

Stephen W. Broadie
Vice President, Financial Policy

April 26, 2011

David Vacca
Assistant Director, Insurance Analysis and Information Systems Department
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Group Capital Assessment Proposal

Dear Mr. Vacca:

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to comment on the Group Solvency Issues (EX) Working Group's draft Group Capital Assessment Proposal. PCI is composed of more than 1,000 member property/casualty insurance companies, representing the broadest cross-section of insurers of any national trade association. PCI members write over \$175 billion in annual premium, 37.4 percent of the nation's property/casualty insurance.

PCI is pleased that the Working Group's approach is separate from the NAIC's minimum capital standards, as set forth in the risk-based capital system and applied to individual legal entities. We also agree that information about an insurance group's target capital should be provided through the Own Risk and Solvency Assessment (ORSA) process. We have the following additional comments:

- The proposal should clarify that its goal is to identify "target capital" as defined by management of the group, and not as a regulatory target. We believe that is the intent of the Working Group, but we would appreciate clarification.
- We have commented in our response to the NAIC's ORSA proposal that, once an annual ORSA report has been performed as a part of the financial examination process, subsequent annual reports should not be required unless material changes occur. For the same reasons, once a target capital assessment has been performed as part of the ORSA, we do not believe subsequent assessments should be required unless material changes have occurred.
- The discussion of aggregate and composite methods looks appropriate, although additional clarity could be provided. In particular we are not sure what "taking account" of holding company leverage means, or the effects of "complexity risk".
- This assessment involves highly proprietary information, and its confidentiality must be maintained.

If you have any comments or questions, please contact me at your convenience. We look forward to discussing our comments with the Working Group.

Sincerely,



Stephen W. Broadie



April 21, 2011

Director John M. Huff
Missouri Department of Insurance
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Sr. Associate Commissioner Danny Saenz
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Via email

Re: ACLI Comments on Group Capital Assessment Proposal for U.S. Compliance with the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs) on Group Capital and to Observe Financial Sector Assessment Program Recommendations

Dear Director Huff and Associate Commissioner Saenz:

The American Council of Life Insurers (ACLI) represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. The member companies represent over 90% of the assets and premiums of the U.S. life insurance and annuity industry. We appreciate the opportunity to offer our views on the recently proposed NAIC Group Solvency Issues (EX) Working Group's Group Capital Assessment Proposal for U.S. Compliance with the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs) on Group Capital and to Observe Financial Sector Assessment Program Recommendations.

ACLI supports the NAIC's efforts

ACLI supports the NAIC's work to study the need to expand the assessment of the financial condition of groups that include insurance company members. We think that the Enterprise Risk Management Workshops that the NAIC has proposed are an excellent opportunity for regulators and insurance company chief risk officers to assess current industry best practices and further integrate meaningful risk management practices and principles into the NAIC's regulatory framework. We look forward to a thorough, productive and deliberative discussion and process.

ACLI also strongly supports recent efforts to enhance coordination among the varied NAIC projects relating to group supervision and enterprise risk management – the U.S. Own Risk and Solvency Assessment (U.S. ORSA), the enterprise risk report required under the newly approved revisions to the NAIC Model Holding Company Act and Form F of the model regulation, and the Group Capital Assessment. We believe a coordinated discussion is critical and that close coordination with other SMI working groups, such as the SMI RBC Working Group and Corporate Governance Working Group continue to be important as well.

Careful consideration and coordination with related federal and international initiatives will also be critical in designing a responsive, meaningful and workable oversight framework. NAIC members are working with federal regulators, the IAIS and the Financial Stability Board, to develop and implement a process to identify and supervise globally significant financial institutions. Related capital requirements could impact U.S. ORSA deliberations. Federal regulators are also considering capital requirements for holding companies for insurance groups that include a bank or thrift within their holding company structure. U.S. insurance regulators must consider these and other related initiatives as they design the mechanics of a U.S. group oversight system.

ACLI firmly shares your belief that consideration of the scope and effectiveness of an insurer's risk management framework, including capital levels, should be an integral part of the supervisor's assessment of an insurer's solvency. Our members believe that an insurer should have a sound process for assessing its capital adequacy in relation to its risk profile and that process should be integrated into its management processes and decision-making culture. The culture should in turn embrace an active internal risk assessment and risk management processes. Clearly, our members support a requirement that an insurer regularly assess its reasonably foreseeable material risks to ensure that its total financial resources are adequate to meet its insurance obligations at all times.

We commend the NAIC for recognizing that there are numerous approaches to group capital assessment in its proposed approach to ORSA. The draft Proposal recognizes that insurers have varied operational structures and that their risks, and their risk management processes are diverse. It recognizes that enterprise risk management processes appropriate to the nature, scale, and complexity of each insurer cannot be formulaic or prescribed. We endorse these principles, believing them essential to effective risk management and to effective supervision.

Further, we understand that the Financial Stability Board's efforts to strengthen global financial stability are placing significant demands on functional regulators, including U.S. state insurance regulators. We offer to assist in meeting those demands in a meaningful way that is compatible with the disparate nature of the U.S. insurance industry and that complements the existing regulatory tools that are working well. Given the scope of those demands and the timetable for meeting them, a collaborative approach is critical to developing an effective and flexible proposal that can be applied uniformly.

ACLI's concerns about this proposal

We appreciate the drafters' thoughtful work in formulating this proposal. These concerns should be viewed as part of our constructive approach to assisting state regulators in meeting the IMF's recommendations and the FSB's demands.

Paradigm shift: U.S. insurance regulation has historically been liquidation-focused. It requires a life insurer to calculate its liabilities conservatively and to have sufficiently marketable assets to meet those liabilities, assuming immediate insolvency. It appears that this draft Proposal would create a new specific "target" capital requirement—*i.e.*,—in addition to RBC. It is unclear how such a requirement would operate. We urge that regulators' goal be to ensure that each insurer has robust enterprise risk management processes; an ORSA, including parameters for target capital, can be part of the documentary evidence to examiners that those processes are embedded into the company's culture.

During the ACLI presentation to the Working Group in Austin, we provided as an example the following seven criteria for critical decision-making in one company's process for developing economic capital models:

1. Definition of solvency
2. Time horizon of risk exposure
3. Risks to models
4. How risks are quantified
5. Measurement metric
6. Target level of capital
7. Reflecting diversification

Over-emphasis on prescribed quantification: We believe that it would be much more useful to regulators to add further guidance on risk-focused examinations to the Examiners' Handbook than to prescribe methods or standards of quantification. That approach is more compatible with the U.S. regulatory framework and would also meet the Standards in ICP 16. More importantly, it has the most potential for giving our regulators the clearest view into how insurers describe and manage their risks. Any prescribed quantifications would likely fall well short of that goal. In addition, we believe that an insurer that manages its risks and capital well should be recognized and the level of supervision adapted; this does not mean a low level of supervision but rather a level of supervision more appropriate to the level of risk to which the insurer is exposed and its ability to manage such risk. We urge the Working Group to endorse the concept and to work with industry to implement more tailored risk-focused examinations. The regulatory focus should be on the quality and effectiveness of the ERM program and processes in managing risk, not on setting prescriptive standards on contents and use of a risk policy statement. That insight, as we've noted, is most suited to the risk-focused examination process.

We earnestly believe that prescriptive quantifications do not inform. Insurers do calculate quantitative sensitivities and would share them with financial examiners. The issue is that quantifications alone are misleading; they tell only part of the story. We urge a less prescriptive and more process-oriented approach that occurs in the context of a risk-focused examination. We urge the Working Group to focus regulatory and company attention on processes and culture rather than on numbers.

ACLI's proposal

Risk-focused financial examination: ACLI members believe the ORSA and any related group capital assessment should be part of the risk-focused financial examination process. That context offers the best route to the best information. In that context, regulators would gain optimal understanding of the soundness of an insurer's enterprise risk management processes, including its internal modeling and capital resources. The examiner's one-on-one conversations with senior management during the examination will be more informative than any quantitative report, as an insurer's management would engage in a dialogue with the regulator.

We believe our common goal should be to add guidance to the Financial Condition Examiners' Handbook that would enhance the effectiveness of insurer-regulator communication about the insurer's risk management processes. We urge that the Working Group consult with financial examiners who have performed risk-focused exams, asking what has proved useful to them in understanding an insurer's risk management processes and what additions they might suggest to the Financial Condition Examiners' Handbook. It might be, for example, that adding a requirement for a qualitative summary of how an insurer manages itself—whether it uses a run-off approach, a one-year horizon, or a five-year horizon—would be useful to financial examiners mapping an insurer's or an insurance group's processes. Consideration might also be given to adding language to the Model Law on Examinations, given the May 2010 Detailed Assessment of Report by the IMF Team re ICP 18 on Risk Assessment and Management and new IAIS Insurance Core Principle 16.

The draft proposal would appear to require a group capital assessment annually within the confidential ORSA. There appears to be a conflict and overlap between this annual review of the ORSA and the annual enterprise risk report required in new Form F of the NAIC Model Insurance Holding Company Act and Regulation. We suggest that the Working Group carefully consider how these proposals can be integrated and coordinated with the regulatory review of ORSA, and into NAIC's overall supervisory framework rather than layering on complex requirements. Developing appropriate guidance for Form F could provide timely and confidential updates to the home state regulator during the periods between financial examinations. We could also discuss whether a high level periodic certification might prove to be a helpful complement, with detail available upon request, for the home state regulator.

Lead state: Oversight of the ORSA/ERM process should be managed through the lead state to ensure coordinated review. Multiple separate reviews of this highly sensitive information would be a significant and unnecessary burden on regulators and companies. Leveraging the risk-focused exam process for this coordinated review should work well.

Confidentiality: An insurer's ORSA and the models it uses to determine capital needs are highly sensitive proprietary information that must be legally protected from inadvertent or compelled disclosure. Confidentiality protections for safeguarding sensitive proprietary information similar to the protections provided in the NAIC RBC Model Law must be enacted in every state. We note also that the confidentiality protections constructed for sharing the Form F material under the new amendment to the Model Insurance Holding Company System Regulatory Act may also be useful. A thorough discussion of a mechanism to ensure appropriate and comprehensive confidentiality protections is critical.

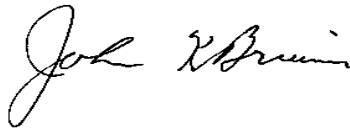
CONCLUSION

Our observations are offered in support of the NAIC's effort to meet the expectations being imposed on U.S. state-based insurance regulation and are tied to our previous comments on ORSA. We believe that ICP 16—*Enterprise Risk Management* and its Standards can be met within the existing U.S. state-based insurance regulatory framework. We also believe that ICP 16 compliance can be achieved quickly and effectively by drafting guidance for financial examiners who are reviewing an ORSA and processes for assessing group capital as part of evaluating the entire scope of an insurer's enterprise risk management processes.


Very truly yours,



Carolyn Cobb,
Vice President



John Bruins,
Vice President & Senior Actuary



Robert Neill,
Senior Counsel

Cc: Director Christina Urias
Arizona Department of Insurance



April 25, 2011

John M. Huff
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RE: NAIC Group Solvency Issues (EX) Working Group: Group Capital Assessment Proposal
For U.S. Compliance with the International Association of Insurance Supervisors (IAIS)
Insurance Core Principles (ICP) on Group Capital and To Observe Financial Sector
Assessment Program Recommendations

Dear Co-Chairmen Huff and Saenz:

The Group of North American Insurance Enterprises (GNAIE) wishes to thank you for the opportunity to respond to the consultation document on the use of the Own Risk and Solvency Assessment (ORSA) as the means to provide confidential information to state insurance department regulators to regularly perform an analysis of the group's financial condition and risks via review of the holding company system's target capital position.

As we said in an earlier consultation on the ORSA, GNAIE believes that consideration of the scope and effectiveness of an insurer's risk management framework should be an integral part of the supervisor's assessment of an insurer's solvency.

GNAIE agrees with the SMI Task Force's view that capital requirements should continue to be based on Risk Based Capital (RBC) methodology, focused on minimum capital levels at the legal entity basis and that a separate group capital requirement will not be added. We agree the economic group capital of an enterprise should not be perceived as the minimum amount of capital before regulatory action will result, but it should be assessed as the capital needed within a holding company system to achieve the group's business objectives.

GNAIE supports an analysis of the group's financial condition and risks as a means to review the holding company system's target capital position. We believe that the risk focused exam is the best place to review a company's ERM program. The Risk Focused Exam process already has in place confidentiality requirements necessary for the examination of the highly confidential material included in the ORSA.

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Timing of the Review

The draft paper suggests an annual submission of the ORSA with updates, as requested by the regulator, throughout the year if necessary. We believe that much of the information in the proposed ORSA will not change on an annual basis. To the extent interim information regarding a company's enterprise risk is necessary, we would suggest an annual update requirement focus on changes to the company's enterprise risks or ERM program. Such interim reporting would simply build on the more detailed information collected during the previous examination.

A periodic ORSA filing would then only contain a high level summary of an insurer's risk management policy with the entire policy being available for review upon examination. Regulators could also make a special request or perform a targeted or limited scope examination if concerns arise from the interim reporting.

Approach Options

We believe a company ERM should be reflective of its business and risks and that the specific form of the ORSA be driven by that enterprise specific approach.

We support providing companies with an option to use a consolidated or aggregated approach for the group's capital assessment. We accept the provision that if several U.S. insurance legal entities are within the same holding company system, those affiliated U.S. insurers must agree to utilize the same approach.

A review of the ERM or ORSA process should be coordinated with the lead state or under the leadership of the group supervisor. It would be very burdensome to have multiple reviews of this material.

We would like to ensure that the same ORSA conducted on an enterprise level including non-US operations is acceptable in the US and other countries and we would urge that the NAIC make its requirements as compatible as possible with global standards so that the enterprise-wide ORSA does not have to be significantly adjusted for NAIC review purposes.

Specific Requirements

We agree these are appropriate items to be addressed in an ERM program and reflected in the ORSA.

- Eliminate intra-group transactions and consequently double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities.
- Take account of the level of leverage, if any, resulting from holding company debt.



- Clearly identify diversification credits and adequately address restrictions on fungibility of capital within the holding company system, including the availability and transferability of surplus resources created by holding company system level diversification benefits.
- Reflect the affects of contagion risk, concentration risk and complexity risk in their group capital assessment.

We look forward to continuing discussions with you on the development of the proposal.

Sincerely,

/s/ William R. Sergeant

William R. Sergeant, CPA, CPCU, CLU, ChFC, FLMI
Chair, GNAIE Solvency Committee

WRS:MEF:cll

Submitted by email to David Vacca at dvacca@naic.org