

MEMORANDUM

TO: Group Capital Calculation (E) Working Group

FROM: Commissioner Altmaier, Chair, Group Capital Calculation (E) Working Group

DATE: October 31, 2017

RE: Proposed Revised Approach to XXX/AXXX Captives

During 2016 and 2017, the Group Capital Calculation Working Group has considered various aspects related to then consideration of the best approach to take with respect to incorporation of XXX/AXXX captives within the overall calculation. During today's conference call, before discussing this issue again I reminded participants that the Working Group had already determined that the purpose of this calculation was to assist lead states in analyzing the financial condition of the group.

I noted that some states believe that a VM-20 valuation of such liabilities would provide states with better analytical information because it's presumed to be a more accurate representation of such liabilities. However, I highlighted that other states have expressed concerns with that approach since the states are unable to require such a valuation of all groups with XXX/AXXX captives; states can really only allow such a method. Further, requiring the VM-20 calculation could be overly burdensome for some groups. The primary issue this raises is a lack of consistency in valuation between groups, which is problematic. I also highlighted that some regulators are very opposed to any approach that allows the use of any types of assets that are not allowed for statutory accounting principles (SAP), even if that issue is only a perception issue. I stated it was my understanding that these captives report full statutory reserves but can recognize LOCs and other non-qualifying SAP assets as capital to fund the difference between economic and full statutory reserves.

I noted that there seems to be no way to overcome this difference of opinion unless the NAIC can require the assets to be consistent with SAP but the liabilities to represent the "economic valuation" with some type of RBC adjustments or we develop a new approach for consideration.

As a result, I suggested the following approach be taken

- 1) We use a valuation that results in essentially "looking through" the transaction all together (i.e. unwind the captive transaction).
- 2) This could include requiring the calculation for the XXX/AXXX captive to report the liabilities consistent with the valuation of the direct writer then requiring the use of SAP on the captive assets.
- 3) This could also include allowing the captive valuation, but requiring some type of on-top adjustment elsewhere in the calculation (and /or RBC charges related to non-qualifying SAP assets) to get to a similar net capital valuation of the XXX/AXXX as required within 2.

If you have any comments, please submit them by **COB December 29, 2017** to Julie Garber (jgarber@naic.org) and Dan Daveline (ddaveline@naic.org).

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