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October 24, 2016

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

RE: *NAIC Staff Memo - Inventory Method Items with Questions* (August 26, 2016)

Dear Commissioner Altmaier,

On behalf of the Solvency Committee's Group Capital Subgroup of the American Academy of Actuaries[1], I appreciate the opportunity to provide comments on the *NAIC Staff Memo - Inventory Method Items with Questions,* exposed by the NAIC's Group Capital Calculation (E) Working Group.

Before we address the questions below or opine on the general construct under consideration, we believe it important to gain a better understanding of the purpose of the calculation. Without a clear understanding of what the NAIC seeks to gain from the calculation, it is difficult to provide meaningful feedback. The purpose can range from detecting weakly capitalized groups to quantifying a minimum amount of capital a group needs to have.

The "inventory method" under consideration provides a basic starting place for looking at the entities that comprise a group. This approach has the advantage of needing few new resources plus familiarity with the process on the part of both the preparer and the regulator.

A case could be made for determining capital adequacy by performing specific calculations (e.g., stress testing and scenario testing) that would explicitly address the risks to which a company is exposed. This is the approach being taken by the International Association of Insurance Supervisors (IAIS). While generating risk-sensitive results, it does involve significant time and expense to complete.

The inventory approach, since it uses readily available data, could be performed efficiently but will not adjust to each company's specific situation.

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[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

The inventory method will cause no investigation or reconciliation of the differing levels of conservatism held in insurer's reserves, which can be significant. For instance, there will be no adjustments for differing reserve levels due to permitted practices in one jurisdiction but not in another. There will also be no explicit testing for liquidity and, of course, the important issue of fungibility (the movement of capital between subsidiaries) is yet to be addressed.

Below are the subgroup's specific responses to questions 1, 3, 4, 6, 7, 8 and 9 organized by question number.

Question 1: Is applying a flat charge to an entity's BACV an appropriate approach for non-insurance entities that are not subject to other capital requirements? If the answer is no, please suggest an alternative approach, including why that approach is preferable to a flat charge.

Response: The inventory method is a good place to start on this iterative group capital initiative. This approach is the most straightforward and readily available; however, it lacks risk-sensitivity and, depending on the scope and complexity of the group, could generate a misrepresentation of the level of group capital.

Question 3: Do you believe that use of a hybrid approach is appropriate? If the answer is yes, what data should be collected and how can that be used in determining a more risk-focused approach?

Response: The hybrid approach, which starts with a flat charge and over time makes modifications for a more risk-focused charge, is an appropriate approach. We encourage the collection of data over time and using such information to make the calculation more risk-sensitive. This is not dissimilar to the continued evolution of risk-based capital (RBC) factors to reflect better data.

Question 4: Which approach is more appropriate for non-insurance entities that are subject to capital requirements: the entity's existing sectorial capital requirement or a flat equity charge? Why do you feel that approach is more appropriate?

Response: The existing sectorial capital requirement is more appropriate than a flat equity charge, as the existing capital requirement should have been determined using vetted techniques and codified accounting.

Question 6: Is analyzing financial information from non-U.S. insurers an appropriate approach to developing country-specific scalars? If the answer is yes, what specific financial information should be obtained and analyzed in developing the scalar? If the answer is no, what approach do you prefer and why is that approach more appropriate?

Response: The scalar concept is theoretically feasible but has some practical limitations. Scalars can be assessed only on a current or retrospective basis. Groups regulated by lead supervisors in countries that use more risk-sensitive metrics (such as market values) will produce values that cycle through being more or less conservative than those metrics that rely on more stable book values. Over time, as different jurisdictions face differing economic environments and/or

changes to their capital constructs, scalars would need to continually be updated. Times of stress could present significant challenges to the creation of appropriate scalars.

Not using scalars does not prevent these issues. Ignoring differences in the calibration of regulatory regimes across jurisdictions, while simpler, only exacerbates the issues of combining multiple regimes.

The degree to which the NAIC seeks a simple, easily auditable capital standard versus a robust, company-specific, risk-sensitive capital standard would largely drive decisions about how to handle this.

If the Working Group does decide to collect financial information for non-US insurers, we support collecting information that meets International Financial Reporting Standards (IFRS).

Question 7: If the Working Group elects to base development of country-specific scalars on financial information, should this information be collected over a number of years or should a data call be performed to collect this information now?

Response: Scalars should be recalibrated over time on a recurring basis. Data for the most recent three years should be collected now and continue to be collected over future years to perform such updates.

Question 8: If the data is collected over a number of years, what approach to these entities should be taken in the interim? Two possible options include the current RBC flat charge for the entity or the entity's non-scaled capital requirements.

Response: Scalars and charges should be set today and recalibrated at future recurring points.

Question 9: Some of the above questions and related responses may be impacted by the chosen scope of the group for purposes of the group capital calculation. Please provide any comments, along with the related rationale, on the appropriate level for establishing the scope of the group for purposes of an analytical tool.

Response: A group should be subject to a single supervisory body. The NAIC should seek to avoid overlap (duplication or triplication) and confusion between federal oversight and supervisors from other countries. Concerns about the group should be worked through a supervisory college. The process used by the lead supervisor to assess the capital needs of the group should be maintained/retained.

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Thank you for this opportunity to provide our views on the Group Capital Calculation (E) Working Group's exposed *NAIC Staff Memo - Inventory Method Items with Questions*. If you have any questions or would like to discuss these issues in more detail, please contact Nikhail Nigam, the Academy's policy analyst for risk management and financial reporting, at +1-202-785-7851 or nigam@actuary.org.

Sincerely,

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Risk Management and Financial Reporting Council
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