September 5, 2017

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

Re: Comments on Exposure Draft Entitled "Treatment of Captives in the Group Capital Calculation," Dated July 19, 2017

Dear Commissioner Altmaier:

The American Council of Life insurers[1] (ACLI) appreciates the opportunity to provide comments on the July 19 exposure entitled "Treatment of Captives in the Group Capital Calculation" (Exposure). ACLI policy is that the calculation must be consistent with existing NAIC model laws, regulations, guidelines or manuals or existing state law. To that end, ACLI believes the treatment of captives in the group capital calculation should be consistent with the NAIC's own framework on XXX and AXXX captives and with regulators' own decisions on other captives.

ACLI Urges Discussion of the Purpose and Use of the Calculation

ACLI believes that developing a group capital calculation that is fit for purpose requires first clarifying that purpose as well as its intended scope of application. While we appreciate the NAIC's statements that the calculation will not become a requirement and that it will not be incorporated in any model law or regulation, the continued lack of clarity regarding the purpose, scope and consequences of the calculation remains an issue of serious concern to our members. We encourage the Working Group to engage in discussion with us on the purpose of the calculation, the scope of its application, and the value that state regulators seek to obtain from it. Attached is a one-page appendix that sets forth ACLI's view with respect to purpose and scope that we hope will begin a conversation with the Working Group. In our view, that conversation should include discussion of current and future regulatory consequences of the calculation's uses.

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[1] The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 95 percent of industry assets, 93 percent of life insurance premiums, and 98 percent of annuity considerations in the United States.

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Any Group Capital Calculation Should Be Consistent with NAIC's Framework on Captives and Domestic Jurisdiction Requirements

ACLI urges the Group Capital Calculation Working Group to align the Group Capital Calculation with existing legal entity laws and regulations following domestic jurisdiction reporting requirements, including the requirements applied to insurer-owned reinsurance captives as well as prescribed and permitted practices. NAIC member jurisdictions approve insurer-owned captive structures for legitimate regulatory and business reasons. The NAIC has noted that captives have reinsured various product types, including term insurance, universal life with secondary guarantees (ULSG), variable annuities, and long-term care, we urge the Working Group to respect the existing state-based system of regulatory requirements that apply to all types of captive reinsurers.

In 2015, the NAIC established the Regulation XXX/AXX Reinsurance Framework for captive reinsurers reinsuring term insurance and universal life insurance with secondary guarantees (hereinafter the "Framework"). The Framework creates a robust regulatory framework for the purposes of policyholder protection that includes enhanced disclosure, collateral, RBC, and financial examination requirements for these types of captives. The Framework took more than a year to develop and almost three years to implement, and during that time, regulators made a series of careful decisions to ensure that all of the Framework's elements worked in concert.

The NAIC made four critical decisions in developing the Framework. They were:

1. Reserve standards for term insurance and universal life contained more prudence than necessary, and that the principle-based reserve (PBR) standards being developed at the time were a better reflection of the desired level of conservatism.
2. Risk-based capital requirements should ensure that captive reinsurers had at least a minimum "RBC cushion," over and above the assets backing the reserves.
3. Policies that were already ceded to captives as of 12/31/14 should be "grandfathered."
4. Robust disclosure requirements were bifurcated into grandfathered and non-grandfathered policies to ensure that the information gathered was tailored to the regulatory requirements of each category.

Below is how the NAIC decided to implement the regulators' decisions:

NAIC Implemented Reserve Standards for XXX/AXXX Captives

In general, XXX/AXXX captives have always maintained reserve liabilities equal to statutory reserve levels for the business assumed. The underlying regulatory concern was not based on reserve levels, but the collateral maintained for the reserves ceded by the direct writer. The collateral consisted of a certain amount of "hard" assets (equal to an "economic reserve") and a certain amount of "soft" assets (equal to the difference between the statutory reserve and the "economic reserve"). The problem was, each regulator had their own idea of what an "economic reserve" was, leading to significant non-uniformity. The Regulation XXX/AXXX Reinsurance Framework set a benchmark for the "economic reserve," making it equal to the PBR reserves prescribed in the NAIC Valuation Manual. The name for this new standard is the Required Level of Primary Security, and a ceding company must maintain "hard asset" collateral at

least as high as this. Any assets approved by the commissioner can be used as the remainder of the collateral, and are called Other Security. These requirements were first adopted in Actuarial Guideline 48, and subsequently included in Model Regulation #787.

NAIC Implemented RBC for Captives Reinsuring Non-Grandfathered Policies

The most difficult part of the Framework to implement was the RBC Cushion for captives reinsuring non-grandfathered policies, because many captives are not required to file RBC reports. As such, it was difficult to determine whether the captive had enough capital to support its liabilities. That is why regulators determined that the most practical solution was to make the ceding company hold any minimum capital shortfall that may arise at the captive. The NAIC set the minimum capital threshold at 300% of Authorized Control Level RBC, since that is the first possible intervention level for RBC. Therefore, the RBC ratio of the ceding company already reflects any RBC Shortfall at the captive.

NAIC Grandfathered Policies

It is important to understand the reasoning behind grandfathering policies. The regulators drafting the Framework ultimately decided to grandfather existing policies because it was, and still is, impossible to "unwind" decisions made in the past. It creates an alternate reality. Policies were priced and capital was deployed based on regulatory decisions that were previously made. It is worth noting that because the vast majority of the grandfathered policies were 20-year term insurance, the block of grandfathered policies shrinks significantly each year.

NAIC Implemented Disclosure Requirements for Captives

A Supplemental Term and UL Reinsurance Exhibit was developed to demonstrate the relationship between the statutory reserves ceded and the "hard" assets being held for each captive reinsurance treaty. Additionally, the "economic reserve" is shown for grandfathered policies and the Required Level of Primary Security is shown for non-grandfathered policies. And, importantly, there is regulator-only disclosure of what the ceding company's RBC would be if the company's XXX/AXXX reinsurance was unwound. It is disclosed only to regulators because it is recognized that the result doesn't reflect business reality and could be misleading to those that don't understand the entire Framework.

ACLI Responds to Decision Points #1-#5

The ACLI provides the following responses to the Exposure's Decision Points, using concepts in the Framework created and adopted by the NAIC.

Decision Point #1: *For captives that assume XXX/AXXX business, should assets backing XXX/AXXX reserves only receive credit in the group capital calculation only when they are admissible under NAIC statutory accounting principles (to the extent that they are not already adjusted in accordance with the SSAP No. 97 adjustments discussed above)?*

There are two answers to this under the Framework.

1. For non-grandfathered policies – The Group Capital Calculation should follow current state-based rules. Assets backing the statutory reserves should receive credit in the group capital calculation if

they meet the definition of Primary Security under Actuarial Guideline 48 and NAIC Model Regulation #787. Primary Security is actually a subset of admissible assets. In addition, the assets should receive credit in the group capital calculation if the assets meet the definition of Other Security (which are any other assets approved by the domestic commissioner) as long as the assets meeting the definition of Primary Security are at least as large as the Required Level of Primary Security under Actuarial Guideline 48 and NAIC Model Regulation #787.

2. For grandfathered policies – Assets backing the statutory reserves should receive credit in the group capital calculation if they meet the requirements that the domestic commissioner has placed on the assets backing the economic reserve. In addition, all other assets acceptable to the domestic commissioner should receive credit in the group capital calculation if the company has met the requirements of the domestic commissioner regarding the assets backing the economic reserve.

Decision Point #2: *Should existing captives be allowed to utilize PBR when calculating reserves for both new and business that was inforce prior to Jan. 1, 2017?*

Assuming that assets are handled correctly under Decision Point #1, there is no need to change the liability calculation of the captives. The Required Level of Primary Security is already based on PBR as defined by the NAIC Valuation Manual.

Decision Point #3: *Should the direct writer of business ceded to a captive be allowed to utilize PBR on both new and inforce business?*

Once again, assuming that assets are handled correctly under Decision Point #1, there is no need to change the liability calculation of the ceding insurer. The ceding insurer is, in essence, receiving the benefit of PBR by way of collateral requirements based upon the Required Level of Primary Security.

Decision Point #4: *Should the direct writer be allowed to use PBR on both new and inforce business, regardless of whether the business in retained by the insurer, ceded to a reinsurer or captive insurer, or otherwise financed?*

The ACLI does not believe that there should be an artificial recognition of PBR in the group capital calculation. The benefits of using PBR on past business is already available to every company that chooses to establish a captive reinsurer and follow Actuarial Guideline 48 and/or NAIC Model Regulation #787. Companies that have established captives have costs associated with setting up the captive (regulatory, financing, etc.) that would not be reflected in such an artificial recognition of PBR.

Decision Point #5: *How should policies that are grandfathered under the NAIC XXX/AXXX Framework be treated in the group capital calculation?*

Consistent with our answer to Decision Point #1, policies that are grandfathered should receive the identical treatment under the group capital calculation as the domestic regulator has approved for the ceding company. As long as there are sufficient "hard" assets to back the economic reserve (as defined by the regulator), then all other assets in the captive acceptable to the domestic commissioner should be counted in the group capital calculation, regardless of whether they meet the requirements of an admitted asset within the NAIC Accounting Practices and Procedures Manual. No other special treatment of grandfathered policies is necessary.

ACLI appreciates the opportunity to share our views. We look forward to the opportunity to discuss them with the Working Group.

Very truly yours,

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APPENDIX

Purpose of a NAIC Group Capital Calculation

A NAIC group capital calculation should be grounded in the principle of policyholder protection. A properly constructed group capital calculation can serve as a tool that provides regulators enhanced transparency into an insurance group thereby improving their ability to assess potential risk posed by any entity, whether regulated or unregulated, within the group.

Scope of Application of a NAIC Group Capital Calculation

The scope of application of a NAIC group capital calculation should be grounded in flexibility for the lead state regulator. Only the lead state regulator should request the calculation after, as appropriate, coordination and consultation with other relevant regulators. Further, prior to requesting the calculation, the lead state regulator should carefully consider and balance the expected additional insight the calculation would produce with the burden placed on the insurance group. In no event should an insurance group be subject to more than one group capital calculation.

Factors the lead state regulator should consider prior to requesting the NAIC group capital calculation include:

1. The lead state regulator should seek to ensure that coordination and cooperation is achieved among all relevant regulators. This can be achieved through supervisory colleges, where appropriate, or through other, less formal means. Appropriate coordination and cooperation among interested regulators will ensure that, among other things, a NAIC group capital calculation undertaken at the direction of the lead state regulator is shared with and accepted by other interested regulators.

2. The lead state regulator should always seek to leverage existing regulatory tools to the greatest extent possible before requesting an insurance group conduct the NAIC group capital calculation.

3. An evaluation of the following items:

    a. the size of the insurance group;
    b. the relative complexity of the insurance group,
    c. the scope of non-insurance activities the insurance group is engaged in; and
    d. the risk management and risk-mitigation practices of the insurance group.