



January 15, 2025

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 three Asset Adequacy Testing (AAT) for Reinsurance Actuarial Guideline (AG) Draft documents (the Exposure) exposed for comment until January 15, 2015². The LPC believes this is an important issue and appreciates LATF's consideration of public comments.

Consistent with our prior comment letters on this topic³, our feedback emphasizes that the Appointed Actuary (AA) should apply actuarial principles and judgment in AAT, while recognizing the need for appropriate documentation and regulatory guidance on specific risks. We emphasize that:

- Current guidelines on cash flow testing acknowledge its complexity. We suggest a comprehensive approach that considers all relevant information and analyses.
- Depending on the circumstances, multiple actuarial methods may be reasonable for evaluating reserve adequacy.

We believe new requirements should protect policyholders by focusing on areas where existing protections may fall short and addressing specific regulatory concerns. Additionally, we encourage changes to AAT that target only material reinsurance risks of concern to avoid deterring effective risk mitigation strategies, thereby minimizing adverse impacts on policyholders.

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 60 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.

² [Asset Adequacy Testing \(AAT\) for Reinsurance Actuarial Guideline \(AG\) Exposure Questions 111824](#), [AAT for Reinsurance AG Presentation LATF 111524](#), and [Draft AG ReAAT 111524](#)

³ See [LPC Comments to LATF on Reinsurance Exposure \(10/10/24\)](#) and [LPC Comments to LATF on Reinsurance Issues \(7/19/24\)](#)

A. Considerations on differentiating between affiliated and non-affiliated treaties

We understand the reason the draft AG is starting with affiliate treaties is because affiliate treaties are believed to be more likely to have the data necessary to support the more detailed asset adequacy analysis envisioned by the draft AG, and that other potentially risky situations with less-than-ideal data will be addressed in a subsequent draft of the AG.

We note that data availability may differ depending on the nature of the affiliate treaty. For example, affiliate treaties between a parent and single subsidiary that cover a single risk and line of business (e.g., level term) may indeed be likely to have the data necessary for the AG's desired CFT. However, in a situation where the affiliate offshore reinsurer covers multiple risks and lines of business, it may be reasonable for the reinsurer to manage assets and liabilities on a broader basis than the single risk or line of business that is the focus of the AG. And although the cedent's AA may be able to discuss investment issues more readily with an offshore reinsurer that is an affiliate, in this situation the AA may not be able to obtain sufficient detail on the specific assets backing the reinsured liabilities due to the confidential and proprietary nature of the reinsurer's investment strategy and/or the segmented nature of the assets.

B. Considerations on wording to reflect a disclosure-only approach for 2025 (versus expectations of additional reserves)

We encourage the AA to consider all relevant information and analyses performed when determining their opinion on whether additional reserves are needed or not. In other words, the need for additional reserves should be determined based on the judgment of the AA that is informed by his or her holistic review of all available information including any and all analyses (e.g., analysis of the creditworthiness of the counterparty, analysis of the overall reserve sufficiency including sufficiency on other business) relating to the adequacy of the assets supporting reserves (hereinafter "holistic review", "holistic assessment", or "holistically"). If additional analysis is mandated by the AG, then that information would provide an additional data point for consideration by the AA. We do not believe the AG should mandate disclosure as an override to the AA's judgment regarding the need for additional reserves. To address this, we suggest the following language for the AG:

For year-end 2025, the AA should consider the analysis required to be performed by this Actuarial Guideline, along with other relevant information and analysis in forming their opinion regarding the potential need for additional reserves. In the event that the AA believes that additional reserves are required (based on their application of appropriate actuarial judgment), then the AA should reflect that in his or her Actuarial Opinion. This Guideline does not include prescriptive guidance as to whether additional reserves should or should not be held. As is already the case, such determination is up to the AA, and the

domestic regulator will continue to have the authority to require additional reserves as deemed necessary.

C. Considerations on aggregation across products or lines of business within a counterparty

We believe that the level of aggregation should reflect the availability of cash flows to the ceding company to satisfy its obligations to policyholders instead of limits by product or line of business. Where cash flows are available to the ceding company to satisfy its policyholder obligations, aggregation should be allowed. Conversely, where cash flows are encumbered or otherwise unavailable to the ceding company to satisfy its policyholder obligations, then aggregation should not be allowed. Where judgment is required to determine whether cash flows are available to the ceding company to satisfy its obligations, the AA should provide support for their decision to aggregate based on an economic evaluation of the availability of cashflows. To address this, we suggest the following language for the AG:

The level of aggregation permitted in testing is dependent on the availability of cash flows to the ceding company to satisfy policyholder obligations when such obligations come due. As a result, aggregation across products, lines of business, treaties, etc. is permitted provided the ceding company AA has determined that such aggregation reflects the availability of cash flows to the entity for which the testing is performed. Where judgment is required to determine whether cash flows are available to the ceding company to satisfy its policyholder obligations, the AA should provide support for their decision to aggregate based on economic rationale.

D. Comments on the example at the end of the exposed slide presentation (in particular, regarding the amount of starting assets that would be part of the cash flow testing to test the post-reinsurance reserve for adequacy)

Background

The example involves a U.S.-domiciled insurer ceding \$100M in reserves to an offshore reinsurer through a coinsurance arrangement with funds withheld. The offshore reinsurer is holding \$80M in reserves. The example highlights two case studies to illustrate different scenarios:

Case Study #1: \$100M in “primary security” assets in the funds withheld account.

Case Study #2: \$80M in “primary security” assets and \$20M in “other security” assets in the funds withheld account.

Ceding Company Perspective

Assets Used in Cash Flow Testing: Assets designated for the payment of claims should be considered in cash flow testing. The AA should evaluate the reinsurance agreements to understand the terms governing access to and funding of the funds withheld account. This includes provisions that apply in situations where the reinsurer fails to pay claims.

Starting Assets for Testing: In coinsurance agreements with funds withheld, it is common for the ceding company to have access to the withheld funds to pay claims. Assuming such access is available, it may be reasonable to use \$100 million in starting assets for cash flow testing in both case studies, reflecting the different attributes of the asset portfolios.

Assuming Company Perspective

Reserves and Surplus: The reinsurer holds \$80 million in reserves and \$20 million as “encumbered” surplus. This surplus is effectively designated for the ceding company’s claims, if needed, providing a margin in case the reserves are insufficient. Over time, this margin would be expected to diminish as the \$100M ceded reserve and the \$80M held reserve converge.

Impact on Capital and Counterparty Analysis: If the encumbered surplus is included in the reinsurer’s capital, it supports the reinsurer’s capital ratios. In this case, since the same assets cannot support both reserve and capital, the AA would need to consider the implications on the counterparty’s capitalization of utilizing the \$20M of encumbered surplus in their cash flow testing when assessing counterparty risk.

Other Security

As the nature of the \$20M “other security” assets in Case Study #2 is unspecified, the AA should consider whether those assets have predictable cashflows and are appropriate to support the specific policyholder obligations under consideration, and if so, project cash flows for those assets under various scenarios, including moderately adverse conditions.

Alternative Starting Asset Approaches

Some may suggest starting with \$80M in reserves held by the reinsurer. If insufficient, the AA might incorporate the remaining \$20M in the funds withheld account as these funds are designated for the ceding company’s claims and are separate from other assets.

Evaluating Reinsurer Financial Strength

When assessing the reinsurer’s capital strength and financial metrics, the AA should consider whether the \$20M encumbered surplus supports the reinsurer’s capital and consider the implications in assessing counterparty risk.

E. Comments on whether, for AG ReAAT purposes in certain moderate-risk cases, attribution analysis should supplement other analysis (e.g., cash flow testing) or be the sole analysis required.

In commenting on potential methods permitted by the AG, it is helpful to first distinguish between (a) the ability to evidence the overall soundness of reserves and (b) the quantification of additional reserves to be held in circumstances where it has been determined that additional reserves are, in fact, required.

The LPC recognizes there are several methods other than cash flow testing that are reasonable and acceptable actuarial methods to evidence the soundness of reserves. We encourage the AG to permit and recognize the results from such other methods to be used. The following two examples may serve to clarify how the application of other methods may be used in support of the new AG requirements.

Example 1: Treaty level reserves are clearly sufficient:

In cases where the amount of reserve held by the reinsurer for liabilities assumed under the terms of a specific treaty is clearly sufficient, it may be easier for companies to use stress testing to demonstrate that this is the case. Stress test scenarios could be developed for each major risk and certain combinations of risks associated with the assumed liabilities and related assets. These stress scenarios would exceed the “moderately adverse” level of prudence typically associated with cash flow testing. By quantifying the level of liability for each of these scenarios, companies may be able to evidence the soundness of their reserves without the need to perform additional CFT.

Example 2: The potential level of deficiency is unlikely to result in the need for additional reserves at the company level:

Stress test scenarios may be used in cases where the amount of reserve being tested is not “clearly sufficient” on a standalone basis (as in example 1) but the AA recognizes that there are other relevant considerations that, when considered holistically, would make it unlikely that the company will need to hold additional reserves. For example, in the case where the AA is required to test a specific treaty that is in scope of the AG, the use of stress test scenarios may be used to determine that the reserves for this specific treaty, when cash flow tested on a standalone basis, are likely to be deficient by an amount ranging from \$x to \$y dollars. If the AA has tested the retained business (i.e., the business not associated with a ceded reinsurance treaty) and has determined that there is significant other sufficiency that greatly exceeds \$y that is available to aggregate and offset the quantified deficiency associated with this specific treaty, then further cash flow testing of the specific treaty is unnecessary. The AA should consider all retained and ceded business in making such as

assessment to ensure that any sufficiency associated with retained business is not used more than once to cover shortfalls in ceded business. In other words, if the sum of ceded business deficiencies exceeds the sufficiency of the retained business, additional reserves would be held.

While the use of stress tests provides one example of alternate methods that may serve to support the transparency sought by regulators, these examples are not intended to suggest that stress testing is the only alternate method that may be used. We encourage the AG to include other methods that are appropriate as doing so would reduce the amount of effort required by companies to provide regulators with the needed transparency and accelerate the time needed to do so.

Regarding the use of attribution analysis, we believe that while such analysis can provide information regarding the potential sources and level of prudence in U.S. statutory reserves relative to reserves held in other jurisdictions, it does not serve to evidence the adequacy of reserves. Further, attribution analysis is a complex and resource intensive process that is likely to produce differing results depending on the order in which the analysis is performed. Therefore, we do not recommend the use of attribution analysis for the purposes of this AG. Such efforts to better understand the reasons for reserve differences using attribution analysis are better suited to an industry study.

F. Comments on the definition of Similar Memorandum and allowing a Similar Memorandum as an alternative to cash-flow testing in some instances “if the cedant’s domestic regulator finds they are able to determine whether the assets are adequate to support the liabilities, with the assistance of the VAWG”.

We believe that the goal of the AG is to address situations in which there are substantive and inappropriate reductions in the assets backing reserves due to the use of reinsurance. Such reserve reductions cannot be addressed by additional disclosure alone. Therefore, we believe that it would be appropriate to scope out reinsurance agreements for which asset adequacy testing is similar in substance to U.S. AAT (in other words, focusing on whether the *analysis* is similar and not whether the memorandum is). If the goal is to fully exempt situations in which U.S. Statutory AAT practices are already employed by the reinsurer (e.g., the reinsurer is already subject to VM-30), we recommend making it clear in section 2 that reinsurance treaties with reinsurers that are filing a VM-30 memorandum covering the subject business are excluded from the scope of the AG. For the remaining in-scope treaties (i.e., those meeting all the scope definitions and without filing of a VM-30 memorandum by the reinsurer), the goal is for the U.S. regulator to obtain asset adequacy testing analysis and results similar to what would be required under VM-30. In the event this information is already documented in another submission (for example, a filing with the reinsurer’s regulator), the needs of the U.S. regulator could be met via the reinsurer filing this document

with the cedent's domiciliary regulator. This would be simpler than trying to define a "Similar Memorandum" and would increase the likelihood that the information is of form and substance that meets U.S. regulatory expectations. If this approach is used, then a definition of "Similar Memorandum" would not be needed.

We also do not believe that the Actuarial Guideline should specifically require consultation with VAWG, since the AG is applicable to requirements for the insurance company and is not prescribing requirements for regulators.

G. Comments on Risk Mitigation under Risk Identification for Purposes of Establishing Analysis and Documentation Expectations

Consider adding the words in italics to the Exposure's sentence on risk mitigation: "Any potential risks or risk mitigants associated with protections such as trusts or funds withheld or letters of credit, particularly with respect to non-affiliated transactions, may be discussed and considered."

H. Comments on when CFT should or shouldn't be mandatory, and comments on examples of other (less rigorous) methods and when they may or may not be sufficient.

The LPC supports the use of CFT to assess the impact of reinsurance on interest sensitive business when the AA determines, based on a holistic assessment, that additional reserves may need to be held at a company level by the ceding company. Further, where practicable, CFT can be used to quantify the amount, if any, of additional reserves needed to be held.

However, in situations where CFT is impracticable or where it is unlikely that additional reserves will be required, the LPC supports the use of other reasonable methods which may serve to provide regulators with the transparency and assurances required but at a lesser cost (a specific example of such alternate methods is provided above in Section E).

If you have any questions or would like to discuss these comments further, please contact [Amanda Barry-Moilanen](#), the Academy's policy project manager, life.

Sincerely,

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Chairperson, Life Practice Council
American Academy of Actuaries