Memo

To:	Director Judith French and Nathan Houdek, Co-Chairs of the Risk-Based Capital Model Governance (EX) Task Force
From:	Patricia Matson, FSA, MAAA, Partner, Risk & Regulatory Consulting, LLC Lynn Manchester, FSA, MAAA, Director, Risk & Regulatory Consulting, LLC Janine Bender, ASA, MAAA, Supervisor, Risk & Regulatory Consulting, LLC
Date:	July 24, 2025
Subject:	RRC Comments regarding Request for comments on proposed preliminary Risk-Based Capital ("RBC") principles and questions

Background

The Risk-Based Capital Model Governance (EX) Task Force is requesting comments on the proposed preliminary Risk-Based Capital ("RBC") principles and questions ("the Exposure").

Risk & Regulatory Consulting, LLC ("RRC") appreciates the opportunity to offer our comments on the proposed expanded governance over the RBC framework. Should you have any questions, we would be glad to discuss our comments with you and Task Force members.

We appreciate the work that the RBC Model Governance (EX) Task Force has undertaken to address what we believe is a critical industry issue, namely RBC principles which *"serve as a strategic foundation to ensure that all revisions to the RBC framework are enhancements that uphold its integrity, adaptability, and global competitiveness and further the principle of Equal Capital for Equal Risk."*

We strongly encourage the Task Force to consider RBC holistically in developing these principles, rather than focusing on specific subsets of RBC in isolation. The principles should apply across the life, health, and property/casualty formulas and should apply to all risk components (not just investment risk). The principles should also consider other aspects of the regulatory framework such as Statutory Accounting Principles.

Regarding the "Questions that the principles and broader framework should be used for guidance," we have the following comments:

1. When should a particular risk be addressed in the RBC model?
   Response: We believe a risk should be addressed if it poses or has the prospect of being a material industry risk. In order to balance the comprehensiveness of RBC with practicality, we believe that capturing risks that may only be represented across a small number of insurers would be challenging and an inefficient use of limited resources. There may be other parts of the regulatory framework, such as additional disclosure requirements, which would be equally effective.

2. What level and type of data and analysis are needed to support the setting of capital factors?
   Response: RRC encourages the use of sound analytical practices to estimate risk and the

associated charges for that risk, guided by the existing regulatory framework and applicable actuarial standards of practice. This should involve the use of credible historical data on loss distributions, which can be used to estimate losses at a defined confidence level. It should also involve fitting less robust data to a distribution, in order to estimate those losses. In addition, anticipated impacts of changes in the risk since the data period are also important to consider. The actual data and analysis will depend on the risk being addressed and the data available. RRC encourages as much consistency of approach as possible, while still considering how the risk manifests and the credibility and reliability of data.

3. How should new and emerging risks and asset types be treated if a capital framework has not yet been developed for them?
   Response: RRC believes the same analytically sound approaches should be used for new and emerging risks. In other words, they should be assessed appropriately and then added to the capital framework once a sound capital approach is developed. In order to capture emerging risk that may not be incorporated into the RBC framework quickly, applying a margin that reflects the perceived risk (as well as its correlation with risks already captured in RBC) on top of the developed factors may be appropriate while more detailed analysis is done. The RBC submissions could also be used to collect data from insurers on emerging risks to support development of factors.

4. What level of statistical safety is to be targeted by the model or, if not, a single target, and how should such tailored safety targets be determined?
   Response: RRC believes that the regulatory community should determine the desired safety level considering the goal of protecting consumers. RRC believes that such a target should be consistent across insurer types and risks, should consider diversification across risks, and should appropriately capture tail risks (which may mean that at least some risks require a conditional tail expectation rather than a point estimate in order to capture "fat tail" risk).

5. When should the calibration of risks to capital factors be re-evaluated?
   Response: RRC recommends a periodic re-evaluation, such as every 10 years. We also suggest developing criteria that would require an interim evaluation, such as substantial changes in market conditions, a major industry shift in solvency levels, or a major change in the underlying accounting rules for items that drive RBC.

6. How should the RBC calculations define and structure governance over model risk, including model development, documentation standards, validation, ongoing monitoring, and change management?
   Response: RRC recommends leveraging model risk governance frameworks that are currently available for both ensuring soundness of the calculation templates as they are developed and changed, and for providing guidance to companies for governing their completion of the RBC calculation templates. One example of such a framework is Supervision and Regulation Letter 11-7 issued by the Federal Reserve (SR 11-7).

7. To what extent should RBC calculations align with Statutory Accounting Principles (SAP)? If alignment is pursued, how should the framework account for, say, valuation differences between directly held assets and securitized exposures, and how might these differences influence investment behavior or regulatory arbitrage?
   Response: Alignment of the calculations with valuation guidance found in the Statutory Accounting Principles is a necessary component. It also creates auditability, which is an important

characteristic. There may be other considerations beyond Statutory Accounting Principles to capture the risk well (similar to how the risk is captured for Variable Annuities in the current Life RBC formula), but that tradeoff should be carefully considered, and any differences should be explained. With respect to the difference between directly held assets and securitized exposures, differences and similarities between treatment should take into account all differences in ownership of exposures. Differences in the management of the assets, cash flow waterfalls, and collateralization triggers can lead to a substantive difference in the risk profile.

8. How should reserves, valuation adjustments, or offsets (e.g., taxes or discounting) be considered?
   Response: Statutory reserves and capital are both intended to provide protection to policyholders. When considered in aggregate (i.e., reserves plus capital), the amounts held should result in a high probability of payment of all claims to customers, including coverage of associated expenses. Capital should pick up where reserves leave off, in other words the margins in reserves would generally cover customer payments with a high degree of certainty, and the combination of reserves and capital would cover those payments with a higher degree of certainty. Diversification across risks should also be considered. We suggest that the time value of money be considered in light of its critical impact on insurers' risk profile.

9. How should existing principles (e.g., the American Academy of Actuaries' Principles for Structured Securities RBC), which regulators have endorsed, fit into the principles?
   Response: RRC believes that any RBC principles adopted or endorsed by regulators should be consistent and that conflicts would likely lead to confusion and potential for arbitrage. If as a result of this effort conflicts should arise, these conflicts should be resolved on a case-by-case basis.

10. How should interaction/co-dependence of factors (e.g., C-1/C-3 and RBC Covariance) be recognized and treated?
    Response: Risk diversification should be considered and applied consistently across companies. RRC recommends something relatively simple like correlation matrices to maintain auditability.

<u>Regarding the "Proposed preliminary RBC principles, applied by company type," we have the following comments:</u>

1. **Use of RBC calculations.** RBC calculations are used as a regulatory tool only to identify potentially weakly capitalized companies unless otherwise required by law, regulation, or supervisory standards. RBC calculations provide regulators with legal permission and/or requirements to intervene at various RBC levels.
   Response: RRC recognizes that RBC is intended solely as a regulatory tool and understands the regulatory concern that RBC may be misused and/or misunderstood. The principles on their own cannot dictate the uses of RBC, only the INTENT can be dictated. RRC suggests that the language be edited to emphasize intent rather than use. Additionally, the calculations provide regulators with information they can use to make decisions about intervention rather than just the ability to intervene.

   a. **Insolvency.**
      i. **Possibility of insolvency**. RBC charges should be set to reflect a level of safety that reduces the probability of insolvency, without eliminating the possibility of insolvency.
         Response: We suggest clarifying this further, such as "RBC charges should be set to reflect a margin of safety. The goal of these charges is not to eliminate the

possibility of insolvency, but rather to reduce the probability of insolvency assuming appropriate regulatory action is taken."

ii. **RBC calculations should secondarily acknowledge their impact on product availability that meets consumer needs.** RBC charges should be sufficiently granular to recognize material differences in risk, particularly when they may materially affect insurer decisions that impact meeting consumer needs.
Response: We believe the statements in this section could be made clearer. RRC suggests either editing the end of the statement to "…particularly when they may materially affect insurer decisions around product offerings to meet consumer needs." Or rewording the entire section, such as "In considering the appropriate safety level for RBC, the balance between increasing solvency and maintaining affordable insurance products should be considered."

iii. **Actions unrelated to solvency.** RBC charges should not serve to promote or inhibit actions by insurers that are unrelated to solvency risk.
Response: RRC has no comments and agrees with this as written.

iv. **Identified risk.** Where identifiable, RBC charges should reflect measurable differences in risks that can impact solvency. The risks captured or not captured within RBC calculations should be identified. Adjustments should offset material risks that are captured in multiple calculations.
Response: RRC finds the language in 1.a.iv to be a bit confusing and suggests clarifying the language, such as, "RBC should include all risks that may be material to solvency. In the event one of these risks is excluded (e.g., difficult to quantify), the exclusion should be documented and explained. In the event that certain risks are captured in multiple components of the formula, appropriate adjustments should be incorporated."

b. **Insurance groups and global competitiveness.** While RBC calculations are designed to identify potentially weakly capitalized companies, they should be acknowledged as a component of assessing capital adequacy for insurance groups, including those active internationally.
Response: We recommend that the language be altered to "…they should be developed with the goal of having them acknowledged…."

2. **Objectivity.** RBC charges should be objective and measured at a consistent statistical safety level. RBC charges should reflect the risk exposure they are intended to measure, capturing differences in their risk distributions, with appropriate considerations for concentration, diversification, and tail risks. They should recognize differences in accounting, reserving requirements, and other offsets (e.g., taxes or discounting) and consider overall business practices and their treatment within the framework (e.g., hedging strategies).
Response: RRC suggests revising the sentence: "They should recognize differences in accounting, reserving requirements, and other offsets (e.g., taxes or discounting) and consider overall business practices and their treatment within the framework (e.g., hedging strategies)." We suggest the language should be revised as follows: "RBC charges should reflect the underlying economic risk. While accounting values may be used in the calculation for simplicity and auditability, the RBC framework should aim to produce RBC amounts that are consistent across risks, based on the desired safety level, and should not be inappropriately skewed due to accounting differences", or something similar. We also believe it may be overreaching to suggest considering "overall business practices and their treatment within the framework." Although, we do agree that RBC should not dis-incentivize good risk management practices.

3. **Consistency with Statutory Accounting.** RBC charges should be derived from values reported in the statutory annual statement.
   Response: RRC recommends enhancing the sentence to start with "To the extent practical, RBC charges…". While RRC recognizes that having RBC charges derived from reported values enhances transparency, in some cases it will not be possible to develop an appropriate risk charge using Annual Statement values alone, so there should be allowance for alternatives in those cases. RRC believes that sound charges should be a higher priority than having them be 100% based on the Annual Statement values.

4. **Emerging risks. Evaluation of emerging risks should consider:**
   a. The level and growth in exposure to the emerging risk;
   b. How quickly the risk can become materially incorporated into insurers' business;
   c. Industry exposure to the risk, as well as industry segment exposure; and
   d. Identification and measurement limitations of emerging risks.

   Response: RRC is unsure what "industry segment exposure" means. Perhaps this is referring to life insurance, health insurance, and property casualty insurance. This should be defined somewhere or clarified. Another factor to be considered is the potential volatility or severity of that risk.

5. **Changes to RBC calculations.**
   a. **Transparency and process.** NAIC RBC stakeholders should collaborate to identify emerging risks that potentially require changes to RBC calculations. Changes to RBC calculations shall adhere to the *NAIC Open Meeting Policy* and should be conducted transparently, allowing stakeholders reasonable time to offer feedback. Complex proposals may require a more iterative process.
      Response: RRC agrees with this and supports transparency of all aspects – principles, calculations, disclosures, etc.

   b. **Equal capital for equal risk.** RBC charges should balance the appropriateness of the existing charge with the added complexity and materiality of the possible change. Refinements to RBC calculations should aspire not to result in deviations from the principle of Equal Capital for Equal Risk.
      Response: RRC agrees with this and does not have any further comments.

6. **Governance.** Components of RBC calculations should adhere to Model Governance Standards that provide processes for model development, documentation standards, validation, ongoing monitoring, and change management. The calculations should be understandable and auditable by regulators. This ensures that future adjustments align with guiding principles and supporting guidelines.
   Response: RRC suggests removing "components of", as the intent is that the entirety of RBC calculations should be well governed. Additionally, we recommend the removal or re-wording of the last sentence (having understandable RBC will not ensure that future adjustments align with the principles).

Thank you for the opportunity to provide comments on this important topic. We can be reached at 813-506-7238/lynn.manchester@riskreg.com or 860-305-0701/tricia.matson@riskreg.com or if you or other members have any questions.