October 10, 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 specific 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.

The following comments are based on the understanding that the additional analysis proposed in the Exposure, when viewed comprehensively alongside other pertinent analyses and data, will better inform the Appointed Actuary in support of forming their actuarial opinion and

[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.

determining the amount of any additional reserves they may recommend. Note that the Scope and Aggregation sections below have not changed since our October 3 letter but are included for completeness.

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

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

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 whether 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 conditions: (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.

Definitions

1. Regarding the definition of Attribution Analysis, we believe there are significant drivers of differences between the pre-reinsurance Statutory Reserve and the Total Reserve. Therefore, we suggest adding the following to the end of the definition, "due to factors such as differences in individual key assumptions, differences in methodologies, such as application of a reserve floor, or differences due to consideration of risk diversification across policies."

2. Regarding the definitions of Deficient Block and Sufficient Block, we suggest clarifying that "cash flow testing scenarios" refers to U.S. statutory cash flow testing at the initial inception date of the treaty, but could be on some other basis for subsequent valuation dates.

Risk Identification for Purposes of Establishing Analysis and Documentation Expectations

1. We generally agree that the higher the risk, the more rigorous and frequent the analysis should be. However, we also note that a less rigorous approach with more conservatism may also be appropriate. We also believe that degree of rigor and frequency should allow for judgment by the Appointed Actuary and should consider the practicality of performing the analysis. For example, it may not be feasible to perform cash flow testing very frequently.

2. We believe that the list of relevant risks is reasonable. The ultimate determination and evaluation of the relevant risks should be performed by the Appointed Actuary, as such determination considers the specific facts and circumstances of a given reinsurance arrangement.

3. We agree that risk mitigants, such as trusts or funds withheld, should be considered. Important considerations in the event of risk mitigants may include provisions related to the amount, nature, maintenance, and fungibility of the assets, as well as the extent to which the assets are set aside solely for claims on the ceded business.

4. We agree with consideration of reinsurance agreements that are both within and outside the U.S. In other words, guidance should be based on the risk profile, rather than the jurisdiction of the reinsurer.

Analysis and Documentation Expectations in Light of Risk

1. Regarding item A, we believe that the guidance in ASOP No. 22 is sufficient. It requires that the actuary consider using cash flow testing and allows application of judgment in the choice of which method to use. It also states that cash flow testing is generally appropriate where cash flows vary under different economic conditions.
2. We believe that if the cash flows associated with the reinsured business are not expected to materially vary under different economic scenarios, a requirement for cash flow testing may not be necessary. In those situations, for otherwise scoped-in reinsured business, we recommend an allowance for other forms of testing, such as stress testing.
3. We also note there may be practical challenges in performing cash flow testing if the Appointed Actuary does not have adequate information regarding the specific liabilities reinsured and/or the associated assets that can limit the usefulness of the analysis. For example, if cash flow testing is required in circumstances in which the Appointed Actuary does not have adequate information (e.g., a block where the cedant has exited that line of business, the liabilities are 100% reinsured, and the reinsurer or a TPA performs policy administration), they would need to utilize more judgment to make assumptions for use in cash flow testing. This, in turn, may indicate the need to include additional margin. Per ASOP No. 22, which states "When determining the level of assumption margins, if any, the actuary should take into account the following: a. the level of uncertainty for the assumption, including sparsity of data." The actuary would also need to follow ASOP No. 41, which requires disclosure of "any cautions about risk and uncertainty" as well as "any limitations or constraints on the use or applicability of the actuarial findings."
4. We also suggest considering the use of submissions to a non-U.S. regulator as an alternative documentation approach. For example, if the business is tested under a scenario analysis submitted to a non-U.S. regulator, that information may be sufficient for use in assessing reserve adequacy or, at a minimum, such information could be used to further narrow the need for any additional analysis to risks not already addressed.

Attribution Analysis

1. Attribution analysis may not be effective in ascertaining whether assets are adequate to cover policyholder obligations. Attribution analysis may be helpful in enhancing the understanding of the drivers of a reinsurance transaction and the components of the NAIC statutory framework that may contribute to a company's desire to use reinsurance. However, such analysis will take time and effort to perform and may not provide as much value as analyses to assess reserve adequacy (e.g., cash flow testing or stress testing). If regulators are interested in exploring drivers behind reserve levels pre- and post-reinsurance, the use of attribution analysis may be considered as part of a separate research initiative or field study, rather than implementing it as a mandatory submission

requirement.

2. We would also suggest that if attribution analysis is used in some form, accommodations be made to allow for reasonable approximations and judgment. Note that such analysis would not be used to directly compare different company results, given the dependence on the order in which the analysis is performed.
3. Finally, consistent with our comments on the definition of attribution analysis, we suggest adding a category for diversification methodology under "(b) Other reserve adjustments due to:".

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."
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.

Documentation

We suggest removing from item A the requirement to present the New York 7 results, and instead leaving the appropriate scenarios to disclose based on the risk profile of the business to the judgment of the actuary. Otherwise, the documentation requirements laid out in the Exposure appear reasonable.

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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,

Vice President, Life
American Academy of Actuaries