May 17, 2024

Rachel Hemphill
Chair, Life Actuarial (A) Task Fore
National Association of Insurance Commissioners

Re: AAT Reinsurance Exposure

Dear Chair Hemphill:

On behalf of the Asset Adequacy and Reinsurance Issues Task Force (AARITF) of the American Academy of Actuaries,[1] I appreciate the opportunity to provide comments to the Life Actuarial Task Force (LATF) regarding the "AAT Reinsurance Exposure 031724" (the Exposure). The AARITF believes this is an important issue and appreciates LATF's consideration of public comments.

In response to the Exposure, the AARITF offers the following feedback. As LATF requested with the Methodology portion of the Exposure, AARITF has considered the Exposure as drafted as well as alternatives. Some members of AARITF view the Exposure as a good starting point to address regulator concerns. Others feel differently and suggest that an alternative approach, such as a disclosure-based approach, may be more appropriate and should be explored. Our comments below reflect both perspectives, starting with the suggested alternative approach, followed by specific comments on the Exposure itself.

A. Alternative Disclosure-Based Approach

LATF may want to consider using an alternative disclosure-based approach, which we've described below.

LATF could consider introducing a confidential filing, implemented via actuarial guidelines (AGs), directing any non-exempt insurer to offer additional disclosures addressing specific areas of concern. These disclosures, which could be both qualitative and quantitative, could then be

[1] The American Academy of Actuaries is a 20,000-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.

used by the domiciliary regulator and the NAIC's Valuation Analysis (E) Working Group as a means to confidentially identify life insurance companies that have reinsurance agreements that may reduce assets to a level that is insufficient to support policyholder obligations or provide inadequate disclosure or insufficiently robust assessment of the reinsurance-related concerns identified by regulators. In this manner, the disclosure could be used by domestic regulators to encourage improvements.

In adopting this approach, the additional disclosures could leverage existing assessments, evaluations, and calculations already performed by the cedent. This may include the cedant's exposure to uncollectible reinsurance. Leveraging existing work products reduces the effort needed by companies to respond to regulatory concerns and may allow for a timelier response to regulatory need for increased transparency.

The implementation of a disclosure-based requirement could also serve to strengthen company practices relating to counterparty assessment over time, as clarifications are made to the AG and feedback is provided from regulators to Appointed Actuaries. The information provided in such filings could be further studied to assess the regulatory concerns, rather than implementing changes to long-standing Asset Adequacy Testing / Analysis (AAA) requirements without sufficient time to thoughtfully evaluate the implications. Such an approach also better aligns with the long-standing ability of the Appointed Actuary to apply appropriate judgment based on their understanding of the specific facts and circumstances of the reinsurance arrangements, supported by the principle-based actuarial standards of practice (ASOPs).

Should LATF be interested in additional details related to an alternative disclosure-based approach, we would be happy to participate in further discussions.

B. Comments on the Exposure

Having reviewed the proposed language in the Exposure, it would seem reasonable to allow Appointed Actuaries to apply judgment in the selection of an AAA method. We recognize that reinsurance has proved to be an effective risk mitigation tool and believe that changes to AAA requirements should not discourage the use of reinsurance for mitigating risk. We also believe that a broadly prescriptive approach may introduce a burden on companies without commensurate benefit. However, there may be instances in which certain reinsurance transactions lead to regulatory questions about the level of assets available to support policyholder obligations. Consequently, we have the following specific feedback on the Exposure.

Terminology

- There appears to be a subset of reinsurance transactions that could create regulatory policyholder protection concerns that are not addressed by the existing AAA

requirements. Therefore, any proposed solution should target those transactions specifically. Such a solution should enhance the actuary's review of such transactions, rather than broadly encompassing all reinsurance transactions. Introducing additional testing requirements for all reinsurance transactions would cause significant additional work for Appointed Actuaries—in some cases without any associated benefit. This could discourage the use of reinsurance, which has been proven to be an effective risk mitigation tool. Further, requiring such testing to be applied without consideration of the specific reinsurance context may result in an incomplete assessment or misimpression of the actual risks.

- For the reasons described in the preceding bullet, we believe that scoping out the following situations might be appropriate:
  - The assuming company submits a VM-30 actuarial memorandum to a U.S. state regulator, or
  - The Appointed Actuary demonstrates that the assuming company holds reserves, either directly or via alternative structures such as funds withheld or assets in trust, that are not materially lower than the cedant's U.S. statutory reserves. A specific materiality threshold could be set for this, or
  - The collectability risk associated with the assuming reinsurer is assessed as insignificant and the Appointed Actuary can demonstrate that it is insignificant. A specific significance threshold could be set for this, or
  - There is objective evidence provided by the Appointed Actuary that assets backing reserves held are adequate to cover moderately adverse conditions.
- Rather than including all treaties with affiliates, such treaties should also be scoped out if they meet at least one of the four criteria as mentioned above, for the same reasons as outlined. Providing specificity on the types of reinsurance treaties that will be in scope also seems reasonable to include.

Materiality

- We would support scoping out treaties that have an immaterial impact on the cedant's overall financial position—for example, a treaty for which reserves ceded are below specified percentages of net reserves and statutory surplus, each determined prior to the application of any new AAA requirements. The aggregate materiality (i.e., the materiality of a combined set of immaterial reinsurance treaties) should also be considered, to prevent inadvertently scoping out multiple treaties that may be individually immaterial

but material when considered in aggregate. A requirement for Appointed Actuaries to provide supporting rationale for scoping out immaterial treaties may also be helpful.

Aggregation

- ASOP No. 22, *Statements of Actuarial Opinion Based on Asset Adequacy Analysis for Life Insurance, Annuity, or Health Insurance Reserves and Other Liabilities*, provides guidance on the aggregation of multiple blocks of business when performing AAA. It requires the actuary not use assets or cash flows that are otherwise encumbered (due to reinsurance or otherwise) to discharge reserve and other liabilities relating to other business if those assets or cash flows cannot be used for that purpose. We encourage an approach that aligns with ASOP No. 22, allowing for aggregation in instances when the assets or cash flows from one block of business are available to support the reserves and liabilities of another block of business.

Methodology

- Review of the counterparty risk exposure is a critical component of AAA when material reinsurance exists regardless of the method used for AAA. In some instances, a robust evaluation of the counterparty's ability to make good on its reinsurance obligations may be sufficient to satisfy AAA requirements.

- We recommend maintaining a principles-based approach that allows for actuarial judgment. Although this may result in a range of reserve levels for any given situation, we believe this is consistent with a principle-based reserving system in which it is incumbent upon the actuary to follow laws, regulations, and actuarial practice to develop these results. We believe that any sort of "mirror reserving" requirement may conflict with the Appointed Actuary's ability to provide an individual opinion on reserve adequacy. It may also conflict with the particular facts and circumstances of the entity for which the actuary is opining.

Retroactivity & Applicability

- The application of a new requirement to in-force treaties would likely present challenges for Appointed Actuaries. Although performance of AAA is already required, many Appointed Actuaries use methods other than cash flow testing (CFT), such as evaluation of counterparty risk or use of cash flow or stress testing analysis performed by the reinsurer. Therefore, many Appointed Actuaries do not currently have the full set of data that is needed to perform CFT on reinsured businesses (such as data on the assets backing the reinsured liabilities). If new AAA requirements apply prospectively to treaties entered into after the effective date of the change, ceding companies should be able to negotiate

reporting requirements within the reinsurance treaty terms that grant access to sufficient reinsurer information. This would then allow the ceding company Appointed Actuary to meet the new requirements for the actuarial opinion for each treaty. To the extent that the reinsurer applies a broader level of aggregation and, thus does not segregate its invested assets for a specific treaty that is in scope, the actuary of the reinsurer and/or the cedant would need to use judgment to make assumptions about how such broader aggregation of reserves and invested assets might be allocated to a specific treaty.

Other General Comments

In addition to the specific comments above, AARITF also offers the following additional considerations.

- Regardless of the approach taken, evaluation of counterparty risk will still be important and is required by ASOP No. 11, *Treatment of Reinsurance or Similar Risk Transfer Programs Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports*. ASOP No. 11 requires that actuaries working for U.S.-based life insurers understand the risks and benefits to their company when entering into reinsurance arrangements, including the purpose of the reinsurance arrangement, its impact on retained business, the nature of the counterparty, the potential exposure they face to the counterparty, the ability of the counterparty to fulfill their obligations under the terms of the reinsurance arrangement, and any counterparty risk mitigating features of reinsurance arrangement.
- Considering the relatively recent emergence of this issue, as well as the proposed solutions, further study of the range of transactions and associated risks may be warranted. This could be done using new information gleaned from the alternative disclosure approach outlined herein or via additional AAA requirements. We would be happy to assist LATF with further analysis of this issue.

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If you have any questions or would like to discuss these comments further, please contact Amanada Barry-Moilanen, the Academy's life policy analyst.

Sincerely,

Tricia Matson, MAAA, FSA
Chairperson, Asset Adequacy and Reinsurance Issues Task Force