

REPORT OF EXAMINATION
OF THE
AUTOMOBILE CLUB OF SOUTHERN CALIFORNIA
LIFE INSURANCE COMPANY
AS OF
DECEMBER 31, 2021

Insurance Commissioner

A handwritten signature in blue ink, appearing to read "P. Deltor".

Filed on February 1, 2023

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Los Angeles, California
December 2, 2022

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

AUTOMOBILE CLUB OF SOUTHERN CALIFORNIA LIFE INSURANCE COMPANY

(hereinafter also referred to as the Company). The Company's statutory home office is located at 3333 Fairview Road, Costa Mesa, California 92626. The primary location of its books and records is 17900 North Laurel Park Drive, Livonia, Michigan 48152.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2018. This examination covered the period from January 1, 2019 through December 31, 2021.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook* (*Handbook*). The *Handbook* requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made

by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Company.

This was a coordinated examination with Michigan as the lead state. It was conducted concurrently with the examinations of AAA Life Insurance Company (Michigan), Auto Club Life Insurance Company (Michigan), and AAA Life Insurance Company of New York (New York). The following states participated on the examination: California and New York.

COMPANY HISTORY

The Company is equally owned by the Automobile Club of Southern California (ACSC), a California nonprofit mutual benefit corporation and the Interinsurance Exchange of the Automobile Club (IEAC), a California reciprocal insurer. ACSC is the ultimate controlling entity of the insurance holding company system, which includes the Company and IEAC.

On September 11, 2013, ACSC and IEAC issued a Commitment Letter to the California Department of Insurance, which ACSC and IEAC will equally provide additional capital contributions to the Company, as needed, in order to maintain the Company's Risk-Based Capital (RBC) ratio at a minimum level of 250%.

On August 1, 2017, ACSC and IEAC extended their commitment by issuing a new Commitment Letter with an effective date of January 1, 2018, and an expiration date of December 31, 2020.

On September 30, 2020, ACSC and IEAC again extended their commitment by issuing a new Commitment Letter with an effective date of January 1, 2021, to provide additional capital contribution required to maintain the Company's RBC ratio at a minimum level of 225%, instead of 250%, and guarantee the Company's solvency until December 31, 2023.

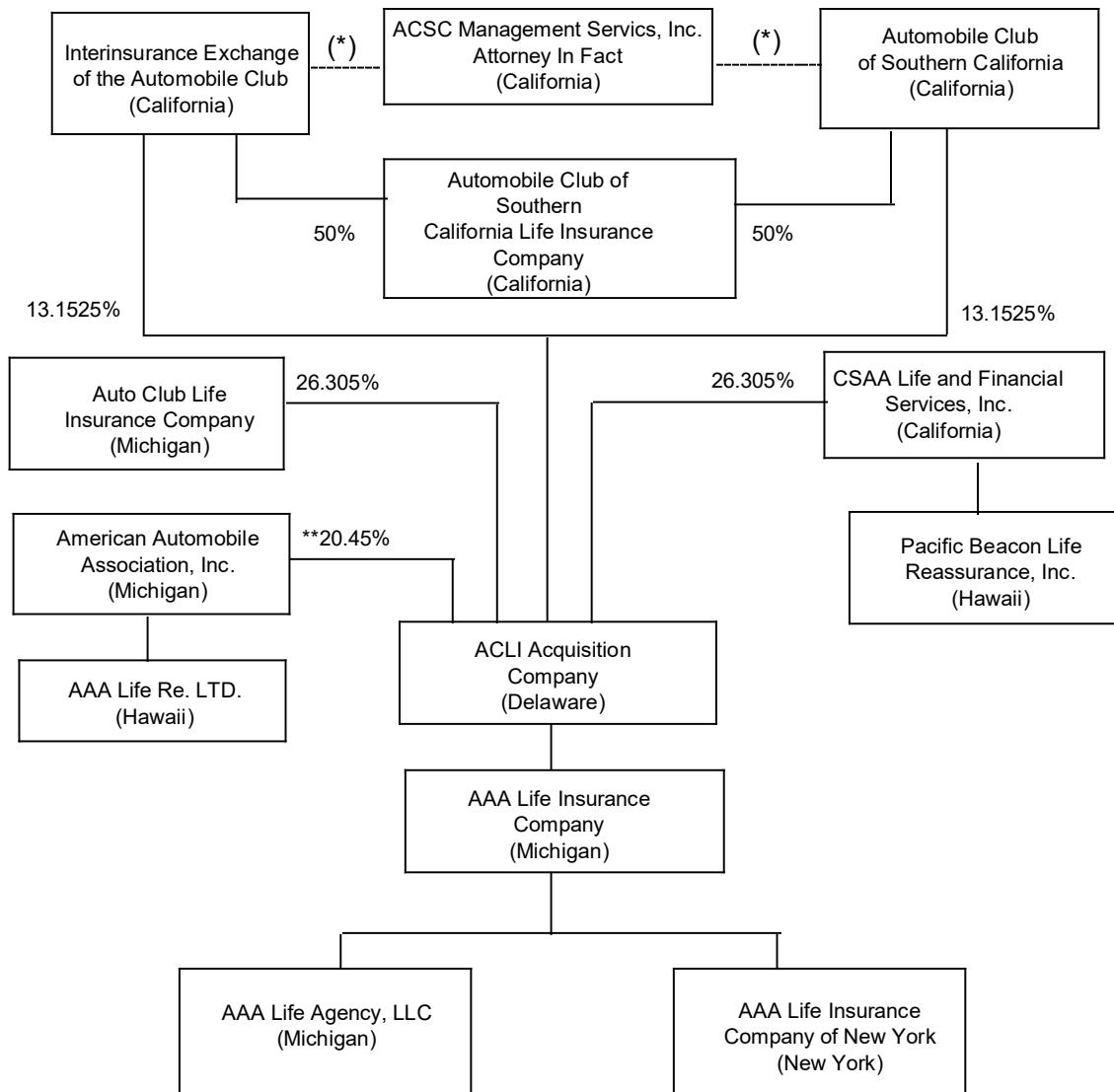
Capitalization

The Company has 26,000 shares of capital stock issued and outstanding with a par value of \$100 per share. The outstanding shares are 50% owned by the Automobile Club of Southern California (ACSC) and 50% owned by the Interinsurance Exchange of the Automobile Club (IEAC).

In order to maintain an adequate capital position, the Company has received \$27 million, \$50 million, and \$32.9 million in 2019, 2020, and 2021, respectively, in cash capital contributions from its parent companies under the terms of the Commitment Letter. As of December 31, 2021, ACSC and IEAC have each made cumulative capital contributions to the Company of \$155.4 million since inception.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company and its affiliated insurance companies, depicts the Company's relationship within the holding system at December 31, 2021: (all ownership is 100% unless otherwise noted)



(*) Contractual or other relationship to operate the Exchange

** American Automobile Association, Inc. sold its shares in ACLI Acquisition Company to AAA Northeast Holdings, Inc (AAA Northeast). Life Alliance Reinsurance Corporation, a subsidiary of AAA Northeast, replaced AAA Life Re. LTD as a party to the Second Amended and Restated Expenses Sharing Agreement, effective June 1, 2022.

The four members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2021:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Christopher M. Baggaley San Clemente, California	Senior Vice President Automobile Club of Southern California
John F. Boyle Coto De Caza, California	President and Chief Executive Officer Automobile Club of Southern California
John P. Bybee Trabuco Canyon, California	Vice President Automobile Club of Southern California
Raju T. Varma Yorba Linda, California	Executive Vice President, Chief Financial Officer, Treasurer, and Controller Automobile Club of Southern California

Principal Officers

<u>Name</u>	<u>Title</u>
John F. Boyle	President and Chief Executive Officer
Raju T. Varma	Vice President, Chief Financial Officer, Treasurer, and Controller
Gail C. Louis	Corporate Secretary
Katherine A. Sieck	Vice President and Assistant Secretary
Anwar M. Othman	Vice President

Management Agreements

Amended and Restated Expenses Sharing Agreement: Effective July 1, 2019, the Company entered into the Amended and Restated Expenses Sharing Agreement with AAA Life Insurance Company (AAA Life), Auto Club Life Insurance Company (ACL), ACLI Acquisition Company (ACLI), Pacific Beacon Life Reassurance Company (PBLR), and AAA Life Re, Ltd (AAA Life Re). Under the terms of the agreement, on an annual

basis, the parties agree upon a unit charge to be applied to each new policy written and each policy inforce. The unit charge is based upon expense assumptions used in pricing each product and includes administration, underwriting, and marketing costs and expenses incurred by AAA Life, ACL, and ACLI for policies reinsured by any party to the agreement. The total expense allocation for each reinsurer is computed as the unit charge for each policy written by ACL and AAA Life, and multiplied by the reinsurance percentage set forth in the applicable reinsurance agreement. Adjustments are made on a quarterly basis to assure the estimated expenses reasonably approximate actual expenses.

Furthermore, the agreement defines a portion of the expenses incurred on the new and inforce policy of AAA Life or ACL as "Shared Organizational Infrastructure Expenses" (Shared OIE). Shared OIE shall equal the actual organizational infrastructure expenses incurred by AAA Life in the calendar year two years prior to such calendar year. The year-to-year increase on the Shared OIE shall be capped at 3%. Any increase over 3% will require the approval of the board of directors of AAA Life. The agreement was non-disapproved by the CDI on August 23, 2019. The amounts paid in 2019, 2020, and 2021 by the Company to AAA Life were \$87,067,764, \$95,147,958, and \$96,059,101, respectively.

On April 26, 2022, the Company filed with the California Department of Insurance (CDI) a Second Amended and Restated Expense Sharing Agreement. Effective June 1, 2022, Life Alliance Reassurance Corporation replaced AAA Life Re as a party to the agreement, and all other parties and terms remain unchanged. The agreement was non-disapproved by the CDI on May 19, 2022.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact life and accident and health insurance only in the state of California, and is also an accredited reinsurer in Michigan. The Company does not directly underwrite any life insurance risks or directly issue any life or annuity

products. The Company primarily assumes life insurance and annuity products from AAA Life Insurance Company and Auto Club Life Insurance Company, affiliated Michigan insurance companies. All premiums assumed by the Company are generated through the life insurance agency operations of the Automobile Club of Southern California.

LOSS EXPERIENCE

The following schedule reflects the net operating losses and net losses from 2019 through 2021 as reported by the Company:

Year	Net Operation Gains (Losses)	Net Income (Losses)
2019	\$ (17,439,222)	\$ (17,421,610)
2020	\$ (41,550,591)	\$ (42,987,003)
2021	\$ (47,806,396)	\$ (47,723,528)
2022*	<u>\$ 18,728,674</u>	<u>\$ 18,723,485</u>
Tota	<u><u>\$ (88,067,535)</u></u>	<u><u>\$ (89,408,656)</u></u>

*Through September 30, 2022.

In total for the examination period through September 30, 2022, the Company reported net operating losses and net losses of \$88.1 million and \$89.4 million, respectively. The operating losses and net losses are primarily due to the continued growth in new business and the first-year costs associated with new business production, which includes an increase in direct mail expense. In 2020 and 2021, the Company experienced higher than expected claim benefits payout due to adverse mortality, largely the result of the Pandemic related claims.

As the Company consistently builds up its in-force policy base during the examination period, the overall interest rate environment also has been favorable to the Company's overall profitability in 2022. The Company has reported larger than usual growth on its assumed business from \$261.6 million during the first three quarters of 2021, compared to \$326.6 million, a 25% growth, during the same period of 2022. Even with the increase of the associated cost of the newly assumed business and higher than usual

claim benefits payout on the Pandemic related claims, the Company has reported the net operating gain and income up to September 30, 2022.

REINSURANCE

Assumed

Effective January 1, 2000, the Company entered into a Quota Share Reinsurance Agreement with AAA Life Insurance Company (AAA Life), a Michigan domiciled insurer, to assume 80% of the California business underwritten by AAA Life and is on a co-insurance basis. The agreement was approved by the California Department of Insurance (CDI) on October 8, 2002. The agreement was amended to increase the assumption percentage to 100%, effective January 1, 2014. The CDI approved the assumption rate increase on September 12, 2013.

On November 1, 2017, the agreement was amended to cede all new or inforce policies, originally written by Ohio Motorists Life Insurance Company and assumed by AAA Life, to the Company. On July 1, 2019, the latest amendment to the agreement was made, adding a Risk-Based Capital ratio of 225% maintenance requirement for the Company. The term of the agreement will continue in full force and effect until December 31, 2024, and automatically renew for five years. The CDI has reviewed the amendments for compliance with California Insurance Code (CIC) Section 1215.5(b)(3) and 1011(c) and determined that no prior approval is required.

Ceded

The Company does not have any ceded reinsurance.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2021. The accompanying comments to the amounts reported in the annual statements should be considered an integral part of the financial statements. There were no examination adjustments made to surplus as a result of the examination.

Statement of Financial Condition as of December 31, 2021

Underwriting and Investment Exhibit for the Year Ended December 31, 2021

Reconciliation of Surplus as Regards Policyholders from December 31, 2018 through December 31, 2021

Statement of Financial Condition
as of December 31, 2021

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 1,504,265,231		\$ 1,504,265,231	
Stocks	3,520,000		3,520,000	
Cash, cash equivalents, and short-term investments	34,156,949		34,156,949	
Contract loans	15,976,537	2,140,100	13,836,437	
Other invested assets	1,721,461		1,721,461	
Investment income due and accrued	13,625,288		13,625,288	
Uncollected premiums and agents' balances in the course of collection	3,860,163		3,860,163	(1)
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	83,973,379		83,973,379	(1)
Other amounts receivable under reinsurance contracts	7,293,542		7,293,542	
Net deferred tax asset	<u>48,468,751</u>	<u>38,375,622</u>	<u>10,093,129</u>	
Total assets	<u>\$ 1,716,861,300</u>	<u>\$ 40,515,722</u>	<u>\$ 1,676,345,578</u>	
<u>Liabilities, Surplus, and Surplus</u>				
				<u>Notes</u>
Aggregate reserve for life contracts			\$ 1,474,048,828	(1)
Aggregate reserve for accident and health contracts			17,986,624	(1)
Liability for deposit-type contracts			2,065,570	(1)
Contract claims: Life			43,739,576	(1)
Contract claims: Accident and health			7,094,192	(1)
Premiums and annuity considerations for life and accident and health contracts received in advance			1,395,874	(1)
Interest maintenance reserve			19,444,111	(1)
Commissions and expense allowances payable on reinsurance assumed			30,157	
General expenses due or accrued			1,144,056	
Miscellaneous liabilities: Asset valuation reserve			16,418,716	(1)
Miscellaneous liabilities: Payable to parent, subsidiaries, and affiliates			<u>8,508,369</u>	
Total liabilities			1,591,876,073	
Common capital stock	\$ 2,600,000			
Gross paid-in and contributed surplus	341,100,000			
Unassigned funds (surplus)	<u>(259,230,495)</u>			
Surplus as regards policyholders			84,469,505	
Total liabilities, surplus, and other funds			<u>\$ 1,676,345,578</u>	

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2021

Summary of Operations

Underwriting Income

Premiums and annuity considerations for life and accident and health contracts	\$ 350,108,910
Net investment income	54,169,824
Amortization of interest maintenance reserve	1,571,582
Aggregate write-ins for miscellaneous income	<u>7,059</u>
Total	<u>405,857,375</u>
Death benefits	107,274,656
Annuity benefits	18,025,952
Disability benefits and benefits under accident and health policies	11,248,190
Surrender benefits and withdrawals for life contracts	60,787,240
Group conversions	394,065
Interest and adjustments on contract or deposit-type contract funds	971,918
Increase in aggregate reserves for life and accident and health contracts	99,789,310
Commissions and expense allowances on reinsurance assumed	62,833,768
General insurance expenses	91,964,819
Insurance taxes, licenses and fees, excluding federal income taxes	1,967,254
Increase in loading on deferred and uncollected premiums	<u>526,132</u>
Total	<u>455,783,314</u>
Net loss from operations before federal income taxes	(49,925,939)
Federal income taxes incurred	<u>(2,119,542)</u>
Net loss from operations after federal income taxes	<u>(47,806,395)</u>
Net realized capital gains	82,868
Net loss	<u>\$ (47,723,528)</u>

Capital and Surplus Account

Capital and surplus, December 31, 2020	\$ 100,871,654
Net loss	\$ (47,723,528)
Change in net deferred income tax	7,866,077
Change in non-admitted assets	(6,710,994)
Change in asset valuation reserve	(2,733,704)
Surplus adjustments:	
Paid-in	<u>32,900,000</u>
Net change in capital and surplus for the year	<u>(16,402,149)</u>
Surplus as regards policyholders, December 31, 2021	<u>\$ 84,469,505</u>

Reconciliation of Surplus as Regards to Policyholders
from December 31, 2018 through December 31, 2021

Surplus as regards policyholders, December 31, 2018		\$ 93,618,342
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net loss	\$ 108,132,141	
Change in net deferred income tax	18,927,381	
Change in net admitted assets		22,604,347
Change in reserve on account of change in valuation basis		700,085
Change in asset valuation reserve		6,489,078
Aggregate write-ins for gains and losses in surplus		50,567
Surplus adjustment: Paid-in	109,900,000	
Total gains and losses	<u>\$ 128,827,381</u>	<u>\$ 137,976,218</u>
Net decrease increase in surplus as regards policyholders		<u>(9,148,837)</u>
Capital and surplus, December 31, 2021		<u>\$ 84,469,505</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Aggregate Reserve for Life Policies and Contracts

Aggregate Reserve for Accident and Health Policies

Liabilities for Deposit-type Contracts

Contract Claims – Life

Contract Claims – Accident and Health

Premiums Received in Advance

Net Deferred and Uncollected Premiums

Asset Valuation Reserve

Interest Maintenance Reserve

The December 31, 2021, policy reserves and related actuarial items were evaluated by Lewis & Ellis, Inc., engaged by the lead state, the Michigan Department of Insurance and Financial Services. Based on the analysis performed, the Company's policy reserves and related actuarial items were found to be reasonably stated. The assigned California Department of Insurance (CDI) actuary reviewed the work performed by the lead state, and recommended that CDI adopt the review and conclusion of the lead state regarding policy reserves and related actuarial items.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

Young, Shu

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Shu Young, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

Oseguera, Ralph

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Ralph
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Ralph Oseguera, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California