ACLI
Financial Security for Life

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Rachel Hemphill,
Chair, NAIC Life Actuarial (A) Task Force (LATF)

Re: Asset Adequacy Analysis for Reinsurance Exposure

Dear Chair Hemphill:

The American Council of Life Insurers (ACLI) appreciates the opportunity to provide feedback on the Asset Adequacy Analysis for Reinsurance Ceded by Life Insurers exposure which was released for public comment on March 17th. ACLI appreciates regulators' interest in this and other NAIC efforts to gain additional insight into reinsurance transactions as part of their ongoing work to ensure policyholders are protected. We also look forward to continued collaboration with regulators to craft constructive and appropriate approaches that accomplish this goal.

Regarding the current LATF exposure, ACLI recommends a framework focused on the creditworthiness of the reinsurer with an enhanced and escalating set of reinsurance-related documentation requirements along with tiers of escalation based on the materiality of the reinsurance transaction. The requirements need to be principle-based due to the complex and bespoke nature of many reinsurance transactions. Such requirements would get to the core issue of whether a counterparty can make good on its obligations and would address the issue by requiring the most rigor where risk is the greatest. It would promote constructive dialogue between regulators and the company and strengthen insights into an insurer's use of reinsurance transactions while still maintaining strong policyholder protections. Critically, it would also ensure that reinsurance continues to be available as an essential tool to manage risks and deliver affordable insurance and retirement solutions to consumers.

We note there are several concurrent efforts at the NAIC related to reinsurance. We suggest the NAIC take a broader view to address these concerns and ensure coordination of the efforts at LATF, the Statutory Accounting Principles (E) Working Group, and other NAIC groups working on these issues. Such an approach avoids duplication of work, promotes consistency, and ensures concerns are understood and addressed.

Please find below the basic principles and documentation requirements of such a framework for LATF consideration. While certain specifics will need to be tailored to address specific concerns of regulators, the framework is conceptually sound and can be adjusted as necessary.

Principles of ACLI's Proposed Framework for Enhanced Assessment of Reinsurance Credit Risk:

- The framework should focus holistically on the **credit quality of the reinsurance counterparty**, not a narrow focus on a single element of the solvency framework (e.g., reserves held by counterparty). Said another way, the focus should be on assessing the ability for the reinsurer to meet its obligations in terms of timing and amount under moderately adverse conditions. From a practical perspective, reinsurance obligations are often met by other sources of cash flow beyond invested assets (e.g., new premiums, capital account investment income, profits from other businesses).

- The framework should be **proportional**, i.e., the more material the risk that the reinsurance obligation is to a cedent or the counterparty, the more rigor is required. Materiality should be viewed relative to the amount of risk in the liability. In some cases, the size of the transaction relative to the size of the cedent or assuming company may also be material, but that is not always the case.

- Aggregation of risks is a foundational premise of the insurance industry and must be a cornerstone of any framework or tools the NAIC moves forward with to enhance state regulator insight into and comfort with reinsurance transactions. The long-term adequacy of a company's assets is not determined by a single liability or asset type, but rather the overall performance of the company across all functions. Any analysis performed should allow full aggregation as part of a holistic review by the Appointed Actuary. Requiring analysis at a more granular level, even at the level of a specific counterparty, could produce misleading results, as insurance companies are not managed in that manner and could lead to an artificial appearance of a shortfall in assets.

- The framework should be **risk-based** with a focus on appropriate disclosures. The disclosure should be commensurate with risks associated with subject business. The onus should be on the Appointed Actuary for full and fair disclosure related to the materiality of the underlying risks associated with each transaction, including the materiality of each risk, and the company's ability to bear these risks in aggregate.

  • The framework should respect jurisdictional differences in insurance regulation, focus on the ability of regulatory frameworks to achieve comparable supervisory outcomes to the state-based system in totality, and comport with both the U.S.-EU and U.S.-UK Covered Agreements and the Credit for Reinsurance Model Law and Regulation.

- No adjustment to reinsurance within asset adequacy analysis would be required where evidence exists that the counterparty can meet its obligations.

- The documentation should be sufficient to allow regulators to identify outliers. Identifying outliers will allow regulators to discuss any concerns with the company in their review work.

- The framework should establish reasonable standards to be applied consistently across states/jurisdictions to avoid creating an unlevel playing field.

ACLI's Proposed Framework for Enhanced Documentation Requirements:

- **Baseline requirements** for all insurers with material reinsurance:

  - Where reinsurance is material, the Appointed Actuary would be responsible for documenting an assessment of the creditworthiness of reinsurance within the Actuarial Memorandum. Special attention would be given to material reinsurance obligations and those that have greater risk exposure.

  - For any reinsurance obligation that presents material risk exposure, the assessment of creditworthiness could include some combination of the following:
    - The reinsurer's current financial condition and credit standing, and the potential for these conditions to change.
    - The extent to which counterparty exposure is collateralized.
    - Contractual treaty provisions for non-performance.
    - Special features of the reinsurer's regulatory environment.
    - Sensitivity analysis or stress testing.
    - Actual or anticipated credit events.

  - The cedent can group transactions of similar reinsurance type if appropriate.

  - If reinsurance is material in aggregate, but no single treaty is individually material, creditworthiness would be assessed for the largest treaties.

- **Supplemental requirements** for a subset of insurers with larger, asset intensive treaties:

  - Required documentation elements for material reinsurance obligations:
    - The rationale for the treaty.
    - A one-time, high-level best efforts assessment of reserve differences between the U.S. statutory framework and the reinsurer's framework.
    - Governance and risk management information about the insurer's monitoring of reinsurance counterparty risk.

Timing and Applicability:

Critical to the discussion of applicability and retroactivity is the amount of effort for companies to implement the requirements. That is, the more significant and prescribed the requirements, the longer the implementation window that will be required. A documentation-based framework such as the one suggested above can be implemented more quickly than a framework that has new quantification or modeling. Further, there may be practical and operational limits that could impair application to treaties issued prior to the effective date of the requirements, which should be considered when establishing guidance.

We believe there should be a targeted scope of requirements. We would propose the following exemption requirements to limit low-value work:

- Treaties issued before 1/1/2022;

- Treaties where a VM-30 Report or equivalent report with an opinion following the domestic requirements of the assuming company;
- Treaties with reciprocal jurisdictions;
- Treaties that do not meet the materiality thresholds as established by the Appointed Actuary;
- Treaties where base statutory reserves (including those held as funds withheld, collateral such as comfort trusts, reinsurance trusts) are at least as great as the levels required in the US and considered in light of assuming company capital requirements; or
- Treaties of traditional mortality YRT business.

We also suggest the Appointed Actuary should be allowed to voluntarily include earlier or immaterial treaties in their analysis of the overall adequacy of company assets.

Thank you once again for your consideration of our comments and we look forward to additional opportunities to discuss this issue in the near future.

Sincerely,

Colin Masterson

cc: Scott O'Neal, NAIC, Fred Andersen (Minnesota), and Ben Slutsker (Minnesota)