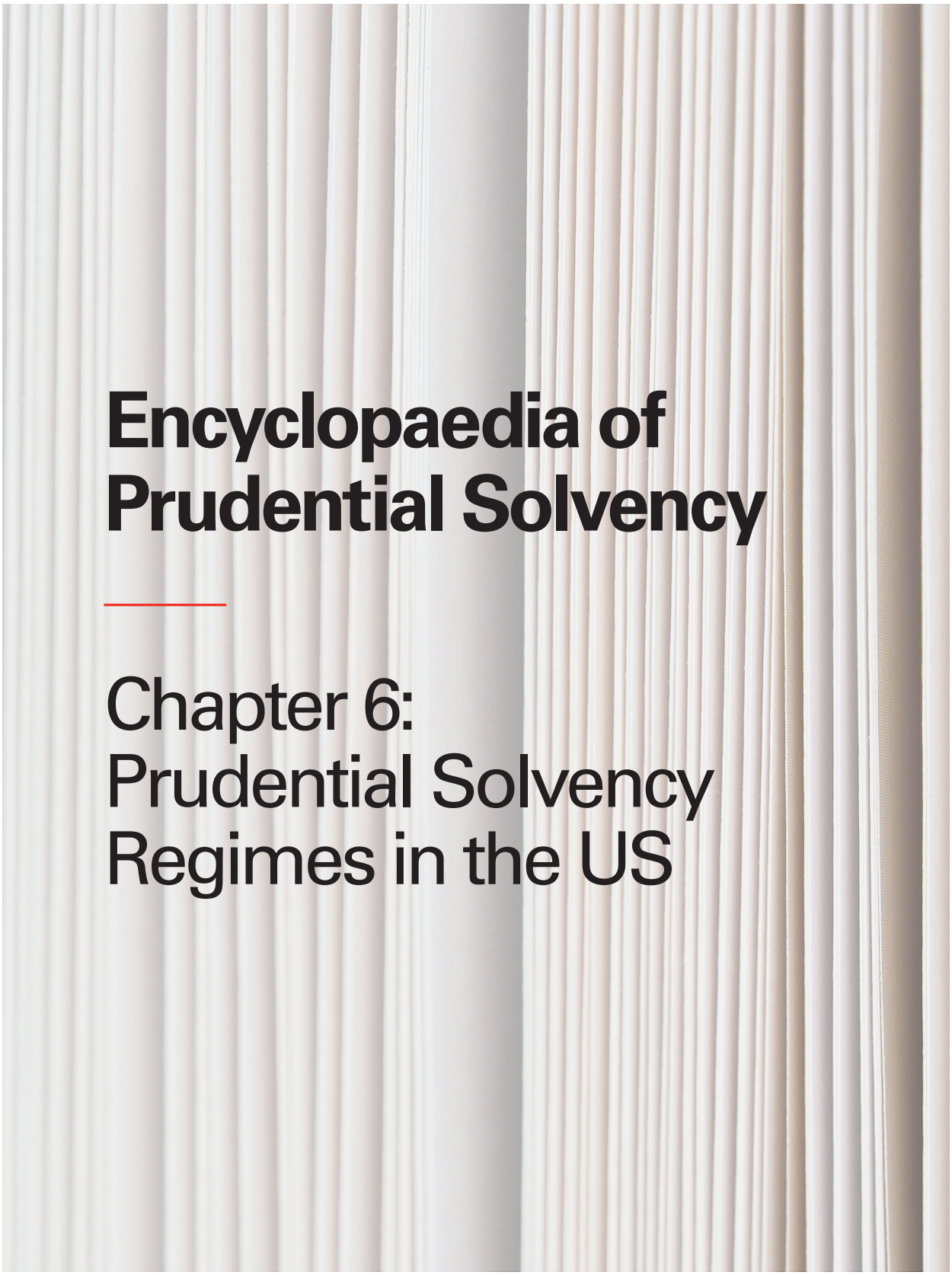
The Standard Formula

Skadden



Encyclopaedia of Prudential Solvency

Chapter 6: Prudential Solvency Regimes in the US

Introduction

This chapter of *The Encyclopaedia of Prudential Solvency* discusses the prudential solvency regime in the United States. The US regulatory framework is defined by its state-based approach, whereby each state's department of insurance holds primary oversight over insurers within its jurisdiction. This decentralised model is deeply rooted in US law, reserving insurance regulation to the states, and is supported by the National Association of Insurance Commissioners (NAIC).[1] The NAIC plays a crucial role in harmonising standards across states through model laws and an accreditation process, which ensures a baseline of consistency in areas such as statutory accounting, risk-based capital (RBC) and group supervision, while still allowing states some flexibility in implementation.

A distinctive aspect of the US system is its focus on solvency at the individual entity level. Insurers must both (a) meet minimum statutory capital requirements and (b) maintain adequate RBC, which is calculated using a formula that accounts for various risk categories, including asset, insurance, interest rate, operational and affiliate risks. The RBC framework is sophisticated, offering diversification benefits and tailored calculations for different types of insurers, such as life, annuity, and property and casualty companies.

In recent years, the US has expanded its regulatory toolkit to address risks that span beyond single entities, reflecting a growing awareness of systemic risk and the interconnectedness of insurance groups. New requirements such as Form F enterprise risk reporting, the Own Risk Solvency Assessment (ORSA), and group capital calculations (GCC) have been introduced to provide regulators with a more comprehensive view of group-wide risks and capital adequacy.

1. Regulatory Structure

In the US, insurance is regulated at state level by state departments of insurance, which are headed by a commissioner or its equivalent. This authority stems from a combination of common and federal law, which collectively affirms that the regulation of insurance is a power reserved to the states. There are some rare exceptions, such as in the case of federal pre-emption.

Commissioners, sometimes referred to as directors or superintendents, can be either elected or appointed. In either case, they are charged with overseeing insurance laws for all market participants within their jurisdiction.

Insurance companies are regulated both independently by their jurisdiction of domicile, and as part of a broader system under the Insurance Holding Company System Regulatory Act[2] (Holding Company Act). This is headed by a lead state for the respective insurer. On the whole, regulatory capital is determined on an individual entity basis. However, over the course of the past 15 years, US insurance laws and regulation have expanded their purview to encompass a broader view of systemic risk and have developed a greater interest in coordinating capital regulation across state and international borders.

The Role of the NAIC

Although a predecessor of the NAIC was formed more than 150 years ago, the NAIC as we know it today has only been operating since the late 1960s. The NAIC is the organisation that sets the standards for the state-level insurance regulators across all 50 states, the District of Columbia and the five US territories: Puerto Rico, the United States Virgin Islands, American Samoa, the Northern Mariana Islands and Guam.

[1] NAIC Website.

[2] Insurance Holding Company System Regulatory Act 2021.

Its primary role is to set standards and provide model laws and regulations. Adoption of certain model laws and regulations is a necessary condition for a state to remain accredited, but it is not sufficient alone. Accreditation is a rigorous process that each state must undergo every five years. It allows each state to afford other states a degree of deference and give assurance that they are operating under a common regulatory framework. It also focuses on standardising financial reporting and solvency ratio requirements. Key accreditation standards include Statutory Accounting Financial Standards (SAFS), the Holding Company Act, RBC, own risk solvency and group capital.

2. Determining Applicable Laws

Each insurance company is "domiciled" in one state, subject to certain exceptions where an insurer can be deemed to be "commercially domiciled" in a second state. While insurers are primarily regulated by their domiciliary regulator, they are also subject to the laws of each and every state where they are licensed. RBC requirements are regulated by the domiciliary state. RBC rules are an accreditation standard, so variations from state to state derive primarily from a state's application of the Statutory Accounting Principles (SAP). Although SAP is also an accreditation standard, states have some flexibility in its adoption, including through the issuance of permitted and prescribed practices. Certain states also maintain desk-drawer rules which can lead to a higher reserving, and accordingly higher RBC requirements for their domestics. This is the case in the context of reinsurance, for example.

States keep broad definitions of what constitutes "insurance business" to provide as much flexibility as possible with respect to the regulatory perimeter, and their scope for regulation, thereby maximising policyholder protection. While it changes from state to state, many jurisdictions (such as New York,[3] as an example), will consider any of the following acts performed within the state as constituting doing "insurance business":

- Negotiating, soliciting or entering into insurance contracts, including policies of insurance, with a New York resident or with any entity authorised to do business in New York.
- Entering into any contract of warranty, guarantee or surety, and proposal thereof, save for anything that is purely incidental to such a contract.
- Collecting premium or consideration for any policy or contract of insurance.
- Doing any business of insurance, including reinsurance, within the meaning of New York insurance law.
- Proposing to do any of these actions in any manner laid out with the intention of evading insurance laws.

The mere fact that some part of the insured risk is present in the state will not automatically give power to the state to regulate or tax the insurer. To be licensed (alternatively referred to as being "admitted" or "authorised"), insurers need to apply to the regulator of their domicile state, which is the state where the insurer is incorporated. Most states adopted the NAIC's standard application form, the Uniform Certificate of Authority Applications (UCAA),[4] and generally in all states this process can take from three to six months. Once regulated in its domiciliary jurisdiction, an insurer will need to obtain a licence in each and every jurisdiction, separately and individually, where it wishes to operate, and it will simultaneously be regulated by the laws of each and every state where it obtains a licence. States will often have "seasoning" requirements, whereby an insurer needs to have been active in the line of business it is applying to be licensed in for a number of years in its domicile state before it can "expand" to a licence in another state's jurisdiction.

[3] Article 11, Chapter 28, Consolidated Laws of New York Chapter 28.

[4] UCAA Official Website.

3. Calculation of Solvency Capital in the US

Minimum Capital and RBC

For an insurer in the US to be licensed, all states prescribe by statute a minimum amount of capital that must be maintained. These requirements vary from state to state, and depend on the line of insurance for which the insurer is licensed. Beyond statutory minimum capital, insurers must also hold RBC.

To assess whether an insurer's RBC is adequate, insurance regulators look to the RBC ratio. There are two relevant ratios:

- Authorised control level RBC (ACL): Most property and casualty (P&C) companies refer to RBC in terms of ACL.
- Company action level RBC (CAL): Life and annuity insurers generally refer to their ratio in terms of CAL.

While the formula for RBC depends on the type of underlying business, the RBC ratio is calculated for all insurers by taking the eligible total adjusted capital (TAC) of the insurer and dividing it by either:

a. the insurer's RBC, such as is the case for ACL RBC; or
b. two times the insurer's RBC, in the case of CAL RBC.

The RBC formula works on a square root basis, which means some diversification benefit is reflected. This is analogous to both Solvency II in Europe and the Bermuda Solvency Capital Requirement (or BSCR), which were discussed in earlier chapters of the Encyclopaedia.

RBC Formula and C-Factors

As noted above, the formula for RBC depends on whether an insurer is engaged in writing P&C, life and annuity or health business. RBC for insurers is comprised of several categories, which are commonly referred to as "C" factors and are identified by number.

- **C-0:** Risks relating to affiliate transactions.
- **C-1:** Asset risk. While all insurers are exposed to asset risk, the components of the C-1 calculation differ significantly by type of insurance. Perhaps unsurprisingly, the C-1 for life and annuity includes more detailed requirements given the specific asset classes and the charges applicable thereto. This has led to a significant focus on the part of many insurers, asset managers and certain service providers to originate assets that are optimal for the balance sheet of life and annuity insurance from an RBC perspective. By comparison, while P&C insurers are also subject to asset risk, with certain exceptions, the risk is typically shorter tail and therefore supported by assets with shorter duration and less complexity.
- **C-2:** Insurance risk. The C-2 factor for life and annuity insurance focuses on mortality and longevity. For certain types of products, morbidity is also a significant factor. By comparison, for P&C insurers, insurance risk focuses on both premium risk and reserve risk.
- **C-3:** Interest rate risk. This is only utilised for life and annuity given the potential for significant interest rate fluctuations over a longer duration of liabilities. Applying this to real-world contexts, a 15-year sustained period of low interest rates prompted insurers to seek higher yields beyond traditional fixed income portfolios, but a subsequent spike in rates triggered record annuity sales and forged expanded partnerships between insurers and asset managers, in order to meet demands of unprecedented annuity volumes with the yield from alternative investments. These commercial changes have led to a heightened regulatory emphasis on asset and interest rate risk for life and annuity insurers.
- **C-4:** Operational risk. While this applies to all insurers, it is more relevant for life and annuity.

In sum, while the RBC ratio formula is the same across the lines of business, the components of RBC and its underlying C factors do not apply equally across all lines of insurance, and the formula for calculating RBC varies as well. This is why comparing the RBC of a life and annuity company to a P&C company, though both stated as ratios, is truly comparing apples and oranges.

4. Systemic Risk and Group-Level Supervision

For more than a decade, the NAIC has been participating in the supervisory colleges of the International Association of Insurance Supervisors[5] (IAIS), and most NAIC regulators deeply value the insights gained from foreign regulators. However, the US model of capital regulation remains, by large distinction, individual state and entity centric. The NAIC and state regulators developed the GCC as a method of improving solvency monitoring activities.

Enterprise Risk Reporting (Form F)

There are some within the NAIC who are sceptical of systemic risk. This is because the insurance industry actually fared quite well in the 2008 financial crisis, particularly as compared to other regulated industries. Many believe this was in large part due to the RBC framework. That said, in recent years, new model laws have been adopted which require reporting of solvency at the group level, specifically through Form F, the ORSA report and group capital.

Form F is a holding company system's enterprise risk report. It's submitted annually by all insurers that are part of a holding company system, and it is designed to identify risks that could adversely affect the holding company system as a whole. This self-reporting mechanism is used as a tool by regulators to help identify systemic risk and to enhance their understanding of the interdependencies of members of holding company systems. Form F is an accreditation standard and was codified into law as a revision of the model Holding Company Act. It's mandatory across all states and is submitted to the lead state regulator, with a copy sent to all other domiciliary states.

Form F is treated as highly confidential under most state laws, since regulators view it as their prerogative, and not that of the individual consumers, in order to regulate solvency and systemic risk. Form F covers everything, including corporate governance and structure, affiliated transactions and other areas of risk exposure. These areas of risk exposure include off-balance-sheet liabilities, support, operational and reputational risks and risks of third parties (for example, from cyber criminals). Like group capital (see below *Group Capital Calculation*), Form F also considers the impact of non-insurers on the holding company. Most states have a deadline of the end of April or mid-May for submission of Form F.

Own Risk Solvency Assessment

In addition to Form F, the ORSA Model Act, which is also an accreditation standard, requires an insurer to provide a self-assessment that looks at its risk management framework, its assessment of risk exposure and its group-level capital adequacy. For international groups that are primarily in Solvency II jurisdictions, the ORSA report can look to adequacy as determined under Solvency II. ORSA is primarily a tool for enterprise risk management, but is also another effective mechanism for regulators to gain further insights into how insurers manage their capital relative to their exposure and risk.

Group Capital Calculation

Beyond Form F and ORSA, insurance holding company systems are also required to produce a GCC. As previously noted, over the past decade, there has been an increasing push within the NAIC to more

[5] IAIS Official Website.

broadly review the overall solvency of an insurer's holding company system, rather than the solvency of the individual insurers in isolation. As a result, the NAIC developed GCCs, which were adopted as model law in December 2020, with an emphasis on the oversight of insurance holding company systems as a whole. Group capital is a tool, similar to RBC and other capital measures for individual insurers, that regulators use to assess solvency and systemic risk. Group capital remains an evolving regulatory topic. Notably, it does not confer any additional authority on state regulators to compel capital contributions. As of 1 January 2026, under the NAIC Model Law, group capital requirements became an NAIC accreditation standard.[6]

The GCC was developed to provide US state insurance regulators with a more consistent and holistic analytical tool to assess the capital adequacy of insurance groups. Many state departments of insurance think regulation at the individual entity level is sufficient and effective for protecting solvency. However, the GCC initiative stemmed from the 2008 financial crisis, which arguably exposed a lack of visibility into the financial interconnections between insurance entities and their non-insurance affiliates, amongst other considerations.

The GCC's key goals include:

- Improving transparency and group-level risk assessment.
- Identifying capital adequacy issues that may not be visible at the individual legal entity level.
- Supplementing existing group analysis processes with a standardised financial metric.

Subject to certain exemptions and limited filings, which are possible under specific circumstances, the GCC covers the following entities in the scope of its application:

- All insurance entities directly or indirectly controlled by the Ultimate Controlling Person (UCP).
- All financial entities, such as banks and asset managers, within the broader group, regardless of where they are located in the organisational hierarchy.
- Non-insurance and nonfinancial entities that pose material risk to the insurance group.

The assessment of such entities begins with review of a properly completed Schedule Y, which forms part the overall risk assessment. Entities not meeting the above criteria can be excluded from the calculation, and this can be agreed with the lead state following a materiality review.

The GCC uses a RBC Aggregation Approach, which does the following:

- It leverages existing legal-entity capital requirements, for example, RBC for insurers.
- It incorporates adjustments for intragroup transactions and ownership structures.
- It applies scalars and proxy measures for nonregulated or foreign entities.
- It aggregates available capital and required capital across the group to compute a group-level capital ratio.

This calculation is organised via a standardised template that includes:

- Entity inventory and classification.
- Adjusted carrying values.
- Capital instruments, such as debt and surplus notes.

[6] NAIC - Financial Regulation Standards and Accreditation (F) Committee; Holding Company Models - Group Capital Calculation and Liquidity Stress Test (Effective 1 January 2026).

- Sensitivity and scenario analysis.
- Summary analytics.

The GCC is intended to enhance but not replace the existing supervisory authority. State insurance regulators, particularly lead states, use the GCC results to:

- Evaluate group-wide financial risks and capital adequacy.
- Identify potential capital strains or contagion risks from non-insurance entities.
- Inform supervisory strategies, including enhanced monitoring, further data requests or coordinated action.
- Complement other regulatory tools, such as ORSA and Form F filings.

5. Reserving Requirements

In the life and annuity space, one of the most notable developments in reserving requirements is the NAIC's implementation of a principles-based reserving framework that shifts away from the formula-based methodology. These changes have had, and are anticipated to continue to have, a significant impact on the capital requirements of life and annuity insurance companies due to increased volatility in reserve levels through the reliance on company-specific assumptions and experience in reserving projections. Additionally, regulators are focusing on large cessions requiring cash-flow testing under certain scenarios.

Existing Framework Under VM-21 and VM-22

Reserving requirements for variable annuities and registered index-linked annuities have historically followed a principles-based approach set forth under VM-21, which applies a principle-based reserving framework to variable annuity and registered index-linked annuity contracts that were sold after 1 January 2020. Under the VM-21 Principles-Based Reserving (PBR) framework, companies consider both company-specific and prescribed assumptions for reserve calculations, determined by complex modelling, stochastic projections and significant documentation and governance requirements.

In contrast, reserving requirements for nonvariable annuities historically followed a formula-based approach that utilises the Commissioners' Annuity Reserve Valuation Method (CARVM). The CARVM generally applies prescribed assumptions and discount rates uniformly across companies.

Updates to VM-22

The implementation of a principle-based reserving framework under VM-22 brings the reserving methodology for nonvariable annuities more in line with that of variable annuities and registered index-linked annuities under VM-21. The VM-22 principle-based reserving framework provides for company-specific assumptions, in addition to prescribed assumptions and real-world economic scenario testing for assets and liabilities. Companies must calculate stochastic reserve and/or deterministic reserve projections across a variety of economic scenarios (generated by the new NAIC Generator of Economic Scenarios),[7] based on company-specific assumptions. In addition, the new principle-based reserving framework includes enhanced asset modelling which necessarily affects asset and liability calculations. As a result of relying on company-specific assumptions, and on the experience and modelling of a variety of economic scenarios, reserve volatility is expected to increase. This is in contrast to the prior uniform and formula-based approach. Such volatility in reserve levels will, therefore, likely lead to increased capital requirements.

[7] NAIC Website.

Implementation and Considerations

The updated VM-22 rules became effective 1 January 2026. Companies have a three-year transition period (*i.e.*, 2026 to 2029) to implement the new reserving requirements under VM-22. After 1 January 2029, all new nonvariable annuities must comply. Further, retrospective application of VM-22 (potentially for business issued on or after 1 January 2017) is under consideration but has not been confirmed by the NAIC.

With the implementation of VM-22, companies during the transition period may want to evaluate current pricing, financing and other elements of their business to determine how such factors will affect projections (as such factors may be utilised in the new principle-based reserving framework). Additionally, companies may consider re-evaluating contracts with an eye toward decreasing reserving volatility, for example through renegotiation of current pricing, interest rates or other elements of the insurance business that would affect reserve levels under the VM-22 principle-based reserving framework.

Updates to AG55

The NAIC's updates to reserving requirements further span to reinsurance business under newly implemented actuarial guideline AG55. State regulators have historically been concerned with the risk that domestic life insurers may enter into reinsurance transactions to materially lower the amount of reserves and thereby facilitate releases of reserves that prejudice interests of their policyholders. Adopted by the NAIC in August 2025, AG55 aims to enhance reserve adequacy requirements for life insurance companies by requiring that asset adequacy testing use a cash-flow testing methodology that evaluates ceded reinsurance as a key component of asset-intensive business.

Under AG55, (re)insurers determine a "Starting Asset Amount," *i.e.*, amount of assets reflecting the assets supporting the reinsured block of business, which is then "tested" through various scenarios under moderately adverse conditions, with results reported to the applicable regulator. Key risks that determine the amount of rigor and frequency of analysis (and documentation) include significant collectability risk associated with the reinsurer (*e.g.*, rating of counterparty, liquidity ratios and/or regulatory actions against counterparty), significant reserve decrease in relation to pre-reinsurance reserve amounts and whether the reinsurance transaction occurs within or outside of the US.

Disclosure of asset adequacy testing results under AG55 was required for applicable (re)insurers beginning with the December 31, 2025, annual statement and is required for all subsequent annual statements. AG55 also provides that for year-end 2026 and later filings, for those blocks subject to cash-flow testing under AG55 (*e.g.*, certain asset intensive reinsurance transactions ceded to entities that are not required to submit a VM-30 memorandum to US state regulators and meet specified reserve thresholds), cash-flow testing should also be performed separately by significant product lines. We are continuing to monitor implementation of AG55, including any potential evolution beyond disclosure.

Conclusion

The US prudential solvency regulatory framework demonstrates a comprehensive and adaptive approach to safeguarding policyholder interests and maintaining financial stability. Its focus on individual entity solvency, robust risk-based capital requirements and evolving group-level supervision tools, such as Form F, ORSA and the GCC, reflects this commitment.

Recent regulatory innovations, including the harmonisation of surplus lines and reinsurance standards, have further modernised the US regime. By balancing state-level autonomy with a drive for consistency at the federal and international levels, the US regulatory system is well positioned for resilience and competitiveness in the future.

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