NAIC ComFrame Development and Analysis (G) Working Group
Discussion Draft on Approaches to a Group Capital Calculation

The NAIC is continuing its work on developing regulatory tools for insurance group capital assessment and oversight by considering construction of a U.S. group capital calculation for U.S. insurance groups. State insurance regulators currently perform group analysis on all U.S. insurance groups, including assessing the risks and financial position of the insurance holding company system; however, they do not have the benefit of a consolidated statutory accounting system and financial statements to assist them in these efforts. A consistent method of calculating group capital for typical group risks could provide a very useful tool for state financial regulators to utilize in their assessment work. A group capital calculation would be a baseline quantitative measure to be used by regulators in conjunction with group-specific risks and stresses identified in ORSA filings as well as risks identified in Form F filings that may not be captured in legal entity RBC filings. Lessons learned and information garnered from such a process would be useful in continuing work internationally with ComFrame and domestically with the Federal Reserve Board regarding group capital requirements for various groups.

This discussion draft is intended to highlight the basic options for consideration by the Working Group for establishing a group capital calculation. It discusses pros, cons and other considerations for each option, and suggests a starting point for the Working Group that does not restrict its ability to begin work on an alternative calculation method in the future. The three basic options discussed are: 1) RBC aggregation approach mostly using existing data; 2) SAP consolidated filing for RBC; and 3) GAAP consolidated filing for RBC-Plus. Potential variations exist for these basic options, and some of those will be briefly mentioned as well.

1) **RBC Aggregation Approach –** this approach utilizes existing regulatory capital calculations for all entities within the holding company structure: RBC for US legal entity insurers (e.g., required capital at trend test level), jurisdiction-appropriate calculations for non-US legal entity insurers, Basel for banking entities, etc. For legal entities without existing capital requirements, a standard would need to be established (e.g., Basel charges or RBC's highest charge of 30%). Adjustments similar to some consolidating entries will need to occur to the surplus figures used to compare to the resulting group capital calculation.

   Potential Variations:
   - ➢ Instead require non-US insurance legal entities to submit information for use in RBC.
   - ➢ Taking that further, even entities without existing capital requirements could be required to submit information for filing in the RBC formula.

   Pros:
   - The natural preference for NAIC members would be to develop a group RBC that is similar to / compatible with U.S. RBC that does not create / impose a totally new basis for, and capital and reporting requirements (with associated increased cost) on, U.S. insurers.
   - Avoids time and effort of establishing a single consolidated accounting system and could use either SAP figures, GAAP figures, or a combination thereof
   - Respects other jurisdictions' regulatory system/existing capital regimes
   - Quickest approach to develop and implement
   - Least impact and cost to industry and regulators

   Cons:
   - Includes amounts from different accounting systems, requiring various consolidating adjustments
   - Uses different capital calculations, so not calibrated to a specific target level
   - Need to establish an accounting basis and/or capital standard for entities not currently subject to a required accounting and/or capital standard

   Other Considerations:
   - If the NAIC and/or the Federal Reserve adopt a GAAP-based calculation requirement in the longer term, this approach could be used as an exception/alternative for insurance groups that do not prepare/file GAAP financial statements. (Again, development of this approach does not preclude working on a different approach for the longer term.)
   - The lessons learned from the development, and the results, when run for all US groups, could be instructive to other jurisdictions, the Federal Reserve, and the IAIS.
   - Currently in developing the ICS, the IAIS is taking a consolidated rather than aggregated approach.

2) **SAP Consolidated Filing for RBC –** this approach requires establishment of consolidating accounting rules for statutory accounting principles (SAP) and use of consolidated financial statements in the RBC formula.

    Potential Variations:
    - SAP consolidation could be limited to just the insurance legal entities, and then using an aggregation approach for all other entities.
    - Separately or additionally, RBC could be adjusted to utilize more going-concern confidence levels and time horizons.

   Pros:
   - Establishes a consistent accounting method for all entities
   - Utilizes RBC (same benefits from Aggregation approach, but for ALL entities)

   Cons:
   - Establishes yet another consolidated accounting standard on top of GAAP and any others (big impact to industry and regulators)
   - A potential lengthier development process needing more resources, particularly if using the variation of a going-concern adjusted RBC
   - Using conservative statutory accounting (more "gone concern") with the variation of "going concern" modifications to RBC could be viewed as inconsistent

   Other Considerations:
   - If regulators and industry were to agree now that this is the approach we should utilize, then this should be developed instead of the Aggregation RBC method.
   - If the NAIC and/or the Federal Reserve adopt a GAAP-based calculation requirement in the longer term, this approach could be used as an exception alternative for insurance groups that do not prepare/file GAAP financial statements – and this would be more consistent with the Federal Reserve's consolidated approach used for the other financial institutions they regulate.
   - Currently in developing the ICS, the IAIS is taking a consolidated approach and looking at both a market-adjusted and GAAP+ approach to valuation.

3) **GAAP Consolidated Filing for RBC-Plus –** this approach utilizes existing Generally Accepted Accounting Principles (GAAP) consolidated financial statement results in an RBC formula that has been adjusted to reflect more going concern confidence levels and time horizons.

    Potential Variations:
    - RBC could remain unadjusted, reflecting more of a "gone concern."

   Pros:
   - Utilizes a consistent accounting method for all entities
   - GAAP consolidated financial statements are already filed by many insurance groups
   - Utilizes RBC structure (similar benefits from SAP consolidated approach, but different factors)

   Cons:
   - Does not address those insurance groups that do not prepare GAAP consolidated financial statements
   - Lacks existing granularity of subaccounts that exists in statutory accounting, which would be required for a fulsome RBC formula
   - A potential lengthier development process with higher cost of implementation (system change etc.) and audit costs, unless using the variation of the existing ("gone-concern") RBC
     - Existing RBC used with going-concern GAAP accounting might be seen as inconsistent

   Other Considerations:
   - Federal Reserve utilizes GAAP consolidated financial statements for banking regulation.
   - If the NAIC and/or the Federal Reserve adopt a GAAP-based calculation requirement in the longer term, an alternative will need to exist for non-GAAP preparers/filers.
   - Currently in developing the ICS, the IAIS is taking a consolidated approach and looking at both a market-adjusted and GAAP+ approach to valuation.