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August 7, 2015

Commissioner Kevin M. McCarty
Chair, ComFrame Development and Analysis (G) Working Group
National Association of Insurance Commissioners
Via email to: rworkman@naic.org

Re: *Discussion Draft on Approaches to a Group Capital Calculation*

Dear Commissioner McCarty:

On behalf of the American Academy of Actuaries'[1] Solvency Committee, I would like to offer the following comments on the *Discussion Draft on Approaches to a Group Capital Calculation* that was exposed by the National Association of Insurance Commissioners' (NAIC) ComFrame Development and Analysis (G) Working Group (CDAWG) on July 23, 2015.

The discussion draft offers a thoughtful overview of potential advantages and disadvantages of three possible factor-based approaches to a U.S. group capital calculation for insurers:
(1) aggregation of existing risk-based capital (RBC) calculations within a group;
(2) a consolidated group RBC calculation based on U.S. statutory accounting principles, and
(3) a consolidated group RBC calculation based on Generally Accepted Accounting Principles (GAAP). In our view, each of these factor-based approaches offers potential as a component of a new group capital measure that leverages the existing U.S. system of RBC.

In this letter, we do not comment on the specific points in the discussion draft. Rather, we note that last year, in addition to exploring potential capital measures based on RBC, CDAWG exposed a concept paper that also highlighted the potential advantages and challenges of a cash flow stress testing (cash flow) methodology. Although a cash flow methodology brings its own challenges, we urge CDAWG to continue considering its possible role in a new group capital measure.

As we noted in our comments last year on CDAWG's concept paper, we believe a hybrid approach that combines RBC and cash flow methodologies may have merit. Factor-based approaches like RBC are useful regulatory tools, but also have significant limitations. For example, it is not practical to expect that factors can be designed to take account of every nuance of risk across insurers. In contrast, a cash flow approach based on internal models can be

[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. The Academy assists 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.

calibrated to an insurer's actual risks. The cash flow approach, of course, has its own disadvantages. Comparable results may be elusive because risks can differ dramatically from insurer to insurer, and internal models require significant resources from both regulators and insurers.

A hybrid approach offers a potential path that draws the best features from RBC and cash flow methodologies. For example, state regulators could use an RBC methodology to establish a minimum required level of capital that applies to all U.S. insurers. A cash flow methodology then could be used to establish a prudent capital level above this minimum. Such an approach could maximize the advantages of each methodology while minimizing the disadvantages. In addition, a well-designed RBC-based minimum could give regulators the flexibility to design a cash flow or similar prudent capital methodology that accounts for the significant economic differences between life insurers, property and casualty insurers, and health insurers.

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Thank you for this opportunity to provide our views on the CDAWG's conceptual proposals for group solvency and capital standards. If you have any questions or would like to discuss this letter in more detail, please contact Lauren Sarper, the Academy's senior policy analyst for risk management and financial reporting, at 202-223-8196 or sarper@actuary.org.

Sincerely,

Elizabeth K. Brill, MAAA, FSA
Chairperson, Solvency Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries

Cc: Michael McRaith, Director, Federal Insurance Office, U.S. Department of Treasury
Tom Sullivan, Senior Adviser for Insurance, Federal Reserve Board
Jeff Schlinsog, Chairperson, Financial Regulatory Task Force, Risk Management and Financial Reporting Council, American Academy of Actuaries