ROLL CALL

David Altmaier, Chair  Florida  Justin Schrader  Nebraska
Susan Bernard/Ron Dahlquist California Peter L. Hartt New Jersey
Kathy Belfi Connecticut Joan Riddell New York
Philip Barlow District of Columbia Jackie Obusek North Carolina
Kevin Fry Illinois Dale Bruggeman Ohio
Jim Armstrong Iowa Mike Boerner/Doug Slape Texas
Gary Anderson Massachusetts David Smith/Doug Stolte Virginia
Leslie Nehring Missouri

NAIC Support Staff: Julie L. Garber

AGENDA

1. Consider Adoption of its June 20, April 19, April 5 and Spring National Meeting Minutes — Commissioner David Altmaier (FL) Attachment A

2. Discuss Comment Letters Received Related to Memorandum on Scope of Group/Non-Insurance Testing—Commissioner David Altmaier (FL) Attachment B
   • Exposed Memorandum
   • Comment Letters Attachment C

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

4. Adjournment
Group Capital Calculation (E) Working Group
Kansas City, Missouri
June 20, 2018

The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met in Kansas City, MO, and via conference call, June 20, 2018. The following Working Group members participated: David Altmaier, Chair (FL); Susan Bernard and Rachel Hemphill (CA); Katharine L. Wade and Kathy Belfi (CT); Philip Barlow (DC); Kevin Fry and Susan Berry (IL); John Turchi (MA); Leslie Nehring (MO); Jackie Obusek (NC); Justin Schrader and Lindsay Crawford (NE); Peter L. Hartt and David Wolf (NJ); James Matheson (NY); Tim Biler (OH); Mike Arendall and Mike Boerner (TX); and Scott A. White, Doug Stolte and David Smith (VA).

1. Discussed the Scope of the Group and Non-Insurance Regulated Entities

Commissioner Altmaier stated the purpose of the meeting is to continue discussions on the scope of the group and non-regulated entities. He stated he believes the two issues are closely linked and suggested the two topics should be included in one document going forward. He stated that NAIC staff had made revisions to each of the previously exposed documents on the two topics based upon comments received on both the scope of the group (Attachment ???) and non-regulated entities (Attachment ???). He suggested NAIC staff explain the rationale for the revised documents, and then the Working Group ask each party commenting in writing to speak on whether the revised documents address their primary comments, and what issues remain to be discussed at the Summer National Meeting.

Dan Daveline (NAIC) stated that with respect to the scope of the group issue, the intent of the changes was: 1) reinforce the desired level of flexibility to be given the lead-state regulator in working with the group in determining the scope of the group; and 2) a consistent process to be used by all states so that a different answer would not result depending upon who the lead state regulator was. Mr. Daveline stated for these reasons, the revised document incorporates a process, or series of steps, where a methodology is used to obtain the desired level of consistency. Mr. Daveline stated that with respect to the steps, he wants to focus on the first five steps, and then pivot to the non-regulated entities document.

Mr. Daveline stated that the first step in the revised scope of the group document was intended to address another consistent theme in the comment letters, which was that state insurance regulators are sensitive to groups being subject to multiple group capital calculations. He said he hopes the words could be modified during the exposure period to make this more clear, but the intent is such groups could be exempted from this calculation.

Mr. Daveline stated that the second step in the revised scope was intended to require the group to develop a list of the entities in the group by first starting with the Schedule Y, then adding into that other entities in the group and finally going through the process of determining if entities should be scoped out of the calculation.

Mr. Daveline stated that a couple of comments suggested that flexibility should be given to the lead state to scope out the calculation entities that are not a material source of capital or material user of capital. He stated that in order to develop some consistency, NAIC staff defined what a material source of capital was, as well as a material user of capital. He stated the threshold for material source of capital was to use the 5% of capital threshold that is often used by auditors and state insurance regulators as a major input into the basis for materiality for their respective work. He stated he does not believe material user of capital was as well defined, and stated that they put forth a threshold of 5% of the group’s net income, on the basis that if that entity was excluded, it would not materially change your view of the group. Mr. Daveline noted that the third step was focused on scopeing out consistently profitable companies, while the fourth step was focused on scopeing out negligible companies. Both steps used the materiality concepts previously noted. He emphasized that some of the complexity in the fourth step was largely directed at getting at the fact that in order to scope out a group of entities, they needed to be consistently negligible, and NAIC staff wanted to avoid gaming the criteria and in turn set up criteria that allowed the same entities to be excluded every year.

Mr. Daveline stated that the fifth step was designed to get at some of the concepts noted by the Texas Department of Insurance (DOI) in their comments. He said that some accounting measures may not be the best measure of risk and to use the materiality definitions as a guide, but with the understanding that regulatory judgment may be needed. He said that the
first two measures allowed the lead regulator to add in companies that otherwise may not be included in the scope of the group and that the third measure was intended to allow the lead regulator to both add in and subtract companies.

Mr. Daveline discussed that the non-regulated entities document had some key aspects to it. Specifically, he indicated that state insurance regulators envision the group submitting a detailed inventory of the entities in the group so that the lead state can use the information to make the determination of the group. He said the real value of the calculation and why it is superior to other calculations that only focus on one number is the ability to understand the sources of the strength and weaknesses of the group so that the lead state can better supervise the entire group. He stated that to the extent this detail could be captured, it allows the grouping of nonfinancial entities to be less rigid. He noted the current document does not discuss: 1) the fact that some large groups have thousands of entities; and 2) the fact that there probably needs to be some decision by the lead state on how the inventory is put together in a grouped manner so that the state insurance regulator can best understand how the group is managed and should be analyzed. He stressed this inventory was the greatest value of the calculation, allowing the lead state to peel the onion back to understand the group. For those reasons, grouping is somewhat unlimited with the exception of the financial entities and simply making sure the lead state has enough detail to obtain the greatest value from the calculation. Mr. Daveline said that many entities in the U.S. are strong, and the calculation should reflect that. Therefore, to the extent that a subgroup of entities in the group are consistently profitable, they should be subject to a fairly minimal charge on the basis that such entities would not be a user of capital and more likely a source of capital. He stated this applies a one-half percent charge to the revenues of such grouped entities. Also included in the revised document were three tests for the non-regulated entities.

Mr. Daveline said that the first test was focused on this same principle that consistently profitable companies should be grouped and subject to a smaller charge, while those entities that might have had a loss in any of the last few years should be spiked out from such grouping and separately subject to a charge that is consistent with the extrapolation of the current operations to those past worst losses on the basis that what happened once could happen again. He stated this test was likely the most risk-sensitive but subject to the need for more data. However, given the inventory, this will also require similar information over a period of time, and as time pass, the requirements of this past data would be less difficult to produce. Mr. Daveline stated that the second test was focused on the principle of how non-regulated entities are more of an operational risk than anything, and is structured in that way based upon recommendations from the American Council of Life Insurers (ACLI). Mr. Daveline stated the third test was the most simple and consistent with the current risk-based capital (RBC) approach, but perhaps the least risk-sensitive.

Mr. Daveline stated that NAIC staff agree with the comment made by the industry that the financial entities are generally going to be the riskiest, and for that reason, with some exceptions, the financial entities should be individually inventoried. He highlighted the changes made to the document for the financial entities, mostly small changes to address comments from the ACLI, but others to address the fact that one of the previous suggestions was difficult to apply. Ms. Belfi stated she appreciates the comments from Texas and how the fifth step incorporated nonfinancial thresholds and flexibility. She stated that at some point, there would need to be some discussion on how the communication by the lead state with the other states would work as she saw such communication to this flexibility to be critical. She also noted that some of the things noted by Texas related to intra-group affiliations should be considered in that determination of profits and losses in the non-regulated entities.

Mr. Stolte asked how confident state insurance regulators were that the aggregation methodology would achieve the comparability threshold that is being suggested as needed by international insurance regulators. Commissioner Altmaier stated that ideally, this Working Group would build a tool desired by state insurance regulators, and to the extent such a tool also met the requirements set by international insurance regulators, that would be great. However, he said he is concerned that the Working Group develops a tool that does not meet the needs of the states and is inconsistent with the thinking of state insurance regulators. Commissioner Altmaier stated an example would be the use of market-consistent valuation, something that would not work in the U.S. and, therefore, not find its way into the Working Group’s discussions. He stated that he is optimistic that once the work was completed, they would find some level of comparability. He stated it was not their goal to achieve comparability, but to instead develop something that works for the system. Then after that, as a byproduct of working for a very effective system, it also should be considered comparable to, if not better than, the International Association of Insurance Supervisors (IAIS) insurance capital standard (ICS).

Mr. Stolte agreed and suggested the field testing should be helpful to these points. Commissioner Wade agreed with Commissioner Altmaier, noting that this is being developed for domestic purposes, and to have the discussions on comparability now as opposed to five years from now, the dialogue would continue in the near future. Lou Felice (NAIC)
stated that what is contemplated in both this domestic testing and the IAIS ICS aggregation is testing to a 300% company action level, which should help.

Mr. Fry asked why the approach developed differs from the IAIS definition of an insurance group. Mr. Daveline responded that what had been developed by NAIC staff is intended to: 1) capture that state insurance regulators today complete their analysis of the group by considering the entities within the control of the ultimate controlling party; and 2) calculate something that represents material risks of the group as a whole. He said that the comments that suggested such an IAIS approach even seem to contemplate the calculation should consider material risks of the group. Mr. Schrader stated that the IAIS workstream on head of the insurance group is in line with the approach NAIC staff used in identifying material risks. Mr. Wolf stated that New Jersey agrees with considering the ultimate controlling party, and insisted that the determination of scope of the group should start with the ultimate controlling party. He stated New Jersey has some concerns with the sixth paragraph as it could lead to incorrect interpretation. He emphasized that the calculation is a tool and should not be used to interpret the rest of the tools of the Insurance Holding Company System Regulatory Act (#440). Mr. Belfi stated she believes the second step does already consider all entities under the ultimate controlling person, and she does not see how it conflicted with the sixth step. Mr. Wolf described it could be a wording issue that could be improved.

2. Heard Industry Reactions

a. Prudential Financial

Ian Adamczyk (Prudential Financial) stated Prudential Financial’s appreciation for the addition of objective criteria into the scope of the group document, but noted it did not see any language regarding its suggestion for applying the calculation to the U.S. operations of a foreign group. He stated there is some question regarding the measurement of the objective criteria, whether U.S. generally accepted accounting principles (GAAP), statutory or a mixture of the two would be used, and the potential for a circular calculation depending upon the answer. Commissioner Altmaier asked if Prudential Financial is supportive of non-U.S. groups completing multiple calculations in different jurisdictions. He responded that this was the case for U.S. groups in other countries and was part of the reasoning. Mr. Adamczyk reiterated how the group capital calculation for U.S. operations provided a number of values and encouraged the Working Group to consider them. Ms. Belfi stated that a good starting point would be filers of the Own Risk and Solvency Assessment (ORSA).

b. AHIP

Bob Ridgeway (America’s Health Insurance Plans—AHIP) stated AHIP believes one size does not fit all and that health insurance is different. He suggested that some of the discussions with the health industry could be taken offline to discuss individually and then brought back into the fold at a later time. He stated AHIP believes that the scope of the group would exclude particular types of groups, such as health insurers. He stated he supports the comments made by the Texas DOI that the Working Group should first focus on internationally active insurers first. He said some of his members are concerned about the complexity of the proposed calculation, and he specifically cited the use of scalars. Instead, the inventory could be more similar to that proposed by Cigna. Mr. Ridgeway stated AHIP supports the process included in the scope of the group. However, it has more questions on excluding specific nonfinancial entities, and more specifically on not requiring five straight years of profits, but only requiring four of those five years. Mr. Ridgeway asked various technical questions related to how Schedule Y, Form B and RBC operate today, and how RBC may operate in the future. Commissioner Altmaier noted that with respect to one of the RBC questions, this was not intended to backdoor an approach, but the testing process may reveal that it should be considered for future changes to RBC.

Mr. Ridgeway asked if state insurance regulators were intending to assess the risks of those entities they do not regulate, and if so, how. Mr. Daveline summarized the various approaches being proposed to test as far as the risk charges to non-regulated entities as outlined in the two memorandums. He focused on the fact that some of the approaches are more risk-sensitive than others, where the first test uses a proposed risk factor based upon past losses, since that is a potential indicator of potential future losses or risks. He stated, therefore, it is risk-sensitive. Commissioner Altmaier stated that even without the calculation, state insurance regulators already consider risks of non-regulated entities when they perform holding company analysis. He highlighted that because this is a tool, and not a requirement, the state insurance regulators would not indicate that the non-regulated entity needed to have more capital injected. He stated the intent was to add this bit of information to the rest of the information on the group so that they can help develop a supervisory plan over the group. Ms. Belfi agreed with Commissioner Altmaier. She described how this calculation is the quantitative manner of pulling all of
the information on the group together and how it is the one bit of information that is currently missing for state insurance regulators.

Mr. Ridgeway suggested that test one is overly complicated and not particularly useful. Mr. Ridgeway suggested test two could have value, but that it needs more review. He stated AHIP’s previous concerns about how scalars continued to exist. He stated the third test is relatively simple, and will generally be fairly consistent from year to year.

Amy Lazzaro (Cigna) reminded the Working Group of Cigna’s proposed approach, which requires: 1) an inventory of domestic entities subject to RBC to show an aggregated RBC; 2) international entities subject to regulation, which also shows a value relative to local capital requirements; 3) non-regulated entities above a certain size with no required capital figure but a listing of their available capital; and 4) group entities below a certain size, again with no required capital figures but a listing of the combined available capital. She said Cigna argues that there is no real value in aggregating apples and oranges (e.g., GAAP, statutory accounting principles [SAP] and foreign capital figures). She further emphasized that when the information from Cigna’s proposed approach is combined with the existing qualitative information from Form F, ORSA, it results in something that gives high value, even without a single number.

Craig Martinez (Aetna) suggested the Working Group be careful with the construction of the calculation to avoid any unintended consequences. Ms. Belfi noted that what was being constructed was for domestic groups and that one suggestion has been made that the calculation begin with internationally active insurance groups (IAIGs). She asked Mr. Ridgeway how many health insurance groups met such criteria. Mr. Ridgeway responded that he is not aware that any of the health groups met the criteria of being IAIGs. Mr. Belfi stated that she believes that was correct and that she would have a problem scoping out the entire health insurance industry. Mr. Ridgeway noted that one state insurance regulator suggested to him that the calculation would provide benefit in understanding the complexity of health companies, but that it would be best to start the construction with those IAIGs first. Ms. Lazzaro stated that if their lead state believes this calculation is needed, Cigna will perform the calculation, particularly if it is crafted to provide value to that state insurance regulator. She made these points in light of the fact that it may come across as inappropriate for the industry to not be subject to this calculation.

Mr. Fry said that while it makes sense to focus on IAIGs first, and if every Illinois group was scoped in, it may not have the desired value as the existing U.S. tools are already effective. Mr. Ridgeway said for the reasons noted, this is why the decision by the lead state on whether the calculation provides value. Commissioner Altmaier stated his view was that the calculation generally should not be different between IAIGs and other domestic groups. However, it might be more constructive for the state insurance regulators to treat life, property/casualty (P/C) and health differently. He stated starting with IAIGs may not allow the state insurance regulators to get to the points on how the latter needs to be considered. He requested the industry work with him, even perhaps on an informal basis, to help address their concerns. Commissioner Wade emphasized how while she appreciates health insurers are different, they need to explain to the state insurance regulators specifically how they should treat such entities differently. She suggested the health industry come to the table with a proposal.

c. BCBSA

Carl Labus (Blue Cross and Blue Shield Association—BCBSA) stated that given the comments from Mr. Ridgeway, which he agrees with, and given the response from the Working Group, he would be willing to work with AHIP and others in developing a proposal for the health industry, given in the fact that most of their members had groups for which 90% of the business was derived from the health insurer(s).

d. Transamerica

Bill Schwegler (Transamerica) recapped how Transamerica’s comments are greatly focused on some of the original NAIC language discussed within the International Insurance Relations (G) Committee, which was focused on the existing state legal entity rules, and should do so 100% of the time—not 90% or 80%. He stated the structure of the group should be honored, and rules should follow those that apply to the legal entity insurer. He stated that some of the existing legal entity rules could be reviewed at this time, but those refinements should be done in partnership with how those processes are developed today. He stated concern about having two different approaches for the same type of entity.

e. ACLI
Carolyn Cobb (ACLI) requested the Working Group imagine sitting in the shoes of the chief executive officer (CEO) of an insurer, where certainty and predictability are extremely important. She also stated that having two RBC frameworks is probably not best, where one was for the legal entity and the other was for the group. With respect to field testing and timing, she stated the ACLI’s members are interested. She stated that that the ACLI has confidence that testing of entities will be a good cross section of the industry. She requested as the testing is completed, there be as much transparency into the findings as possible while also recognizing the confidentiality of the information. Commissioner Altmaier stated he hopes that a material amount of work could be done in early 2019 as part of the field testing. He stated he is hopeful that a productive summer would allow the Working Group to better define the timing.

Ms. Cobb stated while the ACLI supports some of the flexibility of the lead state in step five of the scope of the group document, it believes further discussion may be needed to flesh out the details of this step and some of its specifics. Commissioner Altmaier agreed that additional discussion would be of benefit, but the idea with this step was to give some flexibility for the state insurance regulator to scope in or scope out particular entities. He stated his appreciation to the ACLI for any suggested changes that allow the principles to give the state insurance regulator the flexibility that is needed, but also provide the certainty that is needed by the insurers.

f. **NAMIC**

Michelle Rogers (National Association of Mutual Insurance Companies—NAMIC) said while NAMIC appreciates the efforts to consider the various complex remarks, a number of questions arise with the latest draft. She also stated that regardless of how the issues are resolved, NAMIC is supportive of optionality in the field testing that can begin to be tested soon. She stated that there appears to be desire from state insurance regulators for this calculation to be used in a way that allows the regulator to identify trends within a group and allow follow-up where deemed necessary. She stated if that was the case, it may come back to some of the comments about comparability as previously noted by Mr. Stolte. She stated those other parties may be more interested in how the calculation compares different groups. She also stated that the calculation today should be focused on those groups that are not already subject to an existing capital requirements, such as: 1) one imposed by the Federal Reserve Board (FRB); 2) one imposed by a non-U.S. group-wide supervisor; and 3) one for which the top-tier company in the group is already subject to U.S. RBC. She questioned whether some of the complexity of the proposal could be moved into the calculation as opposed to the criteria. She urged the Working Group to make the template and the specifications available to the general public when they are provided to the field testing entities. Ms. Belfi stated that state insurance regulators are not developing this calculation to compare groups. Ms. Rogers said she understood and said other state insurance regulators may be developing their group capital for such a reason.

g. **PCI**

Dave Snyder (Property Casualty Insurers Association of America—PCI) shared PCI’s views. Tom Finnell (Finnell & Company Consulting) stated views on the revised memorandum were his only, and not those of PCI. Mr. Finnell encouraged a more principle-based approach to the calculation, and noted agreement with some of the comments from Berkshire Hathaway and CNA Insurance Companies. He stated that the IAIS used principles, and it was never an issue for scope of the group. He said the only time it was an issue was when the companies were considering consolidation accounting. He stated that using the term “scope of application” may be a more appropriate term than “scope of group.” He discussed how it would be important to develop: 1) specifications that spell out the calculation; 2) field testing instructions; and 3) the analysis done behind closed doors and confidentially. He made these comments because the documents seem to be more related to analysis. He emphasized that the calculation should not just be a single number, which was the case with the IAIS ICS. He added that the beauty of this calculation is that it goes beyond such a single calculation and can help connect the dots of the various other information the state insurance regulator obtains. He noted that while the calculation of the insurance figure used would be complex, the non-insurance entity calculation would be more arbitrary, but insightful into the group and its individual components. He agreed with the belief that as the group figures being suggested by the state insurance regulators are captured and reviewed over time, the trending of such information to identify change in risks is invaluable. He reiterated his thoughts on such work with other tools and noted how it could be incorporated into the ORSA. Ms. Belfi agreed with the importance of ORSA, but said state insurance regulators cannot dictate what is put in the ORSA Summary Report.

h. **RAA**

Karalee C. Morell (Reinsurance Association of America—RAA) stated the RAA’s appreciation for the changes to the scope of group document to where some allowances were recognized for non-U.S. groups that may already be subject to a group
capital calculation by their group-wide supervisor. She stated the changes also help to address some of the RAA’s concerns about consistent treatment by state insurance regulators.

  i. Berkshire Hathaway

Bruce Byrnes (Berkshire Hathaway) stated he believes the revised document makes significant strides in addressing the industry concerns. However, he said it is hard to evaluate the proposal without understanding the tool being applied. He stated Berkshire Hathaway agrees with Commissioner Wade that it is appropriate for the U.S. to first consider what tools are appropriate for it with the understanding that the additional tool should only be focused on existing gaps in information, and should avoid something that is duplicative or does not add value. He stated that the challenges with the document were with the detailed specific tests included, although some of the principles that are implicit are understandable. He suggested the working group focus at the Summer National Meeting on completing the principles, with the field testing developing the specific tests with various options. He stated that not all tests need to be finalized if the principles are finalized. He raised a number of questions and issues that supported his philosophy towards using principles. He stated that he believes there should be a conflict in scope of the group between this tool and the scope of the group in Model #440. He reiterated his company’s support for a scope of the group that is consistent with the ICP 23, The Group-Wide Supervisor, which considers only insurers and other financial groups. He stated his disagreement with the principle of source of capital and stated that it should instead be the availability of capital. He said that the principle of user of capital might be possible, but the details should be tested. In terms of the factors proposed in the tests, with respect to sister companies that are outside of the insurance entities, the concept of having a single capital charge across the different industries is not credible. He stated, however, that using a standard method, such as 22.5% of book/adjusted capital, has value in that it likely would simplify the use of the calculation for less complex groups. Then, a more complex method can be used for other groups. He argued against using an insurance leverage approach towards other industries. He stated that the idea of an operational risk charge, such as that added to RBC, might work, provided it does not use the proposed banking approach. Ms. Belfi discussed the idea of flexibility being proposed. Mr. Byrnes stated while he is comfortable with his current relationship with his lead regulator and Connecticut as a key regulator, he knows those individuals could change.

  j. CNA Insurance Companies

Jeffrey C. Alton (CNA Insurance Companies) stated he agrees with many of Mr. Byrne’s points and noted that he would focus on the scope of group issue. He said that conceptually, the current draft is a step in the correct direction, but clarity is needed. He stated that regulatory discretion is critical, and the draft is not focused on the group that could affect the payment of policyholder claims and was instead looking for capital wherever it could be found. He stated the need is making sure the group does not have risks that could have a negative impact, but those risks of the broader group should only apply through either contractual means or through contagion risk. He stated he is concerned about a capital model that shows a tremendous amount of capital, but in times of stress, the capital could not be obtained. This would create a cliff for a troubled company. He stated he would be opposed to any type of approach that shows a level of capital that is not available.

Mr. Alton raised a concern about the first step, noting that he understands the purpose, but believes it needs further work because his question is in regard to full recognition without the due process of mutual recognition. Commissioner Altmaier stated that the intent of this language was to avoid duplicative requirements, but it may be worthwhile to consider modifying it further to avoid the issue Mr. Alton highlighted. Mr. Alton stated with respect to the second step, it needs to be modified to avoid circular references. With respect to step three and step four, he said CAN Insurance Companies will use an ICP 23 approach that only looks at the payment of insurance claims, then other risks being exposed to. He said CAN Insurance Companies would be submitting comments to suggest formal changes to address its concerns. Ms. Belfi asked if the state insurance regulator should get to the same place in terms of scope of the group as Mr. Alton suggested. Mr. Alton responded they should. Mr. Schrader suggested that the focus should be on the principles, noting that he agrees with Ms. Belfi that a state insurance regulator should get to the same scope of group using either a top-down or bottom-up approach. Mr. Fry said he agrees with what was being said, but he questioned why step three and step four would not be eliminated. Mr. Alton stated he believes step three and step four were a filter of materiality. He suggested step five be modified and used to replace step three and step four. Ms. Belfi stated he likes the idea of having a threshold, and then step one goes to step five and that can be used to consider all of the factors.
k. UnitedHealth Group

Robert Oberrender (UnitedHealth Group) reiterated some of the previous comments made about the uniqueness of the health industry and how there really are four different industries affected by this proposed calculation in that none of the separate forms of insurance are the same. He asked NAIC staff if they looked at what companies file today before developing the revised memorandum to understand what information is already available. Mr. Daveline responded that the main consideration for the NAIC was addressing the point previously made by Ms. Belfi, and that unlike other tools, this is the quantitative manner of pulling all of the information on the group together. He stated as proposed, it would be helpful and not something current available to the states. Mr. Daveline reiterated his previous comments that if constructed properly, it could be a useful tool for analysts in evaluating the overall financial condition of the group. More specifically, he stated that as long as the tool is constructed to give the state insurance regulator analytical information and give the state insurance regulator the ability to peel back the onion, it would be useful. Mr. Daveline also said that state insurance regulators routinely ask the NAIC today how to go about evaluating the financial condition of the group, and this tool would definitely help as proposed, particularly since it anticipates information being captured and reviewed period over period.

Mr. Oberrender said the proposed materiality limits do not adequately address health groups, where many of their entities may have no capital and consist primarily of software and people. He stated UnitedHealth Group would propose additional health insurance experience be brought into the discussions to bring metrics used for health financial analysis. He said an independent firm had recently done some analysis on the impact of the proposed calculation on various types of health entities. He continued to suggest a one-size-fits-all approach does not work well. He noted any discussion about scope has to include the topic of holding company debt. He stated any limit on holding company debt must be removed and would exacerbate problems with the proposed calculation. Otherwise, the independent firms suggested this calculation would require the industry to either reduce debt by $120 billion or raise equity by up to $400 billion.

Commissioner Altmaier said he looks forward to the input from the health industry. Commissioner Wade reiterated her previous comments that the company should develop an alternative proposal that adequately addresses the issues they have raised. Mr. Oberrender asked if that included feedback on the field testing proposal. He stated it took them two weeks to determine that test because it was so complicated and not applicable. Commissioner Wade said that there were other groups that have hundreds and hundreds of companies, and those companies did not suggest the previous testing template was overly complicated. Commissioner Altmaier said he appreciates alternative suggestions. Mr. Oberrender asked if the analysis prepared by the independent party had been shared with other insurance commissioners and other state insurance regulators. Commissioner Altmaier stated he is not sure what the confidentiality requirements were on the report but would check into that to determine if it could be shared further.

l. Swiss Reinsurance

Stephanie Rawe (Swiss Reinsurance Americas) stated Swiss Reinsurance appreciated the changes to address its previous concerns about applicability towards non-U.S. groups already subject to a group capital calculation from their group-wide supervisor. She stated Swiss Reinsurance supports the lead state flexibility as proposed. She stated its only concern is about the previously suggested double calculation.

m. AIA

Philip Carson (American Insurance Association—AIA) reinforced the principles of group supervisor that were included in the AIA’s comment letter.

n. Texas DOI

Mr. Arendall highlighted the Texas DOI’s written comment that the scope of the group capital calculation should focus on groups with international operations.
o. New York Life

Kristen DiCarmine (New York Life) stated New York Life’s appreciation for addressing a number of comments from the various letters in the latest document and their previously proposed approach towards field testing a number of approaches. However, she said any basis used that is different from that used in the legal entity RBC will need to be substantiated.

3. Discussed its Next Steps

Commissioner Altmaier stated the memorandum would be updated and exposed in the near future for a public comment period ending July 20, in order to allow the comments to be accumulated and distributed for the Summer National Meeting.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.
Group Capital Calculation (E) Working Group
Conference Call
April 19, 2018

The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met via conference call April 19, 2018. The following Working Group members participated: David Altmaier, Chair (FL); Susan Bernard, Rachel Hemphill and Kim Hudson (CA); Kathy Belfi (CT); Philip Barlow (DC); Kevin Fry (IL); James A. McCarthy (MA); Leslie Nehring (MO); Jackie Obusek (NC); Bruce R. Ramge (NE); Peter L. Hattt and David Wolf (NJ); Edward Kiffel (NY); Dale Bruggeman and Tim Biler (OH); Doug Slape (TX); and Doug Stolte (VA).

1. Discussed Comment Letters Received Related to the Memorandum on the Treatment of Senior Debt and Surplus Notes in the GCC

Commissioner Altmaier stated that six comment letters were received and asked that the commenters confine their remarks to the specifics of the contents of the memorandum. He further stated that comments related to other matters (e.g., scope of group and captives) would be handled on other conference calls. He then noted that the purpose of the discussion was to establish a way forward for field testing the impact of these financial instruments on the group capital calculation (GCC). He referred to the revised memorandum in the meeting materials (Attachment 1) as incorporating a number of revisions in response to the comments received and then asked each commenter to summarize their respective comments.

Tracey Laws (Chubb) stated that senior debt was a signature issue for her firm. She added that the Working Group should not be moved by the international discussion on the issue.

Jonathan Rodgers (National Association of Mutual Insurance Companies—NAMIC) said that NAMIC’s comment letter speaks for itself and that he does not have any additional comments.

Stephen Broadie (Property Casualty Insurers Association of America—PCI) and Thomas Finnell (PCI) summarized their organization’s comment letter. Mr. Finnell stated that the comment on surplus notes and most comments on senior debt had been addressed in the revised memorandum. He questioned the description in recommendation 3a and 3b concerning the description of total available capital that includes the value of the senior debt. Mr. Felice clarified that the intent of the wording was not to include the value of the debt in the base for testing a percentage-based cap on senior debt top. Mr. Altmaier stated that the wording will be revised to clarify the intent.

Li Cheng (Prudential Financial) stated that many concerns had more or less been addressed in the revised memorandum and that Prudential generally supports the direction of the revisions and of using field testing to evaluate the issue.

Keith Bell (The Travelers Companies) agreed with Mr. Finnell’s comments on clarifying the description of total available capital in recommendations 3a and 3b.

Robert Oberrender (UnitedHealth Group - UHG) said that the health industry is going through changes to more closely integrate health insurance and health delivery. He said that UHG continues to have issues with the memorandum as revised. Mr. Oberrender said that it is not necessary to include health insurers in the group capital calculation. He added that limiting the amount of senior debt that counts as available capital would: 1) stifle innovation; 2) provide an erroneous view of the group’s financial condition; and 3) result in increased premiums and decreased quality of care to individual policyholders. He stated that there are other tools in place for state insurance regulators that allow them to adequately evaluate the capital position of health groups without adding a group capital requirement. Finally, he offered to engage with the Working Group members on resolving these issues. Mr. Altmaier welcomed the opportunity to engage with the health industry and stated that some of the comments touched on the scope of group issue about which there would be robust discussion during an upcoming Working Group call. Mr. Altmaier also reminded Mr. Oberrender that the GCC was not being developed as a capital requirement, but rather as an additional regulatory analysis tool. Mr. Oberrender responded by asking what a state insurance regulator would do in response to a negative group capital resulting from limits on senior debt. Mr. Altmaier stated that the GCC would be one additional data point for the state insurance regulator to use in an overall evaluation of the group’s financial condition. Mr. Oberrender stated that the potential negative result would be illogical for a group that is rated as strong by the nationally recognized rating agencies.

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Candy Gallaher (America’s Health Insurance Plans—AHIP) stated that a one-size-fits-all cap on senior debt that is not properly calibrated will do harm in the health insurance lines, given the unique operations of health insurers. She added that the Working Group’s purpose should not be conflated with the international work on a group capital standard where no health insurers are included.

Ms. Belfi asked if we were collecting the data for purposes of impact analysis. Mr. Felice stated that impact analysis was a primary goal and that having health data is critical for that impact analysis. Ms. Belfi questioned how helpful the GCC would be in terms of preparing a written summary of her Department’s analysis of a large health organization.

Mr. Broadie asked if one of the options to be tested is no cap on senior debt. Mr. Felice noted that he is not certain and that there would be input taken on what is an appropriate range, but that the caps tested should be connected to the regulatory view on structural subordination. Mr. Altmaier emphasized the importance of impact analysis in the testing.

Yanina Hupka (Selective Insurance Company) asked how the value of assets outside the insurance subsidiaries would be considered. Mr. Felice stated that the carrying value of affiliate entities other than insurers is dictated by statutory accounting principles (SAP); otherwise, the default would be generally accepted accounting principles (GAAP) values used in consolidation. In addition, the aggregated calculation of all entities would be respectful of sectoral and jurisdictional values (expressed in U.S. dollars) for other regulated affiliates anywhere in the holding company structure.

Mr. Felice summarized the revisions posted to the memorandum in response to the comments. He stated that there was wording added to correct recommendation 1 based on updated statutory accounting guidance to recommend that the value of surplus notes purchased by an affiliate should be eliminated from the carrying value and capital calculation (if applicable) of that affiliate in the GCC. He also noted language that was added to clarify the distinction between rating agency analysis and regulatory review. He then described changes under recommendation two and recommendation 3 that were made in specific response to comments received. Recommendation 4a was added to highlight that the criteria for allowing a portion of hybrid (equity content) debt may be different from the criteria applied to senior debt. He highlighted two recommendations that were marked for deletion, including a recommendation requiring downstreaming of debt proceeds to insurance entities within the group. He added that recommendation 4b was added to foster a consistent definition of what constitutes the regulatory view of structural subordination. Ms. Hemphill suggested a revision to recommendation 2 regarding the criteria for senior debt to be recognized as a capital resource. The Working Group accepted that revision. Ms. Hemphill also questioned the deletion of the requirement that the debt proceeds be downstreamed and suggested that it remain. Bill Weller (AHIP) asked how the testing could be kept open to ranges if it was restricted to just cases where the proceeds were downstreamed to insurance entities. Mr. Altmaier stated that both Mr. Weller’s and Ms. Hemphill’s concerns could be addressed via increased flexibility in the wording to consider downstreaming in the testing in the reinstated recommendation.

Mr. Obberender stated that the proposed language was too narrow since health entities do not typically receive proceeds from debt issued by the holding company, relying instead on cash flow to pay dividends and fund repayment for a strong rating. Amy Lazzaro (Cigna) endorsed the comments of UHG. Jeffrey Alton (CNA Insurance Companies) stated that the comments on senior debt and downstreaming of proceeds are related to the discussion on scope of group, and he asked if that issue would be addressed prior to field-testing. Mr. Altmaier said that there would be a general consensus by the Working Group on scope of group for field-testing purposes, and that the revisions to the reinstated recommendation are meant to retain flexibility to collect data regarding the impact of scope of group as it relates to senior debt in the GCC testing. He further stated that state insurance regulators would not be comfortable with completely removing the language on testing a cap based on funds downstreamed to the insurance entities.

Mr. Altmaier concluded by asking Mr. Felice to mark the changes discussed during the conference call and redistribute the revised document for further discussion on a future call.

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 April 5, 2018. The following Working Group members participated: David Altmaier, Chair (FL); Kim Hudson (CA); Kathy Belfi (CT); Philip Barlow (DC); Kevin Fry (IL); Leslie Nehring and John Rehagen (MO); Justin Schrader (NE); Peter Hartt and David Wolf (NJ); William Carmello (NY); Tim Biler (OH); Doug Slape (TX); and Doug Stolte (VA). Also participating were: Steve Kinion (DE); and David Provost (VT).

1. **Discussed the Treatment of Captives in the Group Capital Calculation**

Commissioner Altmaier noted the Working Group’s significant amount of past discussion on the treatment of captives within the group capital calculation. He stated that the most recent discussion took place on the Working Group’s March 13 conference call, during which all parties providing written comments on the most recent memorandum exposed on the topic in October 2017 were afforded the opportunity to summarize their comments and highlight any specific areas of focus. During that conference call, all parties who had previously provided written comments were able to speak to their comments. However, little time remained for Working Group discussion. Commissioner Altmaier stated while there was little opportunity for Working Group members to respond to the comments during that conference call, there were a couple of questions Working Group members raised for which he requested on that conference call that members of the industry be prepared to respond to today. He stated that one member had described how she believes that while the legal entity approach to captives with XXX/AXXX business was appropriate because it protects the insurance legal entity, a different, more economic approach to such business would be better for the group capital calculation. More specifically, while *Actuarial Guideline XLVIII—Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued Under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation* (AG 48) only requires a consistent valuation method for new business after Jan. 1, 2015, a consistent valuation method for new and in force business would be better for this group capital calculation. Ms. Belfi confirmed that she prefers a more economic approach and noted that this was a tool that she wants to be able to use to better understand risk within the insurance group. She stated that since what she is envisioning would use this economic information in a different way, she does not believe it would circumvent state-based regulation, and she had asked Transamerica and the American Council of Life Insurers (ACLI) to respond to that view. Commissioner Altmaier clarified that the question was if an adjustment were made to this calculation, would it conflict with state regulation.

Mariana Gomez-Vock (ACLI) responded that the ACLI’s concern is that group capital calculation using such an adjustment sends the wrong message to the rest of the world with respect to the current framework in AG 48 in that using another method would suggest the current framework cannot be tested. She also noted that this action will muddy the waters on a recent message in a scope of group memorandum that describes how one of the purposes of the calculation was to capture risks coming from outside of the insurer.

Bill Schwelliger (Transamerica) responded that Transamerica had commented on the exposures related to this topic several times, noting that they continue to believe that any tool created should have meaning. He stated this has implications for the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” (Covered Agreement), where the policy statement from the U.S. Department of the Treasury (Treasury Department) suggests it does not need to lead to capital measures at the group level, but it does have to be fit for purpose and have consequences bound in state law. He stated the coalition does support an economic approach and that this is why the AG 48 framework is supported by state insurance regulators since the existing transactions use an economic approach. He stated the NAIC has already acknowledged through the XXX/AXXX Reinsurance Framework the use of an economic approach. He also described that there is already some conflict with the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs), which suggests the redundant reserves should be backed with no assets. The coalition of companies must always follow the appropriate legal entity rules, even when those rules are not economic. He stated Transamerica believes it is problematic to take part of the statutory rules and make side adjustments for those items. He suggested this creates a costly and complex dual solvency system, would erode the credibility of the group capital calculation and create a negative optic around state regulation. In addition, this would lead to difficult questions around the financial strength of state-regulated insurers. Fidelity to the state legal entity system is paramount to the calculation. If there is a desire to modify state requirements, the NAIC, through its Committee process, already has the mechanism to make changes to the states’ system through various means. If there is a desire to address the underlying problem, then it is to
actually change the requirements to eliminate the redundant reserves. He stated this is what is being done on variable annuities. It is not easy, but it can be done.

Pooja Rahman (New York Life Insurance Company) said she agrees that the NAIC should put its best foot forward with the state-based system of legal entity regulation, but there are different rules between legal entity insurers and captive insurers, and making the work product better for a group of insurers that involves both is appropriate. She described the differences in definition for economic reserves used by companies for in force business, which is allowed for with AG 48. She said that for the calculation to be credible, it is best to use a consistent methodology if possible.

Ian Adamczyk (Prudential) stated that Prudential’s position aligns with those from New York Life Insurance Company, Northwestern Mutual Life Insurance Company and The Travelers Companies. More specifically, Prudential does not believe what is being suggested as a consistent methodology for all business does not challenge the existing credibility of the legal entity framework, which Prudential is a strong supporter of. He said Prudential sees it as a new tool that uses an inventory approach, but with on-top adjustments so that it can be used for other uses, including supervisory colleges. He stated that Prudential disagrees with the comment that this would cast doubt on those rules. He described what is being proposed is part of the evaluation of the state-based system, which is appropriate.

Mr. Kinion stated that he has heard a consistent message from NAIC leadership, which is to preserve the state-based system and to have that system recognized by other international insurance regulators. He stated that unwinding captive transactions or making on-top adjustments is inconsistent with that goal. He also described how no other country in the world licenses captive insurance companies like in the U. S., and no other country has other unique differences such as in tax law. He said he is not aware of any international groups or bodies asking for these types of adjustments to be made. He suggested it makes no sense to unilaterally disarm the state-based system. Mr. Provost stated he understood both sides of this argument, noting his concern for taking action conflicting with disapproving of something approved by multiple state insurance regulators.

Mr. Slape stated that Texas supports the Connecticut position and that some of the comments made need to keep in mind that the tool developed must meet the test of comparability and consistency. He said if there are questions about it because of captive structures, then the U.S. runs the risk that U.S. groups with international business will be subject to multiple group capital standards, including the IAIS ICS and/or Solvency II. He stated it is naive to think that if the Working Group comes up with a system that others can poke holes in, that it will not create challenges for these groups that operate internationally. He also noted that it is not inconsistent to have legal entity tools around, and another tool using a different standard on another basis because the action would only be taken on the legal entity. However, that action could be based upon all information available regarding the risks of the group to the legal entity.

Mr. Schrader stated that he agrees with the Mr. Slape’s comments by Mr. Slape and agrees with Connecticut’s position. He stated this tool is important to state insurance regulators and has a different scope, meaning and use than the legal entity approach. He stated for this reason, he supports the on-top adjustment, as it shows both the legal entity calculation as provided for in state law, but that the additional information at the group level adds comparability that will benefit state insurance regulators. He said he has a high interest in anything that provides state insurance regulators with the best information on the risks to the group. While there is an influence from the actions of the Federal Reserve and international parties, what is done must work within the state system and must be cost-effective.

Mr. Wolf stated New Jersey also supports the Connecticut position, as well as the Nebraska position of an on-top adjustment. He suggested it may be helpful to describe the methodology of this on-top adjustment, as well as the method used on the asset side. Mr. Fry stated Illinois favors no adjustment but having an informational-only column so that the impact could be studied for a period of time. He suggested using the economic approach for both the groups with captives. He said those without the companies was something to strive for, emphasizing level setting for all types of companies. Mr. Carmello stated New York also supports the Connecticut position, but he asked for clarification of how that relates to the exposed memorandum. Dan Daveline (NAIC) described that the memorandum outlined various options, but noted that the conversation had shifted more towards the use of a valuation of new business and in force using AG 48, or some estimate of that, and then valuing the assets on a statutory basis, but doing all of that through an on-top adjustment both to companies with and without captives. He noted an estimate approach would attempt to reduce complexity to keep it as cost-effective as possible. Mr. Barlow stated DC also supports the Connecticut position.

Ms. Nehring stated she had some question about the impact of these choices on the scalars used for non-U.S. insurers. Ms. Gomez-Vock responded that the design of scalars takes into consideration the extreme conservatism in the reserves. Mr. Schwegler agreed that this is the case with both methods of the scalars included in the baseline testing done in 2017. He stated that he believes what is being proposed could distort what was developed. Keith Bell (The Travelers Companies)
agreed with Ms. Gomez-Vock, but noted the calculation can be adjusted up or down depending upon the level of conservatism. Ms. Rahman agreed, noting that the U.S. framework has relied upon conservatism in the reserves with less conservatism in the capital requirement. Kevin Mackay (MetLife) stated that the adjustments are both available and required capital, and it is the combination of both that allow the U.S. to make an adjustment for the different levels of conservatism in reserves and capital in different countries. Lou Felice (NAIC) agreed with what had been said, but also noted that the scalars can be adjusted for whichever way the NAIC wants to look at the reserves. If there is an inconstancy in the calculation of the pieces in individual insurers, the scalars may be less accurate for that particular company. However, he noted the valuation of the assets has a greater impact since those types of assets that support the higher level of reserves might cause larger problems. Ms. Nehring stated what Mr. Felice noted is what she thought was the case, and that was helpful. She noted that comparing captives in the U.S. is important, but there is a need to be comparable with other countries.

Commissioner Altmaier stated that he believes that there are still two views and that there was no compromise position at this point. He recommended NAIC staff develop a way to use the original proposal and develop a method of calculation that could be used in field testing. He said that in doing so, it also suggests ways to collect information that compares with and without such an adjustment. He stated the idea is to help provide information that could better educate the decision going forward. After clarification that what was being proposed was consistent with what Mr. Daveline noted before, Ms. Belfi stated she agrees with this approach where NAIC staff develop the methodology being described and with the additional information being requested by Mr. Fry.

Ms. Gomez-Vock stated that it is important to understand that what was originally developed by the ACLI as the Aggregation and Calibration approach was designed and presented to the Federal Reserve. She stated that this was shared with the NAIC for informational purposes, but the ACLI never suggested this approach was appropriate for the NAIC calculation. Commissioner Altmaier stated they would not refer to what is being contemplated as the ACLI approach, but noted that the NAIC received a presentation from the ACLI at the very first meeting of the Working Group, and that it could not be ignored. He stated that it is clear the ACLI does not support that at this time, but it is a basis to address captives and make adjustments to them. Commissioner Altmaier stated he is asking the NAIC to start with such a presentation, and then make adjustments based upon some of the comments received from some members of the industry, as well as what was noted by the Working Group today. He stated that at some point, one approach will need to be selected and that he understands not everyone will agree with the approach taken. He stated he thinks this is one way to move forward, by obtaining some information and eventually some data through testing with and without such adjustment, with the goal that this will allow a decision to be made. He clarified that all that is being requested at this point is a memorandum with such a proposal, but that consistent with the past, no vote will be taken, but rather what is going to be field tested. Any decision will not be made until after this is field tested. Mr. Slape questioned if generally accepted accounting principles (GAAP) reserve should also be considered. Commissioner Altmaier suggested that be considered only after something is more thoroughly developed. He noted he would like to first consider methods consistent with what is proposed in the comment letters.

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 in Milwaukee, WI, March 24, 2018. The following Working Group members participated: David Altmaier, Chair (FL); Susan Bernard and Rachel Hemphill and Kim Hudson (CA); Kathy Belfi (CT); Philip Barlow (DC); Kevin Fry (IL); James McCarthy (MA); Leslie Nehring (MO); Jackie Obusek (NC); Bruce R. Ramage (NE); Peter L. Hartt and David Wolf (NJ); Ed Kiffel (NY); Dale Bruggeman and Tim Biler (OH); Doug Slape (TX); and Doug Stolte (VA).

1. Discussed Comment Letters Received Related to the Memorandum on the Treatment of Senior Debt and surplus Notes in the Group Capital Calculation

Commissioner Altmaier stated that six comment letters were received and asked that the commenters confine their remarks to the specifics of the contents of the memorandum. He further stated that comments related to other matters (e.g. scope of group and captives) would be handled on other conference calls.

Jeffrey C. Alton (CNA Insurance Companies) summarized the comment letter from CNA, noting that it is one of several mixed conglomerate holding companies in the U.S. He said that taking an overly broad view of the scope of the group could lead to a false positive. That is, when the capital from the broader group is included in the group capital calculation, it implies that capital is available to pay policyholder claims, while it actually is not. He also said that a broad scope of the group could have international implications and that there should be some sort of regulatory discretion in determining the scope of the group. He suggested leveraging the work done in Insurance Core Principle (ICP) 23, Group-wide Supervision.

Michelle Rogers (National Association of Mutual Insurance Companies—NAMIC) said that the group capital calculation should align with RBC as closely as possible. When considering scope of the group and inclusion/exclusion of entities, RBC should be used as the floor for this determination, and ICP 23 should be used as the ceiling. She also said that all entities included in RBC should be included in the group capital calculation, whether they are material or immaterial and could be grouped together using a 22.5% charge.

Andrew T. Vedder (Northwestern Mutual) discussed a joint letter from New York Life, Northwestern Mutual and Travelers, stating that the group capital calculation is an additional analytical tool and that its possible deviations would not change or alter legal entity requirements. Regarding applying a charge to non-insurance subsidiaries such as asset managers, he suggested that the Working Group should field test both the 22.5% charge and more of an operational risk-type charge.

Stephen Broadie (Property Casualty Insurers Association of America—PCI) said the focus of the group capital calculation should be on policyholder protection, and therefore, the focus should really be on contagion risk. He said that PCI generally agrees with the NAIC staff memorandum proposal on grouping and scoping, with the exception of part (iii) and discussed the recommendation included in the comment letter. He said that if non-regulated/non-financial entities are going to be included in the group capital calculation, then the capital requirements need to be risk-sensitive, so there is a quite a bit more work that needs to be done related to that. Because development of such charges will be difficult, he recommended limiting the scope of the group to an intermediate financial services holding company.

Ian Adamczyk (Prudential Financial) discussed the joint letter from Prudential and MetLife, stating that the group capital calculation is a complementary analytical tool that should focus on transparency and comparability. With regard to non-insurance and non-regulated entities, he said the comment letter agrees with much of the NAIC staff proposal, but includes a few differences related to topics such as scalars and materiality.

Robert Oberrender (UnitedHealth Group) said that it is not necessary to include health insurers in the group capital calculation as they offer products that are different from other U.S. and international products. He said that the cash flows are stronger, there is not catastrophic risk, and they are re-priced annually. Regarding non-regulated entities, he said that those entities are typically not material relative to a group’s key operations and do not have contagion risk. He said that because a thorough review of the group already takes place, no additional reporting or one-size-fits-all capital charges are warranted. To the extent that a subsidiary does not engage in financial, insurance or securities business and does not have a risk of financial contagion, he said that it should not be included in the group capital calculation.
Commissioner Altmaier asked NAIC staff to revisit the exposed NAIC staff memorandum given the feedback received in the comment letters.

3. Exposed a Memorandum on the Scope of the Group in the Group Capital Calculation

Commissioner Altmaier discussed a memorandum from him dated Feb. 28 that is intended as a discussion-starter on scope of the group. This memo was first introduced at the Working Group’s March 13 conference call. He said that once the group capital calculation is finalized, it will be used by state insurance department financial analysis staff as part of the holding company analysis. The current analysis tools use the ultimate controlling person as the scope of the group, and this is based on the Insurance Holding Company System Regulatory Act (#440). He noted that other tools currently allow for some regulatory discretion in determining the scope of the group, such as Schedule Y, the Enterprise Risk Report (Form F) and the Own Risk and Solvency Assessment (ORSA).

Mr. Alton discussed a letter from CNA and Berkshire Hathaway related to scope of the group (Attachment One-C), noting that he appreciates the suggested use of regulatory discretion, but said that criteria should be developed for exercising this discretion. He said that not having parameters for the regulatory discretion could result in inconsistent application, and the letter included suggested criteria, which leverage the requirements of ICP 23. The letter recommends replacing some of the language in the current memorandum from Commissioner Altmaier.

Ms. Belfi suggested that the fourth question in the memorandum ask regarding communication to domestic states, as opposed to other licensed states. Mr. Dahlquist noted that California has a number of non-domestic companies that write a large volume of business there. The Working Group agreed that the memorandum should be updated to refer to domestic and commercially-domiciled states.

Director Hartt noted that he supports exposing the memorandum without the language recommended by CNA and Berkshire Hathaway, as including that language could limit the discussion prior to the exposure period. Mr. Slape agreed. Mr. Fry supported including the possible criteria related to regulatory discretion, so that people could start considering such. As a compromise, Director Hartt recommended adding a new question to the memorandum that asks what criteria should be considered by the lead state when determining whether something other than the ultimate controlling person should be used as the starting point for the group for purposes of the group capital calculation. There were no objections.

The Working Group agreed to expose the updated memorandum for a 45-day public comment period ending May 8.

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

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MEMORANDUM

TO: Group Capital Calculation (E) Working Group
FROM: Dan Daveline, NAIC Staff
DATE: June 26, 2018
RE: Scope of Group/Non-Insurance Testing

This memorandum represents a combined modified version of the June 11 Scope of Group memorandum and June 11 Non-Regulated Entities memorandum. The revised memorandum is intended to 1) clarify the original intent of the two memorandums; and 2) simplify the presentation since the updated document is intended to be used more specifically for the testing process and less as an explanatory document.

Scope of the Group
In determining the companies for which the group capital calculation should be applied, the group is expected to use the following process:

1) A non-U.S. based group may be exempt from completing a group capital calculation if:
   i) The non-U.S. based group is in a (Reciprocal) Jurisdiction that recognizes the U.S. regulatory regime and accepts the group capital calculation from a U.S. based group to satisfy any group capital requirement;
   ii) The group capital calculation is applied by the Group-Wide Supervisor (GWS) at a level that includes the same (or substantially similar) scope of the group as determined by the lead state in step 7; and
   iii) The lead state can obtain information from the foreign group’s GWS either through a Supervisory College or otherwise, that allows the lead state to understand the financial condition of the group and complete the expectations of other states in its Group Profile Summary (GPS).

2) When developing the universe of all potential entities included in the group capital calculation, the starting point is the insurer’s most recent Schedule Y and the ultimate controlling party, along with other relevant Holding Company Filings pertaining to entities directly or indirectly owned by the ultimate controlling party.

3) Deduct from the universe all entities that are neither a material source NOR a material user of capital. Two principles should be used for determining if an entity meets such a criteria for exclusion: 1) exclusion of a material source of capital will prevent the user from understanding the true financial condition of the group, which is one of the intended purposes of the group capital calculation; 2) exclusion of an entity that is consistently profitable is reasonable on the basis that such an entity is unlikely to be a material user of capital in the future.
In implementing these two principles, the preparer should consider the following more specific circumstances that inform the intent of the criteria:

- Any non-financial entity, that is not directly or indirectly owned by an insurance entity, and has capital/stockholder’s equity of less than 5% (on either a stand-alone basis or in combination with other entities) of the universe’s prior year-end, shall be considered an entity that IS NOT a material source of capital. (Note, all financial entities must be included in the calculation as well as all entities that are directly or indirectly owned by an insurance entity)

- Any non-financial entity that is not directly or indirectly owned by an insurance entity, and that has reported net income in each and all of the most recent five consecutive years shall be considered an entity that IS NOT a material user of capital.

4) Deduct from the universe, all entities that are considered negligible when aggregated. Three principles should be used for determining if an entity meets such a criteria for exclusion: 1) excluding a combination of entities that do not exceed the material source of capital criteria will not prevent the user from understanding the true financial condition of the group; 2) excluding a combination of entities that have not produced net losses in excess of a material portion of the group’s income capacity for a specified period of time is unlikely to be a material user of capital in the future; 3) in excluding a combination of entities, consideration must be given to the fact that combining positives with negatives may understate the potential losses an individual company or combination of companies can create.

In implementing these three principles, the preparer should consider the following more specific circumstances that inform the intent of the criteria:

- Any non-financial entity, that is not owned directly or indirectly by an insurance entity and that is below the capital/stockholder’s equity threshold in paragraph 3 above AND that has combined net income/net losses (for the five most recent consecutive years) that is less than 5% of the net income/loss of the universe as of the prior year-end can be accumulated with other entities that meet such criteria, provided that the aggregation of such entities results in a combined capital/stockholder’s equity of less than 5% as of prior year-end of the universe AND the individual net losses from each of the entities for the most recent five consecutive when combined (cannot be offset with net income during the same periods) of all net losses are less than 5% of the universe’s net income/loss, shall be considered negligible.

5) The group should submit the listing of all excluded entities to the lead state regulator (in a predefined format included in the group capital calculation inventory) to determine if there are entities excluded by the group that create a material risk to the group’s capital. As the regulator reviews the listing, two principles should be used for determining if an entity either should be added back, or subtracted from the list produced by the group; 1) while historical gains can suggest a reduced likelihood for future losses, there may be other indicators of material dependency or material risk that may suggest to the regulator that a potential future loss of 5% of a group’s prior year capital may be possible, in which case the regulator should have the ability to add an entity back that may otherwise be excluded; 2) while historical losses may suggest that a higher likelihood of future losses are likely, there may be other indicators that suggest to the regulator that a potential future loss of 5% of a group’s capital is unlikely, in which case the regulator should have the ability to subtract an entity that may otherwise be included in the scope of the calculation.

In implementing these two principles, the regulator should consider the following more specific circumstances that inform the intent of the criteria:
• Adding any entity that the regulator believes creates a material dependency, where material is defined as 5% of the group’s prior year capital.
• Adding any entity that provides intra-group financial support or has a structural or contractual relationship which the regulator believes could create a material risk to the group’s capital, where material risk is defined as 5% of the group’s prior year-end capital.
• Adding/subtracting any entity that the regulator believes, despite any measures of materiality risk, based upon the activities of the entity, could have a material (adding)/immaterial (subtracting) impact on the group or markets (including counterparties). This includes but is not limited to pass-through entities that provide services to the group or face counterparties that are not adequately captured by a financial evaluation.

6) In the unlikely event that the lead state regulator has determined through the previous steps that the ultimate controlling party is not part of the scope of the group for the group capital calculation, the reasons therefore should be explained and clearly communicated to the other domestic states/other relevant regulators in step 7.

7) The lead state regulator uses the above steps, which implicitly includes considering the lead state’s understanding of the group, including inputs such as the Form F, ORSA, and other information including considering input from other domestic states or other regulators that have an entity in the group, to determine the ultimate scope of the group. It’s important that this type of information be used by the lead state in cooperation with the domestic states and other impacted regulators when developing the scope of the group for purposes of the group capital calculation.

Ongoing Determination (Completed at least Annually)

The scope of the group used in the group capital calculation should be considered for update on an ongoing basis, but at least annually. To assist the regulator in determining the scope of the group, the group capital calculation will include an area where basic financial information on all the entities in the group are included to allow the regulator to gain comfort in determining if the entities excluded from the scope of the group are appropriate. Once the regulator has a full understanding of all the entities in the group, the regulator should work with the group in determining whether this inventory of all companies should be grouped in a specified way in the future. For example, while this inventory must include the full combined financial results/key financial information (net premiums for insurers, total revenues, total net income, total assets, total debt, total capital or equity) for all entities of the ultimate controlling party and all of its subsidiaries, it may be best that this inventory is presented in this area based upon major groupings of entities to maximize the usefulness of this data. The reason being, these grouped figures are intended to be data captured year-in and year-out to allow the regulator to use the figures in a manner that allows the regulator to understand the trends of these figures. Said differently, having the combined information presenting in groupings of a lower number (e.g. 5, 10, 15, 20, 25 entities) would be far more analytically helpful to the regulator than the actual number of entities (e.g. upwards of 1,000 or more entities). In particular, the groupings of the non-financial entities should be considered, since they can be grouped in manner that allows the regulator to understand the group and how they are managed, but understanding that it may be best to separate those entities that may cause some amount of strain since that would allow a more risk sensitive approach to be included in the calculation, and allow the regulator to better understand the group.
To reiterate, this inventory is intended to require legal entity data (or combined legal entities after the lead state regulator has worked with the group to determine the best groupings) as part of the calculation to be certain that such scope is appropriate, given other holding company filings today do not include legal entity/combined legal entity data such as what is being contemplated. (Note also the lead state regulator retains the ability to require further breakout in order to assist in annually evaluating the scope of group)

Non-Insurance Testing
As previously concluded by the Working Group, all insurers must be individually listed in the calculation along with their minimum required capital from their regulator, or as modified for captives or scalars. For other financially entities, they also must be individually listed in the calculation, and will be tested based upon the following (Please note, non-regulated entities where such entities are currently subject to a risk charge in RBC, or subject to a risk charge imposed by a financial regulator, do not need to be individually listed/de-stacked):

1) Financial Entities

A) Regulated Financial Entities
   i. All banks and other depository institutions - Minimum required by their regulator. Test both a) unscaled; and b) scaled to an RBC equal to 300% ACL.
   
   ii. All asset managers and registered investment advisors – Test both a) 22.5% of BACV; and b) 12% of three-year average revenue based upon ACLI suggestion (BASEL operational risk). In addition to an unscaled calculation, test the BASEL operational risk methodology scaled to an RBC equal to 300% ACL.
   
   iii. All other financially regulated entities - Minimum required by their regulator (not scaled)

B) Unregulated Financial Entities
   
   i. Other entities that provide financial activities that support the insurer(s) – Because these entities can cause more strain on an insurer than other non-regulated entities, these entities should receive a 22.5% charge on the BACV. These entities are not subject to a minimum capital requirement.
   
   ii. Other financial entities - For purpose of this calculation, unregulated financial entities include those which create financial risks through products or transactions such as a mortgage, other credit offering, a derivative, corporate guarantees, intercompany indebtedness, operational interdependence, including the existence of shared resources such as IT platforms or treasury or other material operations; materiality to the application of credit rating methodologies to the overall group rating and other financial links. Because these entities can cause more strain on an insurer than other non-regulated entities, apply the greater of the following factors:
      - 22.5% of the BACV
      - Notional value of the contract (e.g. a net worth guaranty/indemnification/guaranty multiplied by a probability factor as determined by the company based upon past historical experience)
      - Other proposed factors suggested by testing participants
NAIC staff is open to allowing grouping of like entities in type 1Ai and 1Bi, above assuming that the members of the group all use the same accounting rules (e.g., all GAAP), and are at least consistent with the way the group manages their business.

2) Consistently Profitable Non-Financial Entities

Any non-financial entity that has reported positive net income each of the past five years can be subject to a minimal charge based upon the principle that consistently profitable companies are unlikely to cause a material loss in the future, and any risk of this changing is likely only minimal operational risk. For these entities, they may be combined and subject to a ½% charge on the most recently reported amount of revenues.

3) Other Non-Financial Entities

Some of the comment letters, including those related to scope of the group, make the argument that non-financial entities are not as risky as regulated entities and other financial entities. NAIC staff believe that while this is not always the case, in many cases it is true. NAIC staff is open to allow the regulator and the group to decide together how best to group and be subject to the following charges that we propose to be tested. Unlimited grouping of non-financial entities is allowed.

Test 1- Principle-Past Income/Loss is a sound predictor of risk

Test a factor that considers the specific net losses/fluctuation in profitability over an economic cycle, where five years is used as a proxy for an economic cycle. This factor will be risk-based not only to the industry, but to the individual company since it considers past performance. The calculation would be determined based upon the following (for each entity or group of entities):

Test 1a-Factor to Apply = (Absolute value of the greatest net loss in the past five years/Gross revenue in that year for that entity or grouped entities) Multiplied by the current year gross revenue for the same entity or grouped entities

Test 1b-Factor to Apply = (Absolute value of the greatest net loss in the past five years/Gross revenue in that year for that entity or grouped entities) Multiplied by the current year gross revenue for the same entity or grouped entities*

*Subject to a minimum charge that assumes a net loss equal to 2% of total gross revenues. The minimum is expected to cover the fact that the group is not consistently profitable or that the losses are not material, but it covers this risk in this way as opposed to requiring a calculation that considers this dependence through the use of a more complex standard deviation of profits over a period of time.

Test 2- Principle-Potential Capital Needs of Non-Financial Entities is Equivalent to an Operational Risk Charge

Test a factor that considers non-financial entities an operational risk

Test 2a-The American Council of Life Insurers (ACLI)/American Insurance Association (AIA) have long suggested that non-regulated entities be subject to either an operational risk charge used in International Basel III or a 22.5% charge on the BACV. The ACLI has further suggested that the 12% Basel Charge be scaled to convert to U.S. RBC. The ACLI notes that when this is done, the scaled factor becomes 2.47% for life insurers (based upon an average RBC operating ratio of 486%) and a factor of 3.64% for property/casualty (P/C) insurers (based on an average RBC operating ratio of 332%). A life factor of 3.7% should also be tested, which corresponds to
a 300% RBC calibration, and P/C of 5.4% based upon an average industry life RBC of 332%. This should be applied on the absolute value of the entities revenues.

**Test 2B** - Use the NAIC recently adopted Operational Risk Charge of 3%, but apply to revenues consistent with test 2a.

**Test 3 - Principle-Simplicity and Consistency with RBC Requirements**
Test a more simple method as suggested by America’s Health Insurance Plans (AHIP). Specifically, test a factor applied to the Book/Adjusted Carrying Value (BACV) of the entity. This should be applied on the absolute value of the entities BACV. NAIC staff suggest the relevant RBC charge (22.5% for P&C and Health and 19.5% (post tax) for Life) applied to BACV (post-covariance) be tested, but with the understanding that the reason we have proposed other alternatives is to attempt to be sensitive to the argument that such an approach may not align the risks posed by these entities when they are not owned by a U.S or foreign insurer. Even if we find that this is the case, the Working Group may find that it is open to considering giving groups the option of using the relevant RBC charge applied to BACV, provided they do so consistently from one year to the next and across all of their entities.
Re: NAIC Group Capital Calculation Memo Scope of Group/Non-Insurance Testing

Dear Mr. Daveline,

Thank you for the opportunity to address the NAIC objectives regarding the application of the US Group Capital Calculation. Because we strongly believe that an insurance group should be subject to only one group capital rule, and that such a rule should be dictated by an insurer's group-wide supervisor, our comments are limited to paragraph one of the memo.

As we understand the memo, the exemption from the US Group Capital Calculation for a non-US based group will be determined by the group's US lead state regulator, after determination that the non-US group is domiciled in a Reciprocal Jurisdiction and adequate information sharing has occurred. The term "Reciprocal Jurisdiction" appears to come from the proposed amendments to the NAIC Credit for Reinsurance Models aimed at implementing the US-EU Covered Agreement. While the concept of a Reciprocal Jurisdiction and the criteria described seem reasonable, the NAIC/State regulatory process for determining Reciprocal Jurisdiction status is brand new and untested. Because the US Group Capital Calculation exemption hinges on such a determination, we encourage the NAIC to recognize exemptions before full implementation during field testing.

We believe that the US Group Capital Calculation developed by the NAIC should only apply to insurance groups for which a US state is the group-wide supervisor. It is critical, as indicated by numerous Interested Parties, that the US Group Capital Calculation not apply to groups that are already subject to non-US group-wide supervision and a group capital requirement. We contend that US regulators expect US-based groups not to be subject to group capital requirements in non-US jurisdictions, and that institution of a US Group Capital Calculation will aid in accomplishing that goal. The exemption provided in paragraph one is a suitable method for achieving this result.

We support the "1-group, 1-group supervisor" principle and suggest the NAIC reject any recommendation that the US Group Capital Calculation be applied to non-US based groups.
Furthermore, artificial creation of US subgroups for purposes of the US Group Capital Calculation would create significant issues internationally. Lastly, exemptions from the US Group Capital Calculation should not be conditioned on an insurer performing the calculation, but rather evidence of adherence to a group capital requirement through reasonable exchange of information between US and non-US regulators.

We look forward to working with the NAIC and state regulators to develop an efficient and effective exemption process. If you have any questions, please contact us.

Yours sincerely,

Matthew Wulf
Head State Regulatory Affairs Americas
Swiss Re Americas

Stephanie Rawe
Head Technical Regulation Americas
Swiss Re Americas
July 20, 2018

Commissioner David Altmaier, Chair
Group Capital Calculation (E) Working Group
National Association of Insurance Commissioners
Via email: ddaveline@naic.org

Re: Scope of Group/Non-Insurance Testing Memorandum

Dear Commissioner Altmaier:

The American Insurance Association, National Association of Mutual Insurance Companies, Property Casualty Insurers Association of America, and Reinsurance Association of America (the “Trades”) appreciate the opportunity to comment on the June 26, 2018 Scope of Group/Non-Insurance Testing memo, and we thank NAIC staff and the Group Capital Calculation Working Group (the “Working Group”) for their continued efforts on this important project. The Trades respectfully offer for the Working Group’s consideration a modified Scope of Group/Non-Insurance Testing memo, attached, for the purpose of providing guidance to regulators and volunteers for the field testing and related analysis processes supporting development of the NAIC’s proposed Group Capital Calculation (GCC).

Since the fundamental role of insurance regulation is policyholder protection, the Trades believe the objective of the GCC should be to augment current regulatory tools with an inventory of group entities along with quantitative and qualitative information to assist the lead state regulator in assessing risks that may adversely affect the ability of the group’s insurers to meet commitments to policyholders.

To accomplish this objective, our proposed memo differentiates between a “Broader Group” and the “Scope of Application” for the GCC. “Broader Group” refers to the universe of entities controlled directly or indirectly by a group’s ultimate controlling person as determined under state laws based upon the NAIC’s Insurance Holding Company Model Act. The “Scope of Application” limits applicability of the GCC to only those entities that the group and lead state have determined are appropriate. Given the criteria set forth in the Trades’ proposed memo and the facts and circumstances of a specific group, the entities within the Scope of Application for a particular group may be the same as those comprising the Broader Group, or may be a subset of those entities.

The Trades’ proposed memo outlines criteria intended to provide uniform guidance to field-test volunteers and lead state regulators as they determine which entities within the Broader Group should be included in the Scope of Application for the GCC. When developing the Scope of Application approach, the Trades considered key concepts and concerns raised by the Working Group, authority provided by both the Holding Company Act and ORSA guidance, as well as applicable international standards to ensure that the framework meets the needs of the U.S. regulatory community while still achieving comparable outcomes for ICS purposes.

Steps for Determining the Scope of Application

The Scope of Application is initially determined by the group in a series of steps, which are summarized here and further explained in our proposed memo:
• Develop an initial inventory of entities using the Inventory of the Group template (Schedule 1). This template includes all entities in the insurer’s most recent Schedule Y along with other Holding Company filings pertaining to entities directly or indirectly owned by the ultimate controlling person.

• Denote the following entities as “included in the Scope of Application” in the Inventory of the Group template:
  o All entities within the “Insurance Group” using a definition for the term similar to that in ICP 23. This ensures that all insurers and material entities under their control, as well as the lowest-level entity that controls all of the insurers, are included in the calculation.
  o All other Financial Entities that are within the Broader Group.
  o All non-Financial Entities within the Broader Group that pose material risks to the Insurance Group.

• Denote all other entities as “excluded from the Scope of Application” in the Inventory of the Group template.

• Submit the completed Inventory of the Group template to the Lead State Regulator, who would then review and discuss as necessary with the Insurance Group and consult with other involved regulators to determine the final Scope of Application.

The Trades’ proposed memo relies on the group’s management to determine which entities meet the criteria for inclusion in, or exclusion from, the Scope of Application. That said, the ultimate determination of Scope of Application remains with the lead state regulator who would review management’s determinations, screen for possible exceptions, and resolve those through discussion with management.

The approach taken in the Trades’ proposed memo does not include the more formulaic guidance regarding profitability and materiality that was included in the June 26, 2018 NAIC staff version of the memo. While such a formulaic approach may have merit, the Trades are concerned that it is an untested proxy for risk and would have unpredictable consequences across groups given their unique circumstances. However, the Trades would not object if regulators use such a formulaic approach to screen or triage data during field testing, e.g., to identify entities within the group that the lead state regulator may want to discuss with management.

Exemptions and Expedited Approaches

Alongside the criteria included in the June 26, 2018 memo regarding exemptions for non-U.S.-based groups, we propose an exemption for U.S.-based groups that are not required to file an ORSA with their lead state regulator. This would recognize proportionality in application of supervisory measures in a manner consistent with both the Annual Financial Reporting Model Regulation and the Risk Management and Own Risk and Solvency Assessment Model Act.

Furthermore, our proposed memo also includes “expedited approaches” that may be utilized by groups that are required to complete a group capital assessment that is essentially similar to the GCC. Specifically, U.S. groups that are subject to the Federal Reserve Board’s group capital requirement may provide that capital assessment as an acceptable alternative to the GCC. The Trades believe this expedited approach is appropriate because completing the GCC would be a duplicative capital measurement for those particular groups.

Additionally, we offer an expedited approach for U.S. groups where the ultimate controlling party is an underwriting entity required to submit an annual RBC report that includes the controlling party and all of its affiliates. In lieu of completing the GCC, these groups may provide their annual RBC report as an acceptable alternative. This expedited approach would recognize that the result of the GCC would simply be the same as the RBC of the ultimate controlling party.
Non-Insurance Testing

Finally, the Trades’ proposed memo contains several alternative risk charges that will be tested with regard to specific types of non-insurance entities. We suggest that additional alternatives be considered, but we are not yet in a position to propose those charges. We urge, however, that the Working Group commit to the principle that there will be a single set of RBC charges once the field-tested GCC is finalized.

We hope our proposed memo will help the Working Group in its efforts to develop the GCC in a manner that is both efficient as well as appropriate for the business of insurance and its regulation in the United States.
Annex 1
Scope of Group/Non-Insurance Testing -- Proposed Text
Joint Submission to the NAIC's Group Capital Calculation Working Group on behalf of:

- American Insurance Association
- National Association of Mutual Insurance Companies
- Property Casualty Insurers Association of America
- Reinsurance Association of America

1. This is an NAIC working document which includes general concepts and proposed technical specifications and options to be used for field testing and analysis of the NAIC’s proposed Group Capital Calculation (GCC)

General Comments

2. Criteria in this document are intended to provide uniform guidance to field test Volunteers, their respective Lead State Regulator and field test analysts as to the Scope of Application for the specific purpose of the GCC. The “Scope of Application” (i.e., for purposes of the GCC specifically) may be narrower, i.e., comprise a subset of, the entities controlled by the Ultimate Controlling Person of the insurer(s) (Broader Group).

3. The initial identification of the Insurance Group and the determination of the Scope of Application is made by a field test Volunteer for submission to its Lead State Regulator, following the principles and steps discussed herein. However, the final decisions as to the identification of the Insurance Group and the determination of the Scope of Application remain the ultimate responsibility of the Lead State Regulator, cooperating and coordinating with other involved regulators. In particular, in the case of Insurance Groups that operate on a cross-border basis, the Lead State Regulator should be able to explain the appropriateness of the identification of the Insurance Group and the determination of the Scope of Application to involved supervisors in other jurisdictions. The Lead State Regulator, in cooperation with other involved regulators, should review the appropriateness of the Scope of Application at least annually and to confirm continued relevance.

4. The fundamental reason for state insurance regulation is to protect American insurance consumers\(^1\). Therefore, the objective of the GCC is to assess quantitatively the collective risks to, and capital of, the entities within the Scope of Application. This assessment should consider risks that originate within the Insurance Group along with risks that emanate from outside the Insurance Group but within the Broader Group. The overall purpose of this assessment is to better understand the risks that could adversely impact the ability of the entities within the Scope of Application to pay policyholder claims consistent with the primary focus of insurance regulators. Consistent with sound regulation, the benefits of the quantitative analysis facilitated by the GCC should exceed the cost of implementation. Such an approach could be achieved by leveraging existing statutory information filed with the Lead State Regulator wherever practical.

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**Definitions**

5. **Broader Group**: The entire set of legal entities that are controlled by the Ultimate Controlling Person of insurers within a corporate group.

6. **Field Test Volunteer, or Volunteer**: An Insurance Group that is participating with its Lead State Regulator and the NAIC in the development of the GCC through the submission of confidential data and field testing exercises.

7. **Financial Entity**: A non-insurance financial institution that makes or facilitates financial intermediary operations (accepting deposits, granting of credits and loans, investments, etc.). The primary examples of financial entities are commercial banks, intermediation banks, investment banks, saving banks, credit unions, savings and loan institutions, investment companies, private funds, commodity pools, swap dealers etc.

8. **Insurance Group**: For purposes of the GCC, a group that is comprised of two or more entities of which at least one is an insurer, and which includes all of the insurers in the Broader Group. Another (non-insurance) entity may exercise significant influence on the insurer(s), i.e. a holding company or a mutual holding company; in other cases, such as mutual insurance companies, the mutual insurer itself may be the Ultimate Controlling Person. The exercise of significant influence is determined based on criteria such as (direct or indirect) participation, influence and/or other contractual obligations; interconnectedness; risk exposure; risk concentration; risk transfer; and/or intragroup agreements, transactions and exposures. An Insurance Group may include entities which facilitate, finance or service the group’s insurance operation, such as holding companies, branches, non-regulated entities, and other regulated financial institutions. An Insurance Group could be headed by:
   - an insurance legal entity;
   - a holding company; or
   - a mutual holding company.

   An Insurance Group may be:
   - a subset/part of bank-led or securities-led financial conglomerate; or
   - a subset of a wider group.

   An Insurance Group is thus comprised of the head of the Insurance Group and all entities under its direct or indirect control.

9. **Lead State Regulator**: as defined in the NAIC’s Financial Analysis Handbook, i.e., generally considered to be the one state that “takes the lead” with respect to conducting group-wide supervision within the U.S. solvency system.

10. **Reciprocal Jurisdiction**: as defined in the Model Law for Credit for Reinsurance.

   **Drafting Note**: The term “Reciprocal Jurisdiction” is from the proposed revisions incorporated to the exposure draft dated June 21, 2018 to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786). The content of this reference may need to be modified if it does not incorporate the mutual recognition of group supervision concept.

11. **Scope of Application**: Refers to the entities that meet the criteria listed herein for inclusion in the GCC. Depending on the facts and circumstances involving a specific group, the application of such
criteria may result in the Scope of Application being the same as, or a subset of, the entities controlled by the Ultimate Controlling Person of the insurer(s).

12. **Ultimate Controlling Person**: As used in the NAIC’s Insurance Holding Company System Regulatory Act.

**Groups Exempted from the GCC**

13. A non-U.S. based group (a group with a non-U.S. group-wide supervisor) may be exempt from the GCC if:

   i. The non-U.S. based group is based in a Reciprocal Jurisdiction that recognizes the U.S. regulatory regime and accepts the GCC from U.S. based groups to satisfy the Reciprocal Jurisdiction’s group capital requirement;

   ii. The non-U.S. Group-Wide Supervisor’s home jurisdiction requires a group capital calculation be applied at a level that includes the same (or substantially similar) Scope of Application as would otherwise be determined by the Lead State Regulator in the absence of this exemption; and

   iii. The Lead State Regulator can obtain information from the foreign group’s Group-Wide Supervisor either through a Supervisory College or otherwise, that allows the Lead State Regulator to understand the financial condition of the group and complete the expectations of other states in its Group Profile Summary (GPS).

14. A U.S. based group is exempt from the GCC if it is not required to file an ORSA with its Lead State Regulator.

**Guiding Principles and Steps to Determine the Scope of Application**

15. The Scope of Application is initially determined by the Insurance Group in a series of steps, listed here and then further explained as necessary in the text that follows:

   • Develop an initial inventory of potential entities using the Inventory of the Group template (Schedule 1)
   • Denote in the Inventory of the Group template the following entities as “included in the Scope of Application”:
     o All of the entities within the Insurance Group
     o All other Financial Entities that are outside the Insurance Group but within the Broader Group
     o All non-Financial Entities that are outside the Insurance Group but within the Broader Group and that pose material risks to the Insurance Group
   • Denote in the Inventory of the Group template all other entities as “excluded from the Scope of Application”
   • Submit the completed Inventory of the Group template to the Lead State Regulator, who would then review and discuss as necessary with the Insurance Group and consult with other involved regulators to determine the final Scope of Application

**Document the Inventory of the Group**

16. When developing an initial inventory of all potential entities, the Field Test Volunteer shall complete the Inventory of the Group template (Schedule 1), which includes all the entities in the insurer’s
most recent Schedule Y, along with other relevant Holding Company Filings pertaining to entities directly or indirectly owned by the Ultimate Controlling Person.

i. This will require entities to complete basic information about each entity, including assets, revenue and net income for each entity on an annual basis. A Volunteer may agree with its Lead State Regulator to provide the data on a sub-grouping basis (see also paragraph 26).

Identify the Insurance Group

17. Include all entities that fit the criteria identified in the definition of the Insurance Group, above, and denote as such (i.e., included or excluded in the Scope of Application) in the Inventory of the Group template.

Identify and Include all Financial Entities

18. Financial Entities within the Inventory of the Group template shall be included in the Scope of Application regardless of where they reside within the Broader Group.

Identify Risks from the Broader Group

19. An Insurance Group may be a subset of a Broader Group, such as a larger diversified conglomerate with insurance legal entities, Financial Entities and non-financial entities.

i. In considering the risks to which the Insurance Group is exposed, it is important to take account of those material risks to the Insurance Group from the Broader Group within which the Insurance Group operates. Entities within the Broader Group but outside the Insurance Group that pose such risks to the Insurance Group should be included within the Scope of Application.

Expedited Approaches

20. To avoid duplicative capital measures for approaches that are essentially similar to the NAIC’s aggregation approach and to address cost/benefit considerations, an expedited alternative is available for the following classes of insurance groups:

i. U.S. groups subject to the Federal Reserve Board’s group capital requirement may provide that capital assessment measure as an acceptable alternative; or

ii. U.S. groups where the Ultimate Controlling Party is an underwriting company that directly or indirectly owns all of the other entities within the Broader Group may provide its Annual RBC report as an acceptable alternative.

Documentation and on-going assessment

21. The Lead State Regulator should review the Inventory of the Group template to determine if there are entities excluded by the Volunteer that the Lead State Regulator nonetheless believes create other than a non-material risk to its insurance operations. Additional information may be requested by the Lead State Regulator to facilitate this analysis.

22. The exclusion or inclusion of entities within the Scope of Application should be regularly re-assessed.
23. The Field Test Volunteer, together with the Lead State Regulator and with technical support from
the field test analysts, would use the above steps, which includes considering the Lead State
Regulator’s understanding of the group, including inputs such as Form F, ORSA, and other
information from other involved regulators, to determine the Scope of Application.

Considerations for Subsequent Field Test Exercises

24. The Scope of Application should be considered for update on an ongoing basis throughout the field
testing exercise, but at least annually. To assist the Lead State Regulator in assessing the Scope of
Application, the Inventory of the Group template will be completed by participants to provide
information and certain financial data on all the entities in the group for the Lead State Regulator’s
and field test analyst’s use in assessing if the entities excluded from the Scope of Application are
appropriate. The Lead State Regulator and the Insurance Group should agree on a designation of
entities from the inventory that may pose risk of a material adverse impact on the group’s insurance
entities and operations. This may allow the GCC to reflect a more risk-sensitive approach and allow
the Lead State Regulator to better understand the group.

25. The Lead State Regulator should work with the group in determining whether the inventory should
list all entities individually, or whether some should be grouped in a specified way in future iterations
of the field test exercise to better illuminate potential areas of risk. For example, groupings of non-
insurance, non-Financial Entities with some common traits (business unit, purpose, e.g.) could
allow the Lead State Regulator to better understand the group and how they are managed. Thus,
while the inventory would include the full combined financial results/key financial information (net
premiums for insurers, total revenues, total net income, total assets, total debt, total capital or
equity) for all entities of the Ultimate Controlling Person and all of its controlled entities, such data
may be reported based upon major groupings of entities to maximize its usefulness and allow the
Lead State Regulator to better understand trends. Annually the Lead State Regulator and the
Insurance Group should agree on such groupings.

Determine Risk Factors for Non-Insurance Entities within the Scope of Application

26. Non-insurance entities not directly owned by an insurer but within the Scope of Application should
use the following methodology to determine the appropriate risk charge to be applied.

Non-Insurance Testing

27. Non-insurance entities that have been determined to be within the Scope of Application should
include within the template the required risk charges and available capital amounts determined by
either the respective regulator of the entity, the methodology outlined below or as modified for
captives or scalars. Such entities must be individually listed in the template, and will be tested
based upon the following:

A. Regulated Financial Entities

i. All banks and other depository institutions - Minimum required by their regulator. Test
   both a) unscaled; and b) scaled to an RBC equal to 300% ACL.

ii. All asset managers and registered investment advisors – Test both a) 22.5% of
    Book/Adjusted Carrying Value (BACV); and b) 12% of three-year average revenue based
    upon ACLI suggestion (BASEL operational risk). In addition to an unscaled calculation,
    test the BASEL operational risk methodology scaled to an RBC equal to 300% ACL.

iii. All other financially regulated entities - Minimum required by their regulator (not scaled)
B. Unregulated Financial Entities

i. Other entities that engage in financial activities or services that support the insurer(s) – Because these entities can pose more risk of a material adverse impact on the group’s insurance entities and operations than other non-regulated entities, a 22.5% charge on the BACV should be tested. These entities are not subject to a minimum capital requirement.

ii. Other Financial Entities - For purpose of the GCC, unregulated Financial Entities include those which create financial risks through products or transactions such as a mortgage, other credit offering, a derivative, corporate guarantees, intercompany indebtedness, operational interdependence, materiality to the application of credit rating methodologies to the overall group rating and other financial links. Because these entities can pose more risk of a material adverse impact on the group’s insurance entities and operations than other non-regulated entities, apply the greater of the following factors:

- 22.5% of the BACV
- Notional value of the contract (e.g. a net worth guaranty/indemnification/guaranty multiplied by a probability factor as determined by the company based upon past historical experience)
- Other proposed factors suggested by testing participants

Grouping of like entities in type 27 Aii and 27 Bi above would be allowed, assuming that the members of the group all use the same accounting rules (e.g., all GAAP), and are at least consistent with the way the group manages their business.

C. Other Non-Insurance, Non-Financial Entities

Non-insurance, non-Financial Entities (including holding companies that are not insurance legal entities) may not be as risky as regulated entities and other Financial Entities. The Lead State Regulator and the group may decide together how best to group such entities and subject them collectively to the following charges for field testing. The agreed-upon basis for such groupings should be disclosed to the field test analysts.

Test 1-Principle-Past Income/Loss is a sound predictor of risk
Test a factor that considers the specific net losses/fluctuation in profitability over an economic cycle, where five years is used as a proxy for an economic cycle. This factor will be risk-based not only to the industry, but to the individual company since it considers past performance. The calculation would be determined based upon the following (for each entity or group of entities):

**Test 1a**
Factor to Apply = (Absolute value of the greatest net loss in the past five years/Gross revenue in that year for that entity or grouped entities) Multiplied by the current year gross revenue for the same entity or grouped entities

**Test 1b**
Same as Test 1a, except subject to a minimum charge that assumes a net loss equal to 2% of total gross revenues. The minimum is expected to cover the fact that the group is not consistently profitable or that the losses are not material, but it covers this risk in this way as opposed to requiring a calculation that considers this dependence through the use of a more complex standard deviation of profits over a period of time.

Test 2- Principle-Potential Capital Needs of Non-Financial Entities is Equivalent to an Operational Risk Charge
Test a factor that considers non-financial entities as operational risk.

**Test 2a**- Non-regulated entities should be subject to either an operational risk charge as used in Basel III or a 22.5% charge on the BACV. The 12% Basel charge should be scaled to convert to U.S. RBC, thus the scaled factor becomes 2.47% for life insurers (based upon an average RBC Company Action Level ratio of 486%) and a factor of 3.64% for property/casualty (P/C) insurers (based on an average RBC Company Action Level ratio of 332%). A life factor of 3.7% and P/C factor of 5.4% should also be tested, which corresponds to the 300% RBC trend test calibration.

**Test 2B**- Test 3% of BACV.

**Test 3- Principle-Simplicity and Consistency with RBC Requirements**
Test a simpler method specifically, a factor applied to the absolute value of the entities BACV. The relevant RBC charge (22.5% for P&C and Health and 19.5% (post tax) for Life) applied to BACV (post-covariance) should be tested, as well as other alternatives that may be more appropriate for risks posed by entities not owned by an insurer. Consider using the relevant RBC charge applied to BACV, provided groups do so consistently from one year to the next and across all of their entities.
| Name of Securities Exchange if Publicly Traded (U.S. or International) | Name of Parent, Subsidiaries or Affiliates | Domicile | Primary Regulator and Contact | Primary Regulator Email | Description & Purpose of Entity | Business Segment | Inter-Company Guarantee | Capital Maintenance Agreement (if yes, described) | Contractual Relationship with Affiliates (if yes, describes) | Back of Accounting | Assets | Liabilities | Capital | Revenue | Net Income | A.M. Best Rating | Moody's Rating | S&P Rating | Prospective Risks | Scope of Application (Y=Include, X=Exclude) | Required Capital |
| NAIC # | FIDN |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Attachment C
July 20, 2018

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

Re: Exposed Memo “Scope of Group/Non-Insurance Testing,” June 26, 2018

Dear Commissioner Altmaier:

A coalition of nine companies (Brighthouse Financial, Global Atlantic Financial Group, Lincoln Financial, National Life Group, Ohio National, Pacific Life, Principal Financial Group, Reinsurance Group of America, and Transamerica; collectively “the Coalition”) appreciates the opportunity to comment on the exposed NAIC staff memo, “Scope of Group/Non-Insurance Testing,” dated June 26, 2018. The Coalition supports ACLI’s comment letter but wishes to supplement ACLI’s letter by reemphasizing the conceptual framework that should underpin the Group Capital Calculation (GCC).

In November 2015, the NAIC adopted a recommendation to develop the GCC using an RBC aggregation approach. The accompanying memorandum noted that RBC aggregation would “build on existing legal entity capital requirements where they exist rather than developing replacement/additional standards.” This principle was broadly supported in 2015, and the Coalition believes it should underpin all facets of the GCC. Stated differently, the GCC should employ, directly and without adjustment, domestic state legal entity rules.

As we have previously emphasized, we consider adherence to legal entity rules vital to the success of the GCC for reasons that include the following:

- It avoids effectively overriding existing laws and regulations;
- It prevents burdening the industry and regulators with a dual solvency system;
- It preserves the efficacy of regulatory tools such as prescribed and permitted practices;
- It enables state regulators to signal to external audiences the robustness of the state regulatory system;
- It maintains the consistency and cohesiveness of the state-based regulatory solvency system as a whole; and
- It facilitates fulfillment of obligations under the U.S.-EU Covered Agreement for a group capital assessment that results in “preventive, corrective, or otherwise responsive measures.”

Relative to the scope of the group and GCC treatment of various entities, the Coalition’s principle means the following:

- The scope of a group subject to the GCC should include all U.S. insurance legal entities and subsidiaries of such entities.
• The GCC treatment of all U.S. insurance legal entities and their subsidiaries should be identical to their treatment within U.S. statutory accounting and Risk-Based Capital.

In reviewing the June 26 memorandum for consistency with the Coalition's principle, we offer the following observations:

A. Scope

When describing excluded entities, the phrase “not owned directly or indirectly by an insurance entity” (or slight variants thereof) in steps 3 and 4 suggests an intent to include all subsidiaries of U.S. insurance legal entities within the GCC. The Coalition supports this proposal, as it creates alignment with legal entity rules. However, the positioning of this phrasing within steps 3 and 4 creates ambiguity. We recommend inserting a separate step, prior to step 3, indicating that, for groups subject to the GCC, U.S. insurance legal entities and their subsidiaries are always included in the GCC.

B. Non-Insurance Testing (i.e. GCC treatment of non-insurance entities)

The Coalition believes that the Working Group may explore a range of potential alternatives for “siblings” of insurance legal entities (i.e. subsidiaries of holding companies). We believe, however, that the GCC must always follow legal entity rules for “children,” or subsidiaries of insurance legal entities.

To the extent that the Working Group is inclined to explore alternatives to legal entity rules within the GCC testing, the Coalition would not necessarily object so long as it is done in formal consultation with the relevant NAIC committees, perhaps through a referral or a joint project. Any changes to legal entity rules should be made through the traditional NAIC and state processes, after which they will automatically be incorporated into the GCC.

Consistent with this paradigm, we have the following input on some specific types of entities:

• **Banks and other depository institutions that are subsidiaries of U.S. insurance legal entities.** Contingent on a formal consultation with the relevant NAIC committees, we are open to testing alternatives to the existing RBC charge. Otherwise the existing RBC charge should be used.

• **“All other financially regulated entities” that are subsidiaries of U.S. insurance legal entities.** Contingent on a formal consultation with the relevant NAIC committees, we are open to testing alternatives to the existing RBC charge. Otherwise the existing RBC charge should be used.

• **“Consistently profitable non-financial entities” that are subsidiaries of U.S. insurance legal entities.** Contingent on a formal consultation with the relevant NAIC committees, we are open to testing alternatives to the existing RBC charge. Otherwise the existing RBC charge should be used.

• **“Other non-financial entities” that are subsidiaries of U.S. insurance legal entities.** Test 3, as we understand it, appears to employ the existing RBC charge. We support exploring other alternatives only if done in formal consultation with the relevant NAIC committees.

Finally, while a seriatim inventory of entities may provide useful regulatory information, the GCC can be simplified and aligned with the legal entity framework by leaving subsidiaries of insurance legal entities as “stacked,” thus enabling the current accounting and RBC treatment to flow into the GCC. We recommend such an approach for field testing purposes.
The Coalition appreciates the opportunity to comment. We look forward to ongoing engagement with the Working Group as the development of the Group Capital Calculation continues.

Sincerely,

Brighthouse Financial
Global Atlantic Financial Group
Lincoln Financial
National Life Group
Ohio National
Pacific Life
Principal Financial Group
Reinsurance Group of America
Transamerica
July 20, 2018

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

Re: Scope of Group/Non-Insurance Testing Memo, dated June 26, 2018

Dear Commissioner Altmaier:

The American Council of Life Insurers (ACLI) advocates on behalf of approximately 290 member companies dedicated to providing products and services that contribute to consumers’ financial and retirement security. ACLI members represent 95 percent of industry assets, 93 percent of life insurance premiums, and 98 percent of annuity considerations in the United States. 75 million families depend on our members’ life insurance, annuities, retirement plans, long-term care insurance, disability income insurance and reinsurance products. Taking into account additional products including dental, vision and other supplemental benefits, ACLI members provide financial protection to 90 million American families.

We appreciate the opportunity to comment on the Working Group's Memo dated June 26, 2018. We found the June 20 hearing on the precursor memo informative and helpful. We appreciated the time that you, your fellow Commissioners, and staff devoted to listening to and engaging with the industry on issues surrounding the development of the group capital calculation (GCC). We were encouraged to hear that the NAIC intends to develop a GCC that works for the U.S. state-based regulatory system.

**Overarching Principles:** We strongly urge the Working Group and NAIC to communicate their vision of how this tool will be used in practice and how it may relate to other supervisory tools and initiatives, both in the near and longer-term. Further insight on these points will help inform stakeholder engagement and provide companies much needed clarity on the potential consequences the GCC may have on their business.

ACLI continues to believe that the GCC should validate, and not diverge from, the existing framework of state-insurance financial regulation, including recognition of the use of properly regulated captives and permitted and prescribed practices. We believe that the U.S. state-based regulatory regime and its RBC system have proven themselves and should be recognized in the GCC.

Field testing will be a critical next step for development of the GCC. We encourage the Working Group to use field testing as a vehicle to better understand the pros and cons of the various methods and approaches that will be discussed over the months ahead. To maximize the value of the field test, a representative cross-section of the life industry should be included in the testing and data on a variety of approaches collected. We ask that regulators be as transparent as possible in sharing their findings from
field testing while respecting the confidentiality of the participating insurers and their data. It would be most useful to share insights from the field test results compared to the NAIC’s goals for the GCC.

**High-Level Comments on June 26 Memo:** We appreciate the efforts the Working Group has made to incorporate feedback from a variety of stakeholders into the revised memo. We support the Working Group’s decision to articulate principles to govern the process for establishing the scope of group and treatment of legal entities within it. We believe articulating such principles to guide field testing is more important than trying to lock into a single solution, materiality threshold, or proposed treatment of an entity-type at this point in the process. However, these principles can and should be refined over time to ensure the final GCC is substantially uniform among the insurers asked to complete it, workable for insurance groups, and provides lead state regulators with useful, realistic information.

**Scope of Group:** We agree that the lead state, in consultation with domiciliary states of the group’s insurers, relevant regulators and the insurance group, should be responsible for determining which entities within the group should be included in the GCC. As noted above, we encourage the NAIC to establish principles that the lead state is expected to consider in making that determination. We agree that the scope of the group should always encompass subsidiaries of an insurance entity.

The final determination of the scope of the group should be documented and explained to other domestic states, relevant regulators and the insurance group.

ACLI supports exemptions from application of the GCC itself for:
- Groups that do not file an ORSA with their lead state regulator;
- Groups subject to group-wide supervision and a group-capital assessment, if their home country supervisor (1) accepts the GCC filed for U.S.-based groups and (2) shares relevant information with lead states upon request; or
- Groups subject to consolidated supervision by the Federal Reserve Board if the lead state supervisor has access to relevant information.

**Treatment of Non-Insurance Entities:** The GCC should be developed in a manner that harmonizes with the state-based system and existing NAIC processes. For entities that are subsidiaries of insurance legal entities, the existing RBC charges should be used. For in-scope entities that are not subsidiaries of insurance legal entities, we support testing a variety of alternatives, including current RBC factors used for similar subsidiary entities, to facilitate the analysis of field testing data.

We support the grouping of similar entities to ease both the operational complexity of the GCC and the ability for state regulators to assess results and identify potential trends within the group.

****

ACLI and its members appreciate the opportunity to be constructive participants in the Working Group’s process. In addition to the comments in this letter, ACLI worked diligently with other U.S. trade associations to try to deliver by the comment deadline joint input on the June 26 exposure draft. We found the process worthwhile, and we support their efforts. Unfortunately, due to time constraints, we were unable to vet all the concepts in the documents with our members, including the inventory, the exemptions and expedited approaches, ‘scope of application’ and the process for determining it, and
recommendations for field testing. We respectfully request a fulsome discussion of those concepts, followed by an exposure period.

Very truly yours,

Carolyn Cobb  
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carolyncobb@acli.com  (202) 624-2340

Patrick Reeder  
Vice President & Deputy General Counsel  
patrickreeder@acli.com  (202) 624-2195

David Leifer  
Vice President & Associate General Counsel  
davidleifer@acli.com  (202) 624-2128
July 20, 2018

Commissioner David Altmaier, Chair
Group Capital Calculation (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO  64106-2197

Via electronic mail

Dear Commissioner Altmaier:

    Cigna and Aetna thank you for this opportunity to provide comments on the Group Capital Working Group’s June 26, 2018 memo Scope of the Group/Non-Insurance Testing for purposes of the Group Capital Calculation (GCC). As we have commented in the past, our companies generally support the RBC aggregation approach and advocates for a GCC that builds upon existing regulatory requirements and which is consistent with the US-EU Covered Agreement.

    We hope that the Working Group will take these comments in the spirit in which they are intended – as a constructive attempt to assist regulators in meeting their regulatory objectives and commitments to the international regulatory community. Attached you will find a red-lined version of the June 26 memo that incorporates the approach previously discussed at the in-person Working Group meeting in Kansas City last month. We ask that the Working Group include our proposed methodology in the next round of field testing.

    Generally speaking, Cigna and Aetna believe that this proposal supports the Working Group’s efforts to provide regulated entities with flexibility while recognizing that not all non-regulated entities pose a material risk to the financial solvency of the holding company. In our view, developing a capital ratio that aggregates non-US and non-regulated domestic entities will not accurately account for differences in regulatory regimes and risks from non-regulated entities. This will result in the reporting of unreliable or misleading information and will create competitive disadvantages among holding company systems. We believe these risks outweigh any potential advantages that may exist in trying to develop an aggregate capital ratio for the holding company system.

    Therefore, we propose the following inventory reporting methodology based on entity type, which is reflected in the attached red-lined memo.

1. For US regulated entities, report an inventory of legal entities subject to RBC along with an aggregated RBC ratio.
2. For non-US regulated entities, report an inventory of material non-domestic legal entities, including actual capital, regulatory target capital, and the applicable local capital regime. Report an aggregate result for those entities under like regulatory regimes.
3. For material non-regulated entities, report an inventory of material non-regulated legal entities including GAAP capital.
4. For immaterial non-regulated entities, either (1) group them together with total GAAP capital or (2) exclude them, based on managerial judgement, while allowing the lead state regulator to review and request additional information on excluded entities and/or request inclusion in an inventory.

The attached illustration of the GCC is an example of a report that would be provided to the lead regulator. We believe that this alternative reporting promotes transparency, eliminates complexity, and removes the potential for distorting a holding company’s capital position. The adoption of this approach, in combination with a holding company’s ORSA report and other existing regulatory tools, will give the lead regulator a transparent view into relevant financial data for regulated entities and their non-regulated subsidiaries, affiliates or partners. We understand the desire for a single capital ratio across regulatory regimes as well as regulated and non-regulated entities; however, we do not think that this objective is achievable, desirable or advisable for the reasons discussed above.

In addition, while the treatment of senior debt was not expressly included in the June 26 memo, we continue to oppose the proposal outlined in the working group’s most recent memo on this issue. Consequently, it is not included in the attached illustration. In our view, the proposed treatment of senior debt crosses the line from monitoring holding company capital, to regulating holding company capital, which we cannot support. Our obligations to policyholders are fully protected without any cap on holding company debt. Therefore, without further clarity on the specific regulatory risks that holding company debt poses to legal entities and policyholders, we cannot support any cap at this time. We look forward to additional dialogue on this issue.

Again, thank you for this opportunity to provide these comments and request that this option be considered as one of the options for field testing.

Sincerely,

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<tr>
<th>Amy Lazzaro</th>
<th>Regulatory Affairs, Cigna</th>
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<td><a href="mailto:Amy.Lazzaro@cigna.com">Amy.Lazzaro@cigna.com</a></td>
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<tr>
<td>Gregg Martino</td>
<td>Regulatory Affairs, Aetna</td>
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<td><a href="mailto:MartinoG@aetna.com">MartinoG@aetna.com</a></td>
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cc: Commissioner Katie Wade  
   Kathy Belfi, Director of Financial Regulation  
   Lou Felice, NAIC  
   Dan Daveline, NAIC
MEMORANDUM

TO: Group Capital Calculation (E) Working Group
FROM: Dan Daveline, NAIC Staff
DATE: June 26, 2018
RE: Scope of Group/Non-Insurance Testing

This memorandum represents a combined modified version of the June 11 Scope of Group memorandum and June 11 Non-Regulated Entities memorandum. The revised memorandum is intended to 1) clarify the original intent of the two memorandums; and 2) simplify the presentation since the updated document is intended to be used more specifically for the testing process and less as an explanatory document, 3) Provide a Summary Group Capital approach with illustration.

Scope of the Group & Summary of Approach
In determining the companies for which the group capital calculation should be applied, the group is expected to use the following process:

1) A non-U.S. based group may be exempt from completing a group capital calculation if:
   i) The non-U.S. based group is in a (Reciprocal) Jurisdiction that recognizes the U.S. regulatory regime and accepts the group capital calculation from a U.S. based group to satisfy any group capital requirement;
   ii) The group capital calculation is applied by the Group-Wide Supervisor (GWS) at a level that includes the same (or substantially similar) scope of the group as determined by the lead state in step 7; and
   iii) The lead state can obtain information from the foreign group’s GWS either through a Supervisory College or otherwise, that allows the lead state to understand the financial condition of the group and complete the expectations of other states in its Group Profile Summary (GPS).

2) When developing the universe of all potential entities included in the group capital calculation, the starting point is the insurer's most recent Schedule Y and the ultimate controlling party, along with other relevant Holding Company Filings pertaining to entities directly or indirectly owned by the ultimate controlling party.

3) The following is a summary of the proposed Group Capital Approach. The approach has the following underlying principles: 1) an inventory approach provides transparency to a Group’s capital, eliminates complexity and removes the potential for distorting a holding company’s capital position, 2) if every entity inventoried has adequate capital on a standalone basis, then the company’s aggregated capital must also be adequate, 3) there is benefit to aggregating entities with similar regimes, but no benefit to aggregating capital ratios across different reporting regimes as the result
would be distorted and not meaningful. Under the proposed inventory method, entities would be organized and grouped as follows:

1. **For US regulated entities**, report an inventory of legal entities subject to RBC along with an aggregated RBC ratio.
2. **For non-US regulated entities**, report an inventory of material non-domestic legal entities, including actual capital, regulatory target capital, and the applicable local capital regime. Report an aggregate result for those entities under like regulatory regimes.
3. **For material non-regulated entities**, report an inventory of material non-regulated legal entities, including GAAP capital.
4. **For immaterial non-regulated Entities**, either (1) group them together, along with total GAAP capital. (criteria for identifying immaterial non regulated entities for grouping, see 4, below or (2) exclude them, based on managerial judgement, while allowing the lead state regulator to review and request additional information on excluded entities and/or request inclusion in an inventory.
5. **See illustration of this methodology (Exhibit A)**

4) **Immaterial Non-regulated entities** may be grouped together in the inventory approach. Entities that are neither a material source NOR a material user of capital may be considered for grouping. In considering entities to be grouped, the preparer should consider the following more specific circumstances that inform the intent of the criteria:

- Any non-financial entity, that is not directly or indirectly owned by an insurance entity, and has capital/stockholder’s equity of less than 5% (on a stand-alone basis) of the universe’s prior year-end, shall be considered an entity that may be grouped with other entities.
- Although an entity meets the criteria for grouping, the filer may choose to list the entity separately.

The group should submit the listing of all grouped entities to the lead state regulator (in a predefined format included in the group capital inventory) As the regulator reviews the listing, two principles should be used for determining if an entity either should be listed separately (as opposed to grouped together), 1) while historical gains can suggest a reduced likelihood for future losses, there may be other indicators of material dependency or material risk that may suggest to the regulator that a potential future loss of 5% of a group’s prior year capital may be possible, in which case the regulator should have the ability to add an entity back that may otherwise be excluded; 2) while historical losses may suggest that a higher likelihood of future losses are likely, there may be other indicators that suggest to the regulator that a potential future loss of 5% of a group’s capital is unlikely, in which case the regulator should have the ability to subtract an entity that may otherwise be included in the scope of the calculation.

In implementing these two principles, the regulator should consider the following more specific circumstances that inform the intent of the criteria:

- Adding any entity that the regulator believes creates a material dependency, where material is defined as 5% of the group’s prior year capital.
- Adding any entity that provides intra-group financial support or has a structural or contractual relationship which the regulator believes could create a material risk to the group’s capital, where material risk is defined as 5% of the group’s prior year-end capital.
- Adding/subtracting any entity that the regulator believes, despite any measures of materiality risk, based upon the activities of the entity, could have a material
(adding)/immaterial (subtracting) impact on the group or markets (including counterparties). This includes but is not limited to pass-through entities that provide services to the group or face counterparties that are not adequately captured by a financial evaluation.

4) In the unlikely event that the lead state regulator has determined through the previous steps that the ultimate controlling party is not part of the scope of the group for the group capital calculation, the reasons therefore should be explained and clearly communicated to the other domestic states/other relevant regulators in step 7.

5) The lead state regulator uses the above steps, which implicitly includes considering the lead state’s understanding of the group, including inputs such as the Form F, ORSA, and other information including considering input from other domestic states or other regulators that have an entity in the group, to determine the ultimate scope of the group. It’s important that this type of information be used by the lead state in cooperation with the domestic states and other impacted regulators when developing the scope of the group for purposes of the group capital calculation.

Comment [BSMB1]: I think this section is N/A, because the filing includes all entities, either listed separately or grouped together. So, there is no need to evaluate “Scope of the Group”. All entities are in scope.
MEMORANDUM

TO: Group Capital Calculation (E) Working Group

FROM: Dan Daveline, NAIC Staff

DATE: June 26, 2018

RE: Scope of Group/Non-Insurance Testing

This memorandum represents a combined modified version of the June 11 Scope of Group memorandum and June 11 Non-Regulated Entities memorandum. The revised memorandum is intended to 1) clarify the original intent of the two memorandums; and 2) simplify the presentation since the updated document is intended to be used more specifically for the testing process and less as an explanatory document. 3) Provide a Summary Group Capital approach with illustration.

Scope of the Group & Summary of Approach

In determining the companies for which the group capital calculation should be applied, the group is expected to use the following process:

1) A non-U.S. based group may be exempt from completing a group capital calculation if:
   i) The non-U.S. based group is in a (Reciprocal) Jurisdiction that recognizes the U.S. regulatory regime and accepts the group capital calculation from a U.S. based group to satisfy any group capital requirement;
   ii) The group capital calculation is applied by the Group-Wide Supervisor (GWS) at a level that includes the same (or substantially similar) scope of the group as determined by the lead state in step 7; and
   iii) The lead state can obtain information from the foreign group’s GWS either through a Supervisory College or otherwise, that allows the lead state to understand the financial condition of the group and complete the expectations of other states in its Group Profile Summary (GPS).

2) When developing the universe of all potential entities included in the group capital calculation, the starting point is the insurer’s most recent Schedule Y and the ultimate controlling party, along with other relevant Holding Company Filings pertaining to entities directly or indirectly owned by the ultimate controlling party.

3) The following is a summary of the proposed Group Capital Approach. The approach has the following underlying principles: 1) an inventory approach provides transparency to a Group’s capital, eliminates complexity and removes the potential for distorting a holding company’s capital position, 2) if every entity inventoried has adequate capital on a standalone basis, then the company’s aggregated capital must also be adequate, 3) there is benefit to aggregating entities with similar regimes, but no benefit to aggregating capital ratios across different reporting regimes as the result...
would be distorted and not meaningful. Under the proposed inventory method, entities would be organized and grouped as follows:

1. For US regulated entities, report an inventory of legal entities subject to RBC along with an aggregated RBC ratio.
2. For non-US regulated entities, report an inventory of material non-domestic legal entities, including actual capital, regulatory target capital, and the applicable local capital regime. Report an aggregate result for those entities under like regulatory regimes.
3. For material non-regulated entities, report an inventory of material non-regulated legal entities, including GAAP capital.

4. For immaterial Non-regulated Entities, either (1) will be grouped together, along with total GAAP capital. (criteria for identifying immaterial non regulated entities for grouping, see 4, below) or (2) exclude them, based on managerial judgement, while allowing the lead state regulator to review and request additional information on excluded entities and/or request inclusion in an inventory.
5. See illustration of this methodology (Exhibit A)

2)

3) 4) Immaterial Non-regulated entities may be grouped together in the inventory approach. Entities Deduct from the universe all entities that are neither a material source NOR a material user of capital may be considered for grouping. Two principles should be used for determining if an entity meets such a criteria for exclusion: 1) exclusion of a material source of capital will prevent the user from understanding the true financial condition of the group, which is one of the intended purposes of the group capital calculation; 2) exclusion of an entity that is consistently profitable is reasonable on the basis that such an entity is unlikely to be a material user of capital in the future.

In implementing these two principles, in considering entities to be grouped, the preparer should consider the following more specific circumstances that inform the intent of the criteria:

- Any non-financial entity, that is not directly or indirectly owned by an insurance entity, and has capital/stockholder’s equity of less than 5% (on either a stand-alone basis or in combination with other entities) of the universe’s prior year-end, shall be considered an entity that may be grouped with other entities.
- Although an entity meets the criteria for grouping, the filer may choose to list the entity separately.
- IS NOT a material source of capital. (Note, all financial entities must be included in the calculation as well as all entities that are directly or indirectly owned by an insurance entity)
- Any non-financial entity that is not directly or indirectly owned by an insurance entity, and that has reported net income in each and all of the most recent five consecutive years, shall be considered an entity that IS NOT a material user of capital.

4) Deduct from the universe, all entities that are considered negligible when aggregated. Three principles should be used for determining if an entity meets such a criteria for exclusion: 1)
excluding a combination of entities that do not exceed the material source of capital criteria will not prevent the user from understanding the true financial condition of the group; 2) excluding a combination of entities that have not produced net losses in excess of a material portion of the group’s income capacity for a specified period of time is unlikely to be a material user of capital in the future; 3) in excluding a combination of entities, consideration must be given to the fact that combining positives with negatives may underestimate the potential losses an individual company or combination of companies can create.

In implementing these three principles, the preparer should consider the following more specific circumstances that inform the intent of the criteria:

- Any non-financial entity, that is not owned directly or indirectly by an insurance entity and that is below the capital/stockholder’s equity threshold in paragraph 3 above AND that has combined net income/net losses (for the five most recent consecutive years) that is less than 5% of the net income/loss of the universe as of the prior year-end can be accumulated with other entities that meet such criteria provided that the aggregation of such entities results in a combined capital/stockholder’s equity of less than 5% as of prior year-end of the universe AND the individual net losses from each of the entities for the most recent five consecutive when combined (cannot be offset with net income during the same periods) of all net losses are less than 5% of the universe’s net income/loss, shall be considered negligible.

The group should submit the listing of all excluded entities to the lead state regulator (in a predefined format included in the group capital calculation inventory) to determine if there are entities excluded by the group that create a material risk to the group’s capital. As the regulator reviews the listing, two principles should be used for determining if an entity either should be added back listed separately (as opposed to grouped together) or subtracted from the list produced by the group:

1) While historical gains can suggest a reduced likelihood for future losses, there may be other indicators of material dependency or material risk that may suggest to the regulator that a potential future loss of 5% of a group’s prior year capital may be possible, in which case the regulator should have the ability to add an entity back that may otherwise be excluded; 2) while historical losses may suggest that a higher likelihood of future losses are likely, there may be other indicators that suggest to the regulator that a potential future loss of 5% of a group’s capital is unlikely, in which case the regulator should have the ability to subtract an entity that may otherwise be included in the scope of the calculation.

In implementing these two principles, the regulator should consider the following more specific circumstances that inform the intent of the criteria:

- Adding any entity that the regulator believes creates a material dependency, where material is defined as 5% of the group’s prior year capital.
- Adding any entity that provides intra-group financial support or has a structural or contractual relationship which the regulator believes could create a material risk to the group’s capital, where material risk is defined as 5% of the group’s prior year-end capital.
- Adding/subtracting any entity that the regulator believes, despite any measures of materiality risk, based upon the activities of the entity, could have a material (adding)/immaterial (subtracting) impact on the group or markets (including counterparties). This includes but is not limited to pass-through entities that provide services to the group or face counterparties that are not adequately captured by a financial evaluation.

In the unlikely event that the lead state regulator has determined through the previous steps that the
ultimate controlling party is not part of the scope of the group for the group capital calculation, the reasons therefore should be explained and clearly communicated to the other domestic states/other relevant regulators in step 7.

The lead state regulator uses the above steps, which implicitly includes considering the lead state’s understanding of the group, including inputs such as the Form F. ORSA, and other information including considering input from other domestic states or other regulators that have an entity in the group, to determine the ultimate scope of the group. It’s important that this type of information be used by the lead state in cooperation with the domestic states and other impacted regulators when developing the scope of the group for purposes of the group capital calculation.

Ongoing Determination (Completed at least Annually)

The scope of the group used in the group capital calculation should be considered for update on an ongoing basis, but at least annually. To assist the regulator in determining the scope of the group, the group capital calculation will include an area where basic financial information on all the entities in the group are included to allow the regulator to gain comfort in determining if the entities excluded from the scope of the group are appropriate. Once the regulator has a full understanding of all the entities in the group, the regulator should work with the group in determining whether this inventory of all companies should be grouped in a specified way in the future. For example, while this inventory must include the full combined financial results/key financial information net premiums for insurers, total revenues, total net income, total assets, total debt, total capital or equity) for all entities of the ultimate controlling party and all of its subsidiaries, it may be best that this inventory is presented in this area based upon major groupings of entities to maximize the usefulness of this data. The reason being, these grouped figures are intended to be data captured year-in and year-out to allow the regulator to use the figures in a manner that allows the regulator to understand the trends of these figures. Said differently, having the combined information presented in groupings of a lower number (e.g. 5, 10, 15, 20, 25 entities) would be far more analytically helpful to the regulator than the actual number of entities (e.g. upwards of 1,000 or more entities). In particular, the groupings of the non-financial entities should be considered, since they can be grouped in manner that allows the regulator to understand the group and how they are managed, but understanding that it may be best to separate those entities that may cause some amount of strain since that would allow a more risk sensitive approach to be included in the calculation, and allow the regulator to better understand the group.

To reiterate, this inventory is intended to require legal entity data (or combined legal entities after the lead state regulator has worked with the group to determine the best groupings) as part of the calculation to be certain that such scope is appropriate, given other holding company filings today do not include legal entity/combined legal entity data such as what is being contemplated. (Note also the lead state regulator retains the ability to require further breakout in order to assist in annually evaluating the scope of group)

Non-Insurance Testing

As previously concluded by the Working Group, all insurers must be individually listed in the calculation inventory along with their minimum required capital from their regulator, or as modified for captives or scalars. For other financial entities, they also must be individually listed in the calculation inventory, and will be tested based upon the following (Please note, non-regulated entities where such entities are currently subject to a risk charge in RBC, or subject to a risk charge imposed by a financial regulator, do not need to be individually listed/de-stacked).
1) Financial Entities

A) Regulated Financial Entities

i. All banks and other depository institutions - Minimum required by their regulator. Test both a) unscaled; and b) scaled to an RBC equal to 300% ACL.

ii. All asset managers and registered investment advisors – Test both a) 22.5% of BACV; and b) 12% of three-year average revenue based upon ACLI suggestion (BASEL operational risk). In addition to an unscaled calculation, test the BASEL operational risk methodology scaled to an RBC equal to 300% ACL.

iii. All other financially regulated entities – Minimum required by their regulator (not scaled)

B) Unregulated Financial Entities

i. Other entities that provide financial activities that support the insurer(s) – Because these entities can cause more strain on an insurer than other non-regulated entities, these entities should receive a 22.5% charge on the BACV. These entities are not subject to a minimum capital requirement.

ii. Other financial entities - For purpose of this calculation, unregulated financial entities include those which create financial risks through products or transactions such as a mortgage, other credit offering, a derivative, corporate guarantees, intercompany indebtedness, operational interdependence, including the existence of shared resources such as IT platforms or treasury or other material operations, materiality to the application of credit rating methodologies to the overall group rating and other financial links. Because these entities can cause more strain on an insurer than other non-regulated entities, apply the greater of the following factors:

   • 22.5% of the BACV
   • Notional value of the contract (e.g., a net worth guaranty/indemnification/guaranty multiplied by a probability factor as determined by the company based upon past historical experience)
   • Other proposed factors suggested by testing participants

NAIC staff is open to allowing grouping of like entities in type 1Aii and 1Bi, above assuming that the members of the group all use the same accounting rules (e.g., all GAAP), and are at least consistent with the way the group manages their business.

2) Consistently Profitable Non-Financial Entities

Any non-financial entity that has reported positive net income each of the past five years can be subject to a minimal charge based upon the principle that consistently profitable companies are unlikely to cause a material loss in the future, and any risk of this changing is likely only minimal operational risk. For these entities, they may be combined and subject to a ½% charge on the most recently reported amount of revenues.

3) Other Non-Financial Entities

Some of the comment letters, including those related to scope of the group, make the argument that non-financial entities are not as risky as regulated entities and other financial entities. NAIC staff believe that while this is not always the case, in many cases it is true. NAIC staff is open to allowing the regulator and the group to decide together how best to group and be subject to the...
following charges that we propose to be tested. Unlimited grouping of non-financial entities is allowed.

**Test 1- Principle- Past Income/Loss is a sound predictor of risk**
Test a factor that considers the specific net losses/fluctuation in profitability over an economic cycle, where five years is used as a proxy for an economic cycle. This factor will be risk-based not only to the industry, but to the individual company since it considers past performance. The calculation would be determined based upon the following (for each entity or group of entities):

**Test 1a- Factor to Apply =** (Absolute value of the greatest net loss in the past five years/Gross revenue in that year for that entity or grouped entities) Multiplied by the current year gross revenue for the same entity or grouped entities

**Test 1b- Factor to Apply =** (Absolute value of the greatest net loss in the past five years/Gross revenue in that year for that entity or grouped entities) Multiplied by the current year gross revenue for the same entity or grouped entities *

*Subject to a minimum charge that assumes a net loss equal to 2% of total gross revenues. The minimum is expected to cover the fact that the group is not consistently profitable or that the losses are not material, but it covers this risk in this way as opposed to requiring a calculation that considers this dependence through the use of a more complex standard deviation of profits over a period of time.

**Test 2- Principle- Potential Capital Needs of Non-Financial Entities is Equivalent to an Operational Risk Charge**
Test a factor that considers non-financial entities an operational risk

**Test 2a-** The American Council of Life Insurers (ACLI)/American Insurance Association (AIA) have long suggested that non-regulated entities be subject to either an operational risk charge used in International Basel III or a 22.5% charge on the BACV. The ACLI notes that when this is done, the scaled factor becomes 2.47% for life insurers (based upon an average RBC operating ratio of 48%), and a factor of 3.64% for property/casualty (P/C) insurers (based on an average RBC operating ratio of 33%). A life factor of 3.7% should also be tested, which corresponds to a 300% RBC calibration, and P/C of 5.4% based upon an average industry life RBC of 33%. This should be applied on the absolute value of the entities revenues.

**Test 2b- Use the NAIC recently adopted Operational Risk Charge of 3%, but apply to revenues consistent with test 2a.**

**Test 3- Principle- Simplicity and Consistency with RBC Requirements**
Test a more simple method as suggested by America’s Health Insurance Plans (AHIP). Specifically, test a factor applied to the Book/Adjusted Carrying Value (BACV) of the entity. This should be applied on the absolute value of the entities BACV. NAIC staff suggest the relevant RBC charge (22.5% for P/C and Health and 19.5% (post tax) for Life) applied to BACV (post-covariance) be tested, but with the understanding that the reason we have proposed other alternatives is to attempt to be sensitive to the argument that such an approach may not align the risks posed by these entities when they are not owned by a U.S. or foreign insurer. Even if we find that this is the case, the Working Group may find that it is open to considering giving groups the option of using the relevant RBC charge applied to BACV, provided they do so consistently from one year to the next and across all of their entities.

*
## Illustration - Group Capital

<table>
<thead>
<tr>
<th>Entity Name</th>
<th>relative size</th>
<th>Capital</th>
<th>Required Capital</th>
<th>Ratio Actual to Required</th>
<th>Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Domestic Entities Subject to RBC</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>regulated entity A</td>
<td>6%</td>
<td>5,000</td>
<td>2,000</td>
<td>250%</td>
<td>RBC</td>
</tr>
<tr>
<td>regulated entity B</td>
<td>41%</td>
<td>35,000</td>
<td>10,000</td>
<td>350%</td>
<td>RBC</td>
</tr>
<tr>
<td>regulated entity C</td>
<td>23%</td>
<td>20,000</td>
<td>6,000</td>
<td>333%</td>
<td>RBC</td>
</tr>
<tr>
<td><strong>Subtotal Regulated Domestic</strong></td>
<td>70%</td>
<td>60,000</td>
<td>18,000</td>
<td>333%</td>
<td>RBC</td>
</tr>
<tr>
<td><strong>International Entities Subject to Regulation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>regulatory entity of Canada A</td>
<td>4%</td>
<td>3,000</td>
<td>800</td>
<td>375%</td>
<td>TAAM</td>
</tr>
<tr>
<td>regulatory entity of Canada B</td>
<td>5%</td>
<td>4,000</td>
<td>1,000</td>
<td>400%</td>
<td>TAAM</td>
</tr>
<tr>
<td><strong>Subtotal Regulated Canada</strong></td>
<td>8%</td>
<td>7,000</td>
<td>1,800</td>
<td>389%</td>
<td>TAAM</td>
</tr>
<tr>
<td>regulatory entity of Korea</td>
<td>5%</td>
<td>4,000</td>
<td>1,200</td>
<td>333%</td>
<td>K-ICS</td>
</tr>
<tr>
<td>regulatory entity of China</td>
<td>2%</td>
<td>2,000</td>
<td>500</td>
<td>400%</td>
<td>C-ROSS</td>
</tr>
<tr>
<td>regulated entities aggregated</td>
<td>1%</td>
<td>500</td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal Regulated International</strong></td>
<td>13%</td>
<td>11,500</td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td><strong>Non Regulated Entities (list entities above a certain size)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>non regulated entity A</td>
<td>5%</td>
<td>4,000</td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td>non regulated entity B</td>
<td>4%</td>
<td>3,000</td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td>non regulated entity C</td>
<td>4%</td>
<td>3,000</td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td><strong>Non Regulated Entities (group entities below a certain size)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>non regulated entities - other</td>
<td>5%</td>
<td>4,000</td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL Capital (mix of STAT, GAAP and foreign)</strong></td>
<td>100%</td>
<td>85,500</td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
</tbody>
</table>

- list all regulated entities subject to RBC
- some value to showing an aggregated RBC
- list material regulated non domestic entities
- there is value showing foreign entity capitalization relative to the local capital requirement
- no real value in aggregating apple/oranges
July 20, 2018

Via Electronic Delivery

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

Attention: Julie Garber and Dan Daveline

Re: Comments Regarding Memorandum Dated June 26, 2018, on Scope of Group and Non-Regulated Entities

Commissioner Altmaier:

We appreciate the opportunity to comment on your memorandum dated June 26, 2018, regarding the scope of the group and non-regulated entities (the “Memo”). We continue to support the NAIC’s development of a group capital calculation (“GCC”). We believe that the calculation, if designed appropriately, will provide a useful supervisory tool to assist lead states in analyzing the financial condition of insurance groups by complementing entity-based solvency requirements.

Scope of the Group

The Memo first sets forth a seven-step process for determining the scope of the group, focusing in particular on the scope of entities within a group that must be included in the GCC. We appreciate that the Working Group’s intent appears to be to develop quantitative measures and other specific criteria by which entities can be excluded from the GCC. In addition to the specific comments set forth below, we would reiterate from our January 12, 2018 comment letter the principle that the GCC should be indifferent to corporate structure, consistent with the industry proposal for an “Aggregation & Calibration” approach for the Federal Reserve Board’s development of an insurance capital standard. This principle has led us to urge the Working Group to apply capital charges consistently within the GCC based on entity type, regardless of whether the entity is owned by an insurer or held elsewhere in the group. We note that this point is also suggested in the Memo’s discussion of the scope of the group, which contemplates excluding non-material, non-financial entities only if they are also not directly or indirectly owned by an insurer. This criterion means that the scope determination will inherently differ for stock insurance companies and mutual insurance companies. In order to minimize the potential for an undesirable incompatibility between treatment of different organization types, we urge the NAIC to ensure that exclusions for non-material, non-financial entities are narrowly construed.
Section 1

Section 1 describes circumstances where a non-US based group with a groupwide supervisor from a reciprocal jurisdiction may be excluded entirely from the GCC. Section 1), iii) could be strengthened by clarifying that the “information” the lead state must be able to obtain for reciprocity to apply includes the group capital calculation applied by the Group-Wide Supervisor, along with supporting information.

Section 3

Section 3 sets forth the criteria by which to determine whether an entity is not a material source or user of capital, and therefore is eligible to be excluded from the GCC’s scope.

This Section indicates that the appropriate threshold for determining if an entity is a material source of capital is whether such entity has less than 5% of capital/stockholder’s equity “on either a stand-alone basis or in combination with other entities”. It is unclear based on the quoted language if the GCC’s scope would exclude all entities on a standalone basis that account for less than 5% of capital (which could permit the exclusion of a large proportion of the group’s capital, if it is spread across a number of non-financial entities each falling below the specified threshold) or if the GCC’s scope would exclude all entities which in combination account for less than 5%. We recommend the language be clarified to confirm the latter interpretation.

This Section also indicates that the appropriate threshold for determining if an entity is a material user of capital is whether it has reported net income in each and all of the previous five consecutive years. We question whether net income alone is an appropriate measure for excluding an entity from the GCC, given that capital is held to cover unexpected risks which may take more than five years to manifest. We recommend that the Working Group further define this test to include either an assessment of potential future loss, as suggested in Section 5 of the Memo, or an assessment of the likelihood that the entity could require a future injection of capital in response to a reasonably foreseeable shock event.

Section 4

Section 4 sets forth the criteria by which “negligible” entities are aggregated and excluded from the calculation. It is unclear to us how Sections 3 and 4 interact if the Section 3 exclusion of non-material sources of capital is to be determined on an aggregate basis. We would further suggest that the 5% threshold in Sections 4 and 5 is too high for determining whether entities are material, and is inconsistent with the materiality threshold that would be applied as part of a financial examination. Instead, we recommend that the materiality threshold be set within a range of 1 to 5% based on the capital and surplus levels of insurance group, operating results of the identified entities, financial position of the group, and other considerations that could impact the effect on the insurance group (see the discussion in Item B. Materiality of the NAIC Financial Condition Examiners Handbook).
Section 5

Section 5 sets forth the process by which a regulator should review the entities excluded from the GCC, as well as additional discretionary criteria by which a regulator may use to either exclude additional entities or reinstate entities excluded under Sections 3 and 4 into the GCC’s scope. We recommend that the Working Group refine this section to include more specific criteria by which regulators can make these determinations, including how a regulator should determine whether an entity is likely to cause a potential future loss in excess of the specified threshold. We also recommend including additional detail regarding the circumstances under which an entity may be excluded or included “despite any measures of materiality risk”. This level of discretion makes sense in the context of adding entities back into the GCC’s scope, but we suggest that for consistency’s sake, the Working Group consider additional criteria that could, for example, demonstrate an entity’s lack of impact on the group or the markets (e.g., if the entity is below a stated size threshold and is not otherwise connected with the group or the broader financial system through contractual or other relationships).

Section 6

We agree with the Working Group that the group’s ultimate controlling person, as defined under the NAIC Model Insurance Holding Company Act, should be the starting point for determining which entities are in scope for the GCC. We recommend strengthening this section by explicitly stating that this default is a rebuttable presumption.

Ongoing Determination

The “ongoing determination” section sets forth a process whereby groups must provide basic financial information for all entities in the group, regardless of whether they should be excluded from the GCC. While this additional disclosure is aimed at ensuring that regulators have appropriate information when making scope determinations, it also discusses the extent to which entities can be grouped. We suggest that the level of grouping included in the ongoing determination disclosure be consistent with the level of grouping permitted by the next section of the Memo.

Non-Insurance Testing

We again thank the Working Group for its consideration of suggestions made in our January 12, 2018 comment letter, including the field testing of multiple methods for asset managers and registered investment advisors. As noted above, that comment letter also noted that we believe the GCC should be indifferent to corporate structure. That principle is not supported by the introductory paragraph to this section, which suggests that non-regulated entities downstream from an insurer, and thus subject to a risk charge in RBC, do not need to be individually listed. This could suggest that such entities may use their risk charge from RBC, rather than the capital calculation listed in the Memo, for purposes of the GCC. We would respectfully suggest that
non-regulated entities should be subject to a capital charge (whether that be a flat charge against BACV or some other method) based on the categories described in the Memo (e.g., regulated financial entities, un-regulated financial entities, non-financial entities), rather than their ownership structure, unless a distinction based on ownership structure can be substantiated through field testing. We suggest that to substantiate such a distinction, the NAIC first confirm purposes for the calculation (e.g., to provide an assessment of solvency of the group, or to assess the potential impact on the insurers within the group of the various sources and demands for capital within the group) and then evaluate how well the alternative approaches achieve those purposes. In doing so, it will be important to bear in mind that deviating from the principle of indifference to corporate structure may result in undesirable outcomes, such as reduced comparability and increased incentives for regulatory arbitrage.

**Consistently Profitable Non-Financial Entities**

In our response to the Section 3 of the Scope discussion, we noted our belief that recent positive net income is not necessarily indicative of decreased financial risk. We suggested that some additional criteria (e.g., a measure of likelihood of potential future loss) could be appropriate, and we would urge the Working Group to apply such additional criteria to this section of the Memo as well.

* * *
We are grateful for your time and attention to our comments. If you would like to discuss this letter with us, please let us know.

Sincerely,

Joel M. Steinberg
Senior Vice President, Chief Actuary & Chief Risk Officer
New York Life Insurance Company

David R. Remstad
Senior Vice President & Chief Actuary
The Northwestern Mutual Life Insurance Company

D. Keith Bell
Senior Vice President, Corporate Finance
The Travelers Companies, Inc.
July 20, 2018

Commissioner David Altmaier, Chair
NAIC Group Capital Calculation (E) Working Group
National Association of Insurance Commissioners
444 North Capitol St. NW
Washington, DC  20001

Attn: Dan Daveline and Julie Garber, NAIC

RE: AHIP’s Comments on the combined Scope and Non-insurance Testing memo

Dear Commissioner Altmaier,

America’s Health Insurance Plans (AHIP) provides the following comments to the Working Group on the Group Capital Calculation and the June 2018 Scope & Non-insurance Testing memo (“the memo”).

We see two separate items that need to be addressed in the memo. The first is the process to determine which companies are included in the group for the purpose of the group capital calculation (GCC). The second is the actual group capital calculation to be performed that includes the entities within scope. We address each of these issues below.

Scope of the Group

AHIP appreciates the June 26 memo recognizes that not all non-insurance entities will have a material effect on the insurance entity. We are concerned however, that the process to determine the entities in scope for the calculation appears to be the same process of a deep level of financial reporting activity that would be used to perform the GCC. In conflating those two steps the requirements create a complicated and burdensome reporting approach that negates the value of determining when an entity is out of scope.

In order to create a more streamlined approach to identify the scope of the group, we agree the process of non-insurance entities providing basic financial information as noted in the paragraph on page 3 of the memo under the heading “Ongoing Determination” is the right approach. We therefore suggest that paragraph be edited into two sections to clarify the two steps. Once entities are identified as in-scope or out-of-scope, only the in-scope entities are in the second step of the process – where all the -in-scope companies would submit detailed financial reporting for the GCC.
AHIP Comments

Page 2

AHIP has concerns related to how non-financial and non-insurance entities will be categorized and measured. We recognize that making these distinctions have inherent challenges:

- There are no established rules or factors to apply to non-financial entities;
- The role and function of some of the non-financial, non-insurance entities found in health holding company systems may be very different from those in internationally active Life and P&C holding company systems.
- The determinations made will have to consider the types of entities, and the role they play in the holding company system.
- The determinations made should look at the structure of the holding company system and consider whether any factors would result in unintended or unexpected results in the GCC,
- Considerations for inclusion or not of the ultimate controlling party is critical for many health holding company systems.

We believe more discussion is needed on these points. We are encouraged by the memo’s recognition that the company and lead state must work together to review the entities in a holding company system to address the separation of those in scope, out of scope as it applies to each organization. And we appreciate the recognition that the ultimate controlling party may not always be part of the group. We believe that in most situations company management (using formulas at most as guideposts) can propose the in-scope inventory, and we support the lead state’s authority to review this and determine the preliminary in-scope entities for which detailed financial information would be provided as necessary to complete the group capital calculation.

In establishing the guideposts, we expect these should vary based on the primary types of insurance coverage the organization is active in. We have noted over the entire period of the Working Group that health is different from other lines of business and therefore guideposts will need to be different. We highlight four of the principle differences we see, and will identify others that may need to be considered as we gain more insight into the process and nature of the actual calculations considered for the GCC.

1. A good number of health organizations have grown from the combining of smaller companies. HMOs for example, started under federal rules that had the effect of severely limiting their ability to reach critical size by themselves. This growth has occurred with the long standing financial recognition of senior debt as a proper way for the combining process to work. Health entities have not been automatically penalized by rating agencies for this debt – and more importantly consumers and regulated legal entities have never been adversely impacted.

2. Some health organizations have grown from the combining of health providers and health insurers (Often where the hospitals, physician groups, etc. established insurance entities). In some of these organizations, the insurer may be far smaller than the parent health provider system, and this dynamic has never harmed regulated legal entities or consumers.

3. Health insurance is fundamentally a very short-term coverage with short term cash flows and no material liquidity risk where debt is really intended for use (and repayment) through the reimbursement for the services provided. Premium rates are generally adjusted annually consistent with changes in benefits and provider reimbursement contracts. Again, consumers and regulated legal entities have never been impacted by these practices.
4. U.S health insurers deal with the unique U.S. health insurance market of individual and group commercial coverage, (the private market) and social health insurance of Medicare Advantage, Part D, State and Medicaid and CHIP programs (the government market) and have minimal international risk exposure. Existing state and federal solvency requirements protect the consumer and legal entities from any adverse impact.

As the process toward increased understanding of the GCC’s calculations continues, we look forward to being able to point out adjustments needed to avoid misleading negative impacts on the calculations of health insurers.

The Group Capital Calculation

At the in-person meeting of the Working Group on June 20th the Working Group clearly stated the GCC is not being developed solely to establish a capital calculation to compare with the internationals standard of “group capital assessment” in certain provisions of the September 2017 US-EU Covered Agreement. We were further advised that state regulators want to understand the true financial condition of a group, thus the memo states that the inventory is intended to require financial data for insight on non-insurance legal entities and to be able to review that data for trends. This acknowledgement was helpful to hear and supports our position that the Working Group’s goals can be achieved without regulating holding company capital or requiring in all cases the use of complicated, yet potentially inaccurate, scalers.

As we have stated, AHIP fully supports giving lead states additional transparency into holding company financial data. In our view, this means that while regulators can and should be able to exercise appropriate authority to monitory holding company capital in an effort to protect the regulated legal entities, we do not envision the GCC as an RBC-like requirement. We note that at its inception, RBC was developed as a tool to monitor legal entity capital for risk of impairment or insolvency. Because the RBC can be derived from filed publicly available annual statements, it has evolved into a requirement that many, including some rating agencies, rely upon to determine the relative financial strength of regulated entities.

While we can support the GCC as a means to provide regulators with confidential financial data to view the larger ecosystem the insurance entity exists in, we cannot support it as a means to regulate holding company systems plans and finances. And we ask that the GCC data and results be subject to the same confidential treatment outlined in Section 8 of the NAIC Insurance Holding Company System Regulatory Act.

Finally, AHIP would like to reiterate its support for the approach that Cigna has advocated for throughout this year. Our members could support a simplified two-step inventory-based approach, that does not rely on (i) the reporting of detailed financial information on all entities within the group, (ii) the use of overly complicated and inaccurate scalers or (iii) the application of approaches designed to address long-term risks, including liquidity, to all holding companies with one or more US insurers. This is a better, cost effective way to provide regulators with the transparency they need to monitor holding company capital. We urge the Working Group to field test this approach next year and would anticipate that several of our members would participate. To the extent that the field test would require detailed financial information on all entities along with the use of scalers, we would anticipate fewer health organizations being willing to participate.
We look forward to more thoughtful discussions on these and other considerations as the memo is discussed. We appreciate the working group’s careful review and discussion of these issues, the NAIC staff’s work on them.

Sincerely,

[Signature]

Candy Gallaher
Senior Vice President – State Policy
America’s Health Insurance Plans

Cc: Bill Weller, consultant to AHIP
    Bob Ridgeway, AHIP Senior Government Relations Counsel
July 20, 2018

Via e-mail to Dan Daveline

Commissioner David Altmaier, Chair
Group Capital Calculation (E) Working Group
Commissioner, Office of Insurance Regulation
State of Florida
The Larson Building
200 East Gaines Street
Tallahassee, Florida 32399-0305

Dear Commissioner Altmaier:

Thank you for the opportunity to provide additional comments on the proposed Scope of Group/Non-Insurance Testing memo with respect to the Group Capital Calculation (GCC) currently under development by the National Association of Insurance Commissioners (NAIC).

As we have stated in our previous comment letters, we are concerned that the NAIC has introduced health insurance into a discussion over group capital standards that originated at the federal and international levels yet never contemplated the U.S. health insurance industry as a part of this conversation. Unlike other insurance lines, health care costs are highly visible to regulators and are substantially paid within sixty to ninety days; risks are typically priced annually; loss ratios are stable; and there has been no history of catastrophic risks over the last nearly hundred years of recorded history in the health insurance sector. For these reasons, we again respectfully request that the NAIC exclude health insurance from the scope of any GCC.

Further, we are concerned about the outstanding issue of holding company debt and the absence of any response on this critical issue despite comments from stakeholders and an independent, external analysis made available to the NAIC. We believe the proposed holding company debt adjustments are flawed and exceed both the charter of the Working Group and the ability of state regulators to implement under existing statutory authority. Moreover, if adopted, the holding company debt proposal would have a disproportionate negative impact on large, diversified groups whose subsidiaries include health insurers.

Adoption of the proposed GCC will have the unintended consequence of raising the cost of health insurance for consumers in this country by elevating the level of excess capital that would be required to be deployed. Independent estimates put the amount of additional capital required under the GCC as high as $114B across the eight largest public health insurance groups, including two recently announced mergers. This capital increase is not without significant cost: we estimate that the proposal as currently configured would add an additional two to five percentage points to the average annual rate of health insurance premium increases. At the high end, it would double the current five percentage point average annual premium increase to ten percentage points. Even at the low end, the impact of the GCC for consumers would be significant.
The new standard will essentially halt the health system innovation that is gaining momentum in this country. This innovation is already bringing more coverage choices for consumers and more integrated, high value services to patients. But by creating barriers to the integration of insurance coverage and the provision of clinical services, it will work to turn the clock back to the siloed, non-market responsive, difficult to navigate services and low value-add indemnity insurance offerings of decades past. It will create a “poison pill” to innovators that are seeking to deploy capital to create more modern, consumer-responsive and cost effective care delivery models. And, as companies are forced to reallocate capital to meet the new standards, the proposed GCC could result in fewer choices and less competition in certain market segments including those serving rural and Medicaid populations. In short, the proposed GCC ignores the foundations of today’s health insurance sector that have nothing in common with the financial institutions and long-tail, multi-line insurers that the GCC was meant to address.

We are concerned that the NAIC seems unwilling to recognize these fundamental differences across insurance markets or address the fact that the GCC presently under consideration threatens the viability of the U.S. health insurance marketplace, which is highly dependent upon the ability to deploy capital to improve health outcomes and lower the costs of health care. We understand that the NAIC currently views the GCC as an “analytical tool.” But a “tool” that materially misstates the solvency of the health insurers with no clear guidance on its purpose or use, will ultimately have real economic consequences for a broad cross-section of stakeholders beyond health insurers – from consumers and businesses to health care providers, from rating agencies to the capital markets. It will raise costs for consumers and stifle innovation. We encourage the NAIC to make public any analysis it has conducted to determine the proposed GCC’s impact on choice, competition and cost in the health insurance market.

Specific to the Scope of Group/Non-Insurance Testing letter, we offer the following comments and questions:

Scope of Group

1. The proposed entity-specific approach for non-financially regulated businesses (based on expanded consolidation, legal entity level disclosure, and net-worth measures of materiality) constitutes a significant volume of new reporting for groups, which likely already provide GAAP consolidated group reporting. For groups with large non-financially regulated businesses, we believe disclosure at the legal entity level will not provide additional regulatory understanding. What is the regulatory value in applying an entity-specific-reporting approach to non-financially regulated businesses that likely already report under GAAP?

2. Is the information sought by the NAIC as part of the GCC already available from other existing information and/or filings by groups (e.g., ORSA, Form F)?

3. GAAP reporting typically consolidates legal entities by business lines, facilitating better group understanding by public and private capital markets, credit rating firms, and vendors. What is the value to regulators of consolidating entities with as little as 10% ownership compared with a GAAP standard which more closely aligns with economic control?
4. Measuring materiality of non-financially regulated businesses based upon equity represents a statutory “gone” versus a GAAP “going concern” approach. Why is equity a preferable measure of scale over earnings and cash flow for non-financially regulated entities?

5. How does the “universe” defined in Paragraph 2 related to the “group” in paragraph 5? Is the “group” reduced by the exclusions in Paragraphs 3, 4, & 5? Would such reductions lower the materiality threshold in Paragraph 5, thereby returning previously excluded entities into scope?

6. The disclosure of excluded legal entities in the GCC inventory format per Paragraph 5 appears to be contradicted by entities excluded in Paragraphs 3 & 4. What is the difference in treatment of excluded entities in Paragraphs 3, 4 & 5?

7. The discretion afforded to Lead States in directing the inclusion of non-financially regulated entities may lead to uneven application of the GCC across states and to forum shopping by regulated entities. This seems especially so in the proposal in Paragraph 6, where the “Ultimate Controlling Party” would not be in group scope. What principles will guide Lead States to unilaterally determine the addition of legal entities based upon “dependency” and financial or operational “support”?

Non-Insurance Testing

The Working Group has yet to provide interested parties any information on: how the GCC will be utilized; the rationale for the statutory approach to non-financially regulated businesses; the reason for adjusting group capital for holding company debt; the usefulness of a “group RBC” based upon scaling capital requirements and statutory capital for non-NAIC financially regulated entities; or the utility of a single regulator to determine capital requirements across all non-financially regulated entities. Absent clarity on all of these issues, we do not believe that field testing would be useful at this point. Nevertheless, we offer the following comments and questions.

1. We have previously discussed why attempts to “scale” differently defined capital requirements and statutory capital measures are not likely to produce a useful outcome for regulators (see our comment letters of 2/23/17 and 4/20/17).

2. The GCC contemplates the application of a single measure, based upon bank operational risk, across a wide spectrum of non-financially regulated entities (for health insurers, this can include pharmacy, health care clinical operations, and technology services and consulting). What is the rationale for utilizing a single measure based upon bank operational risk? Why have a single measure at all? How will the NAIC ensure that this measure is weighted equally to the various measures being applied to other categories of entities?

***

Thank you, once again, for the opportunity to provide our comments. We are hopeful the comments and questions above are useful in the discussion over the GCC, and we are available to discuss this issue further at your convenience.

Sincerely,

[Signature]
July 20, 2018

Via Electronic Delivery

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

Re: June 26 NAIC Group Capital Calculation “Scope of Group/Non-Insurance Testing” Memorandum

Dear Commissioner Altmaier:

Prudential Financial, Inc. (“We”) thank the Group Capital Calculation Working Group (the “Working Group”) for continuing to seek input on foundational elements of the Group Capital Calculation (the “Calculation”). We continue to believe that a Calculation that aims to both provide additional insight into insurance groups and to enhance comparability within and across insurance groups would be of greatest value to state regulators, the NAIC, and market participants more broadly. Specifically, we believe a Calculation that achieves these objectives would:

• Through the inventory approach that serves as the foundation of the Calculation, provide insight into all entities within the group – insurance and non-insurance – and their respective risks;
• Be well suited to serve as a basis for communication in forums such as supervisory colleges, where it is important for members to both understand entity level developments and financial strength, and share a common language for discussing the status of the group;
• Produce a group solvency ratio that offers regulators greater information value when comparing insurance groups;
• Complement current legal entity oriented supervisory tools and position the Calculation to contribute to broader NAIC risk assessment initiatives underway efforts, such as those envisioned through the Macro-Prudential Initiative (“MPI”); and
• Serve as a credible framework to advance at the global level as an “outcome equivalent” approach to the International Association of Insurance Supervisors’ (“IAIS”) Insurance Capital Standard (“ICS”), which aspires to produce comparable outcomes across jurisdictions. Obtaining “outcome equivalent” status is critically important for U.S. based Internationally Active Insurance Groups (“IAIGs”) as it would eliminate the potential need to report results under two distinct group capital frameworks – i.e., the Market Adjusted Valuation (“MAV”) reference method ICS and the U.S.’ aggregation based framework.

The perspectives above guide our thinking on the two topics addressed in the Scope of Group/Non-Insurance Testing Memorandum (the “current exposure memo”) and our response thereto. With respect to setting the scope of group (i.e., entities to be included in the Calculation), we support the use
of a common set of principles to guide lead state efforts, which would maintain consistency in application across insurance groups – and thus a level playing field – and facilitate comparability of results across insurance groups. Generally, we believe the current exposure memo provides a reasonable starting point for field testing an objective approach to establishing the scope of group. Results of the field test should be used to further refine the approach to ensure it leads to consistent application of the Calculation in practice and results that achieve supervisory objectives.

While not directly addressed in the current exposure memo, we believe it is important to comment on the scope of application for the Calculation (i.e., which insurance groups must submit the Calculation to their lead state regulator). In establishing the scope of application, we believe it is important to first consider the purpose the Calculation is expected to serve in assessing activities at both an individual group level and as part of broader risk assessment efforts such as those envisioned through the MPI. Too narrow a scope of application could adversely impact the ability to achieve intended objectives state regulators and the NAIC have for the Calculation, while too broad of one could pose an unnecessary burden to smaller companies. To the extent limits are placed on the scope of application, we believe these could align with other risk focused regulatory tools such as the Own Risk and Solvency Assessment (“ORSAs”). Doing so would ensure continuity across risk focused regulatory tools, enhanced insight into risk across a material portion of the U.S. insurance market (including the U.S. operations of foreign domiciled insurance groups) rather than a narrow subset of it, and a level playing field for the industry. More broadly, we agree that insurance groups at the ultimate controlling level should only be subject to one group capital calculation.

With respect to the treatment of non-insurance entities, we believe approaches applied within the Calculation should be risk sensitive and ensure that the entities’ position within the corporate structure does not affect the results. We are encouraged by the Working Group’s decision to explore methods other than the application of a flat charge on the book/adjusted carrying value (“BACV”) of the entity, which we believe is not sufficiently risk-sensitive and may serve as a disincentive to sound risk management. We believe the decision to field test alternative approaches should be applied more broadly than proposed in the current exposure memo. In addition to broader consideration of alternative methods, we believe that results should be requested on both a scaled and unscaled basis consistently across the different classifications of non-insurance entities. Just as results for non-U.S. insurance operations should be scaled to better align with the U.S. Risk Based Capital framework, so to should results under different regimes applied to non-insurance entities. In the pages that follow we have applied these perspectives to the current exposure memo.

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

Sincerely,

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

TO: Group Capital Calculation (E) Working Group
FROM: Dan Daveline, NAIC Staff
DATE: June 26, 2018
RE: Scope of Group/Non-Insurance Testing

This memorandum represents a combined modified version of the June 11 Scope of Group memorandum and June 11 Non-Regulated Entities memorandum. The revised memorandum is intended to 1) clarify the original intent of the two memorandums; and 2) simplify the presentation since the updated document is intended to be used more specifically for the testing process and less as an explanatory document.

Scope of the Group

In determining the companies for which the group capital calculation should be applied, the group is expected to use the following process:

1) A non-U.S. based group may be exempt from completing a group capital calculation if:
   i) The non-U.S. based group is in a (Reciprocal) Jurisdiction that recognizes the U.S. regulatory regime and accepts the group capital calculation from a U.S. based group to satisfy any group capital requirement;
   ii) The group capital calculation is applied by the Group-Wide Supervisor (GWS) at a level that includes the same (or substantially similar) scope of the group as would be determined by the lead state in step 7; and
   iii) The lead state can obtain information from the foreign group’s GWS either through a Supervisory College or otherwise, that allows the lead state to understand the financial condition of the group and complete the expectations of other states in its Group Profile Summary (GPS).

2) The group capital calculation will apply to insurers subject to ORSA (including the U.S. operations of foreign domiciled insurance groups) to ensure continuity across risk focused regulatory tools.

3) When developing the universe of all potential entities included in the group capital calculation, the starting point is the insurer’s most recent Schedule Y and the ultimate controlling party, along with other relevant Holding Company Filings pertaining to entities directly or indirectly owned by the ultimate controlling party.

4) Deduct from the universe all entities that are neither a material source NOR a material user of capital. Two principles should be used for determining if an entity meets such a criteria for exclusion: 1) exclusion of a material source of capital will prevent the user from understanding the true financial condition of the group, which is one of the intended purposes of the group capital

Commented [A1]: Here and elsewhere in the memo, please clarify the definition of capital and profitability (net income) – e.g., on a GAAP basis, statutory basis, etc.
calculation; 2) exclusion of an entity that is consistently profitable is reasonable on the basis that such an entity is unlikely to be a material user of capital in the future.

In implementing these two principles, the preparer should consider the following more specific circumstances that inform the intent of the criteria:

- Any non-financial entity, that is not directly or indirectly owned by an insurance entity, and has capital/stockholder’s equity of less than 5% (on either a stand-alone basis or in combination with other entities) of the universe’s prior year-end, shall be considered an entity that is NOT a material source of capital. (Note, all financial entities must be included in the calculation as well as all entities that are directly or indirectly owned by an insurance entity)
- Any non-financial entity that is not directly or indirectly owned by an insurance entity, and that has reported net income in each and all of the most recent five consecutive years shall be considered an entity that IS NOT a material user of capital.

Deduct from the universe, all entities that are considered negligible when aggregated.

Three principles should be used for determining if an entity meets such a criteria for exclusion: 1) excluding a combination of entities that do not exceed the material source of capital criteria will not prevent the user from understanding the true financial condition of the group; 2) excluding a combination of entities that have not produced net losses in excess of a material portion of the group’s income capacity for a specified period of time is unlikely to be a material user of capital in the future; 3) in excluding a combination of entities, consideration must be given to the fact that combining positives with negatives may understate the potential losses an individual company or combination of companies can create.

In implementing these three principles, the preparer should consider the following more specific circumstances that inform the intent of the criteria:

- Any non-financial entity, that is not owned directly or indirectly by an insurance entity and that is below the capital/stockholder’s equity threshold in paragraph 3 above AND that has combined net income/net losses (for the five most recent consecutive years) that is less than 5% of the net income/loss of the universe as of the prior year-end can be accumulated with other entities that meet such criteria, provided that the aggregation of such entities results in a combined capital/stockholder’s equity of less than 5% as of prior year-end of the universe AND the individual net losses from each of the entities for the most recent five consecutive years when combined (cannot be offset with net income during the same periods) of all net losses are less than 5% of the universe’s net income/loss, shall be considered negligible.

The group should submit the listing of all excluded entities to the lead state regulator (in a predefined format included in the group capital calculation inventory) to determine if there are entities excluded by the group that create a material risk to the group’s capital. As the regulator reviews the listing, two principles should be used for determining if an entity either should be added back, or subtracted from the list produced by the group; 1) while historical gains can suggest a reduced likelihood for future losses, there may be other indicators of material dependency or material risk that may suggest to the regulator that a potential future loss of 5% of a group’s prior year capital may be possible, in which case the regulator should have the ability to add an entity back that may otherwise be excluded; 2) while historical losses may suggest that a higher likelihood of future losses are likely, there may be other indicators that suggest to the regulator that a potential future loss of 5% of a group’s capital is unlikely, in which case the regulator should have the ability to subtract an entity that may otherwise be included in the scope of the calculation.

Commented [A2]: Ultimately, we believe the determination of inclusion should be risk based but we recognize that may be challenging to implement on a consistent basis. Two alternatives to “net income”, which may we believe may be more appropriate are: • “has not required capital contribution from the group and has reported positive operating income in the past 5, 10, etc. consecutive years” • “revenue”; the basis to use would need to be clarified however, comparatively speaking revenue is less subject to manipulation and more risk sensitive.

Commented [A3]: Please add further clarification on how you expect the materiality threshold to work in practice – e.g., is it intended to be an individual limit or cumulative. In addition to clarifying the text, an example would be helpful.

Further, we believe it would be appropriate to field test a range of options to see how impactful the thresholds are – e.g., 1%, 2.5%, 5%, etc.
In implementing these two principles, the regulator should consider the following more specific circumstances that inform the intent of the criteria:

- Adding any entity that the regulator believes creates a material dependency, where material is defined as 5% of the universe group’s prior year end capital/stockholder’s equity.
- Adding any entity that provides intra-group financial support or has a structural or contractual relationship which the regulator believes could create a material risk to the group’s capital, where material risk is defined as 5% of the group’s universe’s prior year-end capital/stockholder’s equity.
- Adding/subtracting any entity that the regulator believes, despite any measures of materiality risk, based upon the activities of the entity, could have a material (adding) or immaterial (subtracting) impact on the group or markets (including counterparties). This includes but is not limited to pass-through entities that provide services to the group or face counterparties that are not adequately captured by a financial evaluation.

Regulator additions or subtractions of entities should be done in consultation with other domestic states/other relevant regulators and the group. Further, the basis for any additions or subtractions should be documented and communicated to other domestic states/other relevant regulators and the group.

7) The lead state regulator uses the above steps, which implicitly includes considering the lead state’s understanding of the group, including inputs such as the Form F, ORSA, and other information including considering input from other domestic states or other regulators that have an entity in the group, to determine the ultimate scope of the group. It’s important that this type of information be used by the lead state in cooperation with the domestic states and other impacted regulators when developing the scope of the group for purposes of the group capital calculation.

6(b) The final determination of the scope of the group should be in the unlikely event that the lead state regulator has determined through the previous steps that the ultimate controlling party is not part of the scope of the group for the group capital calculation, the reasons therefore should be explained and clearly communicated to the other domestic states/other relevant regulators and the group in step 7, including the reason in the unlikely event that it should occur – that the ultimate controlling party is determined to not be within scope for the group capital calculation.

Ongoing Determination (Completed at least Annually)

The scope of the group used in the group capital calculation should be considered for update on an ongoing basis, but at least annually. To assist the regulator in determining the scope of the group, the group capital calculation will include an area where basic financial information on all the entities in the group are included to allow the regulator to gain comfort in determining if the entities excluded from the scope of the group are appropriate. Once the regulator has a full understanding of all the entities in the group, the regulator should work with the group in determining whether this inventory of all companies should be grouped in a specified way in the future. For example, while this inventory must include the full
combined financial results/key financial information (net premiums for insurers, total revenues, total net income, total assets, total debt, total capital or equity) for all entities of the ultimate controlling party and all of its subsidiaries, it may be best that this inventory is presented in this area based upon major groupings of entities to maximize the usefulness of this data. The reason being, these grouped figures are intended to be data captured year-in and year-out to allow the regulator to use the figures in a manner that allows the regulator to understand the trends of these figures. Said differently, having the combined information presenting in groupings of a lower number (e.g. 5, 10, 15, 20, 25 entities) would be far more analytically helpful to the regulator than the actual number of entities (e.g. upwards of 1,000 or more entities). In particular, the groupings of the non-financial entities should be considered, since they can be grouped in manner that allows the regulator to understand the group and how they are managed, but understanding that it may be best to separate those entities that may cause some amount of strain since that would allow a more risk sensitive approach to be included in the calculation, and allow the regulator to better understand the group. To ensure there is an appropriate level of consistency in how entities are grouped across the sector, information to inform the development of guidelines will be requested as part of field testing.

To reiterate, this inventory is intended to require legal entity data (or combined legal entities after the lead state regulator has worked with the group to determine the best groupings) as part of the calculation to be certain that such scope is appropriate, given other holding company filings today do not include legal entity/combined legal entity data such as what is being contemplated. (Note also the lead state regulator retains the ability to require further breakout in order to assist in annually evaluating the scope of group)

**Non-Insurance Testing**

As previously concluded by the Working Group, all insurers must be individually listed in the calculation along with their minimum required capital from their regulator, or as modified for captives or scalars. For other financial entities, they must also be individually listed in the calculation however, NAIC staff is open to allowing grouping of like entities in (e.g. those that will fall under type 1Aii and 1Bii below, but that the members of the group all use the same accounting rules (e.g., all GAAP), and are at least consistent with the way the group manages their business.

Financial entities will be tested based upon the following: Please note, non-regulated entities where such entities are currently subject to a risk charge in RBC, or subject to a risk charge imposed by a financial regulator, do not need to be individually listed/de-stacked.

1) Financial Entities

A) Regulated Financial Entities

i. **All banks and other depository institutions** - Minimum required by their regulator. Test both a) unscaled; and b) scaled to an RBC equal to 300% ACL.

ii. **All asset managers and registered investment advisors** – Test both a) 22.5% of BACV; and b) 12% of three-year average revenue based upon ACLI suggestion (BASEL operational risk) and c) In addition to an unscaled calculation, test the BASEL operational risk methodology scaled to an RBC equal to 300% ACL.

iii. **All other regulated financially regulated entities** - Minimum required by their regulator a) not scaled; and b) scaled.

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**B) Unregulated Financial Entities Not Subject to a Capital Requirement**

1. Other entities that provide financial activities that support the insurer(s) – Because these entities can cause more strain on an insurer than other non-regulated entities, these entities should receive a 22.5% charge on the BACV. These entities are not subject to a minimum capital requirement.

Other financial entities: For purpose of this calculation, unregulated financial entities include those which create financial risks through products or transactions such as a mortgage, other credit offering, a derivative, corporate guarantees, intercompany indebtedness, operational interdependence, including the existence of shared resources such as IT platforms or treasury or other material operations; materiality to the application of credit rating methodologies to the overall group rating and other financial links. Because these entities can also cause more strain on an insurer, these entities should also be subject to a capital charge for purposes of the group capital calculation. Test than other non-regulated entities, apply the greater of the following approaches factors:

- 22.5% of the BACV
- Notional value of the contract (e.g., a net worth guaranty/indemnification/guaranty multiplied by a probability factor as determined by the company based upon past historical experiences)
- 12% of three-year average revenue based upon ACLI suggestion (BASEL operational risk)
- The BASEL operational risk methodology scaled to an RBC equal to 300% ACLI
- Other proposed factors suggested by testing participants

NAIC staff is open to allowing grouping of like entities in type 1Aii and 1Bi, above assuming that the members of the group all use the same accounting rules (e.g., all GAAP), and are at least consistent with the way the group manages their business.

2) Non-financial Entities

While not always the case, non-financial entities may not be as risky as regulated entities and other financial entities. For purposes of the field test, NAIC staff is open to allow the regulator and the group to decide together how best to group non-financial entities. The agreed-upon basis for such groupings should be disclosed as part of the field test submission and the following calculations should be applied.

A) Consistently Profitable Non-Financial Entities

Any non-financial entity that has reported positive net income each of the past five years can be subject to a minimal charge based upon the principle that consistently profitable companies are unlikely to cause a material loss in the future, and any risk of this changing is likely only minimal operational risk. For these entities, they may be combined and subject to a ½% charge on the most recently reported amount of revenues.

B) Other Non-Financial Entities

Some of the comment letters, including those related to scope of the group, make the argument that non-financial entities are not as risky as regulated entities and other financial entities. NAIC staff believe that while this is not always the case, in many cases it is true. NAIC staff is open to allow the regulator and the group to decide together how best to group and be subject to the following charges that we propose to be tested. Unlimited grouping of non-financial entities is allowed.
i. **Test 1-Principle-Past Income/Loss is a sound predictor of risk**

Test a factor that considers the specific net losses/fluctuation in profitability over an economic cycle, where five years is used as a proxy for an economic cycle. This factor will be risk-based not only to the industry, but to the individual company since it considers past performance. The calculation would be determined based upon the following (for each entity or group of entities):

   a. **Test 1a-Factor to Apply =** (Absolute value of the greatest net loss in the past five years/Gross revenue in that year for that entity or grouped entities) Multiplied by the current year gross revenue for the same entity or grouped entities

   b. **Test 1b-Factor to Apply =** (Absolute value of the greatest net loss in the past five years/Gross revenue in that year for that entity or grouped entities) Multiplied by the current year gross revenue for the same entity or grouped entities

   *Subject to a minimum charge that assumes a net loss equal to 2% of total gross revenues. The minimum is expected to cover the fact that the group is not consistently profitable or that the losses are not material, but it covers this risk in this way as opposed to requiring a calculation that considers this dependence through the use of a more complex standard deviation of profits over a period of time.

ii. **Test 2-Principle-Potential Capital Needs of Non-Financial Entities is Equivalent to an Operational Risk Charge**

Test a factor that considers non-financial entities an operational risk

   a. **Test 2a-The American Council of Life Insurers (ACLI)/American Insurance Association (AIA) have long suggested that non-regulated entities be subject to either an operational risk charge used in International Basel III or a 22.5% charge on the BACV. The ACLI has further suggested that the 12% Basel Charge be scaled to convert to U.S. RBC. The ACLI notes that when this is done, the scaled factor becomes 2.47% for life insurers (based upon an average RBC operating ratio of 486%) and a factor of 3.64% for property/casualty (P/C) insurers (based on an average RBC operating ratio of 332%). A life factor of 3.7% should also be tested, which corresponds to a 300% RBC calibration, and P/C of 5.4% based upon an average industry life RBC of 332%. This should be applied on the absolute value of the entities revenues.**

   b. **Test 2B-Use the NAIC recently adopted Operational Risk Charge of 3%, but apply to revenues consistent with test 2a.**

iii. **Test 3-Principle-Simplicity and Consistency with RBC Requirements**

Test a more simple method as suggested by America’s Health Insurance Plans (AHIP). Specifically, test a factor applied to the Book/Adjusted Carrying Value (BACV) of the entity. This should be applied on the absolute value of the BACV. NAIC staff suggest the relevant RBC charge (22.5% for P&C and Health and 19.5% (post tax) for Life) applied to BACV (post-covariance) be tested, but with the understanding that the reason we have proposed other alternatives is to attempt to be sensitive to the argument that such an approach may not align the risks posed by these entities when they are not owned by a U.S or foreign insurer. Even if we find that this is the case, the Working Group may find that it is open to considering giving groups the option of using the relevant RBC charge applied to BACV, provided they do so consistently from one year to the next and across all of their entities.