

August 16, 2018

The Honorable Tim Scott  
United States Senate  
717 Hart Senate Office Building  
Washington, DC 20510

The Honorable Mike Rounds  
United States Senate  
502 Hart Senate Office Building  
Washington, DC 20510

Dear Senator Scott and Senator Rounds:

Thank you for your letter dated August 1, 2018, regarding the NAIC's proposed Group Capital Calculation (GCC). On behalf of the National Association of Insurance Commissioners (NAIC),<sup>1</sup> we appreciate this opportunity to respond to your concerns related to its application to health insurers.

We are aware of some of the false rhetoric being used by certain health insurers to raise unfounded concerns with our efforts, and are disappointed they have chosen a strategy of political obstructionism over working constructively with regulators to address their concerns. Commissioners from several jurisdictions have offered on numerous occasions to work with these health insurers to better understand their concerns. While these discussions have proven productive with some, at least one health insurer continues to disseminate false information about the GCC. Additionally, as these same health insurers are lobbying Congress for stability funding and asking state insurance departments for significant rate increases that will be borne by your constituents, we would suggest their efforts to undermine greater insight into the justification for such financial relief is a clear illustration of the need for a GCC. We appreciate the opportunity to set the record straight.

By way of background, the NAIC began exploring the development of the GCC in 2015. The GCC was a natural extension of work state insurance regulators had already begun, in part driven by lessons learned from the 2008 financial crisis, to better understand the risks to insurance groups and their policyholders. While insurance regulators currently have authorities to obtain information regarding the capital positions of non-insurance affiliates, we do not have a consistent analytical framework for evaluating such information. The GCC is designed to address this shortcoming and will serve as an additional financial metric that will assist regulators in identifying risks that may emanate from a holding company system.

The GCC and related reporting will provide more transparency to insurance group analysis and make risks more identifiable and more easily quantified. In this regard, the tool will assist regulators in holistically understanding the financial condition of non-insurance entities, how capital is distributed

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<sup>1</sup> Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

across an entire group, and whether and to what degree insurance companies may be subsidizing the operations of non-insurance entities, potentially undermining the insurance company's financial condition and/or placing upward pressure on premiums to the detriment of insurance policyholders. It is envisaged that this calculation will provide 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.

Importantly, the NAIC is not creating a new capital standard for insurers that would necessitate higher capital levels. Rather, the GCC will be an additional reporting requirement built off existing legal authorities. State insurance regulators already have broad authority to take action when an insurer is financially distressed, and the GCC is designed to provide regulators with further insights to allow them to make informed decisions on both the need for action, and the type of action to take. Further, the tool's development is still ongoing and subject to the NAIC's open and transparent committee process. Interested stakeholders have had multiple opportunities to comment on various proposed iterations of the GCC and will have additional opportunities to do so as it continues to be developed. In terms of timing, it is anticipated that the GCC will undergo field testing later this fall and will not be finalized until the end of 2019 at the earliest.

Set forth below are the answers to your specific questions, particularly as they relate to the GCC's application to health insurers.

**1. What is the timeline and process for the NAIC's plans to finalize and adopt the Group Capital Calculation?**

There is still a fair amount of work to be done. The mechanics and assumptions of the GCC have yet to undergo field testing, which, as described above, will likely commence by the end of this year. We expect further adjustments to be made after the field testing and the results of such analysis to be thoroughly vetted, including the opportunity for ample public comment, before any final decisions are made. The NAIC does not anticipate adopting this tool until the end of 2019 at the earliest.

**2. Does the NAIC believe health insurance needs to be included in the Group Capital Calculation because of the Covered Agreement?**

No. This is a clear example of the false narrative that some health insurers are creating. The NAIC process to establish the GCC preceded the covered agreement with the European Union. While implementing the GCC is a requirement for compliance with that agreement,<sup>2</sup> the decision to develop a GCC was not driven by the covered agreement or any international standard setting bodies. As noted, one of the clear lessons learned for all regulators following the last crisis was the need to have a clearer financial picture throughout a group. In fact, international approaches to capital tend to be far more prescriptive in nature than the NAIC's proposed GCC in that they require firms to raise additional capital or impose business constraints if certain thresholds are not met.

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<sup>2</sup> See, Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance (signed Sept. 22, 2017).

### **If not, what is the impetus for including health insurance in the GCC?**

Health insurers, like other types of insurers, frequently affiliate themselves with non-insurance entities and other types of insurers, and are not uniquely insulated from the risks within an insurance holding company system. In fact, given the structure of the health insurance market and the nature of several of their affiliations, the financial condition of health insurers and the premiums policyholders pay may be more sensitive to such risks than other types of insurance companies. For example, we are aware that certain health insurance companies use extraordinary dividends from operating insurers to service the debt of their holding company and non-insurance affiliates. While such an approach may be appropriate given the nature of the business and the financial condition of the entities, the GCC will provide insurance regulators greater insight into those types of transactions and enable regulators to scrutinize them more closely to ensure that they do not undermine the solvency of the insurance company or improperly lead to higher health insurance premiums for consumers.

### **Is there a specific risk in the health insurance market that the NAIC is attempting to address?**

As described above, health insurers often affiliate themselves with non-insurance entities. While Life, P&C, and Health insurers generally weathered the last financial crisis, state insurance regulators have been working to improve their group supervisory tools consistent with lessons regulators learned from that crisis. This would naturally extend to health insurers since they are not uniquely insulated from the risks posed by non-insurance affiliates.

Even though the NAIC believes the GCC's application to health insurers is appropriate, state insurance regulators recognize the unique financial and operating characteristics of health insurers. We recognize the distinct nature of non-insurance subsidiaries and affiliates within some large integrated health groups and believe those aspects are currently captured within the health RBC formula and included as an input into this calculation. We are acutely aware of the difficulties and uncertainties health insurers are facing in the marketplace and the rising premiums that are passed on to your constituents. Again, because the GCC is not a standard resulting in a reflexive response, but simply a regulatory tool, state regulators will have the ability and discretion to weigh a health insurer's GCC in combination with a host of other considerations and metrics and make informed, rational decisions.

It's also important to understand this calculation will not limit the amount of debt a group can issue, or otherwise establish a regulatory level for debt leverage – this is of particular interest to the health insurers. In fact, this calculation will allow some level of debt to be considered as additional group capital and be added to the existing amount of equity under Generally Accepted Accounting Principles (GAAP) of the non-insurers.

### **3. If the NAIC adopts a new Group Capital requirement for health insurance, what actions would states have to take to implement the new requirement or will it take effect immediately upon adoption by the NAIC?**

As previously indicated, the GCC will not be a new capital standard but rather a reporting tool built off of existing authorities. As such, it will be available to states to review as part of their ongoing supervision of the firm and it is up to them to utilize it as they deem fit. Certain states may have to pass laws or regulations to require insurers to report using the new tool. Other states

may be able to rely on existing authorities. States may also have to amend current laws to ensure the confidentiality of the information.

- 4. Some have called the GCC a “tool” while others have said that it is a “requirement.” If it is a “tool” as some have described it, and a regulator looking at the “tool” sees that a company under its jurisdiction appears to be undercapitalized, what action(s), if any, would the regulator be required to take at that time?**

As previously stated, the GCC is a reporting and analytical tool and does not require any regulatory action to be taken. Put simply, the GCC provides additional insight, and allows regulators to then use existing powers to take any needed action on an informed basis and use the tools already in their toolbox to protect policyholders. The GCC will be an additional financial metric, similar to a loss ratio or leverage ratios. Specifically, it will require the group to inventory the available capital, and capital needed for each of the legal entities within the group (regulated and unregulated, insurance and non-insurance), and make adjustments as deemed appropriate for things like double-counting of affiliated holdings. Much of the value of this tool lies in the inventory itself in recognizing the views of other insurance and sectoral regulators on regulatory capital, and identifying entities that can pose material risk to U.S. insurers.

The information that this tool reveals to regulators could result in a range of responses including no regulatory action, additional monitoring, or, just by way of one example, a deeper enforcement of existing authority relating to risks in non-insurance legal entities. It does not require additional capital to be held by insurers beyond what is included in the Risk-Based Capital (RBC) formulas. However, should the ongoing supervision of a firm reveal that a company requires more capital because its position is insufficient to protect policyholders, as in all other situations, regulators will utilize their current authorities to remedy the issue. This approach contrasts with group capital requirements that exist in other jurisdictions such as the EU where regulators and companies may be required to take prescribed steps to add more capital based on their scoring.

- 5. Is any of the information the NAIC is seeking from health insurers as part of the Group Capital process already publically available?**

Yes, some information is available. For example, insurance companies file annual financial statements on a legal entity basis with the NAIC and some of that information is utilized in the calculation. However, other information is not publicly available or is derived from components of otherwise public GAAP figures not directly discernible to the public.

Since the totality of the information is uniquely possessed by the company, it is relatively easy to assemble because the company already has to develop such information for purposes of their GAAP or other public financial filing, and the NAIC does not believe complying with this reporting requirement will be unduly burdensome on companies. With that stated, as previously mentioned, we intend to field test the GCC later this year and if such issues arise, we will explore ways to address them.

**6. What economic analysis has the NAIC conducted to assess the economic impact of a new Group Capital requirement on choice, competition and costs in the health insurance market?**

As regulators of the industry, we are keenly aware of the difficulties and uncertainties health insurers and policyholders are facing in the marketplace and the issues driving those concerns. The GCC is a reporting requirement with minimal costs associated with implementation that provides valuable insights to regulators of this challenging sector. Therefore, it should not have any negative impacts on the choice, competition, and costs in the healthcare market.

With that stated, while the NAIC is still in the process of designing the calculation, once the initial version is completed, the NAIC will utilize the expertise of volunteer companies and seasoned regulators to begin a process of testing various proposed approaches for estimating the capital within a group. The primary purpose of the testing will be to evaluate which, if any of the proposed methods, provide the best measure of risks emanating from the group that could adversely impact the ability of the entities to pay policyholder claims. While this process of testing cannot determine with certainty the impact on all insurers or the industry as a whole, the process, experience and input provided by the volunteer companies and regulators should provide a good gauge of the impact on those companies that do decide to participate. Health insurers would be well served to participate in this field testing process and to demonstrate with data any concerns they have. We have invited their feedback at multiple opportunities in our process, and will continue to do so.

**What is the NAIC perspective on how much health insurance premiums may rise to cover the costs of the new Group Capital requirements?**

As previously stated, the calculation is a reporting tool and not a capital standard. Any costs to a company to make the required filings should be minimal and have no impact on insurance premiums. This GCC will provide regulators greater insights into whether and to what degree health insurance entities, and by extension policyholders' hard earned premium dollars, are being used to subsidize non-insurance entities within a group. Thus far, no health insurer has provided any substantive support to regulators to back up the assertion that premiums would rise.

**7. What analysis, if any, has the NAIC done to determine whether, as a result of the adoption of a new Group Capital requirement for U.S. health insurers, American businesses, consumers and taxpayers will be at any sort of competitive disadvantage compared to business and consumers in European countries.**

The GCC is a reporting tool, and not a capital requirement, and all U.S. groups subject to this proposed future filing requirement will continue to be impacted solely by existing legal entity capital requirements designed for the specific lines of business for which they operate. As such, U.S. health insurers, American businesses, consumers and taxpayers should not be at any sort of competitive disadvantage compared to business and consumers in European countries as a result of this calculation. If anything, we expect the GCC to result in more informed and effective supervision. It is also worth pointing out that as part of our work, we have conducted a "Baseline Exercise" in an effort to fully understand the impact of the GCC. While participating in the Baseline Exercise is voluntary, health insurers have thus far refused to participate, making it difficult for regulators to validate health insurers' talking points.

**8. In recent months, there have been media reports about potential new entrants into the health care markets. What impact does the NAIC predict a GCC will have on potential new entrants to the health insurance market?**

The NAIC does not anticipate the GCC impeding entry into the marketplace. Any company may enter the health insurance market provided they meet existing regulatory requirements designed to protect U.S. policyholders.

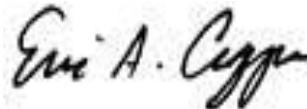
In conclusion, as the primary regulators of the health insurance sector, we are keenly aware of the challenges in health insurance markets and remain ever vigilant to help ensure that our markets remain competitive and consumers remain protected in spite of steadily rising healthcare costs. The proposed GCC is specifically designed to assist regulators in fulfilling those objectives by ensuring that risks outside the insurance entities do not negatively impact an insurer's financial condition and its ability to fulfill its obligations to policyholders. We will continue to work with all stakeholders through our public and transparent process to ensure that the final GCC serves both regulators and benefits the larger market through informed, efficient regulation. We also remain open to working with health insurers on their concerns and would encourage them to direct their energies to working with us rather than continuing to engage in a public misinformation campaign that calls into question their credibility and willingness to operate in good faith.

We very much appreciate the opportunity to respond to this inquiry. Should you or your staff have any questions, don't hesitate contact Ethan Sonnichsen, Managing Director, Government Relations at [esonnichsen@naic.org](mailto:esonnichsen@naic.org), Mark Sagat, Assistant Director Financial Policy and Legislation at [msagat@naic.org](mailto:msagat@naic.org), or Heather Eilers-Bowser, Financial Policy and Legislative Counsel at [heilersbowser@naic.org](mailto:heilersbowser@naic.org).

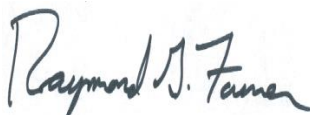
Sincerely,



Julie Mix McPeak  
NAIC President  
Commissioner  
Tennessee Department of  
Commerce & Insurance



Eric A. Cioppa  
NAIC President-Elect  
Superintendent  
Maine Bureau of Insurance



Raymond G. Farmer  
NAIC Vice President  
Director  
South Carolina Department of Insurance



Gordon I. Ito  
NAIC Secretary-Treasurer  
Commissioner  
Insurance Division  
Hawaii Department of Commerce  
and Consumer Affairs

A handwritten signature in black ink that reads "Michael Considine". The signature is written in a cursive, flowing style.

*Michael F. Considine*  
Chief Executive Officer  
National Association of Insurance  
Commissioners