2022 Fall National Meeting
Tampa, Florida

LIFE RISK-BASED CAPITAL (E) WORKING GROUP
Tuesday, December 13, 2022
8:00 – 9:00 a.m.
HB Plant Ballroom A - D - Level 2 - JW Marriott

ROLL CALL

Philip Barlow, Chair

Sheila Travis

Thomas Reedy

Wanchin Chou

Dalora Schafer

Vincent Tsang

Mike Yanacheak/Carrie Mears

Fred Andersen

District of Columbia

Alabama

California

Connecticut

Florida

Illinois

Iowa

Minnesota

William Leung

Michael Muldoon

Seong-min Eom

Bill Carmello

Andrew Schallhorn

Rachel Hemphill

Tomasz Serbinowski

Missouri

Nebraska

New Jersey

New York

Oklahoma

Texas

Utah

NAIC Support Staff: Dave Fleming

AGENDA

1. Consider Adoption of its Oct. 20; Oct. 7; and 2022 Summer National Meeting Minutes—Philip Barlow (DC)

2. Discuss C-2 Mortality Risk Guidance—Philip Barlow (DC)
   - American Academy of Actuaries’ (Academy) C2 Mortality Work Group’s Suggested Guidance
   - American Council of Life Insurers’ (ACLI) Comment Letter

3. Discuss Runoff Companies—Philip Barlow (DC)

4. Discuss Any Other Matters Brought Before the Working Group—Philip Barlow (DC)

5. Adjournment
Draft: 12/3/22

Life Risk-Based Capital (E) Working Group
Virtual Meeting
October 20, 2022

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met October 20, 2022. The following Working Group members participated: Philip Barlow, Chair (DC); Wanchin Chou (CT); Hannah Howard (Fl); Vincent Tsang (IL); Mike Yanacheak and Carrie Mears (IA); Ben Slutsker (MN); William Leung (MO); Derek Wallman (NE); Seong-min Eom (NJ); Bill Carmello (NY); Rachel Hemphill (TX); and Thomasz Serbinowski (UT).

1. Discussed The American Academy of Actuaries’ (Academy) C2 Mortality Risk Work Group’s Instruction Supplement

Chris Trost, (American Academy of Actuaries—Academy), chair of the Academy’s C2 Mortality Risk Work Group, said the purpose of this document is to help companies fill out the new structure for life mortality risks. He said it is in a Q&A format and attempts to address the questions the Academy knows have already come up. Because of its principle-based nature and the concept of pricing flexibility, he said there are a number of examples to help companies map products with the goal being to make it easier to fill out the new structure since it will be in place for the first time.

Mr. Barlow asked whether this should be incorporated into the instructions going forward. Mr. Trost said it is worth doing, but he did not know what approvals would be required to accomplish that. Mr. Barlow said this guidance would be for this year and it is helpful to consider whether it is going to be permanent guidance to be incorporated into instructions. Dave Fleming (NAIC) said this will be referred to as guidance for this yearend and it can possibly be adopted as an appendix to the instructions for next year.

Ms. Hemphill suggested modifying the language on the Actuarial Standard of Practice (ASOP) list in #1 due to concern that other ASOPs may apply also. In addition, she expressed concerns about how pricing flexibility should be assessed (#5). She said she is uncomfortable with the intent to change pricing if emerging experience warrants a change without corresponding support or documentation. She suggested a change to discuss what kind of documentation or support would warrant the assertion that the company intends to change the pricing when there is not a historical precedent. She said she would like to add considerations that are to be looked at when determining whether pricing could be adjusted within five policy years. She questioned the concept of making an immediate correction with respect to the phrase under #5, “If the amount of flexibility is immediately available, then it wouldn’t be necessary to do a present value calculation.” Lastly, she questioned what the path would be for affiliated YRT in Table 1.

Mr. Trost agreed with Ms. Hemphill regarding the ASOP list. Ryan Fleming (Academy) said it would be helpful to consider adding something on what documentation or support would be needed to justify the change. Mr. Fleming said it would also be helpful to add considerations to determine whether pricing could be adjusted or not. In addition, he said the concept of immediately adjusting to offset the adverse mortality experience is about whether a product has sufficient margins to offset the entire change. If it would take more time to respond to the adverse mortality, he said a present value calculation needs to be done. Ms. Hemphill asked whether an example can be provided for the immediate adjustment scenario. Mr. Trost said if the margins are extremely wide for mortality, this falls into the pricing flexibility bucket rather than doing a present value calculation. He agreed “immediately” may not be exactly the right term. Regarding Ms. Hemphill’s last question, Mr. Fleming said based on the instructions all affiliated reinsurance follow the direct policy and this needs some clarification.
The Working Group agreed to expose the instruction supplement for a public comment period of three weeks with those comments to be discussed on a call in November or at the Fall National Meeting.

2. **Discussed Status of Mortgage and Reinsurance Proposals**

Mr. Fleming (NAIC) said he is following up with the American Council of Life Insurers (ACLI) and Mortgage Bankers Association (MBA) on additional analysis. He said the mortgage proposal does have a structural component which needs to be exposed by January. With respect to the reinsurance proposal on comfort trust, based on initial conversations he is working with other NAIC staff to draft a recommendation for the working group to consider. Mr. Barlow said the mortgage and reinsurance proposals will be put on a future call when information becomes ready for next steps.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.
Draft: 12/4/22

Life Risk-Based Capital (E) Working Group
Virtual Meeting
October 7, 2022

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met October 7, 2022. The following Working Group members participated: Philip Barlow, Chair (DC); Sheila Travis (AL); Wanchin Chou (CT); Hannah Howard (FL); Vincent Tsang (IL); Carrie Mears (IA); Fred Andersen (MN); William Leung (MO); Derek Wallman (NE); Seong-min Eom (NJ); Bill Carmello (NY); Rachel Hemphill (TX) and Thomasz Serbinowski (UT).

1. Discussed Proposed Revisions to CM6 and CM7 Mortgage RBC Factors and Formula

Mr. Barlow said a comment letter was received from the American Council of Life Insurers (ACLI) and the Mortgage Bankers Association (MBA) about proposed revisions to the risk-based capital (RBC) factors and formula for CM6 and CM7 mortgages. John Waldeck (Pacific Life) presented the comment letter (Attachment 1) and said the factors for CM6 and CM7 mortgages have traditionally been aligned with the equity real estate transaction's RBC charges. He said the real estate factors were decreased for year-end 2021 and the proposal (Attachment 2) is to bring the factors for CM6 and CM7 mortgages back in line with the charges for equity real estate. As a result, this would reduce the factor for the CM6 mortgages to 11%, which is reflective of the Schedule A real estate investments and reduce the factor for the CM7 mortgages to 13%, which is reflective of the Schedule BA real estate investments.

Mr. Waldeck said the proposal also changes the formula for non-performing mortgages to be the same as that for performing mortgages. The current RBC formula has a write-down component in its calculation. There is also a required floor at the effective charge as if it were a performing loan. Therefore, the resulting actual capital charge could become lower than what the RBC factor prescribes. The proposal for CM7 mortgages is to apply a constant 13%, regardless of the write-down status which would be consistent with the charge for equity assets after foreclosure. Mr. Waldeck said he does not believe this proposal will be reflective of a large change in risk-based capital for any company's mortgage portfolio because, typically, there are very few assets that are held in CM6 and CM7 categories. He said many companies choose to either foreclose quickly and move them onto their equity book or they would be potentially sold.

Mr. Carmello asked whether the proposed changes came up in the process of changing RBC factors for real estate. Mr. Waldeck said he did not believe they did. Mr. Barlow asked whether Mr. Waldeck knew how the 23% RBC factor for CM 7 mortgage was set originally. Mr. Waldeck noted a reference to the relationship to NAIC 5 bonds. Mr. Barlow said it sounds like the factor was determined by association rather than an analysis. Mr. Waldeck agreed. Birny Birnbaum (Center for Economic Justice) asked whether there is any empirical analysis or data to support the revision other than the desire for consistency. Mr. Waldeck said the proposal is based on the analysis done for the equity real estate. Ben Slutsker asked about the comparison and rationale of making the factors at the same level as Schedule BA and Schedule A factors based on the logic of going into foreclosures and eventually becoming categorized as those assets. He said Schedule BA and Schedule A assets include a broader group of different types of assets beyond those that emerged from CM6 and CM7 mortgages. He asked if the resulting foreclosures are considered riskier or not compared to the broader group of Schedule A and Schedule BA assets. Mr. Waldeck said the difference between a mortgage in the process of foreclosure and resulting equity investment is negligible because the analysis of the impairment was already done and the impaired value after foreclosure was to be held on the equity book. Mr. Slutsker questioned whether it is reasonable to keep consistency between CM6 and CM7 mortgages with Schedule BA and Schedule A assets, which also include other types of assets. Mr.
Waldeck said the alignment only applies to the equity real estate in Schedule BA and Schedule A assets while other types of assets have their own applicable factors.

Mr. Barlow said he would like to have the actual analysis of changes RBC formula and asked Mr. Waldeck to put together an analysis. Mr. Waldeck said he would speak with the ACLI and the MBA to find out what can be put together.

2. Discussed Reinsurance and Comfort Trusts

Andrew Holland (Sidley Austin) presented proposed changes to the Life RBC formula (Attachments 3 and 4). He said life reinsurance transactions that are with a licensed or accredited and now a reciprocal jurisdiction reinsurer would not require any collateral to provide for credit for reinsurance. There is a credit in the life RBC instructions when a transaction for which collateral is not required has the benefit of collateral to account for the fact that there would otherwise be an overstatement in the RBC for credit risk to the reinsurance counterparty. That adjustment applies to funds withheld or trustee collateral. He discussed an expansion of that to cover an additional collateral mechanism, which is called a custody control account. It is essentially based on an account control agreement, which is an established collateral mechanism. There are many life insurance transactions where the parties negotiate for collateral to be provided even though it is not needed for credit for reinsurance. It is typically in the form of a comfort trust, which is based on an account control agreement and widely used in the finance industry including insurance companies. This may be done with respect to assets that might be pledged to Federal Home Loan Banks and margin collateral that might be posted to counterparties in connection with derivative transactions. Mr. Holland said the custody control account that has been developed by J.P. Morgan has been designed to provide the same protection to a ceding company that would be provided through a comfort trust. Because of some of the operational mechanics, banks can provide it at a reduced cost with some additional operating flexibility. The proposed change to the RBC formula is expanding the credit to include custody collateral. Custody collateral is a custodial arrangement with a qualified U.S. financial institution using the existing definition. It would have to relate to assets that are segregated from the reinsurer assets and subject to exclusive control and available to the ceding company if the reinsurer fails to pay.

Brad Drake (Sidley Austin) described the mechanics of how the agreement works. He said these are intended to be consistent with Uniform Commercial Code (UCC), Article 9 and the establishment of attachment and perfection and security interest of assets, especially securities. He said the first key step is the establishment of the account by the reinsurer. The reinsurer works with the intermediary bank and establishes a traditional custody account. It is recorded as separate from other assets of the client, reinsurer, the custodian, and other customers of the custodian. That account has been pledged under the reinsurance agreement or another security agreement to the benefit of the ceding company to support the obligations under the reinsurance agreement. The account control agreement establishes the control mechanisms as between the reinsurer and ceding company. The agreement itself contains provisions that grant control over the account to the ceding company and the ceding company is allowed, under specific circumstances, to take control of the account. Prior to that exercise of control, the ceding company instructs the securities intermediary or the bank to take instructions as to investments and withdrawals from the reinsurer. This allows the reinsurer to be consistent with how it works in the trust agreement to direct investments within guidelines that are agreed upon between the companies to make permitted withdrawals. The ceding company can deliver a notice of exclusive control following some sort of event of default that is defined in reinsurance agreement, but especially insolvency or failure to pay on the part of the reinsurer. The ceding company can direct the withdrawal of assets to pay amounts that are due from the ceding company. It would require any further instruction to withdraw that notice of exclusive control if the event of default is cured. Similar to the trust agreement, that notice of exclusive control at least vis-a-vis the control agreement is solely given at the request of the ceding company. It is not restricted under the account control agreement. Similar to a credit for reinsurance trust, the ability to give that may be restricted under the reinsurance
agreement or security agreement. But it is not within the security or intermediary right to contest that notice of exclusive control. Results of these mechanics are to be consistent with Article 9 of UCC and to create that perfected security interest in the bankruptcy context. The mechanism is used for trillions of dollars of transactions in the repo and swap markets. It has been through multiple bankruptcy types of transactions. Specific contractual provisions are available in the form contract provided. Mr. Drake said a comparison chart is also provided which shows the differences in different aspects of credit for reinsurance trusts. Despite having similar benefits or equal benefits to what would be seen in a comfort trust arrangement, he said the custody control account results in a difference in control or the methodologies for control, which result in a very different RBC treatment.

Mr. Barlow said what is being asked in this particular instance is to determine whether the custody control account sufficiently meets the standards to get the RBC treatment that the trustee collateral account currently gets. He asked whether the equivalence between the custody control account and trustee collateral account has been looked at by other NAIC groups. Mr. Holland said the discussions have been with this Working Group. Mr. Barlow said he felt this proposal is more in the area of accounting. Mr. Holland said he viewed it more as the treatment of the account in the insolvency of a reinsurer than an accounting issue. Mr. Clark suggested the Reinsurance (E) Task Force might be able to provide some advice on whether there is equivalence from a legal standpoint. Mr. Holland said while a comfort trust is based on a credit for reinsurance trust, it does not need all of the statutory requirements and regulatory requirements that would be needed in Model 785. It is providing protection to the business that is ceded but is not necessary to achieve credit for reinsurance under statutory accounting. Mr. Barlow said he would like to have the Reinsurance (E) Task Force weigh in on whether they believe there is equivalence in the custody control account before exposing this proposal. Dave Fleming (NAIC) said he would work with Mr. Holland in communications with staff at the Reinsurance (E) Task Force.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.
Draft Pending Adoption

Attachment C

Capital Adequacy (E) Task Force
8/11/22

Life Risk-Based Capital (E) Working Group
Virtual Meeting (in lieu of meeting at the 2022 Summer National Meeting)
July 27, 2022

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met July 27, 2022. The following Working Group members participated: Philip Barlow, Chair (DC); Jennifer Li (AL); Thomas Reedy (CA); Wanchin Chou (CT); William Watson (FL); Mike Yanacheak and Carrie Mears (IA); Fred Andersen (MN); William Leung (MO); Derek Wallman (NE); Seong-min Eom (NJ); Bill Carmello (NY); Andrew Schallhorn (OK); Mike Boerner and Rachel Hemphill (TX); and Tomasz Serbinowski (UT).

1. Adopted its June 17, June 3, April 22, April 7, and Spring National Meeting Minutes

Mr. Leung made a motion, seconded by Mr. Chou, to adopt the Working Group’s June 17 (Attachment A), June 3 (Attachment B), April 22 (Attachment C), April 7 (Attachment D), and March 23 (see NAIC Proceedings – Spring 2022, Capital Adequacy (E) Task Force, Attachment Four) minutes. The motion passed unanimously.

2. Adopted the 2022 Life and Fraternal RBC Newsletter

Ms. Hemphill made a motion, seconded by Mr. Leung, to adopt the content for the 2022 Life and Fraternal Risk-Based Capital (RBC) Newsletter (Attachment F). The motion passed unanimously.

3. Consider Adoption of the 2021 Life and Fraternal RBC Statistics

Mr. Chou made a motion, seconded by Mr. Reedy, to adopt the 2021 Life and Fraternal RBC Statistics (Attachment G). Mr. Barlow said a subgroup of the Working Group has been reviewing the statistics to enhance or otherwise change the statistics to provide useful information in reviewing RBC results. He said there has been a lot of good work done so far, and no changes have been made yet. The motion passed unanimously.

4. Discussed Affiliated Investments

Mr. Barlow said one comment letter was received on the affiliated investments proposal. Brian Bayerle (American Council of Life Insurers—ACLI) presented the ACLI’s comment letter (Attachment H). He said the ACLI reviewed the proposal, and while it has no specific concerns with the proposal, the ACLI notes that the exposed guidance requires reporting insurers to include the carrying values and RBC requirements for all directly owned subsidiaries even if they are non-admitted. If such entities are to be included in RBC, he said it does not seem reasonable to classify them as non-admitted given this reporting requirement. He said the ACLI suggests consideration of a referral to the Statutory Accounting Principles (E) Working Group. He said the affiliated investments are being reviewed by each of the RBC working groups and will be considered together by the Capital Adequacy (E) Task Force.

5. Adopted its Working Agenda

Mr. Barlow said the item to update the C-2 treatment was changed to indicate the development of additional guidance. Mr. Bayerle said the ACLI is requesting the expedited development of the guidance so companies can review it and see if there are still outstanding questions with respect to the adopted factor change. Ryan Fleming

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(American Academy of Actuaries—Academy) said the Academy will be beginning work on this shortly. He asked about the desired time frame for getting this completed. Mr. Barlow said it would be helpful to have something circulated for review prior to its adoption. He asked Mr. Bayerle when this would be needed to help with the completion of the following year’s RBC calculation. If a first draft is available in October, Mr. Bayerle said this will give companies an opportunity to review it to see if there are additional questions on the implementation. He said they have done their first review, and a lot of the questions could be addressed through this guidance. He said the ACLI will work with the Working Group on any remaining questions towards the goal of a final version in the last quarter of this year. Mr. Fleming said the Academy considers this timing reasonable, and it is open to input from interested parties to address questions on the implementation. Mr. Barlow suggested that the ACLI provide its input to the Academy for consideration as the Academy prepares its first draft. He said the Working Group could schedule calls for discussion if it would be helpful to move the process along.

With respect to the item to update the C-3 Phase I (C3P1) and C-3 Phase II (C3P2) methodologies, Mr. Bayerle said the VM-22, Statutory Maximum Valuation Interest Rates for Income Annuities, principle-based reserving (PBR) effort is underway with a field test scheduled for February 2023. He said there will be a C3P1 component, which will need to be discussed by the Working Group, and he asked if this working agenda item could be modified accordingly. Mr. Barlow asked NAIC staff to work with Mr. Bayerle and the Academy to make item four on the working agenda more comprehensive.

Mr. Yanacheak made a motion, seconded by Mr. Schallhorn, to adopt the working agenda (Attachment XX). The motion passed unanimously.

6. Discussed Other Matters

Mr. Barlow said Mr. Carmello and Mr. Yanacheak have expressed interest in reviewing the C3P1 mean reversion parameter. He said it might be beneficial to consider this after the Working Group gets results from the field test, and she asked the Working Group if this is a reasonable approach to take. Mr. Carmello said he was surprised that the VM-20, Requirements for Principle-Based Reserves for Life Products, generator had not been used, which he believes was unacceptable. Mr. Yanacheak said he believes this is something that should have been addressed and asked for comments from industry. Mr. Barlow suggested having someone from the Economic Scenario Generator (ESG) Drafting Group explain their work in detail at the next Working Group meeting and having a discussion logistically about what needs to be done to change the mean reversion parameter. Mr. Carmello suggested switching the generator over to the VM-20, as opposed to the mean reversion parameter only. Nancy Bennett (Academy) said the Academy has been working on a document to discuss with the Working Group all three C-3 phases. There are different methodologies between C3P1 and C3P2, and she said she believes it may not be as simple as just changing the mean reversion parameter in the C3P1 generator. Mr. Barlow said he believes Mr. Carmello is looking for something that could be done relatively quickly as an interim step. Mr. Carmello said he agrees. Mr. Barlow said the Working Group will have this as an agenda item for an upcoming call.

Andrew Holland (Sidley Austin LLP), on behalf of J.P. Morgan, reminded the Working Group of the presentation on reinsurance and comfort trusts provided in March, and he asked for the opportunity to provide follow up requested by the Working Group. Mr. Barlow asked NAIC staff to add this as an agenda item for an upcoming call.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.
October 20, 2022

Mr. Philip Barlow  
Chair, Life Risk-Based Capital (E) Working Group (LRBCWG)  
National Association of Insurance Commissioners (NAIC)  
Via email: Dave Fleming (dfleming@naic.org)

Re: Instruction Supplement for Applying the Newly Adopted Life Insurance C-2 Mortality Factors

Dear Philip,

On behalf of the C-2 Mortality Work Group (“work group”) of the American Academy of Actuaries, we are providing a suggested draft for your consideration in adopting an instruction supplement for applying the newly adopted life insurance C-2 mortality factors. The document is intended to address implementation questions. This would serve as an addendum to the instructions to be considered by the LRBCWG, and not a replacement. The format is question-and-answer.

Sincerely,

Chris Trost, MAAA, FSA  
Chairperson, C-2 Mortality Work Group

Ryan Fleming, MAAA, FSA  
Vice Chairperson, C-2 Mortality Work Group

American Academy of Actuaries
Life RBC—C-2 Mortality Risk

Instruction Supplement for Applying the Newly Adopted Life Insurance C-2 Mortality Instructions

To: National Association of Insurance Commissioners (NAIC) Life Risk-Based Capital (RBC) (E) Working Group

From: American Academy of Actuaries C-2 Mortality Work Group

Date: October 20, 2022

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**Introduction**

This document is a suggested draft for your consideration in adopting an instruction supplement for addressing implementation questions for the newly adopted life insurance C-2 mortality structure, factors, and LR025 instructions. This would serve as an addendum to the instructions to be considered by the LRBCWG, and not a replacement. The format is question-and-answer.

**Relevant Actuarial Standards of Practice**

1. What actuarial standards of practice are relevant in completing the life insurance C-2 work?


**Default Categories**

2. What are the default categories if the assessment of pricing flexibility or remaining rate terms is not completed?

   The intent is for the amounts (net of reinsurance ceded) to default to the highest capital requirement. Direct amounts and reinsurance, both ceded and assumed, are intended to be evaluated separately.

   **Direct Policies Before Reinsurance**

   - For individual life insurance direct policies, the default category will vary depending on whether the policy is a term life or permanent life product. Term life policies should be assigned to the Term Life Policies without Pricing Flexibility category and permanent life policies should be assigned to the Permanent Life Policies without Pricing Flexibility category if the assessment of pricing flexibility is not completed.

   - Group and credit life insurance direct policies should be assigned to the Group & Credit Life with Remaining Rate Terms Over 36 Months category if the assessment of remaining rate terms is not completed.

   **Non-Affiliated Reinsurance Ceded Amounts**

   - For individual life amounts ceded to a non-affiliated reinsurer, the amounts should be assigned to the Life Policies with Pricing Flexibility category if the assessment of pricing flexibility is not completed.

   - For group and credit life insurance amounts ceded to a non-affiliated reinsurer, the amounts should be assigned to the Group & Credit Life with Remaining Rate Terms 36 Months And Under category if the assessment of remaining rate terms is not completed.
Non-Affiliated Reinsurance Assumed Amounts

- For individual life insurance amounts assumed by a non-affiliated reinsurer, the default category will vary depending on whether the policy is a term life or permanent life product. Term life policies should be assigned to the Term Life Policies without Pricing Flexibility category and permanent life policies should be assigned to the Permanent Life Policies without Pricing Flexibility category if the assessment of pricing flexibility is not completed.

- Group and credit life insurance amounts assumed by a non-affiliated reinsurer should be assigned to the Group & Credit Life with Remaining Rate Terms Over 36 Months category if the assessment of remaining rate terms is not completed.

Affiliated Reinsurance—Both Ceded and Assumed Amounts

- Affiliated reinsurers are to assign the factor category based on the categorization for the direct policies.

Size Tiering

3. How does a company allocate the size tiers to the subcategories?

A company does not need to determine the allocation of the size tiers to each subcategory. These calculations will be completed within the LR025 spreadsheet. The allocation of the size tiers will be handled formulaically through a proportionate allocation based on the net amounts at risk entered in aggregate for individual & industrial life and for group & credit life and for each subcategory.

Assessing Pricing Flexibility for Individual Life Policies

4. How should policies be grouped for assessing pricing flexibility?

For the purposes of assessing whether business is categorized as having “Pricing Flexibility,” grouping of gross amounts may be done at either the contract level or at a cohort level consistent with grouping for pricing purposes. Documentation of the grouping should follow company retention policies.

5. How should pricing flexibility be assessed for individual life policies?

The first step is to assess typical business practices. Typical business practices are intended to apply to companies that review mortality rates on a regular basis, there is historical precedent for changing inforce mortality pricing, and/or the company intends to change inforce mortality pricing if emerging experience warrants a change.

The second step is to assess whether pricing can be adjusted within the five policy years following the valuation date. If pricing may be adjusted within the next five policy years, then the policies meet the threshold for having the near-term ability to adjust pricing.

The third step is to quantify the amount of pricing flexibility available and determine whether the amount exceeds the minimum threshold for qualifying for the pricing flexibility category. A material rate adjustment is defined as the ability to recover, on a present value basis, the difference in mortality
provided for in the C-2 factors for contracts with and without pricing flexibility. If the amount of flexibility is immediately available, then it wouldn’t be necessary to do a present value calculation. A present value calculation calculated over the next five years would be necessary if it would take multiple years to recover the difference in mortality. Nonguaranteed elements that aren’t mortality related—such as credited interest rates, expense charges, and policy fees—should not be assumed to be available in assessing pricing flexibility to respond to adverse mortality experience.

The product categories were designed to typically reflect the following categorizations shown in Table 1. The assessment of pricing flexibility is needed to demonstrate that the policies assigned to the Life Policies with Pricing Flexibility category have this flexibility.

<table>
<thead>
<tr>
<th>Table 1. Typical Individual Life Product Categorizations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Life Policies with Pricing Flexibility</strong></td>
</tr>
<tr>
<td>1. Participating whole life insurance policies paying dividends</td>
</tr>
<tr>
<td>2. Universal life policies with current cost of insurance charges less than guaranteed</td>
</tr>
<tr>
<td>3. Annually renewable term life policies with premiums guaranteed for the next 5 or fewer years</td>
</tr>
<tr>
<td>4. Life policies with 5 years or fewer until expiration or maturity</td>
</tr>
<tr>
<td>5. Yearly renewable term reinsurance with rates guaranteed for the next 5 or fewer years</td>
</tr>
</tbody>
</table>

Affiliated reinsurance and co-insurance reinsurance are intended to follow the direct policies.
The following illustrative examples show the type of analysis that is to be completed. The quantification of pricing flexibility is to be aligned with a company’s practices for assessing pricing margins on inforce policies and is not prescribed by the RBC instructions. To simplify, the examples assume the large size, or over $25,000 million, factors with a net amount at risk of $1,000.

Example 1. Term Life Policies without Pricing Flexibility

1. Are premiums on inforce policies changed as part of typical business practices?  
   - No
   - There is no historical precedent or intent to change premiums on inforce.

Assign to the "Term Life Policies without Pricing Flexibility" category.

Example 2. Term Life Policies without Pricing Flexibility

1. Are premiums on inforce policies changed as part of typical business practices?  
   - Yes
   - Rates are reviewed annually, the company has precedent for changing inforce premiums, and/or the company intends to change premiums if emerging experience warrants a change.

2. Can pricing be changed within the next 5 years?  
   - No
   - Current premiums on this cohort overall are guaranteed for more than the next 5 years

Assign to the "Term Life Policies without Pricing Flexibility" category.

Example 3. Term Life Policies without Pricing Flexibility

1. Are premiums on inforce policies changed as part of typical business practices?  
   - Yes
   - Rates are reviewed annually, the company has precedent for changing inforce premiums, and/or the company intends to change premiums if emerging experience warrants a change.

2. Can pricing be changed within the next 5 years?  
   - Yes
   - Current premiums on this cohort overall may be changed within the next 5 years

3. Assess the level of pricing flexibility.

<table>
<thead>
<tr>
<th>Without Pricing Flexibility Factor</th>
<th>0.00085</th>
</tr>
</thead>
<tbody>
<tr>
<td>With Pricing Flexibility Factor</td>
<td>0.00080</td>
</tr>
<tr>
<td>Difference</td>
<td>0.00005</td>
</tr>
</tbody>
</table>

Minimum Pricing Flexibility Needed
- Equal to $1,000 NAR times Difference
- $0.05

Pricing Flexibility Available
- Equal to the present value difference over the next 5 years between current and guaranteed maximum premiums on this cohort overall
- $0.04

4. Is the level of pricing flexibility greater than the minimum needed?  
   - No

Assign to the "Term Life Policies without Pricing Flexibility" category.
**Example 4. Term Life Policies with Pricing Flexibility**

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are premiums on inforce policies changed as part of typical business practices?</td>
<td>Yes</td>
</tr>
<tr>
<td>- Rates are reviewed annually, the company has precedent for changing inforce premiums, and/or the company intends to change premiums if emerging experience warrants a change.</td>
<td></td>
</tr>
<tr>
<td>Can pricing be changed within the next 5 years?</td>
<td></td>
</tr>
<tr>
<td>- Current premiums on this cohort overall may be changed within the next 5 years</td>
<td></td>
</tr>
<tr>
<td>Assess the level of pricing flexibility.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Without Pricing Flexibility Factor</th>
<th>0.00085</th>
</tr>
</thead>
<tbody>
<tr>
<td>With Pricing Flexibility Factor</td>
<td>0.00080</td>
</tr>
<tr>
<td>Difference</td>
<td>0.00005</td>
</tr>
</tbody>
</table>

Minimum Pricing Flexibility Needed

- Equal to $1,000 NAR times Difference
  
  **$0.05**

Pricing Flexibility Available

- Equal to the present value difference over the next 5 years between current and guaranteed maximum premiums on this cohort overall
  
  **$0.20**

4. Is the level of pricing flexibility greater than the minimum needed?

Yes

Assign to the "Life Policies with Pricing Flexibility" category.

---

**Example 5. Permanent Life Policies without Pricing Flexibility**

1. Are mortality charges on inforce policies changed as part of typical business practices?

No

- There is no historical precedent or intent to change mortality charges on inforce policies.

Assign to the "Permanent Life Policies without Pricing Flexibility" category.

---

**Example 6. Permanent Life Policies without Pricing Flexibility**

1. Are mortality charges on inforce policies changed as part of typical business practices?

Yes

- Rates are reviewed annually, the company has precedent for changing inforce mortality charges, and/or the company intends to change mortality charges if emerging experience warrants a change.

2. Can pricing be changed within the next 5 years?

No

- Current mortality charges on this cohort overall are guaranteed for more than the next 5 years, and/or there are secondary guarantees that will last for more than the next 5 years.

Assign to the "Permanent Life Policies without Pricing Flexibility" category.
### Example 7. Permanent Life Policies without Pricing Flexibility

1. Are mortality charges on in-force policies changed as part of typical business practices?
   - Rates are reviewed annually, the company has precedent for changing in-force mortality charges, and/or the company intends to change mortality charges if emerging experience warrants a change.
   - Yes

2. Can pricing be changed within the next 5 years?
   - Current mortality charges on this cohort overall are guaranteed for less than the next 5 years, and there are no secondary guarantees that will last for more than the next 5 years.
   - Yes

3. Assess the level of pricing flexibility.

| Without Pricing Flexibility Factor | 0.00120 |
| With Pricing Flexibility Factor    | 0.00080 |
| Difference                         | 0.00040 |

Minimum Pricing Flexibility Needed
- equal to $1,000 NAR times Difference
- $0.40

Pricing Flexibility Available
- equal to the dividend liability, or present value difference over the next 5 years between current and guaranteed cost of insurance charges on this cohort overall
- $0.30

4. Is the level of pricing flexibility greater than the minimum needed?
   - No

Assign to the "Permanent Life Policies without Pricing Flexibility" category.

### Example 8. Permanent Life Policies with Pricing Flexibility

1. Are mortality charges on in-force policies changed as part of typical business practices?
   - Rates are reviewed annually, the company has precedent for changing in-force mortality charges, and/or the company intends to change mortality charges if emerging experience warrants a change.
   - Yes

2. Can pricing be changed within the next 5 years?
   - Current mortality charges on this cohort overall are guaranteed for less than the next 5 years, and there are no secondary guarantees that will last for more than the next 5 years.
   - Yes

3. Assess the level of pricing flexibility.

| Without Pricing Flexibility Factor | 0.00120 |
| With Pricing Flexibility Factor    | 0.00080 |
| Difference                         | 0.00040 |

Minimum Pricing Flexibility Needed
- equal to $1,000 NAR times Difference
- $0.40

Pricing Flexibility Available
- equal to the dividend liability, or present value difference over the next 5 years between current and guaranteed cost of insurance charges on this cohort overall
- $0.50

4. Is the level of pricing flexibility greater than the minimum needed?
   - Yes

Assign to the "Life Policies with Pricing Flexibility" category.
Assessing Remaining Rate Terms for Group and Credit Life Policies

6. **How should group policies be grouped for assessing remaining rate terms?**
   
   For the purposes of assessing the remaining rate terms, policies should be assessed at the group contract level.

7. **How should the remaining rate terms be assessed for group and credit life policies?**
   
   The remaining rate terms should be assessed based on the premium terms of each group contract and the number of months until expiration or renewal. For group permanent life policies, the evaluation should be completed based on the ability and timeframe for adjusting mortality charges.

   The following examples illustrate the type of analysis that should be completed. To simplify, the examples assume the large size, or over $25,000 million, factors with a net amount at risk of $1,000.

<table>
<thead>
<tr>
<th>Example 9. Group &amp; Credit Life with Remaining Rate Terms 36 Months and Under</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Can the premiums be changed on this group contract or cohort of policies within the next 36 months?</td>
</tr>
<tr>
<td>- The renewal date or expiration date of the contract is within the next 36 months.</td>
</tr>
<tr>
<td>Assign to the “Group &amp; Credit Life with Remaining Rate Terms 36 Months and Under” category.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Example 10. Group &amp; Credit Life with Remaining Rate Terms Over 36 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Can the premiums be changed on this group contract or cohort of policies within the next 36 months?</td>
</tr>
<tr>
<td>- The renewal date or expiration date of the contract or cohort of policies is over 36 months.</td>
</tr>
<tr>
<td>Assign to the “Group &amp; Credit Life with Remaining Rate Terms Over 36 Months” category.</td>
</tr>
</tbody>
</table>

Reinsurance Treatment for Direct Insurers and Non-Affiliated Reinsurers

8. **How should a direct insurer assess the degree of pricing flexibility on its amounts ceded to non-affiliated reinsurers?**
   
   The terms of a direct insurer’s reinsurance treaties should be assessed to determine the degree of pricing flexibility a reinsurer has to change rates on inforce policies.

9. **How should a non-affiliated reinsurer assess the degree of pricing flexibility on its assumed amounts?**
   
   The terms of a non-affiliated reinsurer’s treaties should be assessed to determine the degree of pricing flexibility a reinsurer has to change rates on inforce policies.
Individual Life Policies Changing Categories Over Time

10. Can individual life policies change categories over time if the degree of pricing flexibility changes?

Yes, policies are intended to be assessed at each year-end and could change categories in either direction if the degree of pricing flexibility changes. A few circumstances where this may arise are noted below.

- The dividends on a cohort of participating whole life policies falls below the minimum margin needed to qualify for the Life Policies with Pricing Flexibility category and is now assigned to the Permanent Life Policies without Pricing Flexibility category. Conversely, if the dividends increase above the minimum margin needed then the policies may shift to the with Pricing Flexibility category.

- The difference between current and guaranteed cost of insurance charges on a cohort of universal life policies falls below the minimum margin needed to qualify for the Life Policies with Pricing Flexibility and is now assigned to the Permanent Life Policies without Pricing Flexibility category. Conversely, if the difference between current and guaranteed cost of insurance charges on a cohort of universal life policies increases above the minimum margin needed, then the policies may shift to the with Pricing Flexibility category.

- A secondary guarantee on a universal life policy is triggered for greater than the next five years and the policy is now assigned to the Life Policies without Pricing Flexibility category. Conversely, a secondary guarantee on a universal life policy expires or has less than five years remaining, and the policy is now assigned to the with Pricing Flexibility category.

- A cohort of term life policies reaches the end of its guaranteed premium period and premiums may be adjusted and is now assigned to the with Pricing Flexibility category, whereas previously the policies were assigned to the Term Life Policies without Pricing Flexibility category.

- A reinsurance treaty is renegotiated resulting in a different level of flexibility for the reinsurer to adjust rates.

Populating the Factor Categories for Direct and Reinsured Amounts

11. How should gross, ceded, and assumed amounts be populated for individual life and group and credit life?

The intent of the RBC design is that the total C-2, for a given size band category and before covariance adjustments, across direct insurers and reinsurers should be equal regardless of whether reinsurance is used and the type of reinsurance. The relative share of C-2 between direct insurers and non-affiliated reinsurers will vary depending on the type of reinsurance used. For the direct insurer, amounts for gross and ceded net amounts at risk should be categorized separately and may fall into different categories. For the reinsurer, assumed net amounts at risk should be categorized based on the terms of the reinsurance treaty for non-affiliated reinsurers and the direct policies for affiliated reinsurers. A subcategory could end up with a negative balance if the ceded amount exceeds the gross amount. Negatives will flow through the subcategories, subject to an aggregate minimum of $0 for individual life C-2 and group life C-2.
The following simplified examples illustrate populating the categories depending on the reinsurance used. They are intended to represent the types of categorizations and not the overall aggregate results of a typical company. The examples assume the large size, or over $25,000 million, factors with a net amount at risk of $1,000.

The first step in the process is to categorize gross amounts directly written by the insurer. The second step is to categorize amounts ceded to reinsurers. The third step is to categorize amounts assumed from other insurers. Lastly, the total amounts net of reinsurance should be entered for each subcategory into the RBC LR025 worksheet.

Note, all examples assume a total net amount at risk of $1,000 and the large size band C-2 factors.

<table>
<thead>
<tr>
<th>Example 11. Permanent Life Policies without Pricing Flexibility, 100% Retained</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct Insurer</strong></td>
</tr>
<tr>
<td><strong>Gross</strong></td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Example 12. Permanent Life Policies without Pricing Flexibility, 90% Ceded to Non-Affiliated Reinsurer on a with Pricing Flexibility Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct Insurer</strong></td>
</tr>
<tr>
<td><strong>Gross</strong></td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Example 13. Permanent Life Policies without Pricing Flexibility, 90% Ceded to Non-Affiliated Reinsurer on a without Pricing Flexibility Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct Insurer</strong></td>
</tr>
<tr>
<td><strong>Gross</strong></td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Example 14. Permanent Life Policies without Pricing Flexibility, 90% Ceded to an Affiliated Reinsurer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct Insurer</strong></td>
</tr>
<tr>
<td><strong>Gross</strong></td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
Note, all examples assume a total net amount at risk of $1,000 and the large size band C-2 factors.

**Example 15. Term Life Policies without Pricing Flexibility, 100% Retained**

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
<td>$1,000</td>
<td>$ -</td>
<td>$1,000</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
<td>$ -</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

**Example 16. Term Life Policies without Pricing Flexibility, 50% Ceded to Non-Affiliated Reinsurer on a with Pricing Flexibility Basis**

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
<td>$ -</td>
<td>$ (500)</td>
<td>$ (500)</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
<td>$1,000</td>
<td>$ -</td>
<td>$1,000</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
<td>$ (500)</td>
<td>$500</td>
</tr>
</tbody>
</table>

**Example 17. Term Life Policies without Pricing Flexibility, 50% Ceded to Non-Affiliated Reinsurer on a without Pricing Flexibility Basis**

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
<td>$1,000</td>
<td>$ (1,000)</td>
<td>$ (1,000)</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
<td>$ (1,000)</td>
<td>$ (1,000)</td>
</tr>
</tbody>
</table>

**Example 18. Term Life Policies without Pricing Flexibility, 100% Ceded to an Affiliated Reinsurer**

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
<td>$1,000</td>
<td>$ -</td>
<td>$1,000</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
<td>$ -</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

**Example 19. Life Policies with Pricing Flexibility, 100% Retained**

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
<td>$1,000</td>
<td>$ -</td>
<td>$1,000</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
<td>$ -</td>
<td>$1,000</td>
</tr>
</tbody>
</table>
Note, all examples assume a total net amount at risk of $1,000 and the large size band C-2 factors.

### Example 20. Life Policies with Pricing Flexibility, 75% Ceded to Non-Affiliated Reinsurer on a with Pricing Flexibility Basis

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
<td>$1,000</td>
<td>$ (750)</td>
<td>$ 250</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$1,000</td>
<td>$ (750)</td>
<td>$ 250</td>
</tr>
</tbody>
</table>

### Example 21. Life Policies with Pricing Flexibility, 75% Ceded to Affiliated Reinsurer

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Life Policies with Pricing Flexibility</td>
<td>$1,000</td>
<td>$ (750)</td>
<td>$ 250</td>
</tr>
<tr>
<td>Term Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Permanent Life Policies without Pricing Flexibility</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$1,000</td>
<td>$ (750)</td>
<td>$ 250</td>
</tr>
</tbody>
</table>

### Example 22. Group Life Policies with Remaining Rate Terms 36 Months and Under, 60% Ceded to Non-Affiliated Reinsurer with Remaining Rate Terms 36 Months and Under

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms 36 Months and Under</td>
<td>$1,000</td>
<td>$ (600)</td>
<td>$ 400</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms Over 36 Months</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$1,000</td>
<td>$ (600)</td>
<td>$ 400</td>
</tr>
</tbody>
</table>

### Example 23. Group Life Policies with Remaining Rate Terms Over 36 Months, 60% Ceded to Non-Affiliated Reinsurer with Remaining Rate Terms 36 Months and Under

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms 36 Months and Under</td>
<td>$ -</td>
<td>$ (600)</td>
<td>$(600)</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms Over 36 Months</td>
<td>$1,000</td>
<td>$ -</td>
<td>$ 1,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$1,000</td>
<td>$ (600)</td>
<td>$ 400</td>
</tr>
</tbody>
</table>
**Note, all examples assume a total net amount at risk of $1,000 and the large size band C-2 factors.**

**Example 24. Group Life Policies with Remaining Rate Terms Over 36 Months, 60% Ceded to Non-Affiliated Reinsurer with Remaining Rate Terms Over 36 Months**

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms 36 Months and Under</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms Over 36 Months</td>
<td>$1,000</td>
<td>$ (600)</td>
<td>$ 400</td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
<td>$ (600)</td>
<td>$ 400</td>
</tr>
</tbody>
</table>

**Example 25. Group Life Policies with Remaining Rate Terms Over 36 Months, 60% Ceded to Affiliated Reinsurer**

<table>
<thead>
<tr>
<th></th>
<th>Direct Insurer</th>
<th>Reinsurer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Ceded</td>
<td>Net</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms 36 Months and Under</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Group &amp; Credit Life with Remaining Rate Terms Over 36 Months</td>
<td>$1,000</td>
<td>$ (600)</td>
<td>$ 400</td>
</tr>
<tr>
<td>Total</td>
<td>$1,000</td>
<td>$ (600)</td>
<td>$ 400</td>
</tr>
</tbody>
</table>
Brian Bayerle  
Senior Actuary

November 10, 2022

Mr. Philip Barlow  
Chair, NAIC Life Risk-Based Capital (E) Working Group (Life RBC)

Re: Proposed Instruction Supplement for C-2 Mortality Factors

Dear Mr. Barlow:

The American Council of Life Insurers (ACLI) appreciates the opportunity to submit the following comments on the Instruction Supplement for Applying the Newly Adopted Life Insurance C-2 Mortality Factors (Supplement) developed by the American Academy of Actuaries C-2 Mortality Work Group (Academy). We have a few clarifying questions, as well as broader questions about inconsistency from one of Supplement responses and the principles in development of the factors. We have a few additional areas for clarification in Appendix A.

General questions:

1. Default categories are discussed in Question 2; however, the examples do not elaborate on classification differences between ceding and assuming companies. Please confirm that the ceding company and unaffiliated reinsurer will independently apply the criteria and are not required to coordinate and agree on the same classifications.

2. In Question 3, it is stated that the allocation of the size tiers in each subcategory will be handled formulaically through a proportionate allocation based on aggregate NAR. Please provide more details on this allocation or an example of how this would work. While the NAIC RBC instructions that were recently sent out provide some help, it was not obvious that it will be handled formulaically on LR025. It seems like the calculations are to be done independently and then loaded in the RBC worksheets.

3. Additional examples of how to use pricing flexibility factors varying by tier would be appreciated. Because of the tiering, there are different pricing margins to overcome.

4. In Question 5 step 3, guidance for pricing flexibility factors says to use the differential between the two factors, which is inconsistent with the instructions. How should companies interpret the inconsistency? Trying to pull data for the calculation is not trivial, and it is not clear how contracts can move between categories. This concern is elaborated upon below in the next section.

5. Later, Question 5, bullet 3, says "Nonguaranteed elements that aren’t mortality related—such as credited interest rates, expense charges, and policy fees—should not be assumed to be available in assessing pricing flexibility to respond to adverse mortality experience."
The guidance seems to impose more limitations on the definition of nonguaranteed elements than what is included in the RBC instructions or in ASOP 2. When pricing a product, a company would consider all aspects of the product (including guarantees, nonguaranteed elements, benefits and features, economic assumptions, policyholder behavior assumptions, etc.). Evaluating if pricing flexibility exists should be allowed to be consistent with how products are actually priced.

6. Question 10, bullet 3, says “A secondary guarantee on a universal life policy is triggered for greater than the next five years and the policy is now assigned to the Life Policies without Pricing Flexibility category.” Please provide clarification on the word “triggered.”

7. Expanding on something like Example 23, it would be beneficial to provide examples of ceded vs direct tiers, assuming amounts large enough to flow through multiple tiers.

Inconsistency in guidance for pricing flexibility factors (Question 5)

According to the Academy’s November 2021 documentation:

- The with pricing flexibility factors are derived assuming mortality risk exposure of 5 years. (The underlying assumption is that prices are changed sometime within the first 5 years – effectively limiting mortality risk exposure to the period before price increases occur.)
- The term and perm without pricing flexibility factors were derived assuming mortality risk exposure of 10 and 20 years, respectively.

Therefore, the difference between term and the pricing flexibility factors represents 5 years of adverse mortality (years 6-10), and the difference between perm and the pricing flexibility factors represents 15 years of adverse mortality (years 6-20).

Issue #1: Conceptually, the Step 3 calculation should be based on the difference between current and guaranteed premiums or COI rates for the first [5] years following the pricing change assumed in Step 2 instead of the immediate 5-year period.

- Term example 1: Suppose a company has the contractual ability to raise rates immediately (current < guaranteed premiums), but practically, it takes a while to respond to adverse experience. The company passes Step 2 because it has historical precedent and a documented intent to increase prices by the end of year 3.
  - Step 3 would use the PV of current and guaranteed rate differences for years 1-5 even though the differences in years 1-3 are irrelevant since the company does not expect to raise rates until the end of year 3.
  - A more conceptually consistent calculation would check whether the premium difference from the point of the pricing change forward (i.e., years 4-8) covers the risk charge difference.

- Term example 2: Suppose a company has a monthly premium term product with guaranteed rates for the next 59 months and nonguaranteed rates thereafter, a historical precedent and documented intent to raise premiums for month 60 and beyond, and a sufficient difference between current and guaranteed premiums in months 60-83 (as well as any period beyond month 60) to cover the term and with pricing flexibility RBC factor mortality risk difference.
The contract passes Step 2 but fails step 3 because the difference between current and guaranteed rates in years 1-5 would be near zero (i.e., only the difference in one monthly premium).

The risk for this contract is entirely consistent with the derivation of the with pricing factor – with all risk being passed on after the first 59 months (limiting mortality exposure to <=5 years). However, it would be barred from using the pricing flexibility factors because it cannot cover the RBC factor difference (= modeled mortality risk for years 6-10) in 1 monthly premium.

UL example: Suppose a company has a UL product where current COI charges grade to guaranteed COI charges after a particular age/duration. There are 6 years remaining until current = guaranteed. The company has a historical precedent and intent to raise COI charges by the end of year 4 if mortality experience is adverse. COI differences in years 1-5 are large enough to cover the RBC charge difference between perm and without pricing flexibility factors but COI differences in years 5+ (relevant period after the presumed rate increase) are not.

This contract would pass both Steps 2 and 3 and qualify for pricing flexibility because Step 3 is not testing the conceptually appropriate time period.

Issue #2: For permanent products, the Step 3 calculation introduces a new 5-year limitation (separate from the requirement that a price increase can occur within 5 years) that is not in the adopted instructions and is not consistent with the derivation of the RBC factors. Based on the Academy guidance, a contract not only needs to have the ability to increase rates in the first 5 years but also to cover 15 years of mortality risk (at the ~95%-tile level) with 5 years of COI charges.

For simplicity (to avoid Issue #1), assume that a company has the contractual ability and historical precedent for increasing COI rates immediately for adverse mortality experience. The current vs. guaranteed COI difference for the next 15 years (as well as years 6-20) can cover the RBC factor difference (= mortality risk for years 6-20). However, COI charge differences in the next 5 years cannot cover the extra 15 years of mortality exposure.

This contract would fail the Step 3 test even though in every individual year, the current vs. guaranteed rate difference is sufficient to cover the mortality stress underlying the RBC factors.

While a company needs to have the ability to raise rates within 5 years (in order to limit mortality risk exposure to 5 years), it should not be required to be able to raise rates to cover 15 years of mortality risk in just 5 years for perm. The 5-year limitation is reasonable for Term because it is consistent with the mortality exposure difference embedded in the RBC factor difference.

Using the first 5 years (not 5 years from the point of the rate increase) and requiring perm products to cover 15 years of mortality risk with 5 years of rate increases in Step 3 may have been intended for simplicity and to address concerns if pricing flexibility depends on rate increases that occur far in the future.
While using the first 5 years instead of 5 years starting from the point of the assumed rate increase could be a practical simplification, it may not be appropriate to mandate it if/when it produces a conceptually incorrect categorization that would materially affect results.

Possible ways to address:

- Make the 5-year requirement in Step 3 a safe harbor instead of requirement (e.g., so that the same calculations can be used across term and permanent business as a simplification).
- Allow permanent business to use a longer period in Step 3 with some degree of conservatism (i.e., >5 years but < 15 years) while making Step 2 more principle-based (e.g., need to be able to raise rates materially (roughly in line with mortality stresses) within 5 years). A contract with a back-ended rate increase that raises rates materially only in later durations would fail the principle-based 5-year requirement in Step 2. On the other hand, the classic, conceptual example for pricing flexibility above would pass Step 2 and have a greater chance of passing Step 3.

We appreciate the consideration of our comments and look forward to discussing on a future call.

Thank you.

Sincerely,

cc: Dave Fleming, NAIC
Appendix A: Additional Areas for Discussion or Clarification:

- Since the proposed “pricing flexibility” factors were derived based on a direct writer’s ability to reprice policyholder charges, it is unclear if they appropriately capture the ability of a reinsurer to raise rates on a ceding company.

- The new language for ceded business compounds the level of complexity in an already challenging new requirement and may be overly granular to meet the RBC objective of identifying “weakly capitalized companies.” For example, while gross face amounts are available from policy administrative systems, data to identify reinsurance coverage and reinsurance coverage by type (i.e., YRT, Coinsurance, etc.) will require treaty level assessments, data outside of administrative systems, and a consistent approach for assessing reinsurance pricing flexibility within and across entities.

- We would like clarification on how the mechanics of tiering will work, including situations with negative amounts (reinsurance) in the RBC calculation. For example, if a company has no “gross” face amount in the “with pricing flexibility” category, but under the new structure there will be reinsured face amount in that category — resulting in negative amounts. It is unclear if this was intended, or if the formulas will allow for negative amounts and charges.

- It seems like separate lines in the RBC blank for reinsured NAR (structural change) might be needed to make the risks reported in the RBC blank interpretable and address the issue above.

- The impact of the factors proposed by regulators on the prior call have not been assessed on an industry level, and additional time should be spent to discuss the appropriateness of the adjustments.
MEMORANDUM

TO: Thomas Botsko (OH)
Chair of the Property Casualty Risk-Based Capital (E) Working Group

FROM: David Smith & Doug Stolte (VA)
Co-Chairs of the Restructuring Mechanisms (E) Subgroup

DATE: January 29, 2020

RE: Request for Input

The Financial Condition (E) Committee formed the Restructuring Mechanisms (E) Working Group and Restructuring Mechanisms (E) Subgroup in early 2019. The Subgroup has determined that its priority in addressing its charges is to develop best practices as it relates to reviewing and considering such transactions for approval. While the Subgroup intends to leverage existing practices used by international regulators and other practices proposed in the past for liability-based restructuring, addressing this priority charge is expected to take some time. Among other things, the Subgroup is also charged with the following:

"Consider the need to make changes to the RBC formula to better assess the minimum surplus requirements for companies in runoff. Complete by the 2020 Fall National Meeting."

In order to be responsive to the RBC charge noted above, the Subgroup requests your Working Group to take the lead in addressing this charge. More specifically, as the subject matter experts of the Property Casualty RBC formula, you are best equipped to determine if changes should be made to the formula to better assess companies in runoff. As the issues and positions are identified, we ask that P&C RBC also take the lead in coordinating with other RBC working groups including Life and Health.

We note that the above charge is for companies in run-off rather than for blocks of business only in run-off. The subgroup’s survey of states asked questions regarding the definition of run-off. These responses are shared with the Working Group on the following page for discussion.

As noted above, our charge has a due date of the 2020 Fall National Meeting; therefore to the extent you are unable to come to a conclusion prior to that date, please notify us and include in such a notification a more appropriate date under which you could make such a determination. From there, the Subgroup will request an extension based upon your suggestion.

Please contact me or NAIC staff for this project, Robin Marcotte rmarcotte@naic.org, if you have any questions.

Cc: Dan Daveline, Eva Yeung; Jane Barr
W:\National Meetings\2020\Spring\Cmte\E\Restructuring\Subgroup\Jan 28 call\Memo from RMSG to PCRBC.docx
1. Does your state have a definition for “Runoff Companies”?  

   a. Yes – 4 states  
   b. No – 29 states however, 4 provided responses.

<table>
<thead>
<tr>
<th>State¹</th>
<th>Response</th>
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<tbody>
<tr>
<td>1.</td>
<td>Yes ( none was provided). Comment in RBC it discusses running off or run off but not definition.</td>
</tr>
<tr>
<td>2.</td>
<td>Yes. There is no formal definition. It is understood to mean companies that, voluntary or not, have ceased writing premium except for mandatory renewals required by regulation in various states.</td>
</tr>
<tr>
<td>3.</td>
<td>Yes. Licensed companies that are no longer writing business and have no plans to write in the future.</td>
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| 4.     | Yes. Under the state’s laws "Run-off insurer" means an insurer that: (i) Is domiciled in the state; (ii) Has liabilities under policies for property and casualty lines of business; (iii) Has ceased underwriting new business; and (iv) Is only renewing ongoing business to the extent required by law or by contract. However, for purposes of the Restructuring Mechanism Subgroup, we believe the following definition is appropriate to define "Runoff Companies" in general: "Companies that are no longer actively writing new insurance business or collecting premiums except where required to in accordance with contractual or regulatory obligations, and whose sole material business is the management of an existing or assumed group of insurance policies or contracts through their termination."
| 5.     | No. However, in practice, a run-off company services only existing business, does not write new business, and has no intent to acquire or engage in the business of run-off by acquiring other run-off blocks of business |
| 6.     | No. The state’s insurance law does not define “runoff companies;” however, the state applies a general concept of “runoff companies” to include an insurer that writes no new premium or has had no new policyholders for several years leading to claims administration only. |
| 7.     | No. This concept is something we plan to institute internally in 2019. The details have yet to be determined.                                                                                             |
| 8.     | No. There is no formal definition for "Runoff Companies" in the statutes or regulations.                                                                                                                   |

¹ State numbers are just for the responses and state 1 in a chart may be a different state in the next chart.
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

MEMORANDUM

TO: David Smith (VA) and Doug Stolte (VA), Co-Chairs of the Restructuring Mechanisms (E) Subgroup
    Judith L. French (OH), Chair of the Capital Adequacy (E) Task Force

FROM: Tom Botsko (OH), Chair of the Property and Casualty Risk-Based Capital (E) Working Group

DATE: Oct. 25, 2021

RE: Response to Request for Input Regarding Runoff Companies

The Property and Casualty Risk-Based Capital (E) Working Group formed a small ad hoc group to discuss this topic and try to determine the best course of action. The Restructuring Mechanisms (E) Subgroup requested that the Working Group take the lead in addressing the charge to “consider the need to make changes to the RBC formula to better assess the minimum surplus requirements for companies in runoff.”

After several discussions about what adjustments should be made to the risk-based capital (RBC) formula, the ad hoc group concluded that the best course of action is to monitor these companies through the state analysis and exam team functions. The characteristics and financial conditions of these runoff companies are very diverse, and it would be difficult to incorporate these varied characteristics into one adjusted formula. Many international countries monitor these companies through the analysis and exam processes and do not have a separate RBC formula.

Of the 2020 RBC filers, we identified 111 companies out of 2,477 that have the characteristics of a runoff company. Most of these companies have an RBC ratio greater than 300%. Five are below 200%.

During a series of discussions, the ad hoc group agreed that a runoff company, voluntary or involuntary, should include the following characteristics: 1) no renewing of policies for at least 12 months; 2) no new direct or new assumed business; and 3) no additional runoff blocks of business. In addition, the amount of renewal premium to reserves has also been identified as a characteristic of these types of companies when this ratio is de minimis.

The ad hoc group also recommends that a general and RBC interrogatory be added for the purpose of identifying a runoff company. The domiciliary state shall have the ability to verify the interrogatory response during the annual company financial analysis process.

As the ad hoc group considered various types and conditions of runoff companies, it became apparent that while many of these companies share the characteristic of very long tail liabilities, there are other characteristics of these companies that are so diverse that it made it difficult to summarize them into their own RBC formula.
The ad hoc group reviewed several international perspectives of runoff companies. The international treatment of runoff companies is handled through the Analysis and Exam Teams. The ad hoc group agrees that a similar treatment of runoff companies is warranted.

The ad hoc group has some recommendations for the Working Group regarding the RBC instructions, specifically to the runoff companies. These include the following:

- Remove the Trend Test from the RBC calculation. These are runoff companies, and the possible retrospective premium should not complicate the already diverse situation.
- Remove the charge for premium growth if the company is no longer writing business.
- Remove $R_{cat}$ from the formula. Because one of the characteristics of a runoff company is to not have written any new business for at least 12 months, we believe this short-term liability risk is not warranted.

As the ad hoc group shares its findings with the other two RBC working groups, we expect to hear other perspectives regarding the unique conditions of runoff companies from the Life Risk-Based Capital (E) Working Group and the Health Risk-Based Capital (E) Working Group.

Please contact Eva Yeung, NAIC staff support for the Property and Casualty Risk-Based Capital (E) Working Group, at eyeung@naic.org with any questions.

Cc: Robin Marcotte; Dan Daveline; Jane Barr; Eva Yeung