AMERICAN ACADEMY *of* ACTUARIES

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October 2, 2014

Mike Boerner
Chair, Life Actuarial Task Force
National Association of Insurance Commissioners (NAIC)

Dear Mike:

The American Academy of Actuaries[1] Principle-Based Reserves Strategy Subgroup (PBRSS) appreciates the opportunity to comment on the proposed changes to the September 22, 2014 exposure draft of Actuarial Guideline 48 (AG 48) that was released by LATF on September 25.

We are pleased to see that proposed changes to the treatment of third-party reinsurance in AG48 discussed on the September 25 LATF call seek to address a primary concern raised in our September 17 comment letter, that the Actuarial Method should reflect the impact of risks that have been ceded to a third-party reinsurer.

However, we disagree with the detailed approach discussed on the September 25 LATF call of using a ratio based on *the statutory reserve after reinsurance* divided by *the statutory reserve before reinsurance* to determine the reinsurance adjustment to apply to the Actuarial Method calculated on a gross basis (i.e., before reinsurance to third parties). As stated in our September comment letter, the adjustment to the Actuarial Method determined on a gross basis should appropriately reflect the risks transferred to the third party reinsurer. While our comment letter did not explicitly make reference to Section 8 of VM-20 (Section 8), our intent was to support the approach defined in Section 8 (i.e., PV of net reinsurance cash flows to/from the third party reinsurer) to quantify the risks that have been transferred to the third party. While the use of a ratio based on the statutory reserve before and after reinsurance works reasonably well for proportional reinsurance such as coinsurance, it is not a good proxy for the risks transferred under a non-proportional reinsurance arrangement such as YRT.

In addition, the PBRSS has several concerns with the following revisions to the September 22, 2014 Version to determine the adjustment for reinsurance:

> The Actuarial Method is to be applied by the ceding company to the risks represented by the reserves ceded with respect to Covered Policies as though these are the risks of the

[1] The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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ceding company. The reinsurance Section 8 of VM-20 in the Valuation Manual shall not be used in applying the Actuarial Method. The result of applying the Actuarial Method is limited to the amount of such reserves ceded.

For Yearly Renewable Term reinsurance, the ceded statutory reserve is based on the one-year term mean reserve on the amount of insurance ceded. Our interpretation of the alternative approach quoted above is that it would similarly limit the adjustment for reinsurance by only capturing the risks transferred to a third party YRT reinsurer for the period of time covered by the statutory YRT ceded reserve. For example, the adjustment for reinsurance consistent with this interpretation would only capture the impact of reinsurance cash flows to/from the third party up to the YRT reinsurance anniversary immediately following the valuation date. We disagree with this proposed approach since it deviates from the principle-based approach otherwise taken in the Actuarial Method. For example, the Actuarial Method is calculated on projected non-reinsurance cash flows across all future years, even when those cash flows may include projected adjustable elements like COI charges. To be consistent, we believe the adjustment for reinsurance should also be based on the PV of reinsurance cash flows across all future years (consistent with Section 8) not just the YRT reinsurance cash flows through the YRT anniversary, even though following VM-20 Section 8 may require projection of YRT future premium rates that may be adjustable.

While we recognize that until VM-20 is operative, AG48 will only be applicable to the ceding company, and not the third party reinsurer, we nevertheless support the use of Section 8 to quantify the risks transferred to the captive versus to the third party reinsurer for AG48 purposes. As a risk-based approach, we believe Section 8 is the preferred approach to quantify the risk transferred through reinsurance, especially for non-proportional reinsurance like YRT reinsurance. Also, the use of Section 8 satisfies one of the stated objectives of AG48, that is, is to define the Actuarial Method to produce the same amount as the VM-20 reserve once the Valuation Manual is fully operative.

We also recognize that LATF may be considering the proposed approach as a matter of temporary practical expediency, both because a third party reinsurer will be valuing obligations using pre-PBR methods and because PBR practice for projecting non-guaranteed rates, commonly used In YRT reinsurance, is not yet settled. The proposed approach eliminates, for now, the need to project such YRT rates beyond the period of their certainty, and thus would avoid varying practice in their projection as the new framework takes effect. It does so, however, by ignoring <u>any</u> cost or value of the YRT reinsurance for periods after its next anniversary. If the proposed approach is taken for expediency, we strongly recommend that the issue be revisited once PBR becomes effective.

We hope these comments are helpful. Please contact Brian Widuch, the Academy's life policy analyst (widuch@actuary.org; 202-223-8196), if you have any questions.

Sincerely,

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Chairperson
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