

# **Aggregation Method: Draft Level 1 Document**

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# 1 Introduction

## 1.1 Purpose

1. The purpose of this draft Level 1 document is to set out the overarching principles and concepts for the Aggregation Method (AM). This document describes: (i) a provisional AM (which provides a set of calculations that will be used to identify the final version of the AM); and (ii) the AM Data Collection. This draft Level 1 document was prepared by the NAIC and U.S. state insurance supervisors, with support from other members of Team USA, and in consultation with other interested jurisdictions.
2. The goal of interested jurisdictions that are developing the AM is to have a three-level AM documentation framework similar to that of the ICS. As the provisional AM is further developed and future decisions made regarding certain parameters, Level 2 and 3 documents will be made available.

## 1.2 History/Background

3. The AM concept was introduced as an alternative group capital approach for interested jurisdictions to apply to Internationally Active Insurance Groups (IAIGs).<sup>1</sup> The goal of the AM is to leverage legal entity reported available and required capital to produce a measure of group capital adequacy.
4. At the 2017 IAIS Annual Meeting, the IAIS agreed to collect data from US-based IAIGs and any other willing jurisdiction/volunteer at the option of the group-wide supervisor to assist the US and other interested jurisdictions in the development of the AM, through an annual AM Data Collection. In so doing, the IAIS aims to be in a position by the end of the monitoring period to assess whether the AM provides comparable, i.e. substantially the same, outcomes to the ICS and if so, it will be considered an outcome-equivalent approach for implementation of the ICS as a PCR<sup>2</sup>.
5. At the November 2019 IAIS Meeting, the IAIS agreed on the definition of comparable outcomes and an overarching approach to guide the development of high-level principles and criteria<sup>3</sup>.
6. The IAIS also agreed at the November 2019 meeting to move forward into a five-year monitoring period from 2020 through 2024, during which time optional reporting of the AM would be permitted, at the discretion of group-wide supervisors. As stated in the resulting workplan: “in support of the work on the comparability assessment, there will be an annual AM data collection” with timing that will be “similar to that for the ICS confidential reporting”<sup>4</sup>.
7. Work has begun within the IAIS ICS and Comparability Task Force on developing the comparability assessment process, based on the workplan and timeline that was agreed upon by IAIS members in Abu Dhabi. Following a deliberative process that includes public consultations, the IAIS plans to

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<sup>1</sup> During the monitoring period, other interested Volunteer Groups that do not meet the definition of an IAIG may choose to participate in the annual AM Data Collection exercise, at the option of their group-wide supervisor.

<sup>2</sup> Implementation of ICS Version 2.0, IAIS 2 November 2017

<sup>3</sup> Explanatory Note on the ICS and Comparability Assessment, IAIS 14 November 2019

<sup>4</sup> Work Plan and Timeline 2020-24, IAIS 14 November 2019

adopt in Q4 2022 the definition of comparable outcomes, high level principles and criteria to assess whether an AM provides comparable outcomes to the ICS.

### 1.3 Principles for AM Development

8. Based on legal entity building blocks, the AM provides a lens into group capital adequacy that allow supervisors to analyze, identify and address capital deficiencies where they reside. The AM concept builds on existing capital regimes. Group capital resources and requirements are derived from the aggregation of entity-level reporting.
9. Guiding principles of the AM concept include:
  - Indifferent to Corporate Structure: Location of an entity within the group and/or intragroup transactions do not impact group-level results.
  - Reflective of Appropriate Capital Regimes: Differentiated treatment for insurance/financial entities under existing capital regimes and application of appropriate alternatives for non-insurance entities. This leverages existing solvency frameworks and jurisdictional-tailored approaches to risk.
  - Transparency: Clear line of sight to where risks reside and capital is held. Provides supervisors with the necessary information for assessing risks at the legal entity level within the group.
  - Comparability: Group level results reflect comparable levels of risk through scaling of entity results.
10. The structure and design of the AM is final; however, the parameters for calculating the AM are still under development. The AM is a calculation consisting of five components. During the five years of the monitoring period (2020-2024), a provisional version of the AM will be used. While the final version of the AM will follow the same design as this provisional AM, it ultimately may have different parameters based on decisions informed by the annual AM Data Collection. It will be possible to back-test the AM, applying a variety of parameters with the data collected.
11. As listed below, the components of the AM are described further in Section 2 of this document:
  - Inventory & Group Financials
  - Adjustments
  - Capital Requirements
  - Capital Resources
  - Aggregation

## 2 AM Components

12. The following section describes the five components of the provisional AM. The final version of the AM will use the same components.

## 2.1 Inventory & Group Financials

### 2.1.1 Scope

13. The starting point for the AM is the Consolidated Holding Company or Controlling Insurer in the case of a mutual insurer structure. All entities within the defined insurance (or financial) group are included.
14. The AM is based on reporting at the local entity level. This reporting is used to populate a schedule that separately lists every legal entity within the group and includes relevant financial information including their available and required capital. All figures are converted to a common reporting currency. Exchange rates will be provided in the Level 3 documentation.
15. Each reported entity is mapped by the IAIG to an entity category. There are entity categories for unregulated and regulated entities (“regulated”, in this context, means that an entity is subject to a capital requirement). This category is used to group entities prior to aggregation. Each entity within an entity category has its AM required capital determined in the same manner. Unregulated entities are mapped to categories including “Non-Insurer Holding Company,” “Asset Management,” “Other Non-Insurance/Non-Financial” or “Other Financial”. For regulated entities, the entity category corresponds to a specific capital regime (e.g. RBC Filing US Life Insurer). A full list of the entity categories will be set out in the Level 2 document.

### 2.1.2 Use of Local Valuation, Capital Resources and Capital Requirements

16. For unregulated entities, available capital is based on local GAAP reporting.
17. For regulated entities, unadjusted available capital and unadjusted required capital refer to reported amounts based on the relevant local capital regime. The local unadjusted capital resources reflect all exclusions and adjustments as required by the local capital regime. The local unadjusted required capital is at the prescribed capital requirement (PCR)<sup>5</sup> intervention level or the closest equivalent.
18. A table of local capital regimes and PCR-equivalent intervention levels will be set out in the Level 2 document.

## 2.2 Adjustments

19. Before entities are aggregated, the reported available and required capital figures are adjusted to remove double-counting. After adjustment, an entity’s available and required capital reflects its own risk and not that of its subsidiaries.
20. To ensure that the IAIG has properly eliminated double-counting, details on each adjustment is provided. A table for reporting these adjustments is included in the AM Data Collection.

## 2.3 Capital Requirements

21. The AM capital requirement reflects risk aggregated at the group level. The AM also provides information about the risk posed by every entity within the scope of the group that enables

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<sup>5</sup> A PCR is defined in ICP 17.4 as “a solvency control level above which the supervisor does not intervene on capital adequacy grounds”.

supervisors to conduct jurisdictional analysis. Individual entity level risk charges (e.g. market risk or premium risk) contribute to the group level requirements. As in any aggregation-based methodology, group-level breakdowns of risk will be by type of entity (e.g. entity category, entities by region) rather than by risk charges.

### 2.3.1 Factors/Scalars

22. The contribution of each legal entity to the total capital requirement is equal to a factor multiplied by an exposure measure. The type of exposure measure applied depends on the entity category. All entities within their respective categories use the same factor and exposure measure. For regulated financial entities (including banking and insurance), the exposure measure is the local required capital (after adjustments for double-counting and at a PCR-equivalent intervention level). For these regulated entities, the factor will be referred to as a “scalar”.
23. The exposure measures used in the provisional AM (along with other options being considered for the final AM) are in the table below. In the event an exposure is negative, the required capital is floored at zero.

Reg/Non-Reg	Category	Provisional Exposure Measure	Other Options Tested for Final AM
Entities with Regulatory Capital Requirements	Insurance Entities	Adjusted Required Capital	Results will be re-tested under all scalar option(s) using results of the annual AM Data Collection
	Banking Entities	Adjusted Required Capital	
	Asset Mgmt	Adjusted Required Capital	
Entities without Regulatory Capital Requirements	Non-Insurer Holding Company	Adjusted Available Capital	An alternate option using revenue as an exposure will be tested.
	Asset Mgmt / Other Financial	Revenue	An alternate option using Adjusted Available Capital will be tested.
	Non-Insurance / Non-Financial	Adjusted Available Capital	An alternate option using revenue as an exposure will be tested.

### 2.3.2 Diversification/Fungibility

24. The AM reflects the diversification that is already included in local capital requirements. Given limitations on capital fungibility, the AM does not allow for diversification between different legal entities.

### 2.3.3 Scalar Methodologies

25. Given differences between solvency frameworks, scalars will be used to bring the required capital for each legal entity to a common level. The AM template allows a range of scaling methodologies

to be tested. Each scaling methodology will indicate one scalar per entity category to be used for the full term of the annual AM Data Collection. Based on an assessment of the data and the annual AM Data Collection process, a decision will be made as to which scaling methodology to use in the final version of the AM. The goal is to select a scaling methodology for the final AM that is meaningful from a prudential point of view, relevant for the monitoring of financial soundness and helps provide comparable outcomes to the ICS. AM results from the annual AM Data Collection will be recalculated using the selected set of scalars. Until such a determination is made, the provisional AM will use scalars of 100% as a placeholder.

26. Descriptions of the methodologies used to determine each set of scalars (and factors) will be provided in the Level 2 document. The options to be tested will include a number of approaches. The final scaling methodology will either be one of the tested methodologies or some combination/variation that falls within the range of options under consideration. A complete list of entity categories and their scalars/factors under each methodology will be set out in the Level 3 documentation.

## 2.4 Capital Resources

### 2.4.1 General Considerations

27. Capital resources have one tier with two components: financial instruments and available capital. Qualifying financial instruments are determined using a common set of criteria at the group-level. Available capital is determined at the legal entity level and becomes an input to the aggregated amount. Any capital element (other than a financial instrument) that is not recognized as available capital in the local statutory valuation will also be excluded from capital in the AM.

### 2.4.2 Recognition of Financial Instruments

28. The AM recognition of a financial instrument is based on consideration of a number of criteria focused on five key principles:
  - loss absorbing capacity (on a going concern basis and/or in winding-up)
  - subordination
  - availability to absorb losses
  - permanence
  - absence of both encumbrances and mandatory servicing costs

29. The list of criteria for recognition will be specified in the Level 2 document.

### 2.4.3 Application of Limits to Recognition of Debt

30. The amount of qualifying financial instruments recognized is subject to a limit. This limit and its calculation will be specified in the Level 2 document. In addition, a range of limits will be analyzed during the monitoring period before determining the final version of the AM.

## 2.5 Aggregation

31. After application of adjustments and scaling, the IAIG's available and required capital are aggregated by entity category.

32. Group capital resources are the sum of the adjusted available capital for the underlying entities plus any qualifying financial instruments subject to limits.
33. Group required capital is the sum of the scaled adjusted required capital for the underlying entities.

### 3 AM Data Collection

34. The AM Data Collection has a template and specifications that are released annually. The template can calculate the provisional AM as well as other possible versions of the final AM. Aside from refinements and clarifications to the provisional AM, the contents of the AM Data Collection will be stable for the rest of the monitoring period. If the final version of the AM has different parameters than the provisional AM, the results from prior years can be recalculated retrospectively.
35. In addition to the data needed to calculate the provisional AM, further data will be collected as part of the annual AM Data Collection. This information will help to finalize the AM framework and provide “support of the work on the comparability assessment”, the latter being an IAIS issue (see Section 1.2).