National Association of Insurance Commissioners
The Center for Insurance Policy and Research

Group Solvency Issues (EX) Working Group

Request for Comment on Group Capital Assessment Options

The Group Solvency Issues (EX) Working Group is requesting comments on possible group capital assessment options. Comments should be electronically submitted to David Vacca at dvacca@naic.org by the end of the business day (5:00 p.m. central) on **October 11, 2010**. Comments may, but need not, address some or all of the options set forth below. Additionally, parties may suggest an option not covered by the proposed options below.

BACKGROUND

International Association of Insurance Supervisors (IAIS) Insurance Core Principles

The IAIS recognizes numerous approaches to group capital assessment, ranging from a group-level focus (utilizing the assumption that the group behaves as a single integrated entity) to a legal entity focus (with group risks assessed).

Using a group-level focus, the insurance group is considered a single integrated entity for which a separate assessment is made for the group as a whole. Risks from non-insurance members of the group are considered and require different assumptions in the calculations. Calculations can utilize consolidated accounts or an aggregation method. Consolidated methods have the advantage that intra-group holdings wash out, but the disadvantage that the group is not actually one single entity. An aggregation method can sum surpluses/deficits, requiring adjustment for intra-group holdings, or sum the legal entity capital requirements and available capital ("capital resources"). Aggregation methods have the advantage to measure companies as they legally exist, but require adjustment for cross-border calculations where different valuations and capital requirement methodologies exist.

Under a legal entity focus, the insurance group is not considered as a single integrated entity, but rather as a set of interdependent legal entities, with each insurance company having a capital requirement taking into account *material* risks arising from being part of a group. There is no summation of capital requirements.

Current U.S. State Insurance Group Capital Considerations

In RBC, when the parent is an insurance company, the parent's RBC is a group-level requirement using an aggregation method. That parent's RBC requirement utilizes risk-based capital calculations for directly-owned U.S. insurance affiliates with RBCs and Canadian life insurance affiliates with MCCSRs. Other entities create capital charges based on value measurements.

When the parent is a holding company, regulators currently do not have group capital requirements, although the legal entity capital requirements can be modified by regulators to measure the material risks arising from being part of a group to achieve group capital on a legal entity basis. Additionally, regulators typically attempt to assess group capital risks and considerations during their annual review of the Form B - Insurance Holding Company System Annual Registration Statement and during completion of certain Holding Company Analysis procedures as described in the *NAIC Financial Analysis Handbook*. Although, this information submitted to regulators or that is publically available will vary by group and is not uniform.

GROUP CAPITAL ASSESSMENT OPTIONS

The following are some possible group capital assessment options for which comments are requested. The options are not mutually exclusive.

1. <u>Legal Entity RBC Adjustments</u>

To comply with IAIS standards, the legal entity RBC needs to account for the risks of being part of a group, such as reputational, contagion, or enterprise risks that could have an impact on the insurance company itself. This concept differs from "group-level capital" because the capital requirements do not require any capital levels for any non-insurers in the group. The non-insurer could be in dire financial condition, but there would be no impact to the insurer's legal entity RBC unless that insolvency would have an impact on the financial position of the insurer.

To do this analysis, NAIC would need financial data from the group. Thus, a uniform and consolidated group statement would need to be considered.

2. <u>Group Capital Analysis through ORSA</u>

The International Solvency (EX) Working Group is developing a risk management assessment tool that is currently titled an "Own Risk and Solvency Assessment" (ORSA). U.S. state insurance regulators could develop the ORSA to provide information to perform an analysis of the group's financial condition and risks.

3. <u>Group Capital Calculation</u>

- Parent Insurer

When the parent is an insurer, the RBC currently applies. The RBC use of other countries' capital requirements could be expanded beyond the use of Canada's MCCSR for life insurers. This might require some determination, country by country, of the comparability of capital requirement calculations.

- Parent Holding Company

A group capital calculation and analysis could be created. This group capital calculation could be similarly calculated as the RBC, with adaptation for non-insurance companies deemed "significant" in the group. But the Group RBC would be significantly different than the legal entity RBC given there would be no control levels, but only action levels. Regulatory action with the group capital calculation could be focused on the need to have risk discussions with a group rather than any concrete required action or control. That would leave all control ladders of intervention in the legal entity capital requirements.

