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January 31, 2019

Mr. Mike Boerner
Chair, Life Actuarial (A) Task Force
National Association of Insurance Commissioners
Via email: Reggie Mazyck (rmazyck@naic.org)

Dear Mike,

The Life Reinsurance Work Group of the American Academy of Actuaries[1] (the Work Group) appreciates the opportunity to provide the following comments regarding Valuation Manual Amendment Proposal Form APF 2018-58 (the APF) that has been exposed by the Life Actuarial (A) Task Force (LATF) for comment.

In a November 7, 2017, letter to LATF, the Work Group sought to make LATF aware that varying interpretations of current VM-20 guidance for determination of future nonguaranteed yearly renewable term (YRT) reinsurance rates might result in inconsistent results among companies and, potentially, significant reserve differences. The Work Group identified several approaches to projecting future YRT reinsurance rate scales that it has considered. The Work Group did not arrive at consensus in support of a particular approach or change to VM-20, or consensus that a VM-20 change was necessary. Most approaches considered would involve a degree of prescription; while that would likely narrow the range of differences in modeling between companies, it would also depart from the principle-based approach that the Work Group has historically supported as a preferred methodology.

APF 2018-58 states that it targets an approach similar to "Approach #2" for projecting future YRT reinsurance premium described in the Work Group's letter. If the current nonguaranteed reinsurance rate scale would produce a reinsurance gain for the cedent, then the rate scale is increased at the next feasible rate change date to "break even" from that date forward, subject to any guaranteed maximum reinsurance rates specified in the agreement. The introduction to the APF states that the adjustment to break even should be applied for the cedent's valuation only, not for the reinsurer's valuation of the same contract.

[1] American Academy of Actuaries is a 19,500 member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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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The Work Group makes the following observations:

1. When applied to nonguaranteed YRT reinsurance agreements, the APF, as it states, is most similar to approach #2 of the six discussed in the Work Group's November 7, 2017, letter. The APF elaborates on that approach by specifying how the increase adjustment might be made in aggregate where multiple reinsurance agreements are in place.

2. However, the APF as written applies to reinsurance agreements more broadly than just to YRT reinsurance. Proposed Section 8.C.8 as written applies a break-even adjustment to remove future reinsurance gain to the cedent in any valuation that involves "projecting non-guaranteed future premium rates in a reinsurance agreement."

   YRT reinsurance is common, challenges in projecting nonguaranteed YRT rates have been discussed at length, and the various approaches described in the November 2017 letter from the Work Group have arisen from and have been examined in that context. The Work Group recommends against extending such approaches beyond nonguaranteed YRT reinsurance without more thorough analysis and rationale.

   If LATF's focus is principally YRT reinsurance and its concern is to write Section 8.C.8 broadly enough to address arrangements that are *effectively* nonguaranteed YRT reinsurance but named or structured slightly differently, then proposed Section 8.C.8 could be tightened to cover nonguaranteed YRT reinsurance "or reinsurance arrangements of similar effect."

3. A defect of Section 8.C.8 as written is that it applies only to agreements with nonguaranteed future premium rates. A YRT agreement could be structured to similar effect, for example, by specifying YRT reinsurance with guaranteed premiums but with nonguaranteed/adjustable expense allowances. The Work Group suggests that guidance could explicitly refer to YRT reinsurance "premiums net of expense allowances."

4. Section 8.C.8 has as its trigger the circumstance of projected gains for a direct-writing company. If a reinsurer retrocedes business on a nonguaranteed YRT basis to a retrocessionaire with projected gains for the ceding reinsurer, the circumstance is analogous. The treatment proposed in the APF can be extended in a straightforward way to require adjusting the ceding reinsurer's gains to break even.

5. In the APF's description of the reason for the proposed amendment, it is stated that the proposed break-even adjustment is meant to apply only to the cedent's valuation, not to a reinsurer's valuation of non-guaranteed YRT reinsurance it assumes. Edits are needed to Section 8.C.8 to achieve this, because proposed Section 8.C.8 would currently trigger the break-even adjustment when a projection produces a reinsurance gain for the ceding insurer. Both ceding company and reinsurer might observe gains for the cedent in their projections, and in such cases 8.C.8. can be read as requiring both cedent and reinsurer to make the break-even adjustment.

6. The APF's edits to Section 8.D.1 incorporate a floor of zero to the "credit for reinsurance

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ceded." The Work Group believes that such a floor of zero is already imposed in VM-20 through the existing language defining the credit as the "excess, if any" of the pre-reinsurance-ceded minimum reserve over the post-reinsurance-ceded minimum reserve. The Work Group believes that such a floor, whether in existing language or as re-edited in APF 2018-58, may break the desirable algebraic relation that, in all events, the post-reinsurance-ceded minimum reserve should equal pre-reinsurance-ceded minimum reserve minus credit for reinsurance ceded. To restore that algebraic relation, the Work Group has proposed APF 2018-56.

As stated above, the Work Group has not recommended or endorsed any specific change to guidance for projecting future nonguaranteed YRT reinsurance rates under VM-20. However, if LATF desires to pursue a prescriptive approach similar to the approach contained in the exposed APF 2018-58 for ceded YRT reinsurance structures, then in light of points 2-5, LATF could consider modifying language for Section 8.C.8 along the following lines:

8.C.8 For a ceding insurer valuing its business subject to ceded YRT reinsurance arrangements with nonguaranteed future premium rates (net of expense allowances), or subject to ceded reinsurance arrangements of similar effect, the following adjustment shall be made:

a. Any projected cash flows from these arrangements that result in a reinsurance gain for the ceding company shall be accompanied by an increase to the reinsurance premium rate scales net of expense allowances in these arrangements.
b. The increase in premiums net of expense allowances shall be made such that: starting at the next date at which nonguaranteed premiums net of expense allowances may be increased, the present value of future death benefits associated with these reinsurance arrangements equals the present value of future reinsurance premiums net of expense allowances associated with the reinsurance arrangements.
c. The increase in premiums net of expense allowances will, however, be subject to the limitation that in no event shall premium rates be increased to exceed any guaranteed maximum premiums in the reinsurance arrangements, nor shall expense allowances be reduced below any guaranteed minimum expense allowances of the reinsurance arrangements.
d. For the avoidance of doubt, an increase to the reinsurance premium rate scale net of expense allowances may include either (or both) an increase to the premium rate scale or a decrease in the expense allowances.

In addition, to further reinforce observation #5 that break-even adjustment is required only for the cedent's valuation projections, not for the reinsurer's, then the requirement could be positioned not as Section 8.C.8, but instead within VM-20 Section 8.C.3, since Section 8.C.3 principally takes the cedent point of view.

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Should you have questions regarding these suggestions, please contact Ian Trepanier, the Academy's life policy analyst, at trepanier@actuary.org.

Sincerely,

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American Academy of Actuaries

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