Memo

To:	David Altmaier, Chair (Florida), and members of the Group Capital Calculation (E) Working Group
cc:	Julie Garber, NAIC Sr. Manger, Solvency Regulation
From:	Pat Tracy, LeeAnne Creevy and Tricia Matson, Risk & Regulatory Consulting, LLC (“RRC”)
Date:	May 16, 2016
Subject:	RRC Response to the ACLI’s presentation on “An Aggregation & Calibration Approach to Insurer Group Capital”

Background

The National Association of Insurance Commissioners (“NAIC”) Group Capital Calculation Working Group (“GCCWG”) is evaluating potential approaches for aggregation of capital at the insurance group level (“RBC Aggregation Approach”), in particular for groups with U.S. as well as non-U.S. businesses. The RBC Aggregation Approach would build on existing legal entity capital requirements where they exist rather than developing replacement/additional standards. In selecting this approach, it was recognized as satisfying regulatory needs while at the same time having the advantages of being less burdensome and costly to regulators and industry, respecting other jurisdictions’ existing capital regimes, and likely being the quickest approach to develop and implement. During the April 3, 2016 NAIC National Meeting in New Orleans, the American Council of Life Insurers (“ACLI”) gave a presentation on “An Aggregation & Calibration Approach to Insurer Group Capital.” We believe that this presentation provides an excellent foundation, particularly the guiding principles.

RRC appreciates the opportunity to offer our comments. Should you have any questions, we would be glad to discuss our comments with you and the GCCWG members.

RRC Comments

We suggest the GCCWG consider incorporating enterprise risk management (“ERM”) into the guiding principles for the RBC Aggregation Approach. In other words, the level of required capital would reflect the quality of the ERM in place at the insurer on a global basis. Companies with robust ERM programs would have a lower capital requirement than those entities with immature ERM, reflecting (1) the improved ability of an insurer’s senior management to make informed risk/reward decisions and (2) a lower probability of needed excess capital in times of stress. ERM is the foundation that allows companies to prepare prospective risk filings in the U.S. and globally (i.e., ORSA and ORSA-like filings), regardless of the regulatory regime requirements. The scalar calibration to produce comparable measures of risk across regimes could consider the quality of an insurer’s ERM process in place and how the ERM function is reviewed and tested by the responsible regulator.

Most global companies will have a common ERM framework that supports managing risk and assessing capital adequacy. Reflecting the quality of the ERM framework for entities included in the RBC aggregation has numerous advantages. First, it ties RBC aggregation directly into the risk management process. The global regulatory community recognizes the importance of an entity's strong ERM function in solvency monitoring. The RBC aggregation approach has more credibility if the ERM framework of entities included (non-insurance as well as different regulatory regimes) is considered in some way. We believe, for example, that it might be possible to incorporate the extent to which regulators have requested and reviewed ERM information into the scalar calibration, and it may also be possible to reflect the maturity of the entity's global ERM program in the RBC factors used.

The *EU-U.S. Insurance Project Report to the Steering Committee - Key Elements of Regulation and Supervisory Practices in Respect to Group ORSA* (EU-U.S. document dated November 2015) provides concepts that we believe are relevant to a credible U.S. Group RBC calculation. The U.S. ORSA addresses ERM, stress testing and projections under normal and stressed conditions. The EU-U.S. document states on page 6, "**In order for an ORSA report to be considered appropriate, both EU and U.S. supervisors will expect to bring their inputs and outputs from the ORSA together and provide the links and analysis between them (e.g. interconnectedness between the group business strategy and the group risk profile**)". We believe the ERM Framework provides the inputs and outputs needed to build confidence with users of different prospective capital reports—both ORSA and U.S. RBC aggregation calculation. We note that most prospective risk filings, regardless of the particular regulatory regime's requirements, are in fact supported by the holding company's overall ERM framework.

We recognize that the use of ERM and ORSA as part of the regulatory review process is still evolving, and that it may take some time for regulators to be able to conduct a comprehensive review in evaluating an entity's ERM maturity. This should be considered if aggregated RBC is adjusted for an insurer's ERM. However, the inclusion of this as part of the capital assessment will both encourage insurers to improve their ERM processes, and also encourage them to help their regulators understand it through strong communications and ORSA reporting. This is already happening today with respect to rating agency communications. S&P, for example, includes a detailed review of ERM as part of their overall company rating criteria, and as a result many insurers have increased their focus on strong ERM practices.

We appreciate the opportunity to provide comments to the GCCWG. If you have any questions, please contact us at the following:

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