October 3, 2024

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

Re: AAT for Reinsurance Actuarial Guideline Draft Exposure

Dear Chair Hemphill:

On behalf of the Life Practice Council (LPC) of the American Academy of Actuaries,[1] I appreciate the opportunity to provide comments to the Life Actuarial Task Force (LATF) regarding the AAT for Reinsurance Actuarial Guideline Draft (the Exposure). The LPC believes this is an important issue and appreciates LATF's consideration of public comments.

In response to the Exposure, the LPC offers the following feedback, which we developed to express our view that the Appointed Actuary should be able to apply actuarial principles and judgment in their Asset Adequacy Testing (AAT), while understanding the need for regulators to provide additional guidance regarding the specific risks causing concern.

It is important to us that any new requirements appropriately consider the protection of insurance company policyholders and the general public. Therefore, we support exploring where existing policyholder protections may not be working as intended, with any necessary new requirements focused on ensuring an appropriate level of policyholder protections based on risk.

Further, we recognize that reinsurance has proved to be an effective risk mitigation tool, and believe that any changes to AAT requirements should be targeted to material treaties that are of concern to avoid these changes disincentivizing insurance companies from implementing appropriate reinsurance solutions. Targeting specific treaties should also minimize the creation of adverse effects on policyholders.

Based on LATF's request, the LPC has focused our comments in this letter solely on the Scope and Aggregation sections. However, analyzing individual components of the draft may cause a need to revisit previous discussions before any formal finalization, given the interdependencies

[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.

of each section within the proposed Actuarial Guideline. Of particular note is the definition of scope and the associated level of newly required analysis, as they are intertwined. For these reasons, this feedback should be considered "directional" in nature.

Scope

1. We assume that the impact of the proposal's scope would only cover whether a life insurer is subject to **any** new requirements introduced by the Exposure, and not specifically what those requirements are, which is covered in other sections.
2. Regarding the options laid out in the Exposure, we recommend "Option 1: Narrow scope, some analysis expected for all treaties in the scope." We suggest that any new Actuarial Guideline requiring more detailed analysis than is already performed by the Appointed Actuary be a function of the specific risks of concern to the regulators. As noted in LATF's original goals on this topic, there is a desire to "prevent work by US ceding companies where there's immaterial risk,"[2] and therefore, a narrow scope is appropriate.

   We also believe that a narrow scope has the following benefits:

   a. Provides added policyholder protection elements in instances in which there are specific risks of regulatory concern
   b. Limits the burden on the industry by reducing non-value-added analysis / work being prepared for the regulator that is non-responsive to regulator needs.
   c. Minimizes the review burden on the regulatory community.
   d. Excludes certain treaties / business that are clearly not the drivers of current regulatory concern (e.g., traditional YRT; immaterial reinsurance exposure to any single counterparty).
   e. Allows for more timely implementation.
   f. Eases implementation efforts and allow for learning from the first set of submissions.

   In addition, there is already guidance for actuaries when performing actuarial services in connection with preparing, determining, analyzing, or reviewing financial reports for internal or external use that reflect reinsurance or similar risk transfer programs on life insurance, annuities, or health benefit plans (including disclosure requirements) contained in Actuarial Standard of Practice No. 11, *Treatment of Reinsurance or Similar Risk Transfer Programs Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports*.

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[2] From attachment 9 of the LATF Spring 2024 meeting materials

3. We support the proposed exemption criteria as laid out in Section 2A. However, we have the following suggestions for improvement:

    a. The size threshold refers to "reserve credit or funds withheld or modified coinsurance reserve." As written, this could lead to double-counting, as the reserve credit may already include the funds withheld. We suggest clarifying so that double-counting does not occur.
    b. The treatment of business that includes separate accounts is unclear. We suggest clarifying that if the reinsured business includes separate accounts for which associated risks are assumed by the reinsurer, those separate account reserve credits would be considered in assessing the size threshold.
    c. We suggest including reserves held in Exhibit 7, rather than only including Exhibit 5 reserves in the quantitative scope criteria.
    d. For the quantitative exclusion criteria in Section 2A (1)-(4), we note that the reinsurance reserve reported in Schedule S, Part 3 may not reflect the actual reserve exposure of the reinsurance agreement. For example, when a business is subject to PBR and reserve credits are determined on an allocation basis. Therefore, it may not be appropriate for determining materiality. In such instances, it may be more appropriate to use a reserve calculated by the cedant as the difference between an aggregate reserve pre-reinsurance ceded and an aggregate reserve post reinsurance ceded.

4. We also recommend considering the materiality of a group of treaties or counterparties when determining if a life insurer is in scope. Doing so may help avoid a situation in which multiple immaterial treaties or counterparties have the same outcome as one material treaty or counterparty, but would otherwise cause the life insurer to be exempt from the requirements solely due to individual treaty size.

5. We believe that a key concern raised by regulators relates to reinsurance treaties that result in the pursuit of more aggressive investment strategies and/or a significant reduction in the total asset requirement (reserves plus required capital). Based on this belief and given LATF's stated objective to prevent work by U.S. ceding companies where there is immaterial risk, we believe it may be appropriate to exempt treaties where such conditions do not exist. For example, consideration for an exemption could be given to treaties that meet all of the following: (1) no assets are transferred or assets transferred are segregated (for example, using modified coinsurance, a funds withheld, or having assets held in trust); (2) such assets are adequate (e.g., based on the latest standalone asset adequacy testing) to support the business on a stand-alone basis; and (3) have not been subject to subsequent changes (e.g., material deterioration in experience or material changes in the investment portfolio) that would bring into question the conclusions arrived at in (2).

6. We support the inclusion of older treaties with significant reinsurance collectability risk, as outlined in Section 2.B.

Aggregation Considerations

1. ASOP No. 22 currently provides guidance to Appointed Actuaries (AAs) applying judgment as to when blocks of business may be aggregated for purposes of testing the adequacy of assets supporting booked reserves.

   If LATF chooses to provide additional guidance on aggregation in an Actuarial Guideline, to the extent possible we recommend aligning it with existing guidance in section 3.1.4 of ASOP No. 22, i.e., "the actuary may aggregate reserves … for multiple blocks of business if the assets or cash flows from the blocks are available to support the reserves. … [T]he actuary should not use assets or cash flows from one block of business to discharge the reserves and other liabilities of another block of business if those assets or cash flows cannot be used for that purpose."
   In instances in which such aggregation still results in policyholder protection concerns, we note that the Standard Valuation Law enables the regulator to require an alternative methodology or alternative assumptions: "The commissioner may require a company to change any assumption or method that in the opinion of the commissioner is necessary in order to comply with the requirements of the valuation manual or this Act; and the company shall adjust the reserves as required by the commissioner."

2. Regarding item B of the Exposure, we would support new requirements that include disclosure by the Appointed Actuary of the rationale for aggregation.

3. Regarding item C of the Exposure, which comments on reliability and stability of a sufficient block that is "subsidizing" a deficient one, we believe it would be appropriate to follow the guidance in ASOP No. 22, which states: "When considering aggregation of results to offset deficiencies, the actuary should take into account the type and timing of cash flows, the related cash flow risks, and the comparability of elements of the analysis such as analysis methods, scenarios, discount rates, and sensitivity of assumptions" (section 3.2.4). For example, if a sufficient block has very "back ended" cash flows that are available to support a deficient block on a present value basis, we believe the Appointed Actuary should take into account whether those back ended cash flows can actually support the earlier cash shortfalls for the deficient block. In addition, ASOP No. 7, *Analysis of Life, Health, or Property/Casualty Insurer Cash Flows*, states, "The actuary should consider the impact of any negative interim earnings during the cash flow projection period, if it is appropriate for the purpose of the analysis" (section 3.11). As occurs today, we believe that evaluation of interim surplus results is an important consideration in assessing adequacy. If there are future interim shortfalls on an aggregate

book value basis under moderately adverse conditions, the Appointed Actuary would evaluate whether additional reserves might be needed to address the shortfall.

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

Sincerely,

Jason Kehrberg, MAAA, FSA
Chairperson, Life Practice Council