December 4, 2024

Mr. Ben Slutsker, Chair
Valuation Manual (VM)-22 (A) Subgroup, Life Actuarial (A) Task Force (LATF)
National Association of Insurance Commissioners (NAIC)

Re: Comments on the recently exposed VM-22 Longevity Reinsurance Proposal

Dear Chair Slutsker,

On behalf of the Annuity Reserves and Capital Subcommittee (Subcommittee) of the American Academy of Actuaries,[1] I appreciate the opportunity to comment on the recently exposed VM-22 Longevity Reinsurance Proposal (Proposal) and am pleased to provide the following comments.

Fundamentally, the Subcommittee is committed to a principle-based reserve (PBR) framework, which we believe is inconsistent with reserve floors. As we consider more specifically the Proposal, we offer the following comments:

a.) In a PBR framework, we believe the question of reserve adequacy should be evaluated by reference to the sufficiency of the reserves plus future premiums to mature future claims under a range of potential economic scenarios, rather than reference an a priori expectation regarding the pattern or level of reserves required.
b.) While the Subcommittee does not believe that any contract-level flooring of reserves is consistent with a PBR valuation, flooring the final reserve at zero on a contract-by-contract basis for contracts in the Longevity Reinsurance category should be sufficient to achieve an appropriate reserve level without the need for the additional floor specified in the proposal, provided that reinsurers issuing these contracts maintain robust monitoring and assumption updating procedures (as further discussed below).
c.) Most types of Longevity Reinsurance contracts are structured as "fee-based" products, meaning that the contractual premiums are set equal to the at-issue expectation of the future benefits to be paid plus a risk-fee. By design, this risk fee causes the total premiums to be received to exceed the benefits expected to be paid at the time of contract issue, and these fees are available to offset any adverse experience post-issue.
    i. These risk fees are typically deterministic and contractually fixed from inception.
    ii. For a typical Longevity Reinsurance contract, the only source of potential variation in future risk fees for the assuming reinsurer comes in the form of counterparty default risk on the part of the ceding insurer or reinsurer. Some contracts also contain collateralization requirements that may partially mitigate this counterparty risk. In

[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.

addition, the assuming company can typically terminate the contract if the ceding company fails to pay or becomes insolvent.

iii. Longevity Reinsurance contracts do not generally contain voluntary termination provisions, nor do they have cash surrender values or transaction-level lump sum settlement options. Hence, the probability of receipt of future fees by reinsurers writing this coverage is high.

iv. Given the high probability of receipt of these risk fees, it may be appropriate to consider these future fees when determining the reserve, although doing so may result in modest or zero reserves in certain durations.

d.) If actual contractual experience is less favorable than at-inception expectations (e.g., because a greater-than-expected-at-issue number of annuitants remain living), then projected benefits in the PBR projection will begin to exceed projected premiums (e.g., through the higher benefits projected from the greater-than-expected-at-issue number of living annuitants). These greater-than-expected-at-issue benefits will partially erode the excess premiums inclusive of the risk fee. To the extent the risk fee is projected to become depleted due to unfavorable experience, material reserves would emerge from the Stochastic Reserve calculation, consistent with the emergence of the risk assumed by the reinsurer, even without a contract-level reserve floor.

e.) Since prudent estimate mortality assumptions are required to be used in the Stochastic Reserve, there is already an inherent degree of conservatism embedded in the PBR calculation. If zero reserves are sufficient to mature the liabilities under prudent estimate mortality assumptions, then it is appropriate and consistent with a PBR valuation for the resulting reserve for such a contract to be zero. This simply reflects the fact that the future premiums and risk fees remain adequate to cover the future expected benefits at the reserve objective level, even under prudent estimate mortality assumptions.

f.) Given the incremental and gradual nature of mortality improvement, the risk that mortality moves materially against the reinsurer is most likely to emerge gradually over a long period of time.

g.) Due to the nature of the risk assumed and the large number of insureds typically included in these contracts, the reinsurers issuing Longevity Reinsurance contracts typically employ sophisticated data analytics and long-term mortality improvement modeling techniques when underwriting these contracts. These companies also use similar processes when monitoring actual mortality experience on an on-going basis.

h.) Given the slow emergence but potentially large scale of the risk typically assumed under these contracts, it is imperative that companies writing these contracts maintain robust, responsive, and transparent experience monitoring programs to ensure that PBR reserves adapt to emerging contractual experience appropriately and in a timely fashion. Strong and robust experience monitoring programs may include features such as annual longevity model benchmarking against industry longevity models, annual contract-level assumption reviews, periodic experience monitoring at the contract level for financial reporting and analysis purposes, periodic analysis of longevity experience within sub-populations across contracts (e.g., insureds with similar geographic residency or insureds with similar professions), evaluation of the credibility of experience data with pooling or industry data used when data is not fully credible, stress or shock analysis at the contract or block-level, analysis of mortality versus longevity risk offsets at the legal entity or enterprise level, and review of contract-level valuation assumption setting procedures by the second and third lines of defense. The Subcommittee would recommend that regulators include a review of the company's experience monitoring and assumption setting processes for these contracts as an area of focus when conducting formal risk-based examinations for companies writing Longevity Reinsurance contracts.

i.) Assuming the VM-31 and VM-G requirements to monitor and report ongoing experience and to periodically update prudent estimate mortality assumptions remain in place, these processes

should be sufficient to ensure that any adverse changes are appropriately detected and reflected in reserves as needed without the need for a non-zero reserve floor.

We appreciate the opportunity to provide these comments on the proposal. If you have any questions or would like to discuss this letter further, please contact Amanda Barry-Moilanen (barrymoilanen@actuary.org), the Academy's life policy analyst.

Sincerely,

Chris Conrad, MAAA, FSA
Chairperson, Annuity Reserves and Capital Subcommittee
American Academy of Actuaries