Joint Call of the
Statutory Accounting Principles (E) Working Group and
Life Actuarial (A) Task Force
April 10, 2025

ROLL CALL
Statutory Accounting Principles (E) Working Group

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1. Receive a brief overview of the current Statutory Accounting Principles (E) Working Group exposures and reasons for VAWG referral – *Rachel Hemphill.* Both exposures are on the SAPWG webpage: https://content.naic.org/committees/e/statutory-accounting-principles-wg — **Pages 3-6**

   - Ref #2024-05: Appendix A-791
   - Ref #2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts

2. ACLI presentation — **Attachment 2**

3. Discuss key concerns with determining risk transfer and reinsurance credit on co-insurance and YRT life reinsurance contracts which were identified in VAWG discussions prior to the referral. (Rachel Hemphill – TX) — **Attachment 3**

4. Discuss SAPWG December 2024 Comments Received/ Recommendations (Dale Bruggeman (OH); Kevin Clark (IA) and Rachel Hemphill (TX)) — **Pages 7-16**

5. Discuss Next Steps

1. **Receive a brief overview of the current Statutory Accounting Principles (E) Working Group exposures and reasons for VAWG referral –** ***Rachel Hemphill.*** **Both exposures are on the SAPWG webpage: https://content.naic.org/committees/e/statutory-accounting-principles-wg**

- Ref #2024-05: Appendix A-791
- Ref #2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts

Background/ Timeline:

- Both agenda items were developed in response to the **December 2023** Valuation Analysis (E) Working Group's (VAWG) referral to the Statutory Accounting Principles (E) Working Group.
- Both items were exposed at the **2024 Spring National Meeting**. The Working Group also notified the VAWG, the Life Actuarial (A) Task Force (LATF) and the Reinsurance (E) Task Force (Re TF) of the exposures.
- At the **2024 Summer National Meeting** the Working Group re-exposed the same revisions for both items with a request for specific recommendations. The comment deadline for both items was subsequently extended to Dec. 9, 2024 at the request of the ACLI.
- On **December 17, 2024**, the Statutory Accounting Principles (E) Working Group received a preliminary overview of the December 2024 comments received. The Working Group directed NAIC staff to schedule a joint meeting with the LATF to further discuss the referral from VAWG and the comments received.

Ref #	Title
2024-05 (Robin)	**Appendix A-791**

<u>*Summary:*</u>
This agenda item was developed in response to the December 2023 Valuation Analysis (E) Working Group's referral to the Statutory Accounting Principles (E) Working Group. This referral recommended a clarifying edit to *Appendix A-791 Life and Health Reinsurance Agreements* (A-791), Section 2.c's Question and Answer to **remove the first sentence, which reads, "Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide."** The referral notes that:

> First, this sentence is unnecessary, as it is an aside in a discussion about group term life. More importantly, this statement is being misinterpreted as supporting the use of Commissioner's Standard Ordinary (CSO) rates as a "safe harbor," at or below which YRT rates would be automatically considered not to be excessive.
>
> The 791 section 2c QA guidance does not provide a safe harbor based on CSO. It indicates that if the YRT reinsurance premium is higher than the proportionate underlying direct premium for the risk reinsured, then the reinsurance premium is excessive. VAWG observes that the prudent mortality under the *Valuation Manual*, Section 20: Requirements for Principle-Based Reserves for Life Products (VM-20), may appropriately be either higher or lower than the CSO rate depending on the facts and circumstances.

March 2024 exposed revision to A-791, Life and Health Reinsurance Agreements, paragraph 2c QA are shown tracked:

> 2. No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:
>
> c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current

and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty;

A-791, Life and Health Reinsurance Agreements, paragraph 2c's, Question and Answer):

Q – If group term life business is reinsured under a YRT reinsurance agreement (which includes risk-limiting features such as with an experience refund provision which offsets refunds against current and/or prior years' losses (i.e., a "loss carryforward" provision), under what circumstances would any provisions of the reinsurance agreement be considered "unreasonable provisions which allow the reinsurer to reduce its risk under the agreement" thereby violating subsection 2.c.?

A – ~~Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide.~~ So long as the reinsurer cannot charge premiums in excess of the premium received by the ceding insurer under the provisions of the YRT reinsurance agreement, such provisions would not be considered unreasonable. Any provision in the YRT reinsurance agreement which allows the reinsurer to charge reinsurance premiums in excess of the proportionate premium received by the ceding insurer would be considered unreasonable. The revisions to this QA regarding group term life yearly renewable term agreements ~~is~~ are effective for contracts in effect as of January 1, 2021.

Ref #	Title
2024-06 (Robin)	**Risk Transfer Analysis on Combination Reinsurance Contracts**

Summary:

On December 17, 2024, the Statutory Accounting Principles (E) Working Group received a preliminary overview of the comments received from the August 2024 re-exposure.

In March 2024, the Working Group exposed revisions *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance* to address the risk transfer aspect from the VAWG referral. The SSAP No. 61 revisions which were re-exposed in August 2024, were narrowly focused and incorporated guidance noting that interdependent contract features such as shared experience refunds must be analyzed in the aggregate when determining risk transfer.

The VAWG referral, excerpted below, included risk transfer concerns regarding interdependent contract features which had been analyzed for risk transfer separately instead of in the aggregate. It also raised several concerns regarding the classification of reinsurance contracts and the size of the reinsurance credit taken. The referral noted that (**bolding added for emphasis**):

> VAWG has identified that issues arise when evaluating reinsurance for risk transfer in accordance with *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance*, when treaties involve more than one type of reinsurance, and there is **interdependence of the types of reinsurance, including but not limited to an experience refund that is based on the aggregate experience**. In such cases, VAWG regulators find that these types of reinsurance must be evaluated together and cannot be evaluated separately for the purpose of risk transfer. For example, where a treaty includes coinsurance and YRT with an **aggregate experience refund and the inability to independently recapture the separate types of**

reinsurance, **it is not adequate to separately review the coinsurance and YRT pieces of the transaction for risk transfer**. The treaty as a whole is non-proportional. **This complexity is not immediately apparent to the regulatory reviewer, and it is important that this issue be raised broadly, so that individual state regulators are aware**. Individual regulators are encouraged to contact VAWG if they would like additional perspective when reviewing such treaties.

Generally, VAWG regulators observe that **some companies are reporting an overstated reserve credit due to a bifurcated risk transfer analysis.** Specifically, some companies reported a proportional reserve credit for a coinsurance component, despite in aggregate the reinsurer only being exposed to loss in tail scenarios. From an actuarial perspective, there is consensus among VAWG members that it is not appropriate for a ceding company to take a proportional reserve credit that reflects the transfer of all actuarial risks when not all actuarial risks are transferred.

VAWG recommends that SAPWG discuss this issue, to 1**) increase familiarity with the issue and 2) consider whether any clarifications to risk transfer requirements is appropriate.**

As noted in the referral above, regulators have observed reinsurance transactions that combine both coinsurance and YRT, with interdependent features including an **aggregate experience refund** and recapture provisions that allow for recapture by the cedant, **but only if both components are recaptured simultaneously**.

VAWG observed that some insurers have assessed these components under A-791 as if they were **separate agreements**, concluding that the requirements for risk transfer are met for each. Reserve credit was then taken on each component; a proportional credit for the quota share on the coinsured policies, and a YRT credit for the YRT component. Note that YRT contracts ordinarily cover a percentage of the one-year mortality risk for the net amount at risk on a policy. A simple way to describe net amount at risk is the difference between the policy reserve held and the face value of the policy.

At the **2024 Summer National Meeting**, the Working Group reviewed two letters. One that was in support of the exposed revisions (Claire Thinking) and comments from interested parties' / ACLI that requested further discussion.

The Working Group's exposure is based on existing guidance that is in both U.S. GAAP and in *SSAP No. 62—Property and Casualty Reinsurance Exhibit A – Implementation Questions and Answers,* question 10. The exposed guidance **provides that contracts with interdependent features must be analyzed in the aggregate for risk transfer.** In addition, a reference to A-791, paragraph 6, which requires that the reinsurance contract include provisions that the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings other than as expressed in the agreement, was proposed to be added to the existing required YRT criteria. The exposed wording is excerpted below:

Exposed Revisions SSAP No. 61:

Transfer of Risk

17. Reinsurance agreements must transfer risk from the ceding entity to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement. If the terms of the agreement violate the risk transfer criteria contained herein, (i.e., limits or diminishes the transfer of risk by the ceding entity to the reinsurer), the agreement shall follow the guidance for Deposit Accounting. In addition, any contractual feature that delays timely reimbursement violates the conditions of reinsurance accounting.

~~17.~~18. For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist. The inconsistency that could result from varying interpretations of the term contract is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly

compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers in the aggregate do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

~~18.~~19. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

~~19.~~20. Yearly renewable term (YRT) reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k., shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. For all treaties entered into on or after January 1, 2003, the deferral guidance in paragraph 3 of A-791 shall also apply to YRT agreements. YRT agreements shall follow the requirements of A-791, paragraph 6, regarding the entire agreement and the effective date of agreements. Since YRT agreements only transfer the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

2. ACLI presentation **Attachment 2**

3. Discuss key concerns with determining risk transfer and reinsurance credit on co-insurance and YRT life reinsurance contracts which were identified in VAWG discussions prior to the referral. (Rachel Hemphill – TX) **Attachment 3**

4. Discuss SAPWG December 2024 Comments Received/ Recommendations (Dale Bruggeman (OH); Kevin Clark (IA) and Rachel Hemphill (TX))

Ref #2024-05: Appendix A-791 prior comments

2024 Summer Meeting Interested Parties
Interested parties have no comments on this item.

December 7, 2024, ACLI Comments
ACLI would like to express our sincere gratitude for your time and willingness to collaborate with us on these reinsurance matters. We value the open dialogue and believe it has contributed to a more informed and constructive regulatory process. Through our discussions, we have gained a deeper understanding of the concerns raised by SAPWG regulators while also conveying the perspectives of our members.

ACLI members continue to believe that the two proposals (Ref #2024-05 and Ref #2024-06) are inextricably linked and should be considered together.

Ref #2024-05: A-791 Paragraph 2.c.

ACLI members believe that retaining the language in Appendix A-791, paragraph 2.c., is consistent with the statutory accounting requirement that reinsurance should not deprive a ceding insurer of surplus. With that said, we propose changes below to SAPWG 2024-06 that, if adopted, would address our concerns with the exposed changes in SAPWG 2024-05.

ACLI agrees that statutory risk transfer requires a careful evaluation of the facts and circumstances of a reinsurance agreement and should never rely on a simplistic application of "safe harbor" rules. Appendix A-791 already provides an objective standard by which to assess whether YRT premiums are excessive. That is, premiums are considered excessive if they result in the deprivation of ceding insurer surplus. The adoption of the change proposed by 2024-05 might be interpreted as introducing some other standard to determine whether premiums are excessive. However, no objective criteria have been provided by which to apply such other standards and, as a result, the adoption of the proposed change serves to create the potential for a range of interpretations as to what constitutes an excessive YRT premium. Such differences in interpretation are already surfacing with some parties interpreting the combination of the two SAPWG exposures to indicate that all combination Coinsurance-YRT (Co-YRT) agreements are non-proportional and therefore do not provide reserve credit; a conclusion that ACLI believes is7 /inconsistent with SAPWG intent based on conversations we have had with regulators.

To avoid the potential for misinterpretation, ACLI proposes that the 2024-05 exposed changes only be adopted if done concurrently with the ACLI version of SAPWG 2024-06 proposed below.

Another concern is that some may interpret the proposed 2024-05 exposure to require an assessment of YRT premiums using a standard other than the existing standard provided in SSAP No. 61 that precludes ceding insurer surplus deprivation. In such a case, there could be significant variation in regulatory interpretations as to what constitutes an "excessive" YRT premium leading to inconsistency rather than harmonization.

Recommendation/Prior discussion points:

- **NAIC staff continues to agree with the original Dec. 9, 2023, VAWG referral to the Working Group which noted that the sentence in A-791, paragraph 2c is an unnecessary sentence. NAIC staff defers to the Working Group on timing but continues to recommend deletion of this sentence.**

- The sentence proposed for deletion is to contrast that **individual life** insurance is different in a question / answer about **group term life** (see above). The reason that VAWG suggested deleting the sentence is that companies

were misusing it to imply that the individual life rules could be used for group term life as a premium safe harbor and that is incorrect.

- **The ACLI comments on this item, submitted in December 2024, note that if the ACLI proposed changes to agenda item 2024-06 are adopted, it would no longer have concerns with agenda item 2024-05.**

- Prior discussions with the ACLI and other industry representatives has proposed creating a safe harbor or have pointed to the sentence proposed for deletion as a possible safe harbor for risk transfer. Below is a key excerpt from the minutes December 2024 introductory discussion:

> Rachel Hemphill stated that this item came up during actuarial reviews and was being interpreted by some companies as the converse of what was stated. For context, the sentence proposed to be deleted is "Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide." She noted that the sentence states that above the stated amount would be unreasonable. It does not say below the stated amount is reasonable. She said it was an aside and that regulators need to look at all the existing requirements. She stated that there is not just one statutorily prescribed valuation mortality method and that the *Valuation Manual* (in effect since 2020) provides specific instructions. She noted that the valuation mortality can change over time and from company to company. She noted that she supports removing the aside statement. Bruggeman asked if a new reinsurance agreement covered pre-2020 business. For example, would a block written in 2015 change the discussion on valuation mortality? Hemphill replied that she did not think it did because even prior to the *Valuation Manual's* effective date, there were other aspects of the framework that made it more complex than just one statutorily prescribed valuation mortality.

Ref #2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts
Prior Comments received.

ACLI December 7, 2024 ,Comments
ACLI members continue to believe that the two proposals (Ref #2024-05 and Ref #2024-06) are inextricably linked and should be considered together.

Ref #2024-06: Risk Transfer Analysis for Combination Reinsurance Contracts

ACLI would like to thank SAPWG for the ongoing discussions regarding SAPWG 2024-06. During our discussions, we showed that combination Co-YRT agreements can be structured in ways that satisfy statutory risk transfer requirements as well as in ways that fail to satisfy statutory risk transfer requirements. We showed that when the YRT premiums were set at or below valuation level mortality, risk transfer was achieved (as ceding insurer surplus was protected against deprivation), but when YRT premiums were in excess of these amounts that risk transfer was not achieved (as ceding insurer surplus was not protected and could become negative). We concluded that taking a full proportional reserve credit for coinsured business and a ½ c_x credit for business ceded on a YRT basis (under a combination Co-YRT agreement) would be appropriate when agreements meet statutory risk transfer requirements such as having YRT premiums set at or below valuation mortality. To clarify SAPWG 2024-06 in order for it to recognize this result, we propose the following refinements to the exposure.

Proposed Risk Transfer Framework

ACLI proposes the following framework for assessing combination Co-YRT agreements for statutory risk transfer purposes:

- Any risk transfer assessment of combination Co-YRT agreements should be conducted in the context of

applicable SAP guidance and based on the facts and circumstances of the relevant reinsurance agreement(s).

- SAP coinsurance guidance should be applied to the coinsurance component of the agreement(s) and SAP YRT guidance should be applied to the YRT component of the agreement(s).
- Additionally, an overall assessment of the combined agreement should be performed consistent with the requirement that "the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder[.]"[1] to ensure that ceding insurer surplus is not deprived.

ACLI agrees that if any individual component of a combination Co-YRT agreement does not pass statutory risk transfer, then the aggregate transaction would not pass statutory risk transfer regardless of how it is structured. An overall assessment should include, among other things, an evaluation of:

i) the coinsurance agreement(s) to ensure that all significant risks inherent in the reinsured business are transferred, and

ii) the YRT agreement(s) to ensure that the conditions described in Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k. are not violated, and

iii) the entire agreement to confirm that, when assessed in aggregate, it does not deprive a ceding insurer of surplus or require payments other than from the statutory net gain before adjustments (i.e., as defined in the 2023 SAP life blank line 29, hereinafter "net gain") realized from the reinsured policies.

ACLI agrees that agreements that inappropriately preclude any possibility of reinsurance losses being incurred because of excessive YRT premiums would be of concern from a statutory risk transfer perspective. In evaluating whether this is the case, YRT premium levels should be assessed using statutory principles as any resulting reserve credit will also have been established using statutory principles. In applying statutory principles, statutory valuation assumptions serve as an acceptable benchmark when assessing whether YRT premiums are excessive. More specifically:

- YRT reinsurance results in the assumption of mortality risk for the lifetime of the underlying business. In such a context, the statutory valuation framework already defines a reasonably prudent valuation mortality basis for ceding insurers when reserving for such risks. As such, this same valuation mortality basis should also serve as a reasonable and prudent benchmark for reinsurers to consider when committing to the assumption of mortality risk for the lifetime of the underlying business.

- The determination of reserve credit relates to the underlying statutory reserves that are held by the ceding insurer and determined based on statutory principles and assumptions. It would be inconsistent to determine a reserve credit using GAAP principles and assumptions in relation to underlying reserves that are computed using statutory principles and assumptions.

Proposed Changes to SSAP No. 61 and Appendix A-791

In response to SAPWG's request for specific recommendations, ACLI proposes the following changes to SSAP No. 61 and the introduction of a new question to be added to Appendix A-791 in lieu of the exposed changes proposed in SAPWG 2024-06.

ACLI proposes the following paragraph be adopted in SSAP No. 61. This proposal aims to maintain SAPWG's objective of evaluating agreements in aggregate and ensuring the appropriate application of current risk transfer principles.

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[1] A-791 Page 6

18. *For purposes of evaluating whether a reinsurance agreement satisfies statutory risk transfer requirements, the determination of what constitutes an agreement is essentially a question of substance. Multiple agreements should be evaluated together for risk transfer purposes when they are entered into together to achieve one overall commercial effect and where considerations to be exchanged under one agreement depend on the performance of the other agreement(s). For individual agreements that contemplate reinsurance on both a YRT and coinsurance basis, each of the YRT and coinsurance reinsurance components need to satisfy risk transfer requirements on their respective bases. In addition, when evaluated in its entirety, such agreements cannot deprive the ceding insurer of surplus nor require payments to the reinsurer for amounts other than the net gain realized from the reinsured policies.*

ACLI proposes a second question be added to Appendix A-791 2b:

Question

If business is reinsured under a combination reinsurance agreement where the reinsurer assumes certain risks on a coinsurance, modified coinsurance, and/or coinsurance funds withheld basis and other risks on a YRT basis, what conditions are required to ensure that the ceding insurer is neither deprived of surplus nor required to make payments to the reinsurer from other than the net gain realized from the reinsured policies such that risk transfer is achieved? How are these conditions impacted by the agreement having an experience refund formula?

a. *The reinsurance agreement cannot deprive the ceding insurer of surplus or assets. If treaty provisions limit payment of amounts to the reinsurer to the amount of net gain realized from the reinsured business, then the ceding insurer surplus is not deprived, and risk transfer is achieved.*

   For example, risk transfer requirements are satisfied when YRT premiums are contractually stipulated to be equal to or less than the level of valuation mortality used by the ceding insurer in calculating reserves for the reinsured business at the time of inception of the reinsurance agreement and are contractually constrained not to exceed this level.

b. *The fact that there is an experience refund does not, in itself, cause an agreement to fail risk transfer. However, an experience refund that requires that the ceding insurer reimburse the reinsurer for negative experience using amounts it has in surplus is a violation of risk transfer requirements, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in-force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience.*

Summary

Ultimately, our primary concern remains that some may interpret the proposed 2024-06 exposure to indicate that all combination Co-YRT agreements are non-proportional and therefore should not provide reserve credit. Such an interpretation would affect in-force combination Co-YRT agreements and create the potential for material volatility in surplus levels for ceding insurers who have previously entered into such agreements. In addition, such an interpretation would effectively eliminate the ability to use such agreements going forward. Based on our discussions with SAPWG, it is our understanding that neither of these outcomes are intended.

Another concern is that some may interpret the proposed 2024-05 exposure to require an assessment of YRT premiums using a standard other than the existing standard provided in SSAP No. 61 that precludes ceding insurer surplus deprivation. In such a case, there could be significant variation in regulatory interpretations as to what constitutes an "excessive" YRT premium leading to inconsistency rather than harmonization.

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ACLI believes that one way to maintain the ability to use compliant combination agreements and not bring into question the reserve credits currently being taken by ceding insurers who are party to such agreements is by adopting proposed changes to SSAP No. 61 and Appendix A-791 consistent with those proposed by ACLI above. Such changes aim to make clear that compliant agreements cannot charge "excessive" YRT premiums and provide a clear basis for how an assessment of YRT premiums anchored to existing SAP guidance is to be performed.

Along with the suggested changes above, we propose forming a small working group consisting of regulators and industry experts to finalize language consistent with the objectives noted above within a defined timeline.

Jeffrey G. Stevenson FSA (Sevenson Associates, Inc) Comments

I am a retired actuary with years of experience in reinsurance, primarily with respect to transactions where the primary motivations are not primarily risk transfer. Not long ago I was asked about a treaty arrangement involving combinations of coinsurance and YRT and was told there was some controversy with respect to the accounting.

Combination coinsurance and YRT agreements have been around forever; there shouldn't be much controversy.

Traditionally, the YRT combined in coinsurance agreements is YRT reinsurance inuring to the benefit of the reinsured block.

In this respect, the cash flows of the coinsurance (or Modco) treaty (principally of those intended for purposes other than risk transfer) have traditionally been:

+Premiums
-Claims
-Surrender & Maturity Benefits
-Commissions and Expense Allowances

-Ceded Reins Prems (on Inuring agreements)
+Ceded Reins Dbs (on Inuring agreements)
+Ceded reins Exp Refunds (on Inuring agreements)

-Modco Res Incr (if Modco)
+Modco Interest (if Modco)

- Experience Refunds (if included)

The above result may result in an expense and risk charge with favorable experience.

The inuring agreements in the above could be YRT of mortality risk or other coinsurance of reinsured business of the benefits or even catastrophic stop loss arrangements. The inuring agreements could be traditional YRT with an experience refund arrangement. They could also be YRT agreements of a more financially motivated arrangement, i.e., a high YRT premium based on a high percentage of the valuation mortality basis, combined with a large experience refund.

There is no reason the YRT couldn't be additional quota share of the same block as the coinsurance. Why would ceding companies do this? Well in past circumstances, perhaps they were reinsuring the business with two reinsurers and one reinsurer does not want to retain catastrophic mortality risk but the second reinsurer is willing to take that additional risk in addition to the risks in its own portion of the reinsurer. Including such reinsurance in the single tradition would be done for administrative convenience and if structured as YRT would include additional impacts on reserve and capital requirements. This type of arrangement would not be uncommon for divestiture of the business (might be referred to as administrative reinsurance). My first impression of the combo YRT treaties

presented to me is that the additional YRT is nothing more than inuring reinsurance regardless of what the reinsured business is, just like these arrangements in the past.

My understanding of the new variations of combo treaties is that the YRT is indeed an additional quota share of the coinsured business but the interpretation is that the YRT is not inuring to the benefit of the coinsured business. In fact, in the new interpretations the YRT is treated as a separate agreement with its own cash flows. Moreover, the YRT mortality risk treaty might be on the basis of a high percentage of the valuation table thereby generating a generous experience refund under expected assumptions.

The interpretation being made that the extra YRT arrangement is more like a standalone rider produces a result that in the event of adverse investment scenarios, the high experience refund (on the YRT mortality component) can be combined with adverse experience on the coinsured business to merely produce a lower experience refund with the reinsurer not necessarily reimbursing the ceding company for the adverse experience of the coinsured business.

That might look okay with the arithmetic but in my opinion, it is a clear violation of the life reinsurance model regulation. The reserve or capital credits associated with any treaty with such an arrangement (and with the YRT component not accounted for as inuring reinsurance) should be denied.

Here is the explanation.

Accounting requirements of the model regulation are:

1. Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period, a must be sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured
2. The ceding insurer can't be deprived of surplus or assets at the reinsurer's option or automatically upon the occurrence of some event
3. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement
4. The reinsurance agreement can't involve the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies.

The new interpretation of the added YRT component (an additional quota share of the underlying coinsured business) violates some of all of these accounting requirements.

First off, as for the YRT exemption from the requirements of the model regulation, the combo treaty "interpretation" does not allow for any YRT exemption because the surplus and capital aid of the combination exceeds that of a zero premium YRT treaty. The model regulation accounting requirements should apply to all the components of the treaty.

Let's assume the coinsured portion of the business produces negative cash flows as a result of poor investment experience and the additional YRT business produces an experience refund that more than offsets the negative experience.

Note that all reinsurance has a cost. The YRT portion of the business has a cost associated with it. The cost is Premiums minus Claims minus Experience Refund. (This typically nets to a cost equal to a risk fee or the profit margin of the reinsurer which may or not be a mere risk fee). But in this case the adverse experience of the coinsured business reduces the YRT portion's experience refund, that YRT reinsurance now has an additional cost in addition to the profit margin.

That cost is now a cost of the ceding company. Reinsurance costs of the ceding company have to be reimbursed by the reinsurer through the expense allowance. In this case then, the reinsurer has to reimburse its own charge, thereby resulting in a wash, so there is, in fact, no recovery of the adverse experience refund.

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You can also think of the experience refund as an "optional experience refund." In this case a portion of the YRT experience refund is denied at the option of the reinsurer (it's automatically denied with the occurrence of the adverse experience on the coinsurance). So the use of the YRT as an offset to adverse experience is automatically denying the ceding company of surplus automatically on the occurrence of some event.

The recovery of the adverse experience on the coinsurance is also technically a payment that is not made out of the profits on that coinsured business. It is coming out of an additional premium payment to the reinsurer (the YRT premium).

I recognize that some might make nuanced arguments against these above arguments. However, and most importantly, let's look at the essential substance of the YRT portion of the transaction. The companion YRT arrangement typically has a YRT premium which is a high percentage of valuation mortality (let's say 90%) and any premiums in excess of the claims are experience refunded net of a risk charge. The substance of this transaction is that there is a risk charge paid and claims in excess of 90% of valuation mortality are experience refunded back to the ceding company. (Now this might be structured as YRT because there are other accounting entries such as face amount ceded and reserve credits accompanying the accounting, but the essence of the transaction is essentially a non- proportional stop loss arrangement). The YRT component of the transaction is basically a stop loss arrangement with a risk charge for a premium. In exchange for this risk premium, the reinsurer will pay claims only if they exceed the percentage of the valuation basis mortality relating to the premium. It is an excess of loss structure.

So if we think of the companion YRT agreement in this true economic form, the companion treaty in addition to the coinsurance is nothing more than a risk premium paid to the reinsurer for catastrophic mortality. From this standpoint, the combo treaty arrangement's result in the event of adverse experience on the coinsurance is that the reinsurer is receiving a payment in addition to the risk charge from the ceding company to cover that adverse experience (as is argued above). This is because in order for the transaction to provide for an offset to the losses on the coinsurance, the ceding company would be required to make a payment to the reinsurer in addition to the risk charge! When viewed from this true economic perspective, this is clearly a violation of the model regulation.

To argue that merely changing the companion contract from a stop loss format to an equivalent YRT structure would change the above interpretation (that the contract violates the model regulation) seems just plain wrong.

One can also think of this additional payment as essentially the same as using an artificially high interest rate (like 12%) to calculate coinsurance experience refunds or modco profits. Everyone should recognize that this provision would be a violation of the model regulation as it would be an additional payment or a payment outside of profits in the business. Likewise, any additional premium paid, or reduction in experience refund of associated treaty provisions, would similarly be a violation of the model regulation.

In P&C arrangements, there is often reference to this type of arrangement as a "reinstatement premium." This has no place in a life reinsurance transaction.

This concluding argument of looking through to the substance of the transaction validates all the other above arguments that this new interpretation of the combo structure violates the model regulation!

If the additional YRT is, in essence, accounted for as an inuring agreement, just has it has always been done, the appropriate cash flows fall out in the treaty accounting and the reserve credits are justified.

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Recommendation:

NAIC staff notes that the exposed revisions are narrowly focused on the issue that interdependent contracts, and/or interdependent contract features, must be analyzed in aggregate and (including all relevant facts and circumstances). As all the parties who have commented agree that the entirety of the contract must be analyzed, NAIC staff continues to support adoption of the exposed revisions, with timing subject to the discretion of the Working Group. NAIC staff recommended a joint meeting of the SAWPG and LATF because actuarial expertise would be beneficial in discussing some of the comments received on the actuarial risk transfer analysis. The exposed revisions to SSAP No. 61 are shown in the introductory section for reference.

1. **NAIC staff does not recommend exposing the ACLI proposed revisions to add a new paragraph 18 to *SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance* and to add a second question to Appendix A-791, question 2b**. **Areas of agreement –** NAIC staff concurs with the comments that reinsurance agreements need to be evaluated using all the relevant facts and circumstances and existing guidance.

    - Comments from VAWG and from Stevenson note that not all combination contracts are concerning, but also noted that some of the more concerning combination contracts have structural variations or assumptions on the cash flows that differ from the historic structure / assumptions of many such contracts.

2. **Use of a Valuation Mortality Measure** - The ACLI has also previously recommended is that risk transfer for the entire combination reinsurance contract is achieved if the YRT premium does not exceed the cedent valuation mortality at the time of contract inception. Conversations with actuaries note that the valuation mortality is not fixed under principle-based reserving. The valuation mortality could be based on the net premium reserve, or the modelled reserve. In addition, the reinsurer's valuation mortality can be different than the ceding entity's valuation mortality because the valuation mortality can change over time. Using the valuation mortality at inception does not guarantee that there will not be a future deprivation of surplus to the ceding entity. Therefore, this will not work as a proposed safe harbor. In addition, the Stevenson comments also noted that YRT reinsurance that was a higher percentage of the valuation mortality as being more financially motivated.

3. **YRT requirements** - Note that all the Appendix A-791 requirements apply to coinsurance and only a subset of the A-791 requirements apply to certain types of YRT agreements. SSAP No. 61, paragraph 19 excerpted below specifies the paragraphs of A-791 which apply. Part of the reason noted in the A-791 QA (excerpted below) for excluding YRT from being required to follow all of A-791, is that YRT reinsurance typically only resulted in limited reserve credit. This is typically a portion of the current year mortality benefit (commonly referred to as ½ cx). However, if the YRT treaty reserve credit is higher as specified in A-791 excerpt below, **that type of higher credit YRT treaty is not intended to be excluded from any of the A-791 requirements.**

    One of the VAWG concerns that was echoed by comments from Stevenson, is that the concerning type of combination contracts are resulting in a larger type of reinsurance credit that was not intended to be excluded from A-791 requirements. **Stevenson noted that some of the concerning contracts are resulting in a reinsurance credit that is greater than that of a zero premium YRT treaty (see A-791 QA excerpt below), which indicates that the YRT treaty of this type was not intended to be excluded from A-791.**

From A-791 QA paragraph 1. (Bolding added)

Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

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A – Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt because these do not normally provide significant surplus relief and therefore are outside the scope of this Appendix. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. **For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer.**

From SSAP No. 61, paragraph 19:

19. Yearly renewable term (YRT) reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in Appendix A-791, paragraphs 2**.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k.,** shall follow the guidance for reinsurance accounting, including paragraphs 55-57 of this statement that apply to indemnity reinsurance. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting. ….

4. **Prohibited Elements in Part of a Combination Contract**– Steveson is noting that the YRT combination contract is resulting in the surplus and capital aid that exceeds that of a zero premium YRT treaty which is not intended to be excluded from A-791 (from the discussion and quotes above). Therefore the A-791 accounting requirements should apply to all the components of the treaty. **Stevenson commented that having contract terms in an interdependent contract which are prohibited in a coinsurance agreement on a standalone basis under A-791 would not be compliant with the model law. This is similar to some of the comments and concerns noted by VAWG.**

For ease of review, the WG exposed revisions to SSAP No. 61, paragraph 18, and the ACLI proposed revisions are both illustrated below.

Exposed Revisions SSAP No. 61, paragraph 18:

18. For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For instance, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist. The inconsistency that could result from varying interpretations of the term contract is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers in the aggregate do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

ACLI proposed paragraph, 18:

18. For purposes of evaluating whether a reinsurance agreement satisfies statutory risk transfer requirements, the determination of what constitutes an agreement is essentially a question of substance. Multiple agreements should be evaluated together for risk transfer purposes when they are entered into together to achieve one overall commercial effect and where considerations to be exchanged under one agreement depend on the performance of the other agreement(s). For individual agreements that contemplate reinsurance on both a YRT and coinsurance basis, each of the YRT and coinsurance reinsurance components need to satisfy risk transfer requirements on their respective bases. In addition, when evaluated in its entirety, such agreements cannot deprive the ceding insurer of surplus nor require payments to the reinsurer for amounts other than the net gain realized from the reinsured policies.

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The ACLI proposed revisions partially reword the first sentence in the exposed paragraph18 and proposes to replace the rest of the paragraph with a narrower risk transfer discussion.

5. Discuss Next Steps

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2025/02-18-25 Reg only JT with LATF/2-18-25 R2R Joint call LATF Agenda.docx

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Statutory Risk Transfer Considerations Relating to Combination Co-YRT Agreements

Agenda

- Highlights of examples presented to SAPWG in October 2024
- New multiperiod examples
- Observations
- Appendix
  - ACLI October 2024 presentation to SAPWG regulators

Statutory Risk Transfer Is Based On No Deprivation of Surplus

- Deprivation of surplus
  - Surplus is impacted by net gain from operations
  - Net gain from operations is impacted by reinsurance
  - Surplus is deprived by reinsurance when payments are made from surplus rather than the net gains of the ceded business

Previous Examples - Background

- Simplified example based on:
  - Two in-force blocks of SPWL
  - One year of experience
  - Co-YRT agreement with YRT premiums set equal to valuation mortality (i.e., valuation mortality*Net Amount at Risk)
  - Agreement has an Experience Refund based on the combined experience with a risk charge of $2
- Two sets of scenarios
  - Each set included mortality experience: Best estimate, 110% BE, valuation, 110% valuation
  - Scenarios based on YRT Premiums based on: valuation mortality, exceed valuation mortality

Summary results of illustrative examples

Treaty Type	Mortality Level	No Reinsurance	With Co-YRT Reinsurance	
		Cedent Surplus	Cedent Surplus	Reinsurer Profit
Compliant	100% of BE Qx	45	43	2
	110% of BE Qx	20	18	2
	Valuation level Qx	-	-	-
	110% Valuation level Qx	(30)	-	(30)
Non Compliant	100% of BE Qx	45	43	2
	Valuation level Qx	-	(2)	2
	110% Valuation level Qx	(30)	(32)	2

Key Conclusions

- Cedent surplus is protected against losses when cedent is party to a compliant Co-YRT agreement but not when party to non-compliant agreement
- Reinsurer absorbs all cedent losses when it is party to a compliant Co-YRT agreement but not when the agreement is non-compliant

Multi-Year Example

- Based on **Pre-PBR** business
- Simplified example:
  - The cedent reinsures 100% of two blocks of Limited Pay WL policies
  - Co-YRT agreement with guaranteed YRT premiums
  - Initial ceding allowance of 50% of initial coinsured statutory reserves
  - Agreement has an aggregate experience refund with 1% risk charge of the outstanding reserve relief
- Projections
  - Best estimate assumptions
  - Moderately adverse mortality equal to 110% of best estimate mortality

Ceding Company Surplus Projection – Best Estimate

No Post-Reinsurance Net Loss ⇔ No Surplus Deprivation

		Treaty Duration					
		0	**1**	**5**	**10**	**15**	**20**
	Pre-reinsurance						
Coinsurance Block	Net Cash Flow		136,257	110,373	74,196	43,605	14,455
Coinsurance Block	Change in Statutory Reserve		(108,331)	(73,045)	(31,165)	3,862	6,577
Coinsurance Block	*Net Gain/(Loss)*		*27,926*	*37,328*	*43,030*	*47,468*	*21,032*
YRT Block	Net Cash Flow		136,257	110,373	74,196	43,605	14,455
YRT Block	Change in Statutory Reserve		(108,331)	(73,045)	(31,165)	3,862	6,577
YRT Block	*Net Gain/(Loss)*		*27,926*	*37,328*	*43,030*	*47,468*	*21,032*
	Total Co + YRT Blocks Net Gain/(Loss)		55,852	74,655	86,061	94,935	42,063
	Post-reinsurance						
	Net Cashflow[1]		272,515	220,746	148,391	87,211	28,910
	Net Reinsurance Settlement[2]		(1,905)	(3,033)	(2,869)	(1,683)	(277)
	YRT Block Change in Liabilities		(108,332)	(73,045)	(31,165)	3,862	6,577
	Coinsurance Block Change in FWH Liability	190,459	(66,397)	(64,612)	(49,452)	(24,667)	(21,156)
	Post-reinsurance Net Gain/(Loss)[3]	190,459	95,882	80,055	64,906	64,724	14,053

[1] Net Cash Flow = Premium + Investment Income – Benefits – Expenses
[2] Net Reinsurance Settlement = Net Reinsurance Cash Flow – Change in Funds Withheld – Experience Refund
[3] Post-reinsurance Net Gain/(Loss)=Net Cashflow – Net Reinsurance Settlement – Change in Liabilities for YRT and Co Blocks

Ceding Company Surplus Projection – Adverse Mortality

No Post-Reinsurance Net Loss ⇔ No Surplus Deprivation

		Treaty Duration					
		0	1	5	10	15	20
	Pre-reinsurance						
Coinsurance Block	Net Cash Flow		134,666	107,636	69,723	38,120	10,282
Coinsurance Block	Change in Statutory Reserve		(108,176)	(72,583)	(30,110)	5,347	9,225
Coinsurance Block	*Net Gain/(Loss)*		*26,490*	*35,053*	*39,613*	*43,467*	*19,507*
YRT Block	Net Cash Flow		134,666	107,636	69,723	38,120	10,282
YRT Block	Change in Statutory Reserve		(108,176)	(72,583)	(30,110)	5,347	9,225
YRT Block	*Net Gain/(Loss)*		*26,490*	*35,053*	*39,613*	*43,467*	*19,507*
	Total Co + YRT Blocks Net Gain/(Loss)		52,980	70,106	79,225	86,933	39,014
	Post-reinsurance						
	Net Cashflow[1]		269,332	215,273	139,446	76,239	20,564
	Net Reinsurance Settlement[2]		(1,905)	(3,028)	(2,856)	(1,666)	0
	YRT Block Change in Liabilities		(108,176)	(72,583)	(30,110)	5,347	9,225
	Coinsurance Block Change FWH Liability	190,459	(66,407)	(64,292)	(48,545)	(23,092)	(20,046)
	Post-reinsurance Net Gain/(Loss)[3]	190,459	92,844	75,369	57,935	56,828	9,743

1 Net Cash Flow = Premium + Investment Income – Benefits – Expenses
2 Net Reinsurance Settlement = Net Reinsurance Cash Flow – Change in Funds Withheld – Experience Refund
3 Post-reinsurance Net Gain/(Loss)=Net Cashflow – Net Reinsurance Settlement – Change in Liabilities for YRT and Co Blocks

Observations – Pre-PBR Business

- To satisfy risk transfer requirements, the cedent must demonstrate there was no deprivation of surplus
- One way to assess this condition is that at every duration the cedent's net gain from operation after reinsurance must be positive

Appendix

ACLI October 2024 Presentation to SAPWG Regulators

Statutory Risk Transfer Considerations Relating to Combination Co-YRT Agreements

Agenda

- Review of Prior Meeting
- Co-YRT agreements
  - Proportional
  - No deprivation
  - Application of Statutory Rules to Co-YRT
- Conceptual Examples (one year)
- Discussion

Review

- SAPWG 2024-06 uses GAAP-based SSAP 62R principal
- Nature of risks leads to life regulations with different emphasis
- Statutory accounting is solvency based
- SSAP 61R/Appendix A-791 focuses on no deprivation of surplus
- Over the years, several forms of life reinsurance were developed
- YRT is a uni-risk policy-by-policy form of reinsurance
- Experience refunds return “excess” profits, leaving reinsurers with less accumulated profits and increased risk
- Nonproportional based on the block over time, proportional on cession defined upfront

Co-YRT Agreements are Proportional

- Idea: Co-YRT fit the definition of proportional
- Both the coinsured and YRT reinsured business define risk at the time of cession
- Indemnification is on a policy by policy basis
- Experience refund feature returns profits, if any, in excess of reinsurer margin
- Valuation mortality related YRT premiums matches reserve credit
- Accounting treatment is based on statutory risk transfer principles

No Deprivation of Surplus with Co-YRT

- Idea: Co-YRT meets risk transfer rules when YRT premiums are limited
- Co-YRT agreements where YRT premiums are no more than the valuation mortality do not deprive cedents of surplus
  - Statutory reserves are computed as
    - (PV future Guaranteed Benefits) – (PV future valuation Premiums)
  - Surplus (pre-reinsurance) has already been reduced by the (PV future Guaranteed Benefits) which is computed using valuation level mortality
  - Over time, statutory reserves are released into statutory income and the net margin (valuation mortality in excess of actual claims) is realized in surplus, *if any*
  - Prudent statutory principles do not allow for the recognition of the net margin in surplus until it is realized
  - YRT reinsurance that replaces reserve reduction with a similar level of reinsurance premiums leads to no deprivation of surplus

Discussion Co-YRT and Surplus Impact

- Idea: To satisfy statutory risk transfer, a reinsurance agreement cannot deprive the cedent of surplus
- Entering into a combination Co-YRT reinsurance agreement does not deprive the cedent of surplus provided the YRT premiums are no greater than valuation mortality

No Reinsurance

- Cedent statutory reserves release into statutory income
- Cedent pays actual claims
- The net margin (if any) emerges in statutory earnings / surplus

With Co-YRT Reinsurance

- Cedent statutory reserves release into statutory income
- Cedent pays YRT premiums <= valuation mortality
- The net margin* (if any) is paid to the cedent in the form of an experience refund and emerges in statutory earnings / surplus

- The cedent is no worse off with reinsurance when mortality emerges as expected (other than incurring the reinsurance risk charge)
- The cedent is better off with reinsurance when mortality emerges at levels in excess of what it has reserved for

(*) This net margin is reduced by the reinsurance risk charge (i.e. cost of reinsurance)

Statutory Rules Applicable to Co-YRT

- Idea: Co-YRT must follow statutory rules to meet risk transfer requirements
- Coinsured business provides surplus enhancement, YRT does not
- SSAP 61R has explicit rules for Coinsurance and YRT agreements
  - Coinsurance meets all of Appendix A-791
  - YRT meets Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j., or 2.k.
- Experience refund feature
  - Appendix A-791 provides rules for compliant experience refunds
  - A refund involves a reinsurer paying funds to cedent
    - This means the reinsurer has less accumulated surplus and thus less funds to absorb future losses (i.e., increases reinsurer risk)
- Statutory risk transfer is based on *all significant risks* have been transferred on a permanent basis, not likelihood of loss

Conceptual Examples: Compliant Agreement

- Idea: Sample examples demonstrate features of compliant Co-YRT agreements
- The following examples are meant to be illustrative
- The examples consider one single year of experience
- The examples assume the following:
  - Results are presented from the cedent company perspective
  - The cedent has two blocks of inforce life insurance contracts; you can think of these as two SPWL blocks of business
  - No initial ceding allowance is assumed
  - The statutory reserve release represents the release of expected claims assuming valuation mortality
  - The combination Co-YRT agreement has YRT premiums set equal to valuation mortality
  - The reinsurance risk charge is $2
  - The reinsurance treaty includes an aggregate Experience Refund (ER) provision which results in a payment to the cedent equal to the total reinsurance profits net of the reinsurance risk charge of $2 (to the extent such reinsurance profits emerge)

Example 1: Mortality experience is consistent with best estimate assumptions

No Reinsurance	Co Block	YRT Block	Total
Premium	-	-	-
Claims	(150)	(100)	(250)
tVx Release	175	120	295
Net Stat Profit			**45**
Increase in Surplus			**45**

With Reinsurance	Co Block	YRT Block	Total
Premium	-	-	-
Claims	(150)	(100)	(250)
tVx Release	175	120	295
Statutory Profit	**25**	**20**	**45**
Co Prem	-	-	-
YRT Prem	-	(120)	(120)
FWH Release	(175)	-	(175)
Reins. Claims	150	100	250
Exp. Refund			43
Net Reins. Result			**(2)**
Net Stat Profit			**43**
Increase in Surplus			**43**
Reins. Cost			2
LCF Balance			-

The YRT premium is set to the valuation mortality level

An ER returns all reinsurance profits (net of the risk charge)

The cedent net statutory profit that emerges in the year with no reinsurance in place is $45

Cedent surplus is reduced by risk charge, no deprivation of surplus

Example 2: Mortality experience is 110% of best estimate assumptions

No Reinsurance	Block A	Block B	Total
Premium	-	-	-
Claims	(165)	(110)	(275)
tVx Release	175	120	295
Net Stat Profit			**20**
Increase in Surplus			**20**

With Reinsurance	Block A Co Block	Block B YRT Block	Total
Premium	-	-	-
Claims	(165)	(110)	(275)
tVx Release	175	120	295
Statutory Profit	**10**	**10**	**20**
Co Prem	-	-	-
YRT Prem	-	(120)	(120)
FWH Release	(175)	-	(175)
Reins. Claims	165	110	275
Exp. Refund			18
Net Reins. Result			**(2)**
Net Stat Profit			**18**
Increase in Surplus			**18**
Risk Charge			2
LCF Balance			-

The YRT premium is set to the valuation mortality level

An ER returns all reinsurance profits (net of the risk charge); ER is reduced due to adverse experience

Cedent surplus is reduced by risk charge, no deprivation of surplus

The cedent net statutory profit that emerges in the year with no reinsurance in place is $20, reduced from $45 due to elevated claims

Example 3: Mortality experience equal to valuation mortality

No Reinsurance

No Reinsurance	Co Block	YRT Block	Total
Premium	-	-	-
Claims	(175)	(120)	(295)
tVx Release	175	120	295
Net Stat Profit			-
Increase in Surplus			-

With Reinsurance

	Block A Co Block	Block B YRT Block	Total
Premium	-	-	-
Claims	(175)	(120)	(295)
tVx Release	175	120	295
Statutory Profit	-	-	-
Co Prem	-	-	-
YRT Prem	-	(120)	(120)
FWH Release	(175)	-	(175)
Reins. Claims	175	120	295
Exp. Refund			-
Net Reins. Result			-
Net Stat Profit			-
Increase in Surplus			-
Risk Charge			2
LCF Balance			(2)

The YRT premium is set to the valuation mortality level

No ER is paid as there are no reinsurance profits to refund

Cedent surplus is protected by reinsurance, no deprivation of surplus

Risk charge is uncollected as there are no reinsurance profits to pay for this; a Loss Carry Forward Balance is established

The cedent net statutory profit that emerges in the year with no reinsurance in place is $0, reduced due to elevated claims

Example 4: Mortality experience equal to 110% of valuation mortality

No Reinsurance	Co Block	YRT Block	Total
Premium	-	-	-
Claims	(193)	(132)	(325)
tVx Release	175	120	295
Net Stat Profit			**(30)**
Increase in Surplus			**(30)**

With Reinsurance	Block A Co Block	Block B YRT Block	Total
Premium	-	-	-
Claims	(193)	(132)	(325)
tVx Release	175	120	295
Statutory Profit	**(18)**	**(12)**	**(30)**
Co Prem	-	-	-
YRT Prem	-	(120)	(120)
FWH Release	(175)	-	(175)
Reins. Claims	193	132	325
Exp. Refund			-
Net Reins. Result			**30**
Net Stat Profit			-
Increase in Surplus			-
Risk Charge			2
LCF Balance			(32)

The YRT premium is set to the valuation mortality level

No ER is paid as there are no reinsurance profits to refund

Cedent surplus is protected (improved) by reinsurance, no deprivation of surplus

A Loss Carry Forward Balance is established to track past losses

The cedent incurs statutory losses with no reinsurance in place

Summary conclusions from illustrative examples demonstrating performance of compliant agreements:

- Idea: Compliant YRT agreements utilize reinsurance premiums no greater than valuation mortality level
- Compliant agreements limit the YRT reinsurance premium to the valuation mortality level
- Valuation mortality is a prudent and appropriate level to reserve and price for when assuming long term mortality risks
- These agreements do not impair the surplus of the cedent (beyond a reduction in surplus for the cost of reinsurance or "risk charge")
- These agreements insulate cedent surplus when claims exceed levels for which the cedent is reserved for
- The establishment of a Loss Carryforward (LCF) does not negate risk transfer provided the LCF can only be repaid using future profits (which are uncertain and may not emerge)

Conceptual Examples: Non-Compliant Agreement

- The following examples are consistent with the prior examples with one notable difference; the YRT premiums in these examples exceed valuation mortality levels

Example 5: Non-compliant YRT rates; mortality experience is consistent with best estimate assumptions

No Reinsurance	Co Block	YRT Block	Total
Premium	-	-	-
Claims	(150)	(100)	(250)
tVx Release	175	120	295
Net Stat Profit			**45**
Increase in Surplus			**45**

With Reinsurance	Block A Co Block	Block B YRT Block	Total
Premium	-	-	-
Claims	(150)	(100)	(250)
tVx Release	175	120	295
Statutory Profit	**25**	**20**	**45**
Co Prem	-	-	-
YRT Prem	-	(200)	(200)
FWH Release	(175)	-	(175)
Reins. Claims	150	100	250
Exp. Refund			123
Net Reins. Result			**(2)**
Net Stat Profit			**43**
Increase in Surplus			**43**
Risk Charge			2
LCF Balance			-

The YRT premium is set ***above*** the level of valuation mortality

An ER returns all reinsurance profits (net of the risk charge) which is the usual outcome in favorable mortality scenarios. However $80 of the ER is a return of surplus to the cedent as this $80 was not funded by cedent statutory income

The cedent net statutory profit that emerges in the year with no reinsurance in place is $45

Cedent surplus is not adversely impacted (however this is rarely the case in favorable mortality scenarios)

Example 6: Non-compliant YRT Rates, mortality experience equal to valuation mortality

No Reinsurance	Co Block	YRT Block	Total
Premium	-	-	-
Claims	(175)	(120)	(295)
tVx Release	175	120	295
Net Stat Profit			-
Increase in Surplus			-

With Reinsurance	Block A Co Block	Block B YRT Block	Total
Premium	-	-	-
Claims	(175)	(120)	(295)
tVx Release	175	120	295
Statutory Profit	-	-	-
Co Prem	-	-	-
YRT Prem	-	(200)	(200)
FWH Release	(175)	-	(175)
Reins. Claims	175	120	295
Exp. Refund			78
Net Reins. Result			**(2)**
Net Stat Profit			**(2)**
Increase in Surplus			**(2)**
Risk Charge			2
LCF Balance			-

The YRT premium is set to a level **above** the valuation mortality

An ER returns all reinsurance profits (net of the risk charge) however this $78 ER is a return of surplus to the cedent as it is not funded by cedent statutory income

Cedent surplus deprivation of $2; payment of excessive YRT premiums is sourced from cedent surplus and not statutory earnings

No Loss Carry Forward Balance is established as the $2 risk charge was paid from cedent surplus

The cedent net statutory profit that emerges in the year with no reinsurance in place is $0, reduced due to elevated claims

Example 6: Non-compliant YRT Rates, mortality experience equal to 110% of valuation mortality

No Reinsurance

No Reinsurance	Co Block	YRT Block	Total
Premium	-	-	-
Claims	(193)	(132)	(325)
tVx Release	175	120	295
Net Stat Profit			**(30)**
Increase in Surplus			**(30)**

With Reinsurance

	Block A Co Block	Block B YRT Block	Total
Premium	-	-	-
Claims	(193)	(132)	(325)
tVx Release	175	120	295
Statutory Profit	**(18)**	**(12)**	**(30)**
Co Prem	-	-	-
YRT Prem	-	(200)	(200)
FWH Release	(175)	-	(175)
Reins. Claims	193	132	325
Exp. Refund			49
Net Reins. Result			**(2)**
Net Stat Profit			**(32)**
Increase in Surplus			**(32)**
Risk Charge			2
LCF Balance			-

The YRT premium is set to a level **above** the valuation mortality

An ER returns all reinsurance profits (net of the risk charge) however this $49 ER is a return of surplus to the cedent as it is not funded by cedent statutory income

Cedent surplus deprivation of $32; payment of excessive YRT premiums is sourced from cedent surplus and not statutory earnings

No Loss Carry Forward Balance is established as the $2 risk charge was paid from cedent surplus

The cedent incurs statutory losses with no reinsurance in place

Summary conclusions from illustrative examples demonstrating performance of non-compliant agreements:

- Idea: Non-compliant agreements *do not* limit the YRT reinsurance premium to the valuation mortality level
- While the performance of some business might warrant YRT premiums above valuation mortality levels, assessing YRT premiums above valuation mortality levels results in the payment of amounts from the cedent to the reinsurer which are not funded by statutory profits (but rather funded by surplus)
- Reinsurance agreements can legitimately lay claim on future (uncertain and yet to emerge) statutory profits and not violate risk transfer however, agreements cannot lay claim to cedent surplus

Summary results of illustrative examples

Treaty Type	Mortality Level	No Reinsurance	With Co-YRT Reinsurance	
		Cedent Surplus	Cedent Surplus	Reinsurer Profit
Compliant	100% of BE Qx	45	43	2
	110% of BE Qx	20	18	2
	Valuation level Qx	-	-	-
	110% Valuation level Qx	(30)	-	(30)
Non Compliant	100% of BE Qx	45	43	2
	Valuation level Qx	-	(2)	2
	110% Valuation level Qx	(30)	(32)	2

Key Conclusions

- Cedent surplus is protected against losses when cedent is party to a compliant Co-YRT agreement but not when party to non-compliant agreement
- Reinsurer absorbs all cedent losses when it is party to a compliant Co-YRT agreement but not when the agreement is non-compliant

Discussion

- Co-YRT agreements that limit YRT premiums to the valuation mortality level
  - Consistent with unearned premium nature of statutory reserve credit
  - Agreements do not impair the surplus of the cedent (beyond a reduction in surplus for the cost of reinsurance/ “risk charge”)
  - Agreements insulate cedent surplus when claims exceed valuation mortality
  - Co-YRT Experience Refund provisions comply with Appendix A-791

Combined Coinsurance funds withheld (COFW) /Yearly Renewable Term (YRT)

Joint LATF/SAPWG Meeting
4/10/2025

TDI | SAPWG Exposures Based on VAWG Referrals

- **2024-05**
  - Revisions remove the first sentence of the Appendix A-791 Life and Health Reinsurance Agreements (A-791), paragraph 2.c. Question and Answer.
  - Deleted sentence: "Unlike individual life insurance where reserves held by the ceding insurer reflect a statutorily prescribed valuation premium above which reinsurance premium rates would be considered unreasonable, group term life has no such guide."
- **2024-06**
  - Revisions to SSAP No. 61R incorporate guidance from SSAP No. 62R, Exhibit A, Implementation Questions and Answers, question 10, which requires risk transfer to be evaluated in aggregate for contracts with interrelated contract features such as the inability to independently recapture or experience refunds. Additionally, a reference is added to A-791, paragraph 6, regarding the entirety of the contract.

TDI | Features in Transactions of Concern

Attachment 3

Two reinsurance types, with distinct risk transfer requirements

Combined Coinsurance funds withheld (COFW) /Yearly Renewable Term (YRT) arrangement

Interdependence of the two reinsurance types

An inability to independently recapture the YRT and an aggregate experience refund

The overall effect is a nonproportional coverage, transferring tail risk, but providing substantial surplus relief.

YRT buffer to coinsurance

High YRT premium to provide a "buffer" to potential coinsurance losses

TDI | High Level Risk Transfer Requirements

- Credit for reinsurance should not be given when there are terms that **limit** or **diminish** the transfer of risk (SSAP 61R, Par 17).

- There should not be terms that result in (A-791, 2):
  - Surplus relief that is **temporary**.

TDI | Is Surplus Relief Temporary?

- Are there future <u>net</u> outflows from the cedant related to the reinsured business that aren't reflected by any liability held by the cedant?

TDI | # Is Surplus Relief Temporary?

- Example we can all agree on:

  Scheduled termination or recapture. (A-791 2.d)

- Cedant will have to establish the full statutory reserve, with the difference coming out of surplus.

TDI | Which Risk Transfer Requirements Apply?

- Specific Requirements in SSAP 61R vary based on whether the reinsurance is:
  - Proportional (e.g. coinsurance),
  - YRT, or
  - Non-proportional (e.g., excess of loss).

- In past reviews, companies have presented a bifurcated risk transfer analysis, partially following requirements for coinsurance and partially following requirements for YRT.

TDI | Which Risk Transfer Requirements Apply?

- The bifurcated approach does not reflect that the economics of the coinsurance and YRT are interdependent.
- One aspect of A-791 that YRT is exempted from is "it is improper for a ceding company to pay reinsurance premiums, or other fees or charges to a reinsurer which are greater than the direct premiums collected by the ceding company".
- A-791 notes that YRT is only generally exempt from (certain) A-791 requirements because there is **not significant surplus relief**. YRT is not a concern if "incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus".
- For these interdependent COFW/YRT treaties to be evaluated as satisfying risk transfer, it would need to be demonstrated that the YRT cession and the YRT premium level is not designed, intended, or in any way acting to **enable/allow the coinsurance cession**, and the corresponding **high reserve credit** and **significant surplus relief**.

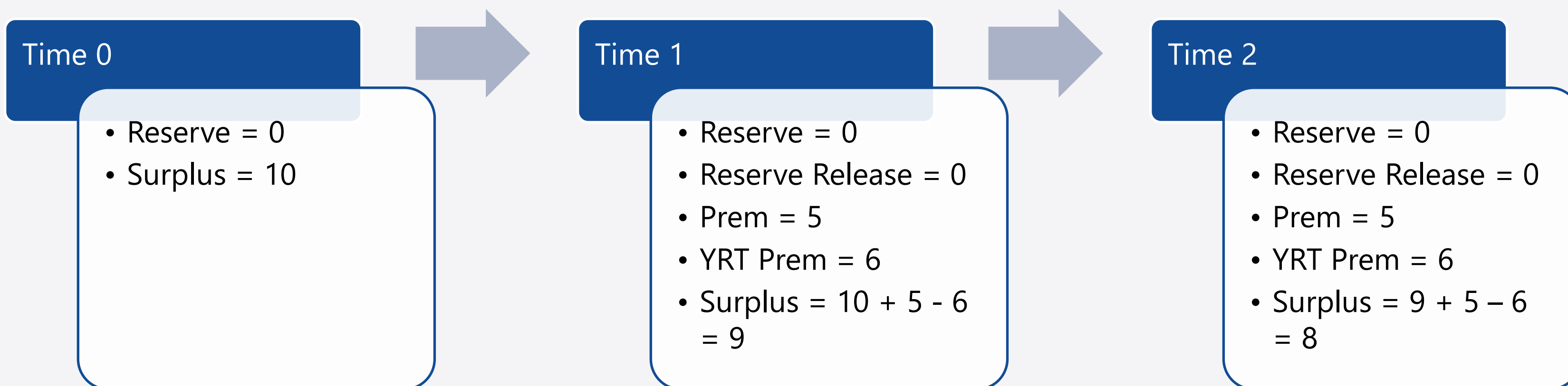
TDI | Misperception of YRT "Safe Harbor"

- Before the VAWG referral, companies presented that YRT premiums were automatically acceptable if they were based on the valuation mortality.
- Similarly, the ACLI initially presented that the key to these treaties passing or failing was dependent on the YRT rates not exceeding the valuation mortality/CSO rates. See excerpt from ACLI deck:

  - **Idea:** Co-YRT meets risk transfer rules when YRT premiums are limited
  - Co-YRT agreements where YRT premiums are no more than the valuation mortality do not deprive cedents of surplus

TDI | Simple Counter to YRT “Safe Harbor”

- Consider a 10-year level term policy[1]
- X Factor of 50%, no deficiency reserves[2]
- Level mortality (so cx stays the same each year, simplification for example)
- YRT reinsurance premium based on the valuation mortality of 6 each year
- Direct premium of 5
- Terminal reserves are 0 each year (cx and premium payments are level)
- Each period, surplus is reduced by the difference between the direct and YRT premiums.



- [1]Chosen for simplicity, examples could be developed with Whole Life, etc.
- [2]Other scenarios where the gross premium is below the valuation net premium but there are not deficiency reserves include where there is a current & guaranteed premium scale or PBR.