acknowledges there are some practical considerations, but there are solutions that could be implemented for all parties. Commissioner Altmaier stated the language was included in the draft as a means to generate discussion. He stated he expects further discussion but that timing would be dependent upon other factors.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.
The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met via conference call on June 2, 2020. The following Working Group members participated: David Altmaier, Chair (FL); Kathy Belfi, Vice Chair (CT); Kim Hudson (CA); Philip Barlow (DC); Carrie Mears, Mike Yanacheak and Kim Cross (IA); Susan Berry and Vincent Tsang (IL); Roy Eft (IN); John Turchi and Christopher Joyce (MA); Judy Weaver (MI); John Rehagen (MO); Jackie Obusek (NC); Justin Schrader and Lindsay Crawford (NE); Edward Kiffel (NY); Dale Bruggeman and Tim Biler (OH); Greg Lathrop (OR); Kimberly Rankin (PA); Trey Hancock (TN); Mike Boerner and Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Discussed Further Modifications to Exposed Exemptions

Commissioner Altmaier stated that the purpose of this conference call is for the Working Group to consider whether further modifications are needed to the previously exposed exemptions on who would be required to file the group capital calculation (GCC). He described how the Working Group had received quite a bit of feedback on those exposed exemptions in the form of comments letters (Attachment B-1) and that the intent is to work through the comments based upon themes, where he will seek input from Working Group members on their views of each of the themes.

a. Size Threshold

Commissioner Altmaier stated that the previously exposed exemptions did not include the concept of a size threshold, be that the comments overwhelming support the concept of a size threshold like that contained within the Risk Management and Own Risk and Solvency Assessment Model Act (#505). Commissioner Altmaier stated that he believes most of the state insurance regulators were of the opinion that the GCC would be a tool that would be helpful for analysts for any group regardless of its size or where it writes its business, but that the Working Group should think about its characteristics and when it would be most helpful. He noted that the Working Group may determine that it may not be most useful for all groups and that care should be taken with the approach. He stated he believes that groups that do not meet the size exemptions of the Own Risk and Solvency Assessment (ORSA) or have international business are the types where state insurance regulators would want the GCC to be completed. He stated, however, that beyond that, he would be open to a proposal that authorized state insurance regulator discretion for groups that did not meet such a threshold. He stated that while there are some individuals that may be concerned with that type of discretion without any guiding principles or criteria, it would be important for the Working Group to consider how best to effectuate.

Mr. Schrader stated he thinks this is an important issue and that regardless of what approach the Working Group takes, either all groups filing or some type of threshold, he believes it is important to have regulatory discretion to either include or exclude those that are outside of the normal given the unique groups that exist. He stated he thinks the ORSA threshold may be a bit high because there were many groups under that threshold that were fairly complex, but that he is in favor of getting for all groups since analysts are expected to perform holding company analysis on all groups. However, if the analyst or state insurance regulators feel there is no value for that company, then they should have the authority to waive them. He stated with commissioner discretion, there is a potential for either a lot of companies to be exempted or no companies exempted. Commissioner Altmaier stated that was a reasonable viewpoint, particularly in the early years, until a determination can be made on how helpful the GCC was.

Mr. Eft stated he is in support of an ORSA exemption, but authority to exempt others if deemed necessary, but not cast as wide of an approach as suggested by Nebraska. Ms. Berry stated that Illinois was of the view that they wanted a threshold closer to the ORSA along with making sure companies with international business would still be captured, but they also see value in an exception where smaller companies are allowed to just file a listing out the companies and some of the other related information, but not the actual GCC itself. Commissioner Altmaier stated that could be helpful in developing a compromise position. Ms. Belfi stated that after listening to Mr. Schrader and others, what she would really like to do as a regulator is eventually let her largest entities to be completing the GCC only and originally was in the camp of the ORSA threshold. However, after thinking about what Mr. Schrader said, she said she does not think it would be a bad idea to cast a wide net to take a one-time look at their group and learn about the risks of the group. Ms. Belfi stated the fact these groups do not complete an ORSA may be a reason to obtain the GCC at least once. Then going forward, if the GCC is not particularly helpful, they could be exempted.
Commissioner Altmaier stated that there appears to be a consensus at least for those that provided their views, and while he expects discussions will need to continue, it would be helpful to first receive a written proposal. He requested NAIC staff to draft language where initially everyone should file the GCC, but lead states should have the discretion to exempt groups below the ORSA and international threshold, but for those that are exempted requiring a filing of the information from the inventory tab of the GCC. He stated ideally, information could be obtained on the number of groups affected, recognizing states’ resources are important. He stated future discussion on guardrails would be helpful as well. Stephen Broadie (American Property Casualty Insurance Association—APCIA) stated the APCIA supports an ORSA threshold and will continue to do so and listen with interest. He suggested the Working Group note that it would be difficult to revise the exemptions given the Working Group is considering putting the exemptions in the Insurance Holding Company System Regulatory Act (#440). Commissioner Altmaier agreed and noted they would be sensitive to that fact.

b. **Accept the RBC Ratio as the GCC for a Top-Tiered RBC Filer**

Commissioner Altmaier noted that for this issue, there was dovetail with the GCC Instructions. Therefore, he said he would like to postpone this discussion until after the exposure period on the GCC Instructions ends in the second half of July.

c. **Accept the RBC Ratio as the GCC for a Top-Tiered RBC Filer**

Commissioner Altmaier stated the Working Group has discussed this issue in the past and has generally stated it would not be in favor of any duplicative regulatory requirements and be open to not requiring the GCC for groups that are required to complete the building block approach (BAA) and file with the Federal Reserve. He stated that if states can obtain a copy of the BBA, he recalls this being the past position. Mr. Boerner agreed with the statements by Commissioner Altmaier. Mr. Schrader stated that until state insurance regulators see what the BBA looks like, there may still be some value of obtaining a listing of entities and related financial information for these groups like the recommendation made for smaller groups as previously made by Ms. Berry. Mariana Gomez-Vock (American Council of Life Insurers—ACLI) stated the ACLI strongly supports this recommendation. She stated the BBA has a similar schedule as the Inventory and other Federal Reserve forms and was quite extensive. Dale Berry (TIAA) indicated the TIAA supports the recommendation and stated he does not believe there is much daylight between the GCC and the BBA. Ms. Belfi stated that it might be helpful for NAIC staff to provide a comparison between the GCC and the BBA.

d. **Reciprocal or Qualified Jurisdictions**

Joseph Sieverling (Reinsurance Association of America—RAA) stated that the RAA supports this exemption because it supports the premise that groups should be subject to a single group capital measure per their group-wide supervisor. Andrew Vedder (Northwestern Mutual) stated that Northwestern Mutual, along with New York Life and Travelers, are generally supportive of this exemption but had some nuances—specifically, looking at the ORSA allowance to make available comparable information that is available to the insurance group to make sure the lead state has the relevant information, which is consistent with the approach being taken by the Working Group on the BBA. He stated under 4(L)2C, the definition of a reciprocal jurisdiction currently does not exempt U.S. groups, and this could be fixed by inserting non-U.S. before group-wide supervisor. Ian Adamczyk (Prudential Financial) stated Prudential Financial’s position is nuanced. He said while it supports the one group and one group standard, Prudential Financial views that from the perspective of applying that exemption at the worldwide level and does not believe the exemption should extend to U.S. subgroups of foreign-based insurers with U.S. subgroups. He summarized the points from Prudential Financial’s comment letter on this subgroup. Kim Welch (Reinsurance Group of America—RGA) stated RGA agrees with the principle of one group capital measure per one group-wide supervisor but that it disagrees with the concept of subgroup reporting. She stated that while the issue is hypothetical now, RGA sees it as a real possibility, and it is concerned that the current wording does not allow a determination of reciprocity. She discussed the need for U.S. regulators to have leverage to encourage reciprocity. She also stated RGA has concerns with the reciprocity in the qualified jurisdictions being limited to reinsurance and, therefore, the exemption should be limited to reciprocal jurisdictions. Matthew Wulf (Swiss Reinsurance Group) stated Swiss Reinsurance Group does not agree with Prudential and whether those concerns come into play, not to mention the difficulty of drawing a box around companies for U.S. subgroups.
Mr. Rehagen stated he believes reciprocity is a very important issue and thinks this is something the Working Group should consider.

e. **Unintended Exemptions**

Ms. Gomez-Vock stated she believes the conversation, as well as the current draft, may have addressed this issue. She did, however, describe how at some point in time it might be helpful to have a memorandum that describes each of the exemptions and the rationale for each.

f. **Commissioner Discretion Concern**

Commissioner Altmaier noted that this issue may have already been raised and asked if there were additional issues that required further discussion at this time. Mr. Sieverling stated he believes Commissioner Altmaier already covered this but noted that if the focus was on either scoping groups out of the calculation, that would make things easier but certainly being more specific on the criteria is what would be needed. Mr. Broadie agreed with Mr. Sieverling.

g. **Commissioner Discretion Concern**

Commissioner Altmaier discussed the importance of this issue and how it is a driving force behind embedding the GCC into a model law. He stated one comment suggested the need to address the confidentiality of the BBA if filed with the lead state, and he said he believes this is a fair comment. He asked Ms. Gomez-Vock if the ACLI could send language to NAIC staff for further consideration. He noted America’s Health Insurance Plans (AHIP) seemed to suggest the current language seems to allow the sharing of the GCC with the International Association of Insurance Supervisors (IAIS). It was noted this would be taken up on a future conference call. Commissioner Altmaier also noted Prudential made some comments. Mr. Adamczyk summarized some of Prudential’s concerns taken from its comment letter. There was no reaction from Working Group members on these comments.

2. **Discussed Other Matters**

Commissioner Altmaier indicated NAIC staff had drafted a Frequently Asked Questions (FAQ) document and for individuals to be aware it will be posted. He also indicated that NAIC staff was intending to hold a webinar to those wishing to participate in understanding how the GCC is intended to work; it would not be an official meeting of the Working Group.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.
The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met via conference call on May 19, 2020. The following Working Group members participated: David Altmaier, Chair, and Ray Spudeck (FL); Kathy Belfi, Vice Chair (CT); Laura Clements (CA); Philip Barlow (DC); Carrie Mears, Mike Yanacheak and Kim Cross (IA); Susan Berry and Vincent Tsang (IL); Roy Eft (IN); Christopher Joyce (MA); Judy Weaver (MI); Constance Peterson and Barbara Carey (MN); John Rehagen and Karen Milster (MO); Jackie Obusek (NC); Justin Schrader (NE); Dave Wolf (NJ); Edward Kiffel and Mark McLeod (NY); Dale Bruggeman and Tim Biler (OH); Greg Lathrop (OR); Joe DiMemmo (PA); Trey Hancock and Hui Wattanaskolpant (TN); Mike Boerner and Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm and Levi Olson (WI).

1. Consider Adoption of its 2019 Fall National Meeting Minutes

Ms. Belfi made a motion, seconded by Mr. Bruggeman, to adopt the Working Group’s Dec. 7, 2019, minutes (Attachment A). The motion passed unanimously.

2. Consider the Exposure of the NAIC Staff Post-Field Test Recap of the GCC and Initial Suggested GCC Revisions

Commissioner Altmaier stated that NAIC staff would be presenting a PowerPoint (Attachment B-1) summarizing preliminary input and revisions resulting in adjustments to the draft revised group capital calculation (GCC) instructions (Attachment B-2) and a revised GCC template (Attachment B-3). He stated that the goal was to expose the documents for a 60-day public comment period, and the bulk of questions and comments should be handled via the comment period. He asked Lou Felice (NAIC) to begin the presentation.

Mr. Felice opened by saying that the bulk of the presentation would focus on the PowerPoint with some references to the instructions. He stated that the template will operationalize what is in the instructions, so the template was provided more for information and descriptive purposes. He pointed out that the materials were developed to be agnostic to pending decisions as to what groups would be required to submit a GCC template. He highlighted directional adjustments to the instructions and template, which include the following:

- Expanded language on possible entities that could be excluded from the GCC scope of application.
- Expanded opportunities for the grouping of non-financial entities and narrowing capital calculation options to two.
- An equity-based factor in the base capital calculation for non-financial entities and non-operating holding companies.
- Addition of a two-step approach to establishing an allowance for senior and hybrid debt as additional capital, including the reporting of paid-in and contributed capital.
- Selection of proxy allowance for senior debt (30%) and hybrid debt (15%).
- A potential course for removal of an informational sensitivity analysis for XXX/AXXX captives.
- Selection of a single scalar option for certain jurisdictions based on the Pure Relative Ratio Approach.
- Additional sensitivity analysis items and the retention of others.
- Expanded collection of “other information” useful for lead-state analysis or to inform future GCC enhancements.
- Added, deleted and relocated data entries on Schedule 1, the Inventory Tab, and in other areas of the instructions/template, including the addition of an attestation.

Commissioner Altmaier expanded on the XXX/AXXX slide, stating that those who wish to comment on this issue should bear in mind that once another group is identified and takes up a charge to conduct further review of XXX/AXXX captives, the informational sensitivity analysis for those captives will be removed from the template.

Mr. Felice also pointed out some areas where feedback is specifically requested. These include, but are not limited to:

- Adding principals and guidance criteria for excluding entities from the GCC scope of application.
- Clarifying modifying the definitions for what is a financial vs. non-financial entity.
- Including greater granularity in applying a capital calculation to non-financial entities.
• Adding criteria for “tracked down streamed’ debt and whether that category should be dropped from the template in favor of relying on “paid-in and contributed capital.”
• Limiting the allowance of additional capital from debt to 50% of total adjusted carrying value.
• Proposals for alternatives for scalars and for the treatment of jurisdictions with less developed capital requirements.
• Collecting information on the source of foreign currency conversion.

Commissioner Altmaier reinforced that there are several areas where the Working Group is actively seeking feedback on the materials. He asked state insurance regulators and interested parties if there are any initial questions.

Stephen Broadie (American Property Casualty Insurance Association—APCIA) asked whether options presented are for Working Group discussion and decision or choices for the group filing the template to pick from when completing the template. Commissioner Altmaier agreed that there is some optionality on the scope of application based on lead-state interaction with the group, while other options are directional, presented with the goal of ultimately agreeing on a common treatment in the template. Mr. Felice agreed, stating that there are directional items and those in which specific feedback could influence the inputs or methodologies included in the GCC template.

Tom Finnell (America’s Health Insurance Plans—AHIP) noted that there is an opportunity for differences in the scope of application across groups based on the application of criteria by lead-states. Commissioner Altmaier stated that the Working Group is trying to balance useful information to the state insurance regulator with comparability between groups. He added that the lead-state has the last word on what is included in the template, and there are opportunities, such as the supervisory colleges, to provide information to other involved state insurance regulators.

Patrick C. Reeder (American Council of Life Insurers—ACLI) asked about the longer-term workplan for the rest of the year beyond the 60-day exposure. Commissioner Altmaier stated that the Working Group will be conducting parallel discussions on the analytics and the proposed revisions to the Insurance Holding Company System Regulatory Act (#440). He added that the agenda for the Working Group beyond the comment period would depend on the comments received during the comment period. The goal is to adopt the template and instructions at some point after the exposure period.

3. **Form a Drafting Group to Review and Improve Staff Developed Guidance for How GCC Will Be Used**

Commissioner Altmaier stated that as an analytical tool, enhancing group-wide analysis for state insurance regulators is the main purpose for the GCC. He noted that NAIC staff have developed an initial guidance and metrics document (Attachment C) that could eventually be passed along for inclusion in the Financial Analysis Handbook or to the Group Solvency Issues (E) Working Group. He added that it was the intent to advance the development via a small drafting group made up of state insurance regulators and interested parties and bring the result of the drafting group’s work back to the Group Capital Calculation (E) Working Group. There were no objections to that course of action. Commissioner Altmaier asked those wishing to volunteer for the drafting group to contact Dan Daveline (NAIC).

Mr. Daveline said the document is laid out in a manner generally consistent with the way risk-based capital (RBC) is used in the Financial Analysis Handbook for looking at trends and thresholds and then drilling down into the root causes and underlying data behind the trends. He added that feedback from the drafting group is needed on whether the data elements collected in the GCC template are sufficient to support the analytics.

4. **Discuss Other Matters**

Commissioner Altmaier stated that one or two open Working Group calls would be scheduled in June to address comments and further discuss the proposed revisions to Model #440 related to adding the GCC and any updates on the analytics guidance.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.

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# Comment Summary - GCC Template and Instructions  
**July 29, 2020**

<table>
<thead>
<tr>
<th>Issue 1</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
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<tbody>
<tr>
<td>Use of the GCC</td>
<td>ACLI</td>
<td>Concerned that some aspects of the instructions and preliminary Draft Analysis Handbook infer a GCC that goes beyond its objective and would turn the GCC into a binding standard or constraint.</td>
<td>General comment but likely consistent with United HealthCare rationale</td>
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<td>United HealthCare</td>
<td>Key area of concern is the statement that “insurance companies may be subsidizing the operations of non-insurance entities, potentially undermining the insurance company’s financial condition.”</td>
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<td>Another concern arises from the statements in that the GCC “provides an additional early warning signal so regulators can begin working with a company to resolve any concerns” and will “allow them to make informed decisions on both the need for action.”</td>
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<td>Concern that the instructions as written may not make clear that the GCC is intended to be used solely by the lead state regulator.</td>
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<td>The idea that non-insurance operations within the group pose a proximate risk to the solvency of the group’s insurers has little historical evidence to support it.</td>
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<td>It seems inappropriate to suggest that the GCC, in and of itself, would be grounds for regulatory action to protect policyholders; that is the function of a regulatory standard, not an analytical tool.</td>
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<td>The statement, “State insurance regulators already have broad authority to take action when an insurer is financially distressed, and the GCC is designed to “allow them to make informed decisions on both the need for action, and the type of action to take,” suggests that the GCC will be used by the domiciliary regulator of each insurer.</td>
<td></td>
</tr>
</tbody>
</table>
Initial NAIC Staff Comments:
Some of the Introductory wording could be revised and / or moved to the Analysis Guidance being drafted & reviewed by the drafting subgroup, particularly with reference to cross subsidization. Comments on other thresholds applied in the analysis guidance can be addressed there. Staff notes that industry representatives are assisting in revising and reviewing the analysis guidance.

Although the GCC in totality can be viewed as an early warning vehicle, the GCC ratio itself is just one piece. This is similar to other analytical tools. Early warning is distinct from capital standard driving statutorily authorized regulator action. Although made clear throughout the GCC process that it will not be a capital standard, clarification of language to avoid any such inference will be considered.

As a group rather than entity-based tool, the submission itself is limited to the lead-State regulator (s/b addressed in Model Holding Company Act), it seems logical that post review regulatory concerns may be shared with other involved regulators in collaborative forums. Staff will look at the suggested language.

<table>
<thead>
<tr>
<th>Issue 2</th>
<th>ACLI</th>
<th>Global Atlantic</th>
<th>Prudential</th>
<th>United HealthCare</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calibration Level</td>
<td>Adopt a 200% ACL calibration level for the GCC. In addition, calibrations of other factors and regimes should be based on 200% ACL level RBC as well.</td>
<td>Inconsistent with RBC reporting and industry’s current reporting of two capital calibration levels, (100% ACL and 200% ACL) results in confusion and frequent misinterpretation of reported ratios; adding a third calibration level for the GCC of 300% ACL will compound the problem. This will lead to additional confusion and misunderstanding by users of financial information, including the regulatory, rating agency, and banking communities.</td>
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<tr>
<td>Lower 300% Calibration (consider lower than 200%) and / or add a diversification component</td>
<td>The calibration does not adequately consider the capital mitigation in diversified integrated holding company systems.</td>
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</table>

Initial NAIC Staff Comments:
Staff recommends that a 300% calibration be retained for a group-wide analytical tool that compliments entity-based RBC. The working group should consider whether using CAL or lower could imply that some specified regulatory action is imminent, especially within the context recommended by some commenters that risk charges mirror entity RBC. Staff believes that would add confusion between RBC as a standard and GCC as an analytical tool. Using a level above CAL RBC is consistent with a regulator analytical tool and consistent with an RBC reference point (Trend Test). Further it applies a reference point that is agnostic to the structure of the group.

A secondary issue is ability to be somewhat consistent with the AM – ICS being proposed by the NAIC in cooperation with other U.S. regulatory partners.

Staff believes that issues related to calibration are better addressed via the working group decisions on the definition of a financial entities, level of post covariance charges to be applied to non-financial entities, and definition of material risk for purposes of potential exclusion of entities from the calculation.

Staff agrees that there should be careful coordination between the GCC Template, and the analysis guidance as regards the level of the GCC ratio. Staff notes that industry representatives are assisting in revising and reviewing the analysis guidance.
<table>
<thead>
<tr>
<th>Issue 3</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope of Application</td>
<td>AHIP APCIA</td>
<td>GCC Instructions should explicitly state that non-material entities (including financial) within the Broader Group (but outside the Insurance Group) should be excluded from the Scope of Application.</td>
<td>All entities that meet the broad definition of “financial” in the GCC Instructions do not necessarily pose material risk (as defined above) under all circumstances. The fact that an entity would be classified as “financial” should be weighed as a factor in the materiality analysis.</td>
</tr>
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<td></td>
<td>State Farm</td>
<td>Requests that excluded entities not be required to be on the Inventory Tab or, at least, the Lead State Regulator have the discretion to not require excluded entities on the Inventory Tab if requested by the preparer.</td>
<td>Gathering information under the GCC from entities that are excluded from the GCC seems counterintuitive and duplicative in certain situations.</td>
</tr>
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<td></td>
<td>State Farm</td>
<td>State Farm questions why the Draft Instructions do not allow exclusion of immaterial financial or insurance entities that are isolated from the group as are non-financial entities.</td>
<td>Acknowledging the isolation of financial and insurance entities fits within already existing regulatory arrangements as well as the GCC and acknowledges that capital is not freely fungible for use by the group or entities within the group.</td>
</tr>
</tbody>
</table>

**Initial NAIC Staff Comments:**
Staff believes that given prior problems (e.g. during the financial crisis) with financial entities, some that appeared immaterial at the time, all financial entities should initially be included in the calculation for both risk and consistency purposes. Staff does appreciate the comments on the breadth and targeting of defining certain affiliates as financial entities as that was one of several areas of the instructions where comments were specifically requested and agrees that revisions are appropriate. The prior and current versions of the instructions do identify some financial entities without regulatory capital requirements with closer reference to their activities, so the working group could consider revisions targeted more specificity related to activities of financial entities.

The instructions currently limit the amount of data that is required from entities that the lead-State regulator agrees should be excluded.
<table>
<thead>
<tr>
<th>Issue 4</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excluded entities / Material Risk</td>
<td>ACLI</td>
<td>GCC Instructions should provide a definition of “material risk” for purposes of the Scope of Application as follows “risk emanating from a non-insurance entity that is of a magnitude that would adversely impact a group’s insurance operations and its ability to pay policyholder claims.” GCC Instructions should provide a principles-based definition of “material risk” for purposes of the Scope of Application. Suggest that “material risk” should be defined as “risk emanating from a non-insurance entity that could adversely impact a group’s insurance operations and ability to pay policyholder claims.” APCIA recommends developing a list of factors related to whether an entity could adversely impact a group’s ability to pay policyholder claims. (List included in letter – Page 2). No single factor is determinative of materiality of risk, nor should these factors be used as a scorecard or checklist.</td>
<td>• Follows the fundamental reason for state insurance regulation and the stated objective of the GCC: policyholder protection. • Is in accordance with international standards. For example, under ICP 23. • Given the diverse structures and business models of insurers, it would be impracticable to develop a one-size-fits-all checklist of guidelines that would be useful for materiality determinations across all groups. • Form B and D processes and Enterprise Risk Reports entail similar considerations and are already enshrined in the state regulatory process. Insurers and regulators could then use these factors to undertake a materiality analysis based on the totality of the facts and circumstances by considering the factors and how they apply to the group’s business.</td>
</tr>
<tr>
<td></td>
<td>AHIP</td>
<td></td>
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<tr>
<td></td>
<td>APCIA</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>State Farm</td>
<td>Requests a baseline materiality definition be provided while maintaining Lead State Regulator discretion to determine if a higher or lower material threshold is appropriate. Suggests a group equity threshold for materiality with a drafting note suggesting 5% threshold subject to regulator discretion</td>
<td>There should be some consistency in application under these provisions and that materiality should be based on the group’s net worth given the GCC is measuring risk of the group and not a particular entity in the group. Baseline for materiality while still allowing the Lead State Regulator and the preparer to use a higher or lower threshold given circumstances presented by the preparer.</td>
</tr>
</tbody>
</table>

Initial NAIC Staff Comments:

Staff agrees that materiality of risk is important in deciding whether to exclude non-financial entities. Staff supports a definition to promote consistency in completion of the GCC. We are supportive of principles-based criteria being included in the instructions. We are also supportive of quantitative Criteria if preferred by the working group but recognize that there has not up until now been coalescence around a single quantitative benchmark.

See staff comments above under Scope of Application (Issue #3) regarding financial entities.
<table>
<thead>
<tr>
<th>Issue 5</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grouping</td>
<td>Prudential</td>
<td>Supports flexibility of current grouping language, but state regulators should retain the option of requesting more granular information should they feel it is needed to obtain a sufficient view of risks within the group.</td>
<td>Self-Explanatory</td>
</tr>
</tbody>
</table>

**Initial NAIC Staff Comments:**
Although staff believes this is implicit, we support adding explicit language.
<table>
<thead>
<tr>
<th>Issue 6</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
</table>
| Definition of Financial Entities | AHIP          | Disagrees with the notion that certain affiliates are inherently riskier than others and more generally with the expanded definition of financial affiliates. Third-party administrators and pharmacy benefit managers, provider groups, and pharmacy benefit managers should not be considered financial entities. | • There is a wide array of types of non-affiliated entities within insurance groups, and it is overly simplistic to conclude that all that are somehow associated with assisting the insurer with contract performance or policyholder services are inherently riskier than others.  
• Form B and D processes recognize that transactions with affiliates may have risks. |
|         | APCIA         | APCIA is concerned with the expanded definition of financial entity in the GCC.                                                                                                                                                                                            |                                                                                                                                                   |
|         | United HealthCare | Base comments are similar to AHIP Comments. This is amplified by lack of diversification credit for the wide array of entities defined as “financial”                                                                                                                                  |                                                                                                                                                   |

**Initial NAIC Staff Comments:**

Staff appreciates the comments on the breadth and targeting of defining certain affiliates as financial entities as that was one of several areas of the instructions where comments were specifically requested. The issue of an appropriate definition of financial entities impacts other concerns identified in the comments including, calibration, scope of application, materiality of risk, and consistency across group structures. The instructions currently do identify some specific financial entities without regulatory capital requirements and some associated activities, so the working group could consider more specificity related to activities based on the activities of those identified entities. As intended, staff also believes that the quantitative aspects of the GCC in the context of a regulatory view, as well as the additional data supporting analytics does compliment rather than overlap the benefits of other regulatory filing requirements.
<table>
<thead>
<tr>
<th>Issue 7</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treatment / Charges Financial Entities</td>
<td>ACLI</td>
<td>To the extent that there are differences in the GCC and legal RBC treatment for subsidiaries that have been de-stacked and reported separately from their legal entity parent, then it seems desirable for the GCC and RBC treatment to align. To the extent that there are differences between the two, we recommend the Working Group explain the rationale for the difference (e.g., achieving substantial consistency in charges regardless of corporate organizational structure) and, if appropriate, refer the issue to the appropriate RBC working for further dialogue.</td>
<td>ACLI believes that the GCC should be consistent with the legal entity rules applied to insurance legal entities – including the subsidiaries of insurance legal entities. In the long run, we believe this approach will benefit regulators and the industry by promoting a more consistent and up-to-date risk framework.</td>
</tr>
<tr>
<td></td>
<td>AHIP</td>
<td>Recommends applying the equity-based capital charge that is recommended for non-financial affiliates to all affiliates that are not subject to a regulatory capital requirement.</td>
<td>Subjecting these entities to a capital charge for financial entities (12% of 3-year average gross revenue – possibly to be increased to 15%) could result in a significant additional charge as compared to current RBC.</td>
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<td></td>
<td>APCIA</td>
<td>in the short term, use a capital charge that is roughly equivalent to the current post-covariance charge (presumably equity charge) for such affiliates in RBC.</td>
<td>Over the first few years of the GCC’s implementation, data can be collected and used to derive a more risk-sensitive charge that is pragmatic (e.g., a differentiated charge for entities of high/medium/low risk as determined by specified criteria).</td>
</tr>
<tr>
<td></td>
<td>Prudential</td>
<td>Supports adopting a single approach for establishing a proxy capital measure for all financial entities that are not subject to a regulatory capital requirement. Supports a method that most closely aligns with how the AM - ICS will ultimately treat this item.</td>
<td>• Ensuring state regulators obtain adequate insight into the entities within the insurance group and risks associated with them is the key point of consideration for these entities and this is best accomplished through the inventory element of the GCC as opposed to an arbitrary proxy capital calculation. • To the extent a state regulator believes an entity poses material risk to the group, they have discretion to request additional information to understand the risks.</td>
</tr>
</tbody>
</table>
Initial NAIC Staff Comments:
Staff notes that as a complimentary group analytical tool covering entities other than those owned by RBC filer, total consistency with RBC is not entirely relevant, particularly for financial entities. Staff does agree that the Capital Adequacy Task Force should determine whether the treatment of financial entities in the GCC is relevant for U.S. Insurer entity-based RBC. This can be tasked to the current Ad Hoc Affiliates Subgroup or directly to the RBC Working Groups.

Staff agrees that an overarching explanation of where differences exist is helpful.

Staff does not recommend using a post covariance charge for most financial entities that are not subject to a regulatory capital charge. Properly defined Financial entities can pose additional non-diversifiable risk. Staff agrees that a narrower more activities focused definition of such financial entities will address many stated concerns.

Staff recommends continuing a revenue-based / enhanced operational risk type charge. Up until this point there seems to have been more agreement around a revenue-based charge for these entities.

Staff has no issue with treating all financial entities that are not subject to a regulatory capital charge the same at least initially. The only current difference is whether to use a 3-year average revenue (currently used for asset managers) or current year revenue only (currently used for other financial entities that are not subject to a regulatory capital charge) as the base used to apply the charge.

Staff supports the 15% charge as reflective of a 300% calibration and consistency whether where international standards are headed but understands that the working group may consider a scaled version as a starting point for the near-term. Staff supports the proposal to consider refinements over time for financial entities not subject to a regulatory capital requirement in order to be more risk sensitive along the lines of the low / medium / high approach suggested by APCIA (e.g. lower risk entities could go with the post covariance non-financial entity charge / medium risk entities, a scaled revenue-based charge / and high risk entities, the full revenue based charge).
<table>
<thead>
<tr>
<th>Issue 8</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treatment / Charges - Non-Financial Entities (incl. material non-financial A / BA)</td>
<td>ACLI</td>
<td>ACLI was unable to discern how the proposed charges for “other non-insurance/non-financial entities” and “material Schedule A/BA entities” were created.</td>
<td>Further clarification on this issue is necessary, including an explanation of why the Working Group is recommending a novel approach that has not been subject to field testing.</td>
</tr>
</tbody>
</table>
|                             | AHIP            | Risk charges for non-financial entities should be equal or very similar to the current charge in the sectoral RBC formulas, i.e., 3% post-covariance charge in the case of health insurers.                               | • The GCCWG has not provided data to suggest that a more substantial risk charge is needed to protect policyholders.  
• Form B and D processes are already in place to ensure that the regulated legal entity is protected from the non-regulated, non-insurance entity.                                                                 |
|                             | APCIA           | During the first few years of the GCC’s implementation use 3% of 3-year average revenue Once some experience is gained with the GCC, the Working Group should consider a simple variable risk charge (low / medium / high risk charge) that is more risk-sensitive based on industry and activity. | A period during which experience will be gained that can then be analyzed in more detail and across more groups than was possible in field testing.                                                                 |
|                             | Prudential      | Supports adopting a single approach for establishing a proxy capital measure for all non-financial entities                                                                                                     | See rational for financial entities.                                                                                                                                                                                 |
|                             | United HealthCare | Charge should be based on the group specific after covariance equity charge.                                                                                                                                   | Using an average industry post covariance charge is not reflective of the proportion of insurance vs. non-insurance business within a group.                                                                 |

**Initial NAIC Staff Comments:**
Once materiality of risk has been established, Staff supports a post covariance equivalent equity-based charge that is broadly consistent with RBC treatment for non-financial entities that are “included” in the GCC. The current template uses a single average post covariance factor across all industry types, but Staff believes that an industry specific charge has merit. A group specific charge was previously tested and could be considered by the working group, but unlikely to have a significant impact on the GCC. However, NAIC Staff would be interested in information to the contrary by a group that has run the numbers given that the NAIC will not be receiving the GCC filings.

Staff supports the suggestion to make future refinements based on continued collection of data but again notes that NAIC will not have access to the submissions.
<table>
<thead>
<tr>
<th>Issue 9</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance for Debt</td>
<td>ACLI</td>
<td>The current debt caps are too restrictive.</td>
<td>• Could negatively impact a group’s ability to prudently manage capital and liquidity risks.</td>
</tr>
<tr>
<td></td>
<td>Prudential</td>
<td></td>
<td>• Tying the constraint to a percentage of the group’s available capital embeds an undesirable element of procyclicality into the GCC, because a company’s available capital is likely to decrease in times of stress, especially if markets crash.</td>
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<td>United HealthCare</td>
<td></td>
<td>• The 30% factor for senior debt and 15% for hybrid debt are being applied to a more conservative base than rating agencies use for establishing limits</td>
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<td></td>
<td>ACLI</td>
<td>Requirements for tracking the down-streaming of debt issuance proceeds to regulated entities should be eliminated.</td>
<td>• Adding a limit of 50% of total adjusted carrying value to the conservative 30% and 15% limits for senior and hybrid debt (relative to total adjusted carrying value + outstanding senior and hybrid debt) effectively lowers the 45% permitted (i.e., 30% + 15%) to approximately 33%.</td>
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<tr>
<td></td>
<td>Prudential</td>
<td></td>
<td>• Interpretations related to how to support “tracking” will be difficult to verify and may lead to inconsistencies across groups.</td>
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<tr>
<td></td>
<td>United HealthCare</td>
<td></td>
<td>• Keeping funds at the holding company level is a prudent strategy that provides insurance groups flexibility to quickly and easily manage capital and liquidity needs across the group.</td>
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<tr>
<td></td>
<td>ACLI</td>
<td>Remove the call option criteria, because the exercise of a call option is typically followed by refinance of the instrument which supports its permanence and structural subordination.</td>
<td>• A tracking requirement could give rise to unintended consequences such as reducing the availability and fungibility of capital resources and forcing U.S. insurance groups to issue greater amounts of debt.</td>
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<td>Relative to the 5-year term, the presence of call options should not prevent a capital instrument’s inclusion as a qualifying instrument. Call options are a common feature of U.S. issued capital instruments.</td>
</tr>
<tr>
<td>Allowance for Debt</td>
<td>Global Atlantic</td>
<td>Eliminate downstream tracking logic and replace it with a simple comparison to paid-in capital and surplus.</td>
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</table>
|                    |                | • Simpler, more efficient, and more reliable test  
|                    |                | • Avoids complications that could result from debt that has been refinanced by the parent as there would be no contribution of the debt amount issued.  
|                    |                | • Avoids complications of tracking upsize transactions where debt is borrowed at one date and then down streamed at a different date.  
|                    |                | • Avoids complications of tracking the reverse: dividends which are up streamed. Are those upstream transactions to be netted against down streamed capital or not?  
|                    |                | • Avoids complications and questions related to M&A transactions – if a company is acquired, does the new parent company automatically assume the historical relationship of down streamed debt, so long as its debt at least equals the debt of the old parent company? |
| APCIA              |                | The treatment of debt differs in some key respects from that which was adopted by the International Association of Insurance Supervisors (IAIS) in the Insurance Capital Standard (ICS) in 2019.  
|                    |                | The GCC could be viewed as less credible by other jurisdictional supervisors including those who may be parties to a Covered Agreement. Comparability of the GCC with the ICS is a looming issue on the horizon, the resolution of which can impact the views of many IAIS member jurisdictions about the efficacy of state-based regulation over U.S.-based insurance groups.  
|                    |                | FED BBA is more closely aligned with the principles-based criteria in the ICS than with the approach taken in the exposed GCC Instructions  
|                    |                | Working Group may need to supplement the GCC Instructions with definitions for each type of instrument. For example, “hybrid debt” is not defined in the Instructions  
|                    |                | • Rating agencies treat subordinated debt issued by a parent company as “hybrid debt” if it is long-dated and has provisions to defer interest payments for a period of time. This could give rise to variation in treatment of hybrid debt (e.g., it may be unclear to a group if it should classify it as “hybrid” or as “subordinated” debt)  
<p>|                    |                | • Comparability with the ICS needs to be considered, and on this point it seems that the more important issue is not whether types of debt are called out by name or more generically by tier, but whether comparable criteria to the ICS are used. |</p>
<table>
<thead>
<tr>
<th>Allowance for Debt</th>
<th>APCIA</th>
<th>Replace terminology “additional capital allowance” with “within supervisory limits”.</th>
</tr>
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<tbody>
<tr>
<td></td>
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<td>Focusing the Instructions’ text on “limits”, rather than “allowance”, will help in some respects with perceptions about comparability.</td>
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<td>Add criteria supporting structural subordination to “Tracked Down-streamed Debt” proceeds rather than eliminate that test.</td>
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<td>• Team USA argued long and hard to support structural subordination in the ICS.</td>
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<td>• While down-streaming has raised many questions about how debt proceeds can be tracked and verified, the ICS criteria are workable and rely in large measure on each group and its group-wide supervisor to make that determination in light of the unique facts and circumstances.</td>
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<td></td>
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<td>• The IAIS avoided prescribing detailed rules or criteria for tracking. APCIA believes the NAIC should do the same in the GCC, leaving the determination of the amount down streamed to the lead state working in conjunction with the group.</td>
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<tr>
<td></td>
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<td>• This would include criteria to support that the qualifying amount of debt to be treated as capital is actually subordinated (either contractually by the terms of the instrument, or structurally), and other principle-based criteria, as in the ICS, to support permanence, loss absorbency, etc. Some refinement of the ICS criteria may be necessary to address U.S.-specific nuances for the GCC.</td>
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<tr>
<td></td>
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<td>Another option to test structural subordination is to limit the amount of senior debt to qualify as capital to that which is in excess of the liquid assets in the holding company.</td>
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<td>As a practical matter, the lender would have recourse only to the liquid assets that remain in the entity that issued the debt (i.e., the holding company in the case of senior debt). The unconsolidated balance sheet of the holding company (reflects a very large, illiquid investment in insurance subsidiaries, control over which is subject to regulatory oversight and approval.</td>
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<td></td>
<td>APCIA is open to the possibility of some allowance for other debt in the future.</td>
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<td></td>
<td>Self-Explanatory</td>
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<td>It would seem appropriate that the overall limitation should apply to all debt, including surplus notes and</td>
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<table>
<thead>
<tr>
<th>APCIA</th>
<th>foreign debt. That said, and as noted above, APCIA supports no limit on surplus notes of mutual insurers.</th>
<th>See Staff Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>we do not offer a view on the overall limit of 50%. However, the ICS comparability issue is also an important goal and encourage the Working Group to give due consideration in the context of the overall limit.</td>
<td>The comparability issue is also an important part of navigating the way forward with the GCC and encourage the Working Group to give due consideration in the context of the overall limit.</td>
</tr>
</tbody>
</table>

**Initial NAIC Staff Comments:**
Staff is open to eliminating the tracked down-streamed option as suggested by some commenters. The arguments put forth by APCIA are relevant, however, structural subordination is strongly represented by insurer paid in capital and surplus which has the most rigorous regulatory control over distributions.

Staff is sympathetic to the point that the proxy allowance for Senior Debt is applied to regulatory available capital rather than GAAP available capital and the 50% limit of otherwise available capital could be adjusted upward if the working group concurs. Staff would initially suggest no more than 75% in order to balance the point raised with recognizing that there is no tiering of capital in reference to the ICS and that the GCC applies the limits to the larger base of available capital rather than required capital.

Staff understands the issue of including Foreign Debt in the limit. However, fully including contractually subordinated debt already recognized by a regulatory authority as capital and included in the carrying values in Inventory B (e.g. U.S. surplus notes and contractually subordinated foreign debt) seems consistent from a regulatory perspective. Staff agrees that foreign senior and hybrid debt that is not included in the value of an entity in Inventory B should be included within the limit.

Staff has some concerns about the APCIA alternative methodology as it may provide too much of an allowance since large groups may rely on illiquid assets at the holding company level and the method would seem to result in including the entire book value of insurers in the group.

Staff supports the suggestion to continue to collect data on “Other Debt” for purposes of future refinements but notes that NAIC will not have access to the filings.

Staff will review language for clarity considering edits provided and definitions of debt instrument types.

Staff will follow-up on the issue of terminology “additional capital allowance” vs. “within supervisory limits” but notes that there is currently no GAAP or SAP allowance for subordinated debt other than surplus notes (so the supervisory limit is essentially zero per accounting requirements). The GCC provides an on top allowance that reflects a supportable proxy alternative for structural subordination.

Allowance for Debt as additional capital is an area of potential divergence between the GCC and AM- ICS.
<table>
<thead>
<tr>
<th>Issue 10</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
</tr>
</thead>
</table>
| Scalars  | ACLI      | Use the Excess Approach over the Pure Approach. Use the Excess Relative Ratio Approach for scaling non-U.S. capital ratios to U.S. RBC. | • This method utilizes two anchor points for scaling.  
• The Pure Relative Ratio lacks a mechanism to ensure that a non-U.S. firm at the regulatory intervention level within its respective country will be at the U.S. RBC intervention level once scaled.  
• The Pure Relative Ratio Approach fails to adequately account for key differences in insurance regimes (e.g., level of conservatism embedded in reserves versus required capital, different valuation and asset admissibility standards, etc.).  
• The decision would prejudge the Pure Relative Ratio Approach as the methodology that should be adopted for the AM and could undermine the ongoing work at the NAIC’s work at the global level to secure recognition of the AM |
|          | Global Atlantic Prudential | Transparency of how the scalars are calculated will be critical, regardless of which scaling methodology is selected | • Consistency – scalars should be calculated and applied consistently across all non-U.S. regimes.  
• Specificity – scalars should be discretely computed and applied amongst life, property casualty and health insurance companies.  
• Stability – the results of applying scalars to Non-U.S. capital ratios should not be volatile; for example, converting to U.S. RBC should not yield a significant headwind in one year, and a significant tailwind in the following year |

Initial NAIC Staff Comments:
Scalars remains an open issue. The use of the Pure Relative Ratio appeared to strike a good balance between precision, simplicity and ease of explanation.

However, staff has no strong feelings between the two approaches and believes that the working group should be open additional approaches while maintaining a placeholder methodology.

The working group should be aware of ongoing work on the AM-ICS as scalar methodology is an area of potential convergence between the GCC and AM-ICS.
## Initial NAIC Staff Comments:

**Staff recommends against deleting the sensitivity analysis tab in its entirety.** The XXX/ AXXX sensitivity test is in process of removal. The information contained in most other analysis points informs future decisions on capital charges, and more generally the primary purpose of the template as an analytical tool and should be retained for a period of time for further assessment of its value.

**Staff understands that some of the sensitivity analysis will fall away as more finalized decisions on treatment of financial entities not subject to regulatory capital requirement and for treatment of non-financial entities and perhaps on scalars are incorporated into the GCC template**

**Staff believes that the data is more readily accumulated in the Sensitivity Tab from other parts of the template. Separating it would require additional work particularly for non-insurance entities.**

<table>
<thead>
<tr>
<th>Issue 11</th>
<th>Commenter</th>
<th>Essence of Comment</th>
<th>Primary Rationale</th>
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| Sensitivity Analysis | ACLI Prudential | Eliminate Sensitivity Analysis Tab altogether | • Narrowing the design of the GCC will ensure insurers, supervisors (domestic and foreign) and other stakeholders have a clear vision and understanding of what the GCC is (e.g., it would eliminate the need to distinguish between a “Base” view and alternative measures).  
• To the extent broader information on the insurance group is of interest to a state regulator, we believe it should be obtained through discretionary powers as opposed to embedding it in the GCC template. |
<p>| Coalition | Supports Eliminating the XXX/ AXXX analysis in favor of a referral. | • The need for the GCC to adhere fully to legal entity rules in support of the state-based legal entity solvency system |</p>
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<th>Issue</th>
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<th>Primary Rationale</th>
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</table>
| 12    | United HealthCare | Questions the rationale for collecting information on intangible assets (such as deferred acquisition costs, provider contracts, customer lists, and goodwill). | • The focus on intangible assets, to the exclusion of other types of assets, seems unwarranted.  
• Regardless of their availability for sale, intangible assets do produce a stream of income to the group; otherwise, GAAP accounting would require that they be written down in value or written off entirely.  
• As businesses rely more and more on digital assets and intellectual property as the basis for their operations, and less and less on fixed assets, there is more scrutiny of the value of those assets, and there should be less concern about whether the stated values are appropriate. We  
• Both business trends and accounting changes have made the differentiation of “intangible” assets increasingly less relevant. |

Initial NAIC Staff Comments:  
Staff notes that the GCC represents a regulatory view of group available capital. It is not intended that the value of intangibles allowed under GAAP, SAP or another accounting basis should be excluded. However, staff believes that there is some value in quantifying the extent that group capital is comprised of illiquid non-physical assets. This can provide good regulatory information in in addition to the views of rating agencies or other group stakeholders.  
Staff is comfortable with assessment of the value of the data collected in the Tab by the Analytics Guidance Drafting Group and making any adjustments accordingly.

| Issue 13 | Commenter | Other Technical Comments, Language Edits, Clarification requests and Second Tier Concerns | AHIP, APCIA, UHG |
Mariana Gomez  
Vice President & Associate General Counsel  
202-624-2313  
Marianagomez@acli.com  

July 24, 2020

Commissioner David Altmaier  
Chairman, NAIC Group Capital Calculation (E) Working Group  
Florida Office of Insurance Regulation  
[via-email to lfelice@naic.org]

Re: NAIC Group Capital Calculation (“GCC”) Working Group’s exposure on the GCC template and instructions

Dear Commissioner David Altmaier,

ACLI is pleased to have the chance to provide an overview of our views on the exposed GCC template and instructions. We fully acknowledge the deadlines the NAIC is working against. However, the GCC instructions and template asked for feedback on a broad range of substantive issues, ranging from scalars, the definition and treatment of financial and non-financial entities, the treatment of senior and hybrid debt, plus others. The issues in the exposure are complex and the consequences for our members are potentially significant. In addition to the complexity inherent in this group level calculation, the ongoing, extraordinary circumstances related to the coronavirus make it even harder to properly analyze and assess the GCC without assessing its impact over time.  ACLI members agree that more time is needed to analyze many of the GCC components. ACLI members expect other areas of concern, beyond those identified in this letter, to emerge as regulators and industry observe the GCC’s performance over time. Therefore, as indicated in several instances below, the ACLI urges the NAIC to continue to engage with stakeholders and to publicly consult again on these key elements, overall design and implementation of the GCC over the coming months.

To the greatest extent possible, our letter provides ACLI’s specific recommendations on the exposure. ACLI has also provided a set of general, overarching comments on the GCC, and highlights several -process and governance related issues. In addition to those areas, our letter provides a preliminary issue-spotting list of other areas that are in need of additional analysis and work by the NAIC, including the treatment of capital instruments in the GCC, and the treatment of financial entities and non-financial entities.
PART I. OVERARCHING COMMENTS ON THE GCC AND EXPOSURE

This part of our letter provides general, overarching comments that are generally applicable to the entire exposure, instead of a single recommendation.

ACLI fully supports an aggregation-based approach that is consistent with the existing legal entity RBC framework. ACLI supports the development of an aggregation-based approach that is "intended to build on existing legal entity capital requirements where they exist, rather than developing replacement/additional standards."\(^1\) We fully support this objective and believe the GCC should leverage and adhere to the existing regulatory frameworks – including legal entity RBC rules – and industry practices and norms to the greatest extent possible.

ACLI encourages the Working Group to ensure that design choices enhance transparency into group risk and avoid introducing procyclicality into the GCC. ACLI believes the current proposal may include elements that could be procyclical and have the unintended consequence of disrupting the ability of regulators and insurance groups to navigate periods of stress. For example, the proposed debt limits, which are based on available capital could have procyclical effects in times of stress, when available capital tends to contract and capital requirements tend to increase. ACLI urges the Working Group to devote the appropriate resources and time to review these items to avoid introducing procyclical risks into the GCC.

ACLI believes GCC design choices should be consistent with the intent for the GCC to be a tool, rather than a standard or binding requirement. ACLI supports the NAIC’s development of a GCC as an additional "tool" that is intended to provide regulators with greater insight into insurance groups.\(^2\) However, we are concerned some aspects of the instructions and the preliminary Draft Analysis Handbook give rise to a GCC that goes beyond this objective and would have the effect of turning the GCC into a binding standard or constraint.

All references to “Base GCC” should be eliminated. The references to “Base GCC” may be a holdover from previous versions of the instructions when formal on-top adjustments were contemplated. We are concerned that the use of the term “Base GCC” throughout the document insinuates that there are multiple GCC’s, and we believe this could cause unnecessary confusion around the GCC.

ACLI believes the process for developing and refining the GCC requires further consideration. Given the potential consequences the GCC may have on members, ACLI believes the Working Group should take time to consider further alternative approaches to certain elements and perform additional quantitative analysis. We also believe a clear process must be established for future revisions to the GCC, a rationale for decisions should be provided that is consistent with the stated

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\(^2\) See Attachment B-2, GCC Instructions. at p. 5, para. 2 (describing the GCC as a tool intended to provide regulators greater insight into insurance groups – e.g., a holistic understanding of the non-insurance entities in the group, insight into capital distribution across the group, etc.).
purpose of the GCC, and the Draft Analysis Handbook should be exposed for public review and comment before it is finalized.

**Decision points on items in the instructions should be guided by the purpose and objective of the GCC, as described in the Instructions.** ACLI believes the decision points should favor design choices that provide more transparency to regulators and do not conflict existing standards or introducing new standards. ³ Although this is not directly addressed in the Instructions, we believe a prudent group solvency regime should avoid imposing measures that impede the ability of regulators and insurers to navigate periods of stress.

**PART II. ACLI’S COMMENTS ON RELATED PROCESS AND GOVERNANCE ISSUES**

This section identifies and issues recommendations on process and governance issues related to the GCC and exposure.

**ACLI believes alternative approaches should be considered and additional data collection, quantitative analysis and monitoring should be performed prior to finalizing the design of the GCC.** ACLI strongly believes that this is critical to determine if the GCC components are fit for purpose and would be consistent with the Working Groups message that getting the GCC right is more important than getting it done soon.

**ACLI believes a clear and transparent process for future revisions to the GCC framework must be established.** Paragraph 7 of the draft instructions notes that the GCC instructions are expected to be “modified, improved, and maintained in the future.” We believe the process for making changes to the GCC should require notice to stakeholders and include an opportunity for public consultation. We recommend that the Working Group develop a GCC governance process like what is used for the Accounting Practices and Procedures Manual and the Valuation Manual. Separately, we believe the process for updating scalars for design changes or to account for evolution in supervisory regimes should also be transparent and subject to a clearly defined governance process.

**The Draft Analysis Handbook should be exposed.** The Draft Analysis Handbook should be exposed for public review and comment before it is finalized. While ACLI appreciates the opportunity to serve as a participant in a drafting group composed of a limited number of regulators and industry participants, we believe all interested parties should have an opportunity to weigh in on the content given the significant impact it may have on the role the GCC plays in practice. For example, the previously distributed version of the draft analysis included a proposed 175% intervention point, which appears to conflict with the description of the GCC as a tool meant to enhance transparency into a group’s risks rather than a binding standard or constraint. Given the high-profile nature of the GCC, public exposure of the Handbook and any potential intervention points are necessary.

³ The avoidance of new standards is consistent with the description of the GCC in the Instructions and the NAIC’s August 16, 2018 letter to Senators Scott and Rounds. In the August letter, the NAIC notes that the “NAIC is not creating a new capital standard for insurers that will necessitate higher capital levels. Rather, the GCC will be an additional reporting requirement built off existing legal authorities.” Available at https://www.naic.org/documents/government_relations_181816_scott_rounds_letter.pdf.
PART III. RECOMMENDED IMPROVEMENTS TO THE GCC INSTRUCTIONS AND TEMPLATE

This section of our comments addresses the issues where ACLI has provided specific recommendations for the instructions or template during our preliminary review. Some of these items, such as the treatment of senior debt, are also candidates for further work and analysis.

1. Scalars. ACLI members recommend the Excess Capital Ratio Approach.

The primary goal of a scalar is to ensure aggregated data and thereby ratios across jurisdictions are comparable. While the Pure Relative Ratio (“Pure”) and Excess Capital Ratio (“Excess”) Approaches are both relevant supervisory capital metrics, only the Excess Approach uses a total balance sheet approach and leads to an appropriate measure of excess capital.

As a result, ACLI recommends the Excess Approach over the Pure Approach. Unlike the Pure Approach, the Excess Approach keeps the total asset requirement (reserves plus required capital) constant before and after scaling. As a result, the Excess Approach places greater weight on differences in reserve requirements, which can vary significantly across the globe. We believe this creates a more level playing field regardless of an insurer’s subsidiary locations and will provide a comprehensive approach for aligning foreign regimes to the U.S. RBC framework.

The Pure Approach does not adjust for available capital and could result in a distortion of excess capital levels, depending on the entity’s capitalization levels and its jurisdiction. For example, by not taking into account the intervention levels of local regimes, the Pure Approach would allow entities that a jurisdiction deems to be undercapitalized to be considered adequately capitalized for group ratio purposes, simply due to scaling, which could ultimately detract from the credibility of the GCC.

Another benefit of the Excess Approach is that it maintains the actual levels of excess capital because it adjusts both available and required capital, which improves the accuracy of the GCC with respect to the actual amounts of excess capital held by a group. The management and maintenance of excess capital levels is a top priority for treasurers of insurance companies, and the GCC should accurately reflect the amount of excess capital levels that is held by a group.

Members also believe that the total balance sheet approach employed by the Excess Approach may better position the GCC, and Aggregation Method (“AM”), for the forthcoming efforts to secure recognition of the AM as comparable to the market-based version of the Insurance Capital Standard (“ICS”). The principles and criteria for the comparability assessment will take into account “analysis of individual elements of a group solvency approach, i.e. valuation, capital resources, and capital requirement.” Consequently, a scaling approach that effectively provides for a translation of reserve levels and capital requirements would be better suited for the comparability assessment than the Pure Approach. Further, the Excess Approach supports the goal of comparability by providing a more accurate comparison of the total assets (all loss absorbing resources within a

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group) that are required when comparing regimes. We have attached a brief explanation of the differences between the Pure and Excess Approaches.

2. **The calibration of the GCC and scalars for foreign insurance regimes should be 200% ACL RBC.**

ACLI disagrees with the proposed calibration of the non-U.S. insurance scalars and the GCC ratio at the RBC trend test level (300% ACL RBC). We believe the GCC should be calibrated to the 200% ACL RBC, which is consistent with 100% Company Action Level (CAL) RBC. In addition, calibrations of other factors and regimes should be based on 200% ACL level RBC as well. Using 300% as the calibration for the GCC is likely to introduce confusion because the GCC calibration will depart from a well-established market-norms for legal entity insurers of assessing RBC based on a 100% CAL level, without offering any identifiable benefits. We are also concerned that establishing a different calibration point for the GCC could result in unintended consequences such as changes in market expectations for the capitalization of underlying insurance entities.

3. **The GCC’s proposed treatment of capital instruments, in particular the qualifying criteria for senior and hybrid debt, should be subject to further study and analysis.**

We believe that the current debt caps are too restrictive and could negatively impact a group’s ability to prudently manage capital and liquidity risks. Further, it is not clear how the inclusion of the proposed limits would enhance transparency into risks within an insurance group, which the NAIC has noted is the primary intent of the GCC.

There are times when companies may need to quickly raise capital, and issuing senior or hybrid debt is a reliable way to accomplish this, especially during times of economic stress. We do not believe it is appropriate for the GCC to introduce constraints that may inhibit the ability for insurers to prudently use these capital instruments. In addition, we believe that tying the constraint to a percentage of the group’s available capital embeds an undesirable element of procyclicality into the GCC, because a company’s available capital is likely to decrease in times of stress, especially if markets crash.\(^5\)

To the extent the Working Group believes some form of limit is necessary, we believe it must consider a suite of less restrictive options and would welcome the opportunity to work with you to conduct further analysis on the subject.

On a more granular level, the GCC instructions (p. 34, para. 65) require that the capital instrument has a fixed term of a minimum of 5 years at the date of issuance or refinance, including call options. The presence of call options should not prevent a capital instrument’s inclusion as a qualifying instrument. Call options are a common feature of U.S. issued capital instruments. This

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\(^5\) ACLU is aware that the analysis of field-testing results showed that approximately 25% of volunteers would not receive full credit for the capital instruments they issued because of the prescribed limits. We are concerned that the field testing captured a point-in-time point of view that may not demonstrate the impact these restrictions might have on groups during periods of economic decline. During periods of economic stress, an insurer’s available capital tends to constrict, and its capital requirement rises, which would further limit the recognition of these capital instruments and discourage their use.
criterion would shorten the term and prevent most instruments from qualifying as structurally subordinated. We recommend removing the call option criteria, because the exercise of a call option is typically followed by refinance of the instrument which supports its permanence and structural subordination.

4. Capital Instruments. ACLI recommends eliminating the down-stream tracking requirement.

ACLI agrees with the NAIC staff’s recommendation to eliminate the down-stream tracking requirement for senior debt. There are a number of reasons why the downstream tracking requirement could prove difficult to implement, such as complications that could arise when the debt has been refinanced by the parent, or how to track upsize transactions where debt is borrowed at one date and then down-streamed on a different date. Downstream tracking also raises questions about how to treat up-streamed dividends (are they netted against down-streamed capital?), as well as how to treat M&A transaction. For example, if a company is acquired, does the new parent company assume the historical relationship to the down-streamed debt, so long as its debt at least equals the debt of the old parent company?

Some of our members have also expressed concern that groups with an operating holding company who utilize a more centralized capital and liquidity management strategy that prioritizes holding funds at the holding company level would be disadvantaged by this approach. If the proceeds must be down streamed for the company to get any credit, then a group would have to issue more debt at the legal entity insurance level if it wished to maintain the same debt-funding levels at the operating holding company level without hurting its capital ratio.

5. ACLI supports the Working Groups recommendation to remove parts of the Sensitivity Tab, and more broadly, believes the remaining elements of the tab should be removed from the template.

ACLI has long advocated that the GCC should be consistent with entity level RBC rules and we are concerned that the inclusion of approaches within the GCC that deviate from legal entity rules, such as the unwinding of permitted and prescribed practices should not be included in a sensitivity tab. Further, ACLI members ability to comment on the specifics of the sensitivity tab was also constrained by the lack of formulas inside the tabs. Therefore, further discussion of its purpose and use, as well as a discussion on the context of this information is warranted if the tab is retained. To the extent the information on the Sensitivity Analysis Tab is of interest to state regulators, ACLI believes they should use their discretionary powers to obtain it rather than embedding it in the GCC template.

Irrespective of the tabs continued existence (or not) in the template, we strongly believe that all references to “Base GCC” should be removed from the Instructions and replaced with “GCC”. Using the term “Base GCC” creates confusion and a potentially false narrative that there are multiple versions of the GCC. Eliminating this need to distinguish between a “Base GCC” and multiple alternative GCCs will provide a stronger foundation for the NAIC to advance an AM at the global level.

6. Grouping/De-stacking and Materiality
ACLI supports efforts to simplify and streamline the GCC by permitting companies to either group related entities, or to relax the requirements to “de-stack” an entity. ACLI also supports the grouping or netting of non-operating holding companies. To the extent there are concerns that these simplification efforts may obstruct a regulators ability to obtain adequate insight into the potential group risks, this is addressed by giving regulators the option to ask groups to submit more detailed information (i.e., supervisors may direct a company to de-stack certain entities or desegregate some groupings).

In general, ACLI believes that the GCC should be consistent with the legal entity rules applied to insurance legal entities – including the subsidiaries of insurance legal entities. The GCC de-stacks subsidiaries from insurance legal entities and in some cases, applies a GCC treatment to the subsidiary that differs from the legal entity treatment. To the extent that there are differences in the GCC and legal RBC treatment for subsidiaries that have been de-stacked and reported separately from their legal entity parent, then it seems desirable for the GCC and RBC treatment to align. To the extent that there are differences between the two, we recommend the Working Group explain the rationale for the difference (e.g., achieving substantial consistency in charges regardless of corporate organizational structure) and, if appropriate, refer the issue to the appropriate RBC working for further dialogue. In the long run, we believe this approach will benefit regulators and the industry by promoting a more consistent and up-to-date risk framework.

ACLI believes it would be helpful if the GCC Instructions employed a consistent definition and threshold of materiality for de-stacking and other GCC purposes where consistent with the purposes of the GCC. However, this is an area that clearly requires additional thought and consideration to establish an appropriate threshold for materiality.

**PART IV. ACLI’S PRELIMINARY LIST OF ISSUES NEEDING FURTHER ANALYSIS**

This section of our comments addresses issues that ACLI members have identified as significant concerns, but that require additional clarity from the Working Group and/or further member development and discussion, in order for ACLI to make a specific recommendation. These are areas where we suggest more time be allowed for NAIC staff and interested parties to work together to develop specific recommendations.

1. **Financial entities and non-financial entities**

   1.1. **Additional clarity is needed for the definition of financial entity, non-financial entities, and material schedule A/BA affiliates.**

   The definition of financial entity remains unclear and needs additional clarification. In general, we believe that financial entities should be limited to operating entities with meaningful obligations to third parties. Passive investment vehicles or subsidiaries that manage or hold investments predominantly on behalf of the insurer should not be considered financial entities. An operating entity may issue debt, create syndications, issue loans, accept deposits and/or generally act as a fiduciary. The activities of an operating entity require active management on behalf of third parties. In contrast, a passive investment vehicle, like an investment subsidiary, as defined by NAIC rules [Schedule D], or other subsidiary that holds investments on behalf of the insurer [e.g., Schedule BA entities], should not be considered a financial entity. This rubric of using active management on behalf of others versus simply holding or managing an
investment on behalf of the insurer works well to determine if an entity should be classified as a financial entity or non-financial entity, even when an entity, like a mutual fund, may have a mix of activities.\(^6\)

Based on the existing definition of “financial entity” in the Instructions, we believe that the Working Group intended to exclude passive investment vehicles and subsidiaries that manage or hold investments predominantly on behalf of the insurer, but we believe additional clarity is necessary to telegraph that intent.

As such, we recommend the following for your consideration:

“For purposes of this definition, a subsidiary of an insurance company whose predominant purpose is to manage or hold investments on behalf of the insurance company and its affiliated insurance (greater than 90% of the investment subsidiary’s assets are for these insurance affiliates) should NOT be considered a Financial Entity.”

If the interpretation of the definition of financial entity is correct, additional clarity is requested on how to record the various affiliates, including but not limited to non-US statutory investment entities and funds that roll-up to the ultimate financial entity and that may manage and hold investments on behalf of the insurer and third parties. Should such entities be split on the basis of US/non-US statutory status or simply included under the financial entity?

1.2 Additional clarity is also needed for the “exception to the exception” for “material” A/BA entities.

ACLI requests additional clarification on what the impacts are of building an exclusion for Schedule A/BA into the definition of “affiliate,” when it seems like the Schedule A/BA exclusion is an exclusion from de-stacking. We believe this may be better placed in the de-stacking instructions.

ACLI recommends that the exception to the exception for material A/BA items be limited to operating entities, and not apply to passive investment vehicles, which may be of significant size but would not provide a regulatory benefit by de-stacking from existing RBC treatment. If the Working Group adopts this exception it will also be necessary to adopt a threshold for materiality. (see comments above regarding desire for consistency in materiality thresholds). In addition, the Working Group will need to address the inconsistency between the “exception to the exception” and the direction in Paragraph 50 that values for non-insurance / non-financial U.S. RBC filers will not be de-stacked.

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\(^6\) For example, a mutual fund may have a mix of activities such as taking deposits, holding investments on behalf of third parties, they collect fee income. However, even if a mutual fund has passive investment activity, a mutual fund will generally have liabilities in excess of 5%, which means the mutual fund cannot be classified as an investment subsidiary under NAIC rules.
1.3 Treatment or charge for non-financial entities without a capital requirement and material Schedule A/BA entities

ACLI was unable to discern how the proposed charges for “other non-insurance/non-financial entities” and “material Schedule A/BA entities” were created. The Working Group field tested seven different potential charges for these entities, but staff is now recommending a new charge that was not field tested. Additionally, despite NAIC staff’s attempt to explain how the new 7% charge was created, our members are still unsure how the charge was derived, why it was selected, and why it differs substantially from the corresponding RBC treatment. Further clarification on this issue is necessary, including an explanation of why the Working Group is recommending a novel approach that has not been subject to field testing.

2. GCC Instructions.

2.1 The Instructions should be reviewed to ensure consistency regarding regulatory discretion and clarify expectations for certain elements.

For example, the Instructions provide several clear examples of lead-state supervisory discretion that could impact how the lead-state supervisor and the insurance group define the scope of the group (see e.g., para 18, para 20, and drafting note to para 61).

We recommend supplementing the Instruction’s definition of “ultimate controlling person” with a reference to the discretion provided to the lead-state supervisor in the Instructions (see e.g., para 18, para 20, and drafting note to para 61). This clarification ensures that the definitions are consistent with the discretionary language in the instructions, as provided in paragraphs 18, 20, and the note accompanying paragraph 61:

“Ultimate Controlling Person: As used in the NAIC’s Insurance Holding Company System Regulatory Act (Model #440) and as implemented by the lead state supervisor.”

2.2. We request that the Working Group revise the Instructions to provide clarity on the following items:

In light of the instructions for when de-stacking is not required, there needs to be additional, corresponding instructions about what should be included in “Schedule 1” and “Inventory” tabs, in light of instructions for when de-stacking is not required. For example, if an entity is not to be de-stacked, then presumably it should not be listed on Schedule 1/Inventory tabs. Otherwise, this sets up a confusing “include/exclude” decision, which is a different issue (goes to “scope of application”). We request that the instructions include language that clearly address this issue.

For Schedule Y entities that are not de-stacked, should they all be listed on the Questions tab, like Schedule A/BA are currently?

Additional instruction on Inventory B, Column 5 (reported intra-group guarantees, LOCs and other) would benefit from examples that demonstrate application. It appears that this column, like those near it, is intended only to eliminate double counting of capital. If the presumption is correct, then it would be helpful if this was noted in the instructions.

ACLI believes that scalars are an integral part of an aggregation method. We remain concerned that a significant number of countries lack a scalar. It is our understanding that the NAIC staff sought to develop scalars for the countries that had a material amount of business from U.S. parented groups within its borders. While it was understandable for the initial focus to be on countries with a material percentage of U.S. based insurers doing business there, the lack of scalars for certain jurisdictions has created material differences in their GCC ratio. If the NAIC lacks access to the appropriate dataset to create the scalars, we recommend allowing the lead state some flexibility with default assumptions.

In addition, there are formula errors in Column K. For example, K14 is supposed to be taking 12% of the average revenue, but instead it is taking 12% of Reported Calc Capital. Similar issues exist in cells K16, K18, K19, K21 and K22.

We believe the scaling factors for Non-Insurance Entities need a broad review. Specifically, the scaling factors for Asset Managers, financial entities with regulatory requirement, financial entities without a regulatory requirement, and other non-insurance/non-financial entities. The NAIC has selected some of the more conservative scaling factors from the 2019 field test and provided no explanation for their decisions. These factors require a larger discussion.

CONCLUSION

Thank you for the opportunity to provide these comments. ACLI welcomes the opportunity to discuss our comments with you in the future, and we would also welcome the opportunity to contribute to additional analysis and discussion regarding the issues raised in our letter.

Sincerely,

Mariana Gomez
Pure Relative Ratio vs. Excess Capital Ratio

- NAIC GCC proposals uses scalars to add capital regimes with the goal of comparability.

- Pure Relative Ratio (PRR) approach adjusts required capital only
  - Available capital is not adjusted and results in excess capital being distorted.

- Excess Capital Approach (ECA) adjusts both available and required capital (i.e. total asset requirements)
  - Excess capital is not affected.

Implications

- The capital ratio and excess capital are both relevant supervisory capital metrics.

- ECA better supports comparability by addressing both metrics.

- Excess Capital Approach takes a whole balance sheet approach as it assesses total asset required and accounts for reserve differentials.

- Excess Capital Approach creates a more level playing field regardless of an insurers’ subsidiary locations.

- Pure Relative Ratio will create an unlevel playing field depending on an insurer’s subsidiary locations.
Pure Relative Ratio (PRR) Example

PRR preserves the relative capital position versus industry average however it distorts excess capital.
- SII subsidiary’s capital ratio remains above industry avg after scaling and Japan stays below (see blue circles)
- Excess capital changes after scaling which creates an unlevel playing field (see red circles)

US insurer with SII subsidiary Unscaled

US insurer with SII subsidiary PRR Scaled

US insurer with Japan subsidiary Unscaled

US insurer with Japan subsidiary PRR Scaled

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<th>B: Reserve Margin</th>
<th>C: Required Capital</th>
<th>D: Excess Capital</th>
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<td>425</td>
<td>283%</td>
<td>175%</td>
</tr>
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1 Assuming US insurer is operating at industry avg capital ratio, Euro is above and Japan is below avg
Excess Capital Approach (ECA) Example

ECA preserves both relative capital position versus industry average and excess capital by adjusting available capital and creates comparability

- SII subsidiary’s capital ratio remains above industry avg after scaling and Japan stays below (see blue circles)
- Excess capital remains unchanged after scaling (see red circles)

### Excess Capital Approach

#### Excess Capital

<table>
<thead>
<tr>
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<tr>
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#### Best Estimate Liability

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<tr>
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<tr>
<td>Industry avg capital ratio</td>
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<tr>
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### Industry Capital Ratio

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### Excess Capital Ratio Scalar

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### Required Capital

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### Excess Capital

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<tbody>
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### ECA Scaled

#### Excess Capital Approach

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#### Best Estimate Liability

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### Industry Capital Ratio

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### Excess Capital Ratio Scalar

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### Total Assets

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<tr>
<td>Total Assets(^2)</td>
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### Solvency Ratio

<table>
<thead>
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### Industry Capital Ratio

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### Excess Capital Ratio Scalar

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</table>
July 20, 2020

Commissioner David Altmaier, Chair
Group Capital Calculation (E) Working Group
National Association of Insurance Commissioners

Via e-mail to Lou Felice: lfelice@naic.org

Re: Exposure of Proposed Group Capital Calculation Instructions and Template

Dear Commissioner Altmaier:

America’s Health Insurance Plans (AHIP) appreciates the opportunity to comment on the changes that have been proposed by the NAIC’s Group Capital Calculation (E) Working Group to the Group Capital Calculation (GCC) Draft Instructions and Template, as well as the related FAQ Document, and PowerPoint.

AHIP appreciates the hard work of the GCCWG and of NAIC staff in developing the GCC under tight timeframes as well as in suboptimal working conditions that persist with the ongoing pandemic. In a separate letter submitted on July 15, we stated our appreciation to the working group for recognizing appropriate exemptions and expedited treatments for filing of the GCC.

We have some comments below regarding the GCC Instructions that we hope will be seen as constructive. But we first want to call out what we see as clear “positives” in the revised draft GCC and acknowledge the efforts of you and your working group to bring these to bear:

- The overall approach maintains that the GCC is an analytical tool for use by the lead state that will not, in and of itself, dictate capital requirements.
- Appropriate exemptions and expedited treatments from filing all or part of the GCC template have been provided and which provide, in certain instances, for the Lead State Commissioner to use discretion to allow filing only of Schedule 1, i.e., as an analytical construct it could be a sufficient supervisory measure without aggregation to a single group-wide measure.
- Groups could exclude certain non-financial entities from the Scope of Application and large, decentralized groups could request up front a reduction in the scope.
• Determination of materiality of risk posed to the insurance group by non-insurance entities in the broader group will be a qualitative determination (the Financial Analysis Handbook Drafting Group is to consider appropriate criteria).
• Modified instructions for the GCC template are less onerous (than in field testing), i.e., with more grouping and less de-stacking.
• Senior and hybrid debt criteria and limits will accommodate a large majority of debt held by insurance groups to be recognized in group capital.

With that, AHIP would like to provide the following suggestions relative to the GCC Instructions.

I. Scope of Application

Determination of Material Risk

AHIP believes the GCC Instructions could improve the readability of the principle-based guidance for establishing the Scope of Application of the GCC. Currently, some of the principles are included in the section on “definitions” which follows other text where both an understanding of those definitions and the principles therein would be useful for the reader. As well, sections which would appear by the heading to be about principles are more focused on instructions for completing parts of the template.

The section of the GCC instructions on scope of application is intended to help the holding company and its lead state to reach an understanding as to whether a non-insurance entity within the Broader Group poses material risk to the Insurance Group. It should provide principles-based guidance for companies and their lead-state regulators to identify such entities that do not pose material risk and therefore can be excluded from the Scope of Application.

As a threshold matter, the GCC Instructions should provide a definition of “material risk” for purposes of the Scope of Application. In this context, we believe “material risk” should be defined as “risk emanating from a non-insurance entity that is of a magnitude that would adversely impact a group’s insurance operations and its ability to pay policyholder claims.” Likewise, the GCC Instructions should explicitly state that non-material entities within the Broader Group but outside the Insurance Group (as both terms are defined in the GCC instructions) should be excluded from the Scope of Application.

These points naturally follow from the fundamental reason for state insurance regulation and the stated objective of the GCC: policyholder protection. Indeed, paragraph 13 of the GCC Instructions already makes clear that “the overall purpose of this assessment is to better understand the risks that could adversely impact the ability…to pay policyholder claims”.

2
This reasoning is also in accordance with international standards. For example, under ICP 23, the fact that a non-insurance entity poses risk is not, alone, determinative of whether that entity should be in or out of the scope of group supervision; rather, to be considered included in scope, there also must be some means by which the non-insurance entity could actually transmit that risk to the group’s insurance operations, as well as a lack of adequate safeguards that would mitigate that risk of transmission. We believe that the GCC instructions currently embrace those concepts. However, terms such as “cross support mechanisms,” and “safeguards” are not defined and it is unclear how they are intended to apply in the context of the scope of application.

For effectuating the materiality analysis for purposes of the Scope of Application, AHIP believes it is necessary for holding companies and lead states to consider the facts and circumstances of a particular entity within a group in a holistic manner. Given the diverse structures and business models of insurers, it would be impracticable to develop a one-size-fits-all checklist of guidelines that would be useful for materiality determinations across all groups. Strict or formulaic quantitative measures are likewise an insufficient proxy for materiality. Instead, the materiality analysis must be assessed in the manner it has been historically – by considering the unique circumstances of the relevant entity and group. We believe that to be the intent of what has evolved through field testing, i.e., an interactive process whereby the group brings forward its suggestions as to entities that should be excluded from the scope of application for a discussion with the lead state, ultimately culminating in an agreement on the scope.

We are not suggesting to somehow upset that interactive process or discussion between the group and its lead state. Rather, AHIP simply recommends facilitating it with definitions for “cross support mechanisms” as well as “safeguards” over the possible transmission of risk between the subject entities of that discussion.

We note that the Form B and D processes entail similar considerations and are already enshrined in the state regulatory process. For example, a detailed review is made of inter-company transactions and agreements that could, depending upon their terms and other pertinent information, fall into the category of “cross support mechanisms” as contemplated by the GCC instructions. Examples could (depending on the facts and circumstances) include certain loans, transactions not in the ordinary course of business; guarantees or other undertakings for the benefit of an affiliate, management agreements, service contracts, cost-sharing arrangements, reinsurance agreements; tax allocation agreements, and more. These agreements are already filed and approved with states. States can leverage these processes already in existence for visibility into cross support mechanisms that may be able to transfer material risk.

As well, Enterprise Risk Reports filed with the lead state already provide information as to the existence of “enterprise risk” defined as “any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole…”
Taken together, Forms B and D and Enterprise Risk Reports establish examples of “cross support mechanisms” as well as whether there is risk that could have a material impact to the insurers in the group (presumably via transfer through at least one such mechanism). It stands to reason that in the GCC, only such risks of non-insurance non-financial entities outside the insurance group that are already identified through those processes could therefore have a material impact and for which the subject entity(ies) that are the source of that risk would therefore be included in the scope of the GCC.

Finally, the GCC Instructions currently contemplate excluding only non-material, non-financial entities from the Scope of Application. However, the Working Group should also consider allowing non-material financial entities within the Broader Group (but outside the Insurance Group) to be excluded from the Scope of Application. We understand that the Working Group views financial entities, in general, to be of greater risk than other affiliates. Even so, all entities that meet the broad definition of “financial” in the GCC Instructions do not necessarily pose material risk (as defined above) under all circumstances. The fact that an entity would be classified as “financial” for purposes of the GCC should be weighed as a factor in the materiality analysis described above, but that alone should not be determinative of materiality.

II. Risk Charges for Material Non-Insurance Entities

*Non-Financial Entities*

AHIP’s view is that risk charges for non-financial entities should be equal or very similar to the current charge in the sectoral RBC formulas, i.e., 3% in the case of health insurers. The GCCWG has not provided data to suggest that a more substantial risk charge is needed to protect policyholders. In addition, existing regulatory processes, such as the Form B and D processes, are already in place to ensure that the regulated legal entity is protected from the non-regulated, non-insurance entity. Adding an additional risk charge is unwarranted in light of existing regulatory requirements.

Further, the GCCWG has not provided data indicating that policyholders are any more at risk in a diversified insurance holding company than in a non-diversified group. If that is a concern, and if it is desired to consider changes to underlying RBC levels, that should be handled through the appropriate (e.g., Health) RBC Working Group.

*Financial Entities*

On a related matter, AHIP is concerned with the breadth of the expanded definition of “financial entity” in the GCC Instructions. If the Working Group maintains this expanded definition of “financial entity”, we recommend using a capital charge that is roughly equivalent to an entity’s current post-covariance RBC charge. If it is desired to consider changes to underlying RBC levels, that should be handled through the appropriate (e.g., Health) RBC Working Group.
The exposed GCC Instructions provide that certain non-insurance affiliates of an insurer be deemed as financial. We understand that the Working Group views such affiliates to be of greater risk relative to other types of affiliates, and by deeming them to be financial, they would be listed separately for analytical purposes as well as subjected to a higher capital charge. Specifically, the exposed GCC Instructions add the following to the definition of “financial entity”:

“Affiliates that are integral to the performance of the insurance contract or the provision of insurance or financial products or services to policyholders, members or depositors [Examples include: agents, reinsurance intermediaries, claims adjusters or processors, third party administrators, pharmacy and other benefit managers, provider groups or entities that provide more than X percent of the policy benefits under policies issued by insurers within the group, and ] will be treated as financial entities.”

AHIP fundamentally disagrees with the notion that certain affiliates are inherently riskier than others, as based on the language cited above which would effectively deem some affiliates to be considered financial, including third-party administrators and pharmacy benefit managers, provider groups, and pharmacy benefit managers. There is a wide array of types of non-affiliated entities within insurance groups, and it is overly simplistic to conclude that all that are somehow associated with assisting the insurer with contract performance or policyholder services are inherently riskier than others. Indeed, the Form B and D processes recognize that transactions with affiliates may have risks, and that a determination of such risk is very fact-specific to the subject entities and underlying transactions or agreements.

Further, subjecting these entities to a capital charge for financial entities (12% of 3-year average gross revenue – possibly to be increased to 15%) could result in a significant additional charge as compared to current RBC for several reasons:

- The base of the entity’s charge would be changed from BACV to gross revenue.
- The factor applied to the base would increase from 7% BACV to 12% of gross revenue.
- Removing the charge from the insurer’s RBC—where it is subject to the covariance adjustment—to a separate line item for the affiliate itself, where the capital charge is aggregated without a similar covariance calculation or other recognition of risk diversification.

In addition, AHIP has concerns about the reference to “entities that derive a majority of their gross revenue from services that are integral to the performance of the insurance contracts within the group or from the provision of other financial services to policyholders within the group will be considered a Financial Entity without a regulatory capital requirement” in the definition of “Financial Entity.” The GCCWG has not provided evidence to suggest that services performed by such affiliates add risk to the group. In our view, because of greater regulatory oversight
through the Form B and D and other regulatory processes, these arrangements actually reduce the group’s risk.

Therefore, AHIP recommends using an equity-based capital charge that is roughly equivalent to the current post-covariance charge for such affiliates in RBC.

III. Treatment of Debt as Qualifying Capital

AHIP very much appreciates that the GCC will, in large measure, recognize certain senior and hybrid debt as capital. Debt is a critical capital resource for many of our members. The capital markets are well-established and have proven to be a reliable resource for the funding of debt instruments, even during the 2008-2009 financial crisis. Experience has shown time and again that the debt markets can be tapped quickly and utilized to enhance policyholder protection in a flexible and cost-efficient manner. Moreover, in periods of macroeconomic stress such as the financial crisis, the use of debt can be a more attractive alternative to the issuance of stock in depressed markets while also avoiding dilution of shareholder interests.

IV: Other Comments

In the attachment, AHIP has provided other comments and questions of a technical nature that were provided by our members.

* * * * * * *

Again, AHIP appreciates the opportunity to offer comments on the GCC Instructions and Template.

Sincerely,

Bob Ridgeway
Senior Government Relations Counsel
1. We note that there are many areas within the template that are labeled “further work needed” or “technical discussions needed.” For example, “Summary Group Alternative 4” is blank. Also, in Summary 2 – Top Level: No formulas appear in the sensitivity section. When will companies have a completed template to review and test, and what other opportunities will there be to provide input on the template based on their review?

2. “Summary Alternative 5 – Organizational Option” is missing from both the template and the instructions. This option is intended to allow the reporting entity to present a summary of the results to assist regulators with understanding the submission.

3. Schedule 1D – Reporting “net dividends paid/(received)” is more practical and meaningful, because many entities act as “pass-through” for moving dividends up the corporate structure. In that context, “dividends received and not retained” becomes unnecessary.

4. I.A.2 in the instructions suggests that another consequence of “subsidization” may be “upward pressure on premiums to the detriment of insurance policyholders.” This implies that the GCC might somehow be a factor in regulating insurance premium rates, which we believe to be an inappropriate use of the GCC based on our understanding of its objectives.

5. I.A.2 in the instructions states that the GCC “provides an additional early warning signal to regulators so they can begin working with a company to resolve any concerns in a manner that will ensure that policyholders will be protected” and will “allow them to make informed decisions on both the need for action, and the type of action to take.” As stated, this is an overly ambitious aspiration for the GCC. In particular, at least in early years of implementation, the GCC will produce a ratio that would require much reliance on other existing regulatory tools to interpret—not the other way around. We understand that the Financial Analysis Handbook Drafting Group is working on guidance for regulators as to how the GCC would be utilized as part of financial analysis and in developing the Group Profile Summary. We recommend deleting the cited phrases in the instructions and await to comment on the work of the Drafting Group in that regard.

6. II.E.20. of the instructions discusses an annual redetermination of scope. This raises concerns about the meaningfulness of year-to-year trends in the GCC should the scope change. And if companies automate processes to produce the GCC, revisions would have to be made on an annual basis.
7. AHIP is unclear as to why the NAIC is proposing to collect data on intangible assets, which is not an element that is necessary to calculate the GCC.
July 20, 2020

Commissioner David Altmaier, Chair
Group Capital Calculation (E) Working Group
National Association of Insurance Commissioners

Re: Proposed Revisions to the Group Capital Calculation Instructions

Dear Commissioner Altmaier:

The American Property Casualty Insurance Association (APCIA) appreciates the opportunity to comment on the Group Capital Calculation (E) Working Group’s revised draft Group Capital Calculation (GCC) Instructions. APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

APCIA reiterates our appreciation that the NAIC is moving with the appropriate speed to develop the GCC and help incorporate it into state law. We likewise thank the Working Group and NAIC staff for their continued efforts to advance this important project. We offer these comments on the revised GCC Instructions for the following three topics: (1) Scope of Application, (2) risk charges for material non-insurance entities, and (3) treatment of capital instruments and debt.

I. Scope of Application

A. Determination of Material Risk

APCIA believes the GCC Instructions should include more detailed and principle-based guidance for establishing the Scope of Application of the GCC. In particular, guidance is needed for determining whether a non-insurance entity within the Broader Group poses material risk to the Insurance Group. This will allow companies and their lead-state regulators to identify such entities that do not pose material risk and therefore can be excluded from the Scope of Application, with as much consistency as possible across groups and states.

As a threshold matter, the GCC Instructions should provide a definition of “material risk” for purposes of the Scope of Application. In this context, we believe “material risk” should be defined as “risk emanating from a non-insurance entity that could adversely impact a group’s insurance operations and ability to pay policyholder claims.” Likewise, the GCC Instructions should explicitly state that non-material entities within the Broader Group (but outside the Insurance Group) should be excluded from the Scope of Application.
These points naturally follow from the fundamental reason for state insurance regulation and the stated objective of the GCC: policyholder protection. Indeed, paragraph 13 of the GCC Instructions already makes clear that “the overall purpose of this assessment is to better understand the risks that could adversely impact the ability … to pay policyholder claims”. This reasoning is also in accordance with international standards. For example, under ICP 23, the fact that a non-insurance entity poses risk is not, alone, determinative of whether that entity should be in or out of the scope of group supervision; rather, to be considered included in scope, there also must be some means by which the non-insurance entity could transmit that risk to the group’s insurance operations. In sum, there is more than sufficient justification for the GCC Instructions to make clear that the crux of the materiality analysis is whether an entity could adversely impact a group’s ability to pay policyholder claims, and that non-material entities (as determined using the definition of “material risk” in the preceding paragraph) should be excluded from the Scope of Application.

For effectuating the materiality analysis for purposes of the Scope of Application, APCIA believes it is necessary to consider the totality of the facts and circumstances of a particular entity within a group. Given the diverse structures and business models of insurers, it would be impracticable to develop a one-size-fits-all checklist of guidelines that would be useful for materiality determinations across all groups. Strict or formulaic quantitative measures are likewise an insufficient proxy for materiality. Instead, the materiality analysis must consider the unique circumstances of the relevant entity and group.

To that end, APCIA recommends developing a list of factors related to whether an entity could adversely impact a group’s ability to pay policyholder claims. Insurers and regulators could then use these factors to undertake a materiality analysis based on the totality of the facts and circumstances by considering the factors and how they apply to the group’s business. After this analysis, a determination can be made as to whether an entity is material. To be clear, no single factor is determinative of materiality of risk, nor should these factors be used as a scorecard or checklist. Below we offer examples of factors that should be considered when determining materiality of risk:

- The nature of the subject entity and specific activity(ies) that give rise to the risk.
- The means by which risk can be transmitted, or prevented from being transmitted, from the entity to the group’s insurance operations.
- The means applied for risk mitigation or transfer to third parties and the extent to which risk is reduced or transformed (e.g., to credit risk).
- Past experience (i.e., the extent to which risk from the entity has impacted the Insurance Group over prior years/cycles).
- The existence of cross-support mechanisms between the entity and the Insurance Group (e.g., guarantees).
- The location of the entity within the Broader Group and how direct or indirect the linkage may be.
- The existence and relative strength or effectiveness of structural safeguards that could minimize the transmission of risk to the Insurance Group (e.g., whether the corporate shell can be broken).
• The existence of sufficient capital within the entity itself to absorb losses under stress and/or if adequate capital is designated elsewhere in the Broader Group for that purpose.
• The extent to which there is risk diversification (e.g., where risks of one or more entities outside the Insurance Group are potentially offset (or exacerbated) by risks of other entities) and whether the corporate structure or agreements allow for the benefits of such diversification to protect the Insurance Group.
• The degree to which capital management across the Broader Group has historically relied on funding by the Insurance Group to cover losses of the subject entity.
• The degree of risk correlation between the subject entity and the Insurance Group.

The GCC Instructions currently contemplate excluding only non-material, non-financial entities from the Scope of Application. However, the Working Group should also consider allowing non-material financial entities within the Broader Group (but outside the Insurance Group) to be excluded from the Scope of Application. We understand that the Working Group views financial entities, in general, to be of greater risk than other affiliates. Even so, all entities that meet the broad definition of “financial” in the GCC Instructions do not necessarily pose material risk (as defined above) under all circumstances. The fact that an entity would be classified as “financial” for purposes of the GCC should be weighed as a factor in the materiality analysis described above, but that alone should not be determinative of materiality.

B. Scope of Application Starting Point

APCIA supports the new starting point proposed in the revised GCC Instructions that would allow large decentralized groups a reduction in Scope of Application up front in some cases. Likewise, we agree with NAIC staff’s suggestion that regulatory evaluation of an up-front reduction in Scope of Application should be based on established guidance that can be applied consistently across states. For this purpose, the GCC Instructions should provide guidance that is similar to the materiality test detailed in the preceding section. We believe utilizing similar guidance would be appropriate since the underlying purpose of excluding entities from the Scope of Application is the same, regardless of whether entities are first listed on Schedule 1 or excluded up front.

II. Risk Charges for Material Non-Insurance Entities

A. Non-Financial Entities

In the short term, risk charges for non-financial entities should be 3% of 3-year average revenue. By “short term” we mean during the first few years of the GCC’s implementation, a period during which experience will be gained that can then be analyzed in more detail and across more groups than was possible in field testing. In the meantime, APCIA recommends using average revenue over a 3-year period as the base for the risk charge in order to minimize volatility.

Once some experience is gained with the GCC, the Working Group should consider a variable risk charge that would be more risk-sensitive based on the industry or activity(ies) in which the subject non-financial entity participates. APCIA does not believe that the variable charge needs to be developed in an overall complex fashion, especially since the published field-test results show this charge had a fairly minor impact overall (e.g., as compared to the inclusion of debt as qualifying capital or the use of scalars). Rather, a future variable charge could be as simple as a
construct based on an assigned risk category (e.g., high/medium/low) with a differentiated charge for each.

**B. Financial Entities**

APCIA is concerned with the breadth of the expanded definition of “financial entity” in the GCC Instructions. If the Working Group maintains this expanded definition of “financial entity”, we recommend using, in the short term, a capital charge that is roughly equivalent to an entity’s current post-covariance RBC charge, while also developing a high/medium/low-risk construct with differentiated charges for the long term.

The exposed GCC Instructions provide that certain non-insurance affiliates of an insurer are deemed as financial. We understand the Working Group views such affiliates to be of greater risk relative to other types of affiliates, and by deeming them to be financial, they would be listed separately for analytical purposes as well as subjected to a higher capital charge. Specifically, the exposed GCC Instructions add the following to the definition of “financial entity”:

> “Affiliates that are integral to the performance of the insurance contract or the provision of insurance or financial products or services to policyholders, members or depositors [Examples include: agents, reinsurance intermediaries, claims adjusters or processors, third party administrators, pharmacy and other benefit managers, provider groups or entities that provide more than X percent of the policy benefits under policies issued by insurers within the group, and] will be treated as financial entities.”

We have some concerns about the language cited above, which would effectively deem some affiliates to be considered financial. There is a wide array of types of non-affiliated entities within insurance groups, and it seems overly simplistic to conclude that all that are somehow associated with assisting the insurer with contract performance or policyholder services are inherently riskier than others. Subjecting these entities to a capital charge for financial entities (12% of 3-year average gross revenue – possibly to be increased to 15%) could result in a significant additional charge as compared to current RBC, for several reasons:

- The base of the entity’s charge would be changed from BACV to gross revenue.
- The factor applied to the base would increase from 7% BACV to 12% of gross revenue.
- Removing the charge from the insurer’s RBC—where it is subject to the covariance adjustment—to a separate line item for the affiliate itself, where the capital charge is aggregated without a similar covariance calculation or other recognition of risk diversification.

Therefore, in the short term, APCIA recommends using a capital charge that is roughly equivalent to the current post-covariance charge for such affiliates in RBC. Over the first few years of the GCC’s implementation, data can be collected and used to derive a more risk-sensitive charge, but also one that is pragmatic to develop and implement (e.g., a differentiated charge for entities of high/medium/low risk as determined by specified criteria).
III. Treatment of Debt as Qualifying Capital

APCIA very much appreciates that the GCC will, in large measure, recognize certain senior and hybrid debt as capital. Debt is a critical capital resource for many of our members. The capital markets are well established and have proven to be a reliable resource for the funding of debt instruments, even during the 2008-2009 financial crisis. Experience has shown time and again that the debt markets can be tapped quickly and utilized to enhance policyholder protection in a flexible and cost-efficient manner. Moreover, in periods of macroeconomic stress such as the financial crisis, the use of debt can be a more attractive alternative to the issuance of stock in depressed markets while also avoiding dilution of shareholder interests.

There is, however, an overarching issue that is presented by the way debt is treated in the proposed GCC Instructions. The treatment of debt differs in some key aspects from that which was adopted by the International Association of Insurance Supervisors (IAIS) in the Insurance Capital Standard (ICS) in 2019—which was the culmination of a long and hard negotiation process with U.S. interests supported by the NAIC, Federal Reserve Board (FED), and Federal Insurance Office (“Team USA”). As a result, and given the nature of the differences, the GCC could be viewed as less credible by other jurisdictional supervisors including those who may be parties to a Covered Agreement. Comparability of the GCC with the ICS is a looming issue on the horizon, the resolution of which can impact the views of many IAIS member jurisdictions about the efficacy of state-based regulation over U.S.-based insurance groups.

At the same time, the FED is working to complete its Building Block Approach (BBA) applicable to insurance groups under its supervision (i.e., savings and loan holding companies). The currently proposed approach in the BBA is more closely aligned with the principles-based criteria in the ICS than with the approach taken in the exposed GCC Instructions. While the proposed BBA approach would disallow debt except for grandfathered surplus notes, in some respects that is due to the unique mandate of the FED. For example, a criterion in the proposed BBA is that financial instruments be “subordinated to depositors and general creditors of the building block parent”, thus reflecting the FED’s mandate to protect the depository institution within the group.

With those high-level comments as an introduction, the following comments are intended as constructive suggestions to address some technical points in the GCC Instructions and template regarding debt. In addition, we offer some thoughts that may be helpful in addressing international perceptions.

A. Qualifying Instruments

APCIA recommends using criteria, rather than defined terms, to identify qualifying capital instruments. The GCC takes the approach of testing whether certain types of debt qualify as capital—specifically, senior debt, hybrid debt, surplus notes and “similar” instruments, and “other debt”. This contrasts with the approach taken by the IAIS in its ICS V.2.0 for the Monitoring Period, and by the FED in its proposed BBA. Both the ICS and the FED focus on criteria (e.g., permanence, loss absorbency, etc.) that are agnostic as to the title or name of a particular instrument.
There are two implications that we see. First, should the GCC go forward as currently proposed, the Working Group may need to supplement the GCC Instructions with definitions for each type of instrument. For example, “hybrid debt” is not defined in the Instructions. We understand that rating agencies treat subordinated debt issued by a parent company as “hybrid debt” as long as it is long-dated and has provisions to defer interest payments for a period of time. This could give rise to variation in treatment of hybrid debt (e.g., it may be unclear to a group if it should classify it as “hybrid” or as “subordinated” debt). On another level, comparability with the ICS needs to be considered, and on this point it seems that the more important issue is not whether types of debt are called out by name or more generically by tier, but whether comparable criteria to the ICS are used.

**B. Treatment of Senior and Hybrid Debt**

Using the calculation described below, the Instructions provide for an “additional capital allowance”. We first note this terminology has a potential connotation of an amount that is granted, in this case, to qualify as capital. We do not believe that to be the true nature of the calculation. Rather, for instruments that qualify for capital treatment based on specified criteria, it is a calculation to determine whether the aggregate dollar value of those instruments is within supervisory limits, and if not, the excess amount that would then disqualify. APCIA believes that focusing the Instructions’ text on “limits”, rather than “allowance”, will help in some respects with perceptions about comparability.

For subordinated senior and hybrid debt instruments meeting specified criteria, the GCC Instructions are detailed and have certain options remaining for consideration by the Working Group. In brief, the amount that would qualify would be determined based on the following inputs:

1. Tracked down-streamed proceeds.
2. Total paid-in capital and surplus of U.S. insurers.
3. A proxy value, i.e., for senior debt, 30% of available group capital pre-debt plus outstanding senior and hybrid debt (15% in the case of hybrid debt).

The amount that would qualify for treatment as capital in the GCC would be the larger of (3) over the larger of (1) or (2), subject to two caps:

- The total amount of outstanding senior and hybrid debt.
- The amount of senior debt and hybrid instruments allowed in group capital cannot exceed 50% of group capital before such debt.

While APCIA is of course not privy to the confidential, company-specific results of GCC field testing, it appears based on the wording in the GCC Instructions alone that in the vast majority of cases the amount of paid-in capital and surplus will exceed tracked down-streamed proceeds and, possibly, the proxy values as well. (The NAIC reported that field-test results showed only a handful of groups that were impacted by the limit, and only half of those resulted in a “haircut” greater than 10% of reported debt). This, in part, is because the calculation includes the paid-in capital and surplus of all U.S. insurance entities in the group, regardless of the source of that capital (whether from debt proceeds or otherwise).
The GCC Must Test for Subordination to Policyholders. There are indications in the exposed GCC Instructions that consideration is being given to simplifying the process by eliminating the down-streaming criterion altogether such that qualified debt would be the greater of (3) over (2), above, subject to the caps. If so, there would in effect be no explicit test to support that the debt is structurally subordinated. Recognizing that U.S. senior debt is not contractually subordinated, this could raise issues about international perceptions about the GCC. Team USA argued long and hard to support structural subordination in the ICS, finally achieving victory in Abu Dhabi last November. While use of structural subordination in the ICS is termed by the IAIS as a “national discretion”, it is an option nonetheless in the ICS that is now recognized by the IAIS and its key member jurisdictions on the IAIS Executive Committee who voted to adopt ICS 2.0. Therefore, we have concerns with the notion of deleting the down-streaming criteria without any other criteria to support subordination, as explained in the following paragraphs.

At a time when comparability with the ICS is an issue that is quickly coming to the forefront, it is not clear why the GCC would now take a very different route with respect to the treatment of debt. While down-streaming has raised many questions about how debt proceeds can be tracked and verified, the ICS criteria are workable and rely in large measure on each group and its group-wide supervisor to make that determination in light of the unique facts and circumstances surrounding each respective group. The IAIS avoided prescribing detailed rules or criteria for tracking. APCIA believes the NAIC should do the same in the GCC, leaving the determination of the amount down-streamed to the lead state working in conjunction with the group.

APCIA believes a similar approach (to the ICS) can be just as workable in the GCC—focusing on criteria that are agnostic to the type or name of any particular financial instrument. This would include criteria to support that the qualifying amount of debt to be treated as capital is actually subordinated (either contractually by the terms of the instrument, or structurally), and other principle-based criteria, as in the ICS, to support permanence, loss absorbency, etc. Some refinement of the ICS criteria may be necessary to address U.S.-specific nuances for the GCC. Indeed, structural subordination is an example of such a nuance for which Team USA successfully negotiated before the IAIS to accommodate U.S. practices in the ICS. This would avoid a comparability issue with respect to which capital instruments qualify as capital resources. That said, one area where there could be explainable and appropriate differences with the ICS involves limits on the amount of those qualifying capital resources (such as described below with respect to surplus notes, which in our view, and as argued by Team USA before the IAIS in the case of the ICS, should have no limit) given some of the unique features of state-based regulation in the United States.

Therefore, to the questions posed by the exposed GCC Instructions as to whether the down-streaming / tracking test should be maintained and, if so, what criteria should be in place, APCIA recommends keeping the test and using the criteria (with any U.S.-specific refinements necessary) that have been approved in ICS 2.0 for the Monitoring Period. That is, structurally subordinated debt should increase available capital to the extent the group and its lead state have determined such amount supports the insurance operations and is insulated from recourse by the lender, through tracking of down-streamed proceeds of the instruments into insurance subsidiaries.
There is, however, one other criterion for down-streaming that the Working Group could consider as an option to tracking down-streaming. Fundamentally, jurisdictional supervisors who permit subordinated debt to be treated for regulatory purposes as capital do so because policyholders remain protected; whether structurally subordinated or by the terms of the instrument, legally enforced restrictions and safeguards prevent the lender from “pulling the rug out from under” policyholders such that the debt is considered sufficiently permanent and loss absorbing. The issue becomes, to what assets and how much of those assets would the lender nonetheless have recourse?

As a practical matter, the lender would have recourse only to the liquid assets that remain in the entity that issued the debt (i.e., the holding company in the case of senior debt). For many groups, the unconsolidated balance sheet of the holding company (for public companies, the separate financial statements of the registrant are publicly reported in Form 10-K filed annually with the SEC) reflects a very large, illiquid investment in insurance subsidiaries, control over which is subject to regulatory oversight and approval. The amount of other, liquid assets in the holding company is typically much smaller. So, another option to test structural subordination is to limit the amount of senior debt to qualify as capital to that which is in excess of the liquid assets in the holding company. This would be easier to determine and to verify and may produce a value that would satisfy the group. If not, the group could revert to the tracking of down-streaming criterion.

C. Other Debt

Debt other than senior and hybrid debt is not allowed as capital pursuant to the exposed GCC Instructions. However, we understand that data will be collected in the GCC template for purposes of facilitating a sensitivity test based on a 15% allowance (of available group capital pre-debt plus outstanding senior and hybrid debt). We understand that the Working Group may later consider allowing limited amounts of other debt as capital if criteria can be determined. APCIA is open to the possibility of some allowance for other debt in the future. However, we believe that consideration should also be given to comparability with the ICS and adherence to the principle of subordination.

D. Surplus Notes

APCIA agrees surplus notes should be treated as capital in the GCC and with no limit, as proposed in the Instructions. We understand that Team USA argued before the IAIS for a similar outcome in the ICS, especially for mutual insurance companies. The IAIS ultimately decided to make some accommodations for mutual-company surplus notes (included in Tier 2 instruments) but retained limits, albeit limits that are slightly higher than those applied to non-mutuals. Nonetheless, APCIA supports the GCC treatment with no limit, given the well-established supervisory requirements and safeguards that surround all aspects of the issuance, maintenance, and repayment of surplus notes in the U.S.

E. Foreign Debt

APCIA likewise supports the GCC’s treatment of foreign debt. For debt issued by foreign entities, the GCC respects the treatment afforded by the local supervisor while also holding to the principle of subordination, whether that be achieved structurally or through the terms of the
instrument. If subordination is in place and if approved by the local supervisor as capital, the debt would qualify as capital in the GCC, a position with which APCIA agrees.

F. Overall Limitations on Debt as Capital

The exposed GCC Instructions have an overall limit on the use of debt as capital (i.e., senior debt and hybrid instruments allowed in group capital cannot exceed 50% of group capital before such debt). It is unclear if “group capital” as used for this test would include full value for surplus notes and qualifying foreign debt. Given that there is a separate limit applied to senior and hybrid debt – no more than 100% of such debt can qualify – it would seem appropriate that the overall limitation should apply to all debt, including surplus notes and foreign debt. That said, and as noted above, APCIA supports no limit on surplus notes of mutual insurers. It is important that all insurers be able to include unlimited amounts of capital from at least one organic source and one external source. In the case of stock companies, those would be retained earnings and common stock, respectively. In the case of mutuals and similar companies that cannot issue common stock, those would be retained earnings and surplus notes.

We observe that there are members of NAIC staff who participate in the development of the GCC as well as field testing of the ICS through their role on the IAIS Capital and Solvency Field Testing Working Group. Only they would be in a position to assess how the impact of the proposed limits in the GCC compare to those in the ICS for groups that have participated in both the GCC and ICS field testing exercises. Because APCIA is not in the same position, we do not offer a view on the overall limit of 50%. However, we do recognize that the comparability issue is also an important part of navigating the way forward with the GCC and encourage the Working Group to give due consideration in the context of the overall limit.

We look forward to discussing our comments with you and the Working Group.

Sincerely,

______________________________
Stephen W. Broadie
Vice President, Financial & Counsel

______________________________
Matthew B. Vece
Manager & Tax Counsel
July 20, 2020

Commissioner David Altmaier
Florida Office of Insurance Regulation
Chair, NAIC Group Capital Calculation (E) Working Group
via e-mail to ddaveline@naic.org and lfelice@naic.org

Re: GCC Working Group Exposures

Dear Commissioner Altmaier:

A coalition of fourteen companies (Brighthouse Financial, CNO Financial, Genworth Financial, Global Atlantic Financial Group, Hannover Life Reassurance Company of America, Jackson National Life Insurance, Lincoln Financial Group, National Life Group, Principal Financial Group, Protective Life, Reinsurance Group of America, Sammons Financial Group, Standard Insurance Company/StanCorp Financial Group, and Transamerica) (collectively, the “Coalition”) appreciates the opportunity to comment on the exposure of the: a) Staff Group Capital Calculation (GCC) PowerPoint (the “PowerPoint”); b) revised draft instructions; c) revised GCC template; and d) FAQs relating to these documents.

The Coalition’s primary area of advocacy has been the need for the GCC to adhere fully to legal entity rules in support of the state-based legal entity solvency system. Accordingly, we welcome significant improvements within the exposed materials that eliminate several proposed “on top adjustments.” In this letter, we specifically want to indicate our support for the proposed treatment of XXX/AXXX captives.

In particular, we understand the revised instructions to include no “on top adjustments” for captives or permitted/prescribed practices. Furthermore, slide 11 of the PowerPoint indicates that a proposed sensitivity analysis for XXX/AXXX captives will be excluded from the GCC template “upon referral to an E Committee Group or Subgroup for Further Risk Assessment.” Once this occurs, we understand that further analysis would be separate from the GCC itself. Assuming our understanding is correct, the Coalition fully supports the proposed treatment and looks forward to working with the relevant group of regulators.

We thank you, the Working Group, and NAIC staff for your attention to this letter and prior Coalition correspondence. We look forward to continuing to work with you and your team as the NAIC moves towards finalization of the GCC.

Sincerely,

Brighthouse Financial
CNO Financial
Genworth Financial
Global Atlantic Financial Group
Hannover Life Reassurance Company of America
Jackson National Life Insurance
Lincoln Financial Group
National Life Group
Principal Financial Group
Protective Life
Reinsurance Group of America
Sammons Financial Group
Standard Insurance Company/StanCorp Financial Group
Transamerica
July 20, 2020

Lou Felice  
Solvency and Capital Policy Advisor  
National Association of Insurance Commissioners

Dear Mr. Felice,

Global Atlantic appreciates the opportunity to comment on the exposure draft of the revised GCC instructions and the revised GCC template. Our comments address concerns with the following:

- Capital calibration
- Downstream tracking of debt
- Scalar methodology
- Scalar governance

We also seek guidance on whether GAAP equity values should include or exclude OCI when GAAP is used as the accounting method to determine the carrying value of an entity.

**Capital Calibration**

We have concerns with the current proposed approach of using the trend test level of 300% ACL as the capital calibration level. First of all, 300% ACL is inconsistent with the 200% ACL (= 100% CAL) calibration level widely used in the insurance industry for RBC. We believe this will lead to confusion and misunderstandings when comparing RBC to GCC, potentially undermining the current RBC standard. RBC ratios are typically in the 350% to 450% range, but the GCC ratio will be much lower. For example, if the underlying RBC ratios of the companies in the group average 450% RBC, the resulting group capital ratio will be ~300%.

In addition, we believe the insurance industry’s current reporting of two capital calibration levels, (100% ACL and 200% ACL) results in confusion and frequent misinterpretation of reported ratios; adding a third calibration level for the GCC of 300% ACL will compound the problem. We believe this will lead to additional confusion and misunderstanding by users of financial information, including the regulatory, rating agency, and banking communities.

We strongly request that the NAIC adopt a 200% ACL calibration level for the GCC.

**Downstream Tracking of Debt**

The current instructions rely on downstream tracking in order to count debt proceeds as part of available capital. In practice, our company borrows externally in order to downstream it to the insurance companies; however, we have not found it necessary to track downstream transactions and question whether a tracking system would simply introduce complexity without providing a benefit.
We are in favor of a proposal to eliminate downstream tracking logic and replace it with a simple comparison to paid-in capital and surplus, for the following reasons:

- Simpler, more efficient, and more reliable test
- Avoids complications that could result from debt that has been refinanced by the parent as there would be no contribution of the debt amount issued.
- Avoids complications of tracking upsize transactions where debt is borrowed at one date and then down streamed at a different date.
- Avoids complications of tracking the reverse: dividends which are up streamed. Are those upstream transactions to be netted against down streamed capital or not?
- Avoids complications and questions related to M&A transactions – if a company is acquired, does the new parent company automatically assume the historical relationship of down streamed debt, so long as its debt at least equals the debt of the old parent company?

If the downstream tracking approach is maintained, once layers of transactions of the type described above are introduced, a comprehensive downstream tracking system will need to be developed, communicated, applied and reported across the industry in a way which is comparable and reliable. Our view is that industry and regulator efforts to track down streaming will not add value. In our case, the resulting capital adjustment will be the same whether we develop a downstream tracking process or whether we run a simple test ensuring that paid in capital at least exceeds the capital adjustment amount.

Scalar Methodology

We support the Excess Relative Ratio Approach for scaling non-U.S. capital ratios to U.S. RBC. This method utilizes two anchor points for scaling:

1. The respective industry average capital ratio
2. The regulatory intervention level.

The alternative scaling approach, the Pure Relative Ratio, relies solely on the industry average capital ratio to translate a non-U.S. capital ratio to U.S. RBC. It does not take in to account the regulatory intervention level. Since the Pure Relative Ratio approach adjusts required capital only, available capital is not adjusted, resulting in excess capital being distored. Since the Excess Relative Ratio approach adjusts both available capital and required capital, excess capital is not affected.

Thus, the Pure Relative Ratio lacks a mechanism to ensure that a non-U.S. firm at the regulatory intervention level within it’s respective country will be at the U.S. RBC intervention level once scaled. This is a material fault. Again, we support the Excess Relative Ratio Approach, and its ability to align regulatory intervention levels across jurisdictions.

Scalar Formulation

Transparency of how the scalars are calculated will be critical, regardless of which scaling methodology is selected. In order to appropriately manage capital under the group framework, firms must have a thorough understanding of how scalars behave. Many non-U.S. countries rely on market-
value based capital ratios, which have potential to behave differently than the book-value based RBC measure.

We believe the following themes should define the scalars:

Consistency – scalars should be calculated and applied consistently across all non-U.S. regimes.

Specificity – scalars should be discretely computed and applied amongst life, property casualty and health insurance companies.

Stability – the results of applying scalars to Non-U.S. capital ratios should not be volatile; for example, converting to U.S. RBC should not yield a significant headwind in one year, and a significant tailwind in the following year.

Additionally, we believe answers to the following questions are critical for firms to understand the impact of the scalars:

1. How is the country average computed? Is the concept of country average based on equal weighting each firm? Alternatively, is it size weighted, such that a large provider in Country Y may dominate the average of Country Y?

2. How frequently will the scalars be updated?

3. Will scalars derived from Year 20XX be applied to 20XX actual results, or will timing of filings and data availability create a lag?

4. Will scalars take into consideration only a single year, or alternatively, will a rolling average mechanism be utilized?

**GAAP Equity**

The GCC instructions are silent on whether OCI should be included or excluded when GAAP equity is used as the carrying value of an entity. Companies typically report GAAP equity excluding OCI to lessen the amount of volatility that can arise when including market value adjustments of assets. Excluding OCI is also consistent with statutory accounting rules that generally do not reflect the market value of assets. We suggest that the GCC instructions include guidance on whether OCI should included or excluding when reporting GAAP equity. Otherwise there could be inconsistencies in how companies report GAAP equity amounts.

Again, thanks for allowing us to provide our comments on the revised GCC instructions.

Sincerely,

Lauren Scott
Head of Regulatory and Government Affairs
Global Atlantic Financial Group
July 20, 2020

Via Electronic Delivery

Commissioner David Altmaier
Florida Office of Insurance Regulation
Chairman, NAIC Group Capital Calculation (E) Working Group
Via email to Lou Felice (lfelice@naic.org)

Re: The National Association of Insurance Commissioners (“NAIC’s”) Draft Group Capital Calculation (“GCC”) Instructions and Template

Dear Commissioner Altmaier:

Prudential Financial, Inc. (“we”) thank the Group Capital Calculation Working Group (“Working Group”) for continuing to seek input on key elements of the GCC. We support the development of supervisory tools, such as the GCC, that will enhance state regulators’ ability to protect policyholders and insurance markets. Further, we believe the GCC framework – through its employment of an inventory approach to obtain insight into all entities within the group and the location and sources of capital – can achieve the NAIC’s stated objective of providing state regulators a “panoramic, transparent view of the interconnectedness, business activities, and underlying capital support for an insurance group.”

While the foundation of the GCC framework is strong, we believe appropriate outcomes for a number of key design elements is essential to ensure the final version provides state regulators appropriate insight into risks while minimizing the potential for unintended consequences. In the pages that follow, we identify the approaches that we believe would best position the GCC to accomplish these objectives.

We again thank the Working Group for seeking stakeholder input on key elements of the GCC and would welcome the opportunity to discuss the information included in this response should the Working Group or NAIC staff engaged in the GCC project wish to do so.

Sincerely,

Ann Kappler
Senior Vice President, Deputy General Counsel and Head of External Affairs
Prudential Financial, Inc.
Overview

We strongly support the Working Group’s decision to employ an aggregation based approach in order to “build on existing legal entity capital requirements where they exist rather than developing replacement/additional standards.” As the Working Group has rightfully noted, such an approach strikes an ideal balance of “satisfying regulatory needs while at the same time having the advantages of being less burdensome and costly to regulators and industry and respecting other jurisdictions’ existing capital regimes.”

As the Working Group takes steps to finalize the GCC, we encourage it to pursue approaches that are aligned with the objective of providing regulators transparency into risks while avoiding the creation of additional standards that are unnecessary and may be burdensome and costly. Further, we also encourage the Working Group to consider the impact the various design choices may have on the ability of the GCC to provide appropriate insight into risks (e.g., avoid false positives and negatives) and how they could affect the ability of supervisors and/or insurers to navigate periods of stress.

Limitations on the Recognition of Senior and Hybrid Debt Should be Removed

We believe the proposed limitations on the recognition of senior and hybrid debt are inconsistent with the NAIC’s stated intent for the GCC to serve as tool for obtaining insight into insurance groups rather than a binding constraint and further, could discourage the prudent use of debt instruments as an effective capital and liquidity management tool – particularly during times of stress. We therefore believe the Working Group should eliminate the proposed limits on the degree to which senior and hybrid debt qualify as available capital.

Insurers weigh a number of critical elements when establishing and managing their capital structures such as rating agency targets, cost, tax implications, etc. In practice, these considerations serve as effective guardrails against behavior that may be detrimental to the insurer or policyholders. Similar to the Working Group’s decision to leverage the strength of existing solvency regimes rather than developing replacement/additional standards, we believe the GCC should leverage existing market forces that promote sound capital management practices across the sector. The May 19 NAIC Group Capital Calculation Post Field Testing Staff Input presentation highlighted that under the current GCC proposal, 25% of the volunteer companies from the 2019 field test that reported senior and/or hybrid debt would not receive full credit for the capital instruments they have issued. We believe this percent could increase significantly during economic downturns as an insurer’s available capital declines and required capital increases, which would further limit the recognition of these resources and inappropriately discourage their use. Eliminating the proposed limits on the recognition of senior and hybrid debt would avoid the potential for the GCC to trigger such procyclicality.

Should the Working Group insist on maintaining limitations, we request the following changes to better acknowledge the presence of existing market guardrails and reduce the potential for the GCC to inhibit an insurer’s ability to manage its capital structure in a manner it feels is most appropriate and have procyclical effects during economic downturns. Further, the purpose of any imposed limitations that are retained should be explained in light of the stated intent for the GCC to serve as tool to obtain insight into risks as opposed to a binding constraint.
• The cap of the allowance at 50% of total adjusted carrying value in Inventory B should be eliminated given that the underlying allowances, which are modeled largely after rating agency approaches, already have conservatism embedded in them.
  
  o Specifically, the 30% factor for senior debt and 15% for hybrid debt are being applied to a more conservative base than rating agencies use for establishing limits – i.e., the GCC intends to apply the factors to the sum of total adjusted carrying value + outstanding senior and hybrid debt while rating agencies typically base their assessment on the group’s total consolidated U.S. GAAP equity.
  
  o Adding a limit of 50% of total adjusted carrying value to the conservative 30% and 15% limits for senior and hybrid debt (relative to total adjusted carrying value + outstanding senior and hybrid debt) effectively lowers the 45% permitted (i.e., 30% + 15%) to approximately 33%.

• More broadly, the different objectives of the GCC versus rating agency frameworks must also be considered. For example, S&P’s capital model is calibrated to much higher confidence levels (e.g., 97.2% for “BBB”) and views 20% to 40% financial leverage, based on a group’s total consolidated U.S. GAAP equity, plus outstanding debt, as “neutral”.

• Requirements for tracking the down-streaming of debt issuance proceeds to regulated entities should be eliminated. Keeping funds at the holding company level is a prudent strategy that provides insurance groups flexibility to quickly and easily manage capital and liquidity needs across the group. We believe a tracking requirement could give rise to unintended consequences such as reducing the availability and fungibility of capital resources and forcing U.S. insurance groups to issue greater amounts of debt.

The Base GCC Should Use the Excess Capital Ratio Scalar Approach

Prudential disagrees with the suggested change to apply the Pure Relative Ratio option at 300% RBC Calibration in the Base GCC. We believe that a total balance sheet approach to scalars – as embodied in the Excess Capital Ratio Approach – is necessary to adequately account for key differences across insurance regimes, such as the level of conservatism embedded in reserves versus required capital, different valuation and asset admissibility standards, etc. and avoid distorting the measure of required, available, and excess capital. Further, we believe embedding a scalar methodology with shortcomings (i.e., the Pure Relative Ratio Approach) in the Base GCC could undermine the NAIC’s ongoing work at the global level to secure recognition of the Aggregation Method (“AM”). Therefore, while we believe the Excess Capital Ratio Approach is an appropriate method for including in the Base GCC we would also support using a scalar of 100% (i.e., not scaling foreign insurance regimes) until there is greater clarity on what scaling approach will ultimately be included in the AM.

Through its simplistic approach of only focusing on required capital, the Pure Relative Ratio Approach fails to adequately account for key differences in insurance regimes (e.g., level of conservatism embedded in reserves versus required capital, different valuation and asset admissibility standards, etc.). While the limited analysis to date may suggest the two approaches yield similar results, we believe they would diverge in cases where individual insurer or industry capitalization levels change and that the conceptual shortcomings of the Pure Relative Ratio Approach could result in false positives or negatives.
More broadly, we are concerned that adopting the Pure Relative Ratio Approach for purposes of the Base GCC would undermine the ongoing work at the NAIC’s work at the global level to secure recognition of the AM as comparable to the reference method version of the Risk-based Global Insurance Capital Standard (“ICS”). Specifically, we believe that the decision would prejudge the Pure Relative Ratio Approach as the methodology that should be adopted for the AM. Further, we believe it will be essential for the comparability assessment work to take a holistic approach to accounting for the different tools and methods supervisors employ to ensure insurers hold adequate loss absorbing resources to protect policyholders; of the two approaches the Working Group has considered, the Excess Capital Ratio Approach – with its total balance sheet approach – is the only one of the two that would accomplish this.

In the May 19 NAIC Group Capital Calculation Post Field Testing Staff Input presentation, NAIC staff noted the need to continue to explore the topic of scaling in conjunction with similar work for ICS – AM. We support this recommendation and believe it highlights the importance of keeping the GCC and AM in step with each other and taking time to consider the appropriateness of the methodology relative to a suite of criteria, including the reasonableness of the assumptions, ease of implementation, and stability of the parameterization. That said, while we strongly believe the Excess Capital Ratio Approach should be used in the Base GCC (and the Base AM), an alternative path that should be considered is to use a scalar of 100% for the Base GCC until there is greater clarity on what scaling approach will ultimately be included in the AM. Such an approach would avoid prejudging that the AM should employ the Pure Relative Ratio Approach and avoid the potential need to modify the Base GCC in the future if a different scaling methodology is embraced for the AM.

The Calibration of the Base GCC and Scalars for Foreign Insurance Regimes Should be 200% ACL RBC

Prudential disagrees with the suggestion to calibrate the Base GCC ratio or scalars for foreign insurance regimes at 300% authorized control level (“ACL”) RBC – i.e., the Trend Test level. Instead, we believe they should be calibrated to 200% ACL RBC – i.e., Company Action Level (“CAL”) as it has long been common practice for insurers to communicate and stakeholder to assess financial strength on this basis. We believe using 300% as the calibration would unnecessarily interrupt well-established market norms and introduce unwarranted confusion for insurers and stakeholders without any discernable benefit. Further, we believe calibrating to a 300% ACL RBC level could create confusion over, or trigger an unwarranted reset of, how the NAIC’s time tested ladders of intervention approach to the supervision of capital adequacy works in practice.

We recognize a relationship has been established between the 300% ACL RBC level and 100% Solvency Capital Requirement (“SCR”) for Solvency II in the U.S.-EU and U.S.-UK Covered Agreements and further, that the NAIC’s Evaluations of Reciprocal Jurisdictions have similarly established relationships between the 300% ACL RBC level and intervention points under the solvency regimes of Bermuda, Japan, and Switzerland. However, we do not believe these developments justify upending years of industry norms, and the likely confusion that would result from calibrating the Base GCC or scalars of foreign insurance regimes at a 300% ACL RBC level. While we speculate that international considerations may be contributing to the interest in using the 300% ACL RBC level for calibration purposes, we believe it is incumbent on the Working Group to confirm its rationale so a more informed debate could be held with interested parties before a final decision is made.
Prudential believes the GCC template should be limited to reporting of the Base GCC (and the required inputs thereto) and that the Sensitivity Analysis tab should be deleted. Narrowing the design of the GCC will ensure insurers, supervisors (domestic and foreign) and other stakeholders have a clear vision and understanding of what the GCC is (e.g., it would eliminate the need to distinguish between a “Base” view and alternative measures). Notwithstanding the comments above regarding scalar methodology, we believe clarity in the design of the GCC is critical as insurers and supervisors move to introduce the GCC as an additional metric to monitor and manage and would provide a stronger foundation for the NAIC’s ongoing efforts to advance the AM at the global level.

To the extent broader information on the insurance group is of interest to a state regulator, we believe it should be obtained through discretionary powers as opposed to embedding it in the GCC template. We believe “Input 6 – Questions” should be transitioned to a Microsoft Word document as it is more user friendly format (note that the NAIC employs such an approach for its work on the AM at the global level). A word based file could serve as a more flexible vehicle for insurers and state regulators, including potential instances where the regulator wishes to receive information beyond that which is included in the GCC template (note a fillable PDF could also be used).

Prudential appreciates the Working Group’s consideration of permitting grouping of similar non-insurance entities and/or relaxing the requirement for de-stacking as we believe such flexibility would reduce the burden of completing the GCC template. While we support such flexibility, we believe state regulators should retain the option of requesting more granular information should they feel it is needed to obtain a sufficient view of risks within the group.

For simplicity, Prudential supports adopting a single approach for establishing a proxy capital measure for all financial entities that are not subject to a regulatory capital requirement. Further, we believe it would be beneficial for the Working Group to select the method it believes most aligns with how the AM will ultimately treat this item. Per our comments above, we support grouping of similar entities and thus support the netting of non-operating holding companies. We similarly support adopting a single approach for establishing a proxy capital measure for all non-financial entities that are not subject to a regulatory capital requirement.

We believe ensuring state regulators obtain adequate insight into the entities within the insurance group and risks associated with them is the key point of consideration for these entities and this is best accomplished through the inventory element of the GCC as opposed to an arbitrary proxy capital calculation. To the extent a state regulator believes a non-regulated entity poses material risk to the group, they have discretion to request additional information to understand the risks. Further, such situations would be better addressed through in-depth analysis on a case-by-case basis as a formula driven proxy capital calculation would likely fail to reflect the underlying risk exposures. That said, we believe further consideration of approaches is unwarranted and the Working Group should narrow the
GCC template to single approach for each respective category of entities rather than continuing to test multiple approaches.

**The Draft Financial Analysis Handbook Guidance Should Be Exposed for Comment**

Materials for the May 19 public meeting of the Working Group included an Attachment C – “Draft Regulatory Guidance on GCC”, which was not part of the materials recently exposed for comment. We request that the Working Group provide interested parties an opportunity to provide input on this material before it is finalized.

Below are some initial thoughts on the draft version that was included in the May 19 meeting materials.

- Establishing a minimum threshold that must be maintained to avoid triggering a more in depth supervisor review and/or the need to develop a plan to reduce risks would be inconsistent with the NAIC’s stated intent for the GCC to serve as a tool rather than a binding standard.

- The detailed nature of the guidance seems premature given the range of design elements that have yet to be finalized, which could have a material impact on GCC ratios, and ongoing consideration of which insurers will be exempt from having to file the GCC.
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Via Electronic Delivery

Commissioner David Altmaier
Florida Office of Insurance Regulation
Attention: Mr. Lou Felice
J. Edwin Larson Building
200 E. Gaines Street, Room 101A
Tallahassee, Florida 32399

RE: Draft Instructions from the Chair of the Group Capital Calculation (E) Working Group to the Chair of the Group Solvency Issues (E) Working Group

Commissioner Altmaier:

State Farm Mutual® Automobile Insurance Company and its affiliates ("State Farm"), appreciate the opportunity to submit these comments concerning the Draft Instructions from the Group Capital Calculation (E) Working Group (the “Working Group”). As you know State Farm participated as a volunteer group and provided feedback as to the Group Capital Calculation (“GCC”) and its supporting informational elements during its development. State Farm understands that the GCC provides an evaluation tool for domestic regulators to consider along with various other risk information already being provided by groups, such as the Own Risk Solvency Assessment (“ORSA”) Report filing.

State Farm urges the Working Group to consider the entirety of the regulatory structure when evaluating whether to include additional measures through the Draft Instructions on insurers or the holding company of those insurers that are not entirely exempted, especially when the group structure is simplistic, focused on insurance operations and when such parent of the holding company is a regulated insurer.

As a volunteer participant State Farm benefitted from the effort and transparency the Working Group has utilized all along in developing the GCC and appreciates that the Draft Instructions incorporates many of the industry’s clarifications and suggested additions. However, State Farm suggests a few more amendments to the Draft Instructions to recognize today’s overall financial regulatory scheme and limit duplication as much as possible for regulators and those being regulated when such groups are not exempted from GCC and are substantially an insurance group.
Scope

State Farm requests that the same isolation method of excluding non-financial entities be available for other entities in a group.

State Farm supports the Draft Instructions statement in paragraph 12 that recognizes there are groups that have material diverse non-financial activities that are isolated from the financial/insurance group and that could lead to a narrowing of the scope of the GCC in agreement with the Lead State Regulator. However, State Farm questions why the Draft Instructions do not similarly recognize financial or insurance entities that are also similarly isolated from the group. The purpose of the GCC is to evaluate a group’s solvency soundness through a numerical calculation to ensure the primary regulated insurance entities within the group remain sound. Acknowledging the isolation of financial and insurance entities fits within already existing regulatory arrangements as well as the GCC, and acknowledges that capital is not freely fungible for use by the group or entities within the group. Since the same mechanisms recognized by the Draft Instructions to isolate the non-financial entities can be and are being used to isolate financial or insurance entities, the Draft Instructions should recognize the isolation no matter the entity type.

The GCC should not ignore the other existing provisions of the Holding Company Act or solvency provisions applicable to the individual insurance member of the group, such as the Risk Based Capital (RBC) calculation that provides a similar numerical calculation of soundness, financial statements and other applicable regulatory requirements. These provisions, commonly referred to as the windows and walls regulatory scheme, protect the capital of that insurance entity such that capital is not freely available for the use by the group or any other entity within the group. Similar to the recognized ability of non-financial entities to be isolated from the rest of the group, the windows and walls approach isolates the insurance entities from material transaction with affiliates and in a sense isolates the entities. Expanding the acknowledgement of the ability to isolate financial and insurance entities is not radical and fits within the overall goal of the current windows and walls regulatory approach as well as the GCC, to protect the solvency of the insurance members of a group. Just as a non-financial entity may be isolated and pose no risk to an insurance entity in the group, if a financial entity is isolated from the group, it does not pose a solvency risk to the insurance entity. Finally, an argument could also be made that if the insurance entity is isolated from the group in a similar fashion, the group does not pose a risk to the isolated insurance entity. For these reasons, State Farm requests that groups be allowed to present a narrower scope for entities that are otherwise isolated to the Lead State Regulator who would have discretion to accept such narrowing of the scope for that group’s GCC.

State Farm requests that excluded entities not be required to be included on the Inventory Tab or discretion be provided to the Lead State Regulator to exclude, especially when the information is otherwise provided.
In paragraph 14, the third bullet provides that “All entities, whether to be included in or excluded from the Scope of Application are to be reported in the Inventory Tab of the template.” Presumably, this includes the non-financial entities that are isolated and excluded under paragraph 12 or paragraph 30 and financial/insurance entities that are excluded under paragraph 10 and 18. If this is accurate, preparers will be required to provide the required information on entities that are excluded from the scope of the GCC. While there may be certain situations when such information would not otherwise be provided to the Lead State Regulator, in an insurer parent lead group this information is already provided through other required regulatory submissions including but not limited to, financial statements and RBC calculations of the parent insurer or the insurance entities. Gathering information under the GCC from entities that are excluded from the GCC seems counterintuitive and duplicative in certain situations. State Farm requests that excluded entities not be required to be on the Inventory Tab or, at least, the Lead State Regulator have the discretion to not require excluded entities on the Inventory Tab if requested by the preparer.

*State Farm requests a baseline materiality definition be provided while maintaining Lead State Regulator discretion to determine if a higher or lower material threshold is appropriate.*

The Draft Instructions use the term “material” in discussion whether an entity can be excluded or is to be included in the GCC. State Farm believes discretion should remain with the Lead State Regulator, however, it is important to have a clear understanding of what is meant by “material” and to create some consistency in application. For paragraphs 10 and 18 there is no guidance, but for paragraph 30, which addresses determining what is an “affiliate” to be included in the GCC, it states in part:

> For purposes of the GCC, affiliates will NOT include those affiliates reported on Schedule A or Schedule BA, EXCEPT in cases where there are financial entities reported as or owned indirectly through Schedule A or Schedule BA affiliates or where a non-financial, non-insurance Schedule A or Schedule BA affiliate represents greater than X percent of an insurance entity’s adjusted available capital.

The paragraph provides a Drafting Note providing guidance to regulators:

**DRAFTING NOTE:** Initial suggestion is to set “X” threshold for material non-financial entities no higher than 5%.

State Farm suggests adding to the Draft Instructions, additional Drafting Notes in the paragraphs using the term “material”, a baseline for materiality of 5% of the group’s net worth while still allowing the Lead State Regulator and the preparer to use a higher or lower threshold given the particular circumstances presented by the preparer.

State Farm believes that there should be some consistency in application under these provisions and that materiality should be based on the group’s net worth given the GCC is measuring risk of the group and not a particular entity in the group. RBC calculation along with other regulatory
requirements provides the Lead State Regulator the information necessary to evaluate the solvency risk of an individual insurance entity and the GCC should be focused on information that a Lead State Regulator doesn’t already receive and be focused on the impacts to the group. Including a Drafting Note provides guidance, allows the Lead State Regulator and the preparer to utilize a different value for unique situations, and allows the focus of the GCC on those matters that truly impact a particular group.

State Farm offers these comments on the Draft Instructions to help streamline the process for those groups required to conduct the GCC. The intent of the comments is to help the focus of the preparer and Lead State Regulator to be on the insurers of that group and the material impacts of other members of the group that may have on the solvency of the insurance members.

Thank you for your time and consideration in this project and to our comments. If there are any questions concerning the comments, please contact me.

Sincerely,

Chuck Feinen
State Farm Mutual Automobile Insurance Company
July 20, 2020

Hon. David Altmaier
Commissioner
Florida Office of Insurance Regulation
Chair, Group Capital Calculation Working Group
The Larson Building
200 East Gaines Street
Tallahassee, FL 32399-0305

Via electronic mail to Lou Felice

Re: Comments on GCC Instructions and Template

Dear Commissioner Altmaier:

We write today on behalf of UnitedHealth Group, one of the nation’s largest managed care and healthcare services companies, which, through its UnitedHealthcare business platform, administers and provides healthcare benefits to more than 45 million individuals in all fifty states and the District of Columbia. UnitedHealth Group’s Optum business segments provide health services, including pharmacy services, health care delivery, population health management, collaborative care delivery, information technology, and health care financial services to 115 million individuals and more than 100,000 physicians, practices, and other health care facilities nationwide. We thank you for the opportunity to provide comments on the recently released draft Group Capital Calculation (“GCC”) template and instructions.

We appreciate the simultaneous disclosure of the template, instructions, confidentiality provisions and the handbook draft. This is helpful context for understanding the working group’s intent for this initiative.

**Comments on the Instructions**

The GCC Instructions address not only the mechanics of filling in the template, but also many considerations that regulators are supposed to apply when using the template. We have comments about both aspects of the Instructions. We have divided our comments on the instructions into two sections – our key concerns, and additional concerns that do not rise to the level of a key concern but nevertheless are important to consider as these instructions are finalized.

Our comments in both sections are labeled according to the paragraph labels in the GCC Instructions.
Key Concern #1: Calibration Level

V.A.40: As we have explained previously, with supporting numerical examples, the method being used to produce the “scalars” [sic] for alien insurers is incorrect, as it takes into account only differences in the average capital being held, and not the relative conservatism of reserves. While there are other conceptual problems with the concept of scalers as being employed here, this particular error should be corrected; we had previously offered a suggestion as to how to make the correction.

VI.57 and VI.58: For entities that file an RBC report, the requirement is to report “entity required capital” at 150% of Company Action Level (CAL). There is no justification for this. Reference is made to the trend test in the RBC formula, which may result in an action level event for entities with Total Adjusted Capital below 150% of CAL; however, that can only occur if certain other, relatively unusual conditions exist, and those other conditions are not tested for in the GCC. Consider the illogical result this would produce for a group where the ultimate controlling person was an RBC filer with Total Adjusted Capital equal to 130% of CAL: the entity would be considered well capitalized from an RBC standpoint, and yet would fall below the 100% level in the GCC. This seems especially misguided given that early drafts of the Financial Analysis Handbook procedures suggest further scrutiny of a group when the GCC ratio is below 175%—i.e., is below 262.5% of CAL.

Furthermore, 100% of CAL may itself be excessive. Early in the development of the GCC, the question was raised as to how the diversification benefit of large, heterogeneous groups would be reflected. Clearly, such a group is less risky than its individual components standing alone would be. The NAIC’s decision at that time was not to have an explicit diversification adjustment (like the covariance adjustment in RBC) built into the GCC, but instead to take diversification into account when interpreting the results. Accordingly, a diversified group should have a capital benchmark that is less than the corresponding benchmark for an individual entity—which in the case of an RBC filer would be CAL. From that standpoint, calibrating the GCC even to 100% of CAL would be conservative; using 150% of CAL is unjustifiably conservative. The mere addition of legal entity capital and capital requirement, without any provision for diversification should is not be interpreted as group risk-based capital regulation.

These concerns about calibration are heightened by the language in paragraph I.A.2 (discussed above) indicating that the GCC will be a basis for regulators to take actions with respect to a group. Even if the GCC will be used solely as an analytical tool, the analysis should be based on an appropriate calibration, to avoid unnecessary follow-up questions and prolonged discussions. However, if the GCC will, in and of itself, be grounds for regulatory action (as suggested by some of the language in the instructions), it is absolutely critical that the calibration not misstate the riskiness of the group.

Key Concern #2: Definition of “Financial Entity”

IV.22: We believe that the definition of “Financial Entity” is far too broad, in that it sweeps in “Affiliates that are integral to the performance of the insurance contract or the provision of insurance or financial products or services to policyholders, members or depositors,” such as “claims adjusters or processors, third party administrators, pharmacy, medical provider groups, and other benefit managers,” etc., even when those entities are not material to the group or calculation as a whole. Affiliates that merely provide contracted services to a carrier should not be defined as “financial”: they do not create any more financial
risk to their affiliated insurers than do non-affiliates that provide the same services to other insurers. In fact, given that regulators have oversight over inter-affiliate service agreements, we suggest that affiliated service providers present less risk than do non-affiliates. In the case of health groups, some of the examples given actually diversify risk for the insurance entity in the group, facilitating more access to capital by the insurance entity. The aim of the working group should not be to promote smaller, less integrated or diversified groups.

VI.61: We again object to the notion that “entities that derive a majority of their gross revenue from services that are integral to the performance of the insurance contracts within the group or from the provision of other financial services to policyholders within the group will be considered a Financial Entity without a regulatory capital requirement” [emphasis added]. As noted in our comments on paragraph IV.22, the fact that those services are being performed by an affiliate does not add risk to the group, but in fact because of greater regulatory oversight should be considered to reduce the group’s risk. We also point out that the “Financial Entity” designation is being applied only to such entities that provide services primarily to affiliates; clearly, therefore, it is not the activities of those service entities that are considered risky, since if they provide those services primarily to non-affiliates they are not considered “Financial Entities.” Again, the working group should not want the GCC to limit the scale, diversification, integration or efficiency of groups, given historical evidence of the benefit of size, diversification, and efficiency to group credit standing, as evidenced in public credit ratings.

**Key Concern #3: Intangible Assets**

VI.83: We question the rationale for collecting information on intangible assets (such as deferred acquisition costs, provider contracts, customer lists, and goodwill). The focus on intangible assets, to the exclusion of other types of assets, seems unwarranted. While it may not always be possible to sell intangibles quickly for cash equal to their reported value, that is true of a wide variety of tangible assets (such as real estate, plant and equipment, and airplanes) that are not being singled out. Furthermore, regardless of their availability for sale, intangible assets do produce a stream of income to the group; otherwise, GAAP accounting would require that they be written down in value or written off entirely. As businesses rely more and more on digital assets and intellectual property as the basis for their operations, and less and less on fixed assets, there is more scrutiny of the value of those assets, and there should be less concern about whether the stated values are appropriate. We believe that any focus on intangible assets—which has not previously been discussed by the working group—is unwarranted, and there is no valid reason to collect information in the GCC or otherwise differentiate this specific category of assets.

We note that securities in a “tangible” investment portfolio are valued on the net present value of expected cash flows to the investor in the private and public markets—despite the tangible nature of the issuers’ assets or capital producing these cash flows. Just over one-third of the S&P 500, which is well represented in corporate debt and equity investment asset classes, have negative tangible net worth. The differential treatment of “tangible” financial investments and physical assets versus income-producing intangible assets is inconsistent.

We note also that the increasingly digital economy is based on software and information assets. Under GAAP, the capitalization of software assets is narrow, and amortization relatively short, compared to traditional fixed assets. Furthermore, changes made to GAAP in 2001 eliminated both the “pooling of interests” accounting in acquisitions and the amortization of goodwill. Accordingly, both business trends and accounting changes have made the differentiation of “intangible” assets increasingly less relevant.
Key concern #4: Use of the GCC

I.A.2.: We suggest several revisions to this paragraph.

One key area of concern is the statement that “insurance companies may be subsidizing the operations of non-insurance entities, potentially undermining the insurance company’s financial condition.” Whether or not all or any of the insurance companies in a group are “subsidizing” other operations within the group is not relevant to the insurance company’s financial condition. Insurance regulators are already empowered to monitor and restrict the flow of capital out of the insurance entities, by means of restrictions on dividends, oversight of transactions with affiliates, and application of the statutory provisions regarding hazardous financial condition, among other methods. If the outflows from insurers to other members of the group are endangering the solvency of the insurers, that points to a regulatory failure that cannot be solved by the GCC. The GCC was never, in our understanding, intended to be a tool for each legal entity regulator to use for legal entity solvency monitoring. That is a function of U.S. risk-based capital (RBC) and state-based insurance regulation, not group-level supervision.

That same sentence in paragraph I.A.2 suggests that another consequence of “subsidization” may be “upward pressure on premiums to the detriment of insurance policyholders.” The GCC was never intended to be a tool for the regulation of insurance premium rates, and we find it highly concerning that this consideration is being introduced in this fashion.

The idea that non-insurance operations within the group pose a proximate risk to the solvency of the group’s insurers has little historical evidence to support it. The real lessons of the financial crisis of 2008 proved that even when an insurer belonged to a group with significant financial risk in other areas of operations, its policyholders were not subjected to significant risk, because the legal entity structure in the United States effectively protected them, especially relative to other group-oriented insurance regulatory regimes. It is clearly not the case that risk within a complex, diversified holding company system necessarily translates to risk to the individually regulated insurance entities or to their policyholders. Each state is responsible for reviewing the financial condition of the legal entities within its jurisdiction, and for decades, including the financial crisis of 2008, that first line of review has proved to be the most effective system worldwide. The GCC may identify “risk” in the larger holding company system, but that will not necessarily translate to better identification of risks to any insurer within that system. We suggest that the Financial Analysis Handbook is the more appropriate location for commentary about how to interpret the risks identified by the GCC.

Another concern arises from the statements in paragraph I.A.2 that the GCC “provides an additional early warning signal to regulators so they can begin working with a company to resolve any concerns in a manner that will ensure that policyholders will be protected” and will “allow them to make informed decisions on both the need for action, and the type of action to take.” It seems inappropriate to suggest that the GCC, in and of itself, would be grounds for regulatory action to protect policyholders; that is the function of a regulatory standard, not an analytical tool. The ratio produced by the GCC as well as the additional information provided in the GCC template may provide grounds for a regulator to have discussions with a group about its risks, but they would not be grounds for inferring that policyholders must be “protected” so that the regulator must “take action” by requiring the group to “resolve concerns.”

We also have a concern that the instructions as written may not make clear that the GCC is intended to be used solely by the lead state regulator. In the statement that the GCC “provides an additional early warning signal to regulators so they can begin working with a company to resolve any concerns,” the use
of the word “company,” rather than “group,” could be taken to suggest that the GCC is intended to be a tool for any regulator responsible for any legal entity within a group. Likewise, the statement, “State insurance regulators already have broad authority to take action when an insurer is financially distressed, and the GCC is designed to ... allow them to make informed decisions on both the need for action, and the type of action to take,” suggests that the GCC will be used by the domiciliary regulator of each insurer. We do not believe that is intended to be the function of the GCC.

In accordance with the foregoing comments, we propose revising paragraph I.A.2 as follows.

2. More specifically, the GCC and related reporting provides more transparency to insurance regulators regarding the insurance group and make risks more identifiable and more easily quantified. In this regard, the tool assists regulators in holistically understanding the financial condition of non-insurance entities, how capital is distributed across an entire group, and whether and to what degree insurance companies may be subsidizing the operations of non-insurance entities. The GCC is an additional reporting requirement but with important confidentiality protections built into the legal authority. State insurance regulators already have broad authority to take action when an insurer is financially distressed, and the GCC is designed to provide lead state regulators with further insights into the risks of the group as a whole, to allow them to make informed conclusions about the financial condition of the group both the need for action, and the type of action to take.

I.A.3. This paragraph contains a statement indicating that the GCC could be used “in conjunction with group-specific risks and stresses identified in the Own Risk and Solvency Assessment (ORSA) Summary Report as well as risks identified in Form F filings that may not be captured in legal entity RBC filings.”

While the GCC, the ORSA, and Form F are all intended to evaluate the risks of the group, we think it likely will be misleading to financial analysts to suggest that the GCC can be used together with the other two. They lack comparability to each other, for several reasons.

- The ORSA report and Form F reflect a company’s own internal risk analysis, whereas the GCC depends largely on rules prescribed by the regulators.
- The ORSA is forward-looking, and typically considers multiple future years. The GCC relies on historical data, mostly from the single most recent year.
- The “capital” that is considered for purposes of ORSA may be defined differently than the “capital” identified by the GCC.

The last sentence of the paragraph states, “Finally, it’s important to understand that regulators believed that a group capital calculation would be another valuable tool to complement the states’ legal entity focused solvency assessments.” Again, we are concerned that this statement could be construed to encourage use of the GCC by individual state regulators other than the lead state. The stated purpose of the GCC has always been to provide a tool to allow the lead state to better understand the risks to the group as a whole.

In light of those two concerns, we recommend that the paragraph be revised as follows.

3. 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. It was noted prior to development that 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. It was also noted that a group capital calculation could serve as a baseline quantitative measure to be used by regulators, to supplement in conjunction with the view of group-specific risks and stresses provided by identified in the Own Risk and Solvency Assessment (ORSA) Summary Report filings and as well as risks identified in Form F filings that may not be captured in legal entity RBC filings. Finally, it’s important to understand that regulators believed that a group capital calculation would be another valuable tool to complement the states’ legal entity focused solvency assessments.

II.E.20.: We are concerned about the potential for an annual redetermination of scope. If the scope of application were revised frequently, then year-over-year trends in the GCC would not be meaningful. There should be a materiality standard developed to determine when and if a group’s scope is reconsidered; e.g., something based on the cumulative increase in the amount of the group’s capital that is out-of-scope. To reduce burden on the group, such redetermination should be based upon material changes in the group, not changes in the reviewer.

V.A.33: This paragraph refers to “the lead state regulator and template reviewer.” We question whether this is intended to suggest that the template reviewer can be someone other than the lead state regulator. If not, we suggest removing the phrase “and template reviewer” as it appears to be redundant and confusing. If there are intended to be multiple reviewers, we renew our concerns about the use of this tool by any party other than the lead state regulator.

V.A.37: Given that the GCC analytical procedures in the Financial Analysis Handbook are still undergoing development, it is not possible to speak in any but the broadest way about analytics. Probably, the description should be limited to the statement, “This tab includes or draws from entity-category-level inputs reported in the Tab or elsewhere in the GCC template to be used in GCC analytics.”

Instructions Comments – Additional Concerns

We provide the following as some additional considerations for revisions to the instructions.

I.A.7. In the third sentence of this paragraph, the phrase “similar such as” appears to be an editing error. We suggest revising the sentence as follows.

The GCC instructions and template are intended to be modified, improved and maintained by the NAIC in the future, similar such as are existing tools such as the Accounting Practices and Procedures Manual, the Annual Statement Instructions and Risk-Based Capital formula and Instructions.

Also, we suggest deleting the final sentence of the paragraph. While “additional items, such as stress testing” may still be considered open, they are not relevant to the instructions for the current version of the GCC.

II.C.12: It is not clear exactly what is meant to be included in “cross support mechanisms.” We would ask the work group to consider the following when working to define “cross support mechanisms”:

- Is this limited to formal, legally enforceable financial guarantees among members of the group?
- Does it matter whether such guarantees can only result in payment to insurers, not from insurers?
• Can the definition of “cross support mechanisms” ever result in the ultimate controlling person being out of scope?
• If the ultimate controlling person is always in scope, would all of its subsidiaries of material size automatically be in scope, since they could have a material impact on the ultimate controlling person?

II.C. 13.: The last sentence of this paragraph says, “Consistent with sound regulation, the benefits of the quantitative analysis facilitated by the GCC should exceed the cost of implementation.” We question why this is referenced as part of the instructions. We do not believe there has been an attempt to quantify the benefit of the GCC; and, in fact, the procedures for how the GCC will be used in practice are only now being developed. Until we know how the GCC will be employed, it seems to be premature to include an assertion about its benefits here. We also suggest that any attempt at determining the “cost of implementation” needs to take into consideration other tools regulators are mandating that carriers complete, such as the ORSA and Form F, and the legal entity grid, all of which were similarly described as tools to assist in group supervision.

II.E.17.: Early in the development of the GCC, the NAIC stated that one of the fundamental principles underlying the calculation was that it would ignore group structure; an entity would be treated essentially the same, regardless of where it was positioned in the group. That principle was relaxed somewhat for subsidiaries of insurers, to try to maintain consistency with RBC as much as possible. Now it seems to have been abandoned altogether, since a non-financial entity that is not part of the “Insurance Group” may be excluded from the scope of the GCC, whereas an otherwise identical entity that is part of the “Insurance Group” must be included. In the current draft, it appears that even the ultimate controlling entity may be excluded from group scope, despite clear influence in the group on corporate governance and capital allocation. Given the definition of “Insurance Group” (paragraph IV.23), this could lead to the inclusion of a non-financial subsidiary that has no connection to the insurance operations other than being owned by the same holding company as the insurers in the group. The rationale for this disparate treatment is not at all clear. Overall, the working group should not create a GCC that leads to preferential group organizational structure.

II.E.18.: This paragraph introduces the concept of exclusion being justified by the determination that the entities excluded “do not pose material risk to its [i.e., the group’s] insurance operations.” This seems eminently reasonable. It is not clear why that same concept should not be adopted to resolve the problem noted in the comment above on paragraph II.E.17.

Section III: There is no Section III. We assume this is merely a tabulation error and not an entire section that has been omitted.

IV.23: With regard to the definition of “Insurance Group,” please see our comment above on paragraph II.E.17. As currently defined, the “Insurance Group” is not limited to the insurers within a group and their own subsidiaries. Merely being owned by the same intermediate holding company that happens to own the insurers in the group is enough to make a non-financial entity part of the insurance group. This does not seem reasonable. The “Insurance Group” should be defined to exclude any non-financial entities that are not actually owned by the insurers.

IV.28: The “Ultimate Controlling Person” is defined to be, “As used in the NAIC’s Insurance Holding Company System Regulatory Act (Model #440).” Model #440 does indeed use the term, but while it defines “control” and “person,” “ultimate controlling person” itself is never defined—that is, there is no
explanation of what “ultimate” means. This seems an important concept that should be defined more precisely, especially since the “head of the Insurance Group” may be distinct from the “Ultimate Controlling Person.”

IV.30: The definition of “Affiliate” applies an inappropriate threshold for materiality to Schedule A and Schedule BA assets, based on the capital of the insurance entity that owns the asset. The GCC is intended to be a measure of the group’s capital, and any materiality threshold should be set relative to the entire group (insofar as it is in scope), and not relative to any individual entity within the group. Note, in fact, that paragraph VI.51 states a materiality criterion for Schedule A and Schedule BA assets based on the capital of the group, not the entity that owns them.

VI.54: The instructions call for the reporting of all dividends paid within the group. This is significant—and, in the context of a balance-sheet-oriented calculation, unnecessary—additional burden. We note that in many cases, a dividend may pass through one or more holding companies before it reaches its final destination (e.g., from insurer to intermediate holding company to ultimate controlling person). Seeing the same dividend being recorded multiple times is very likely to create confusion. We suggest it would be more useful to show, for each entity, only the net of dividends paid and dividends received. In that case, the columns for Dividends Paid and Dividends Received could be collapsed into a single column. Also, it is not clear that the Yes/No response in the Dividends Received and Not Retained column is useful, as it relies on what is “expected” rather than what is certain; a better approach might be to include dividends declared but unpaid in the column for dividends.

Also with regard to paragraph VI.54, we question how meaningful it is to designate some capital contributions as being funded from debt proceeds. There may be a lag between when debt proceeds are received by the debt issuer and when capital is contributed to a downstream entity; how long may the lag be before the capital contribution is no longer considered to be “from debt proceeds”? Also, if a parent makes a capital contribution when needed, and then subsequently replenishes its own capital through debt issuance, shouldn’t that be deemed to be essentially the same as receiving the debt proceeds and then infusing them into the subsidiary? Furthermore, debt-funded capital injections may well survive the maturity of the debt. Because cash is fungible, it does not seem to be a worthwhile effort to try to determine the particular source from which a capital contribution was funded. We recommend that if holding company debt is to be included in capital, then the limitation should be the insurance entities’ total paid-in capital.

VI.56: We point out that intra-group guarantees, solvency reinsurance, and capital maintenance agreements typically do not have notional values. Moreover, triggering of these arrangements has historically been very unlikely. In an earlier communication from the NAIC on this subject, the estimated notional value was weighted by expected utilization. This weighted approach should be used here.

Comments on the Template

Although we understand the need to have a tool that quantitatively calculates group results, we suggest it is inappropriate to use the tool as a way to simply gather information about unregulated entities that do not impact the results of the GCC calculation itself, especially as most of this information is available to regulators from other filings. The following are examples of the information being collected that does not impact the results of the calculation:
• a significant amount of information related to trend analytics, which - on the legal entity basis - are not meaningful to the calculation;
• Reinsurance Assumed from Affiliates and Reinsurance Ceded to Affiliates. We question the relevance of the information to the calculation and note that this information is readily available in the annual statements;
• the notional values of both Intercompany Guarantees and Capital Maintenance Agreements, because 1) most, like insolvency reinsurance, have no stated value or have values that are based upon a calculation and not a fixed amount; and 2) in practice, these have extremely low probability of triggering guarantor action (earlier versions of this analysis weighted any notional amount by currently expected use);
• the value of intangible assets;
• descriptions related to intragroup assets; the values of some intragroup assets are also asked for on the Questions tab;
• descriptions related to reported adjustments;
• dividends paid and received;
• how downstream debt proceeds are tracked; and
• a listing of Schedule A and BA assets, which can easily be found in the NAIC financial statements.

Thank you for the opportunity to provide our input. We believe that addressing the issues we raise above will lead to the GCC being a more useful tool for regulators.

Sincerely,

James R. Braue
Director, Actuarial Services
UnitedHealth Group

cc: Kathryn Belfi, Vice-Chair, Group Capital Calculation Working Group
    Dan Daveline, NAIC
    Randi Reichel, UnitedHealth Group