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April 16, 2019

Mr. Mike Boerner
Chair, Life Actuarial (A) Task Force (LATF)
National Association of Insurance Commissioners

Dear Mr. Boerner,

The Life Reinsurance Work Group ("the work group") of the American Academy of Actuaries[1] appreciates the opportunity to provide comments on Amendment Proposal Form (APF) 2019-17 and APF 2019-24, addressing reinsurance reserve credit for nonguaranteed yearly renewable term (YRT) reinsurance. The work group would like to offer the following for consideration.

APFs 2019-17 and 2019-24 both take the approach of calculating and applying a margin to current YRT premiums to establish "prudent estimate reinsurance premiums" in valuing a cedent's modeled reserves (that is, its deterministic or stochastic reserves). Both APFs would apply the margin adjustment immediately at the next date when premium adjustment can be made under the terms of the reinsurance contract and continually, year by year, thereafter. A plausible rationale is presented for the elements of the mechanics of both APFs.

APF 2019-17 differs from APF 2019-24 principally by

1) Further increasing the margin applied to the YRT current premium scale by adding an adjustment for future mortality improvement (FMI) potentially expected by the reinsurer and potentially reflected in some portion in the current YRT rates; and
2) Seeking to limit the margin penalty that cedents with smaller, less-credible blocks might otherwise incur by instructing that—solely for purposes of computing the prudent reinsurance premium margin adjustment—prudent estimate mortality should be recalculated using credibility of at least 80% and a sufficient data period of at least 10 years.

Although spreadsheets to illustrate APF mechanics have been provided, neither APF has been tested in practice across a range of companies with actual blocks of business, actual YRT

[1] The 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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reinsurance treaties, and actual YRT current rate scales. This is in contrast to many aspects of VM-20, which have been tested in pilots or impact studies. The work group believes there is the potential for material, perhaps unintended, impacts on reserves and on companies' elective use of YRT reinsurance from either proposal, as outlined below.

- One expects that APF 2019-24 has had internal testing by the proposing companies. Wider testing of impact is appropriate. Testing "what ifs" with the illustrative spreadsheet, it appears that under APF 2019-24 reserve credits larger than the pre-PBR reserve credit for YRT reinsurance (= ½ cx, per the Accounting Practices & Procedures Manual) may be produced in some circumstances and at some durations.
- The Work Group is not aware of any testing, yet, of APF 2019-17. Adapting the illustrative spreadsheet to consider a few "what if" examples, the work group believes that under APF 2019-17 as currently drafted:
    - It is possible that some, perhaps even many, cedents could incur a reserve penalty for purchasing YRT reinsurance. (That is, the post-reinsurance modeled reserve could materially exceed the pre-reinsurance modeled reserve.) The concept of a "negative reserve credit for YRT reinsurance" is not prima facie unreasonable from the frame of reference of pure best-estimate cash flows measured at issue time zero, but because PBR has significant prescribed margins and is not best-estimate, it is also not a simple given to expect that cedent PBR reserves should increase because "YRT reinsurance has a cost." Nor is it obvious that the prescribed mechanics for adjusting out FMI in APF 2019-17 would regularly give a quantitative margin and reserve credit that make sense under actuarial scrutiny. What does seem likely is that *if* using YRT reinsurance increases the statutory reserve rather than reducing it, YRT use will be discouraged relative to its use today.
    - The FMI adjustment is potentially large, so choices made in the details of its design might change the result significantly.
    The guardrail applied to the APF 2019-17's adjustment for FMI uses Society of Actuaries (SOA) Mortality Improvement Factors that might not be most desirable for this application. The SOA states that its improvement scale "represents a view of reasonable mortality improvement factors for short and medium term projections and is not intended to be employed as a standard for longer term projection periods."
    - The adjustment for smaller, less-credible cedents appears that it could—for some companies and treaty values—enlarge the margin (through interaction with the adjustment for FMI) and work to the disfavor of such companies.

<u>Conclusion and Recommendation</u>

The work group does not view either APF 2019-17 or 2019-24 as necessarily flawed in basic concept or strategy, and we expect that adjustments to details could be made to improve each. In recent weeks we have also seen new APFs and new potential approaches to the treatment of YRT reinsurance under PBR be suggested by interested parties. LATF could conclude that one or more of these new approaches is also worthy of consideration.

The Life Reinsurance Work Group recommends that LATF consider targeting implementation of changes to YRT treatment for the 2021 Valuation Manual, not for the 2020 manual, in order to allow enough time to complete a thorough analysis and testing of the proposals. The work group and the Academy Life Practice Council offer our resources to support LATF in the analysis and testing.

For 2020, we believe robust disclosures of YRT treatment in the PBR Actuarial Report would be warranted and would be pleased to work with LATF to develop enhancements to VM-31 to address this.

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The work group appreciates the efforts of the LATF to further the discussion of YRT reinsurance under PBR. If you have any questions or would like further dialogue on the above topics, please contact Ian Trepanier, life policy analyst, at trepanier@actuary.org.

Sincerely,

Richard Daillak, MAAA, FSA
Chairperson, Life Reinsurance Work Group
American Academy of Actuaries