

Applicability of Risk-Based Capital to Captive Risk Retention Groups

The Risk Retention Group (E) Task Force has concluded that captive risk retention groups (RRGs) should be subject to a consistent formula to assess capital levels given the assumed level of risk. The Task Force has concluded that it is reasonable and appropriate for RRGs to be subject to the NAIC risk-based capital (RBC) formula and law as modified by this applicability standard. Domestic regulators applying the RBC standard must use additional care and judgment in applying this standard due to the unique nature and accounting standards implemented by RRGs chartered as captive insurers.

Section I Applicability of risk-based capital

- A. Captive RRGs are ~~generally~~ subject to the NAIC RBC formula and model law with the exception of insurers that meet the criteria outlined in Section II. The use of RBC as a regulatory tool shall be solely for the use of domestic regulators. Non-domestic regulators should not be able to take action against RRGs based ~~solely~~ upon the RBC results. This includes denying or revoking registration in the non-domestic state, or requesting the domestic regulator to perform an examination of an RRG based upon the RBC results. ~~Action levels as outlined in the NAIC model law shall not be deemed mandatory for RRGs.~~ If an action level is triggered, the tool should provide the domestic regulator with the authority to exercise reasonable discretion with respect to the appropriate action to be taken, based on specific factors relevant to the RRG.
- B. Captive RRGs generally maintain their books and prepare their financial statements on the basis of generally accepted accounting principles (GAAP). The NAIC RBC formula was developed for use with insurers that utilize statutory accounting principles (SAP) rather than GAAP. No modifications or eliminations are to be made to GAAP assets or liabilities when applying the RBC formula.
- C. Letters of credit (LOCs) provided for capital purposes under the laws of the domestic state shall be included in surplus and total adjusted capital for purposes of applying the RBC formula.
- D. Reclassification of GAAP assets, such as reinsurance ceded receivables, may be required on the balance sheet for purposes of applying the RBC formula.
- E. Manual modifications to the NAIC RBC Blank/formula may need to be made by RRGs to properly account for GAAP assets, liabilities, LOCs, or other differences from SAP. RRG domiciles may issue instructions to domestic RRGs regarding accounting for and classification or reclassification of GAAP assets and liabilities, and LOCs, within the NAIC RBC formula.

Section II In the discretion of the domestic regulator, captive RRGs that meet the following conditions may be exempt from the RBC ~~standard~~ action levels and the domestic regulator is not required to comply with Sections 3-6 of the Model Law should they occur:

- A. RRGs that have relatively few members and their sponsoring organizations are large well-capitalized entities whose financial condition and support for the RRG can be adequately assessed; ~~and/or~~
- B. RRGs that have significant reinsurance agreements that meet the RRG guidelines and are approved by the domestic regulator.