**DRAFT FOR DISCUSSION**

**Criteria to Assess VM-20 Solutions for Modeling Non-guaranteed Reinsurance**

Below is a list of potential criteria that could be used to assess proposed VM-20 amendments regarding non-guaranteed reinsurance.

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| Consideration | Potential APF selection criteria and other requirements |
| 1. 1. Level of prescription | * + The APF should be principles-based, as defined in VM Section I, Overview of Reserve Concepts:     - Uses one or more methods, or one or more assumptions, determined by the insurer pursuant to requirements of Model #820 and the Valuation Manual     - Reflects risks that are associated with the policies being valued capable of materially affecting the reserve   Note: The definition above does not preclude the use of appropriate guardrails or the use of a formulaic component. |
| 1. 2. Modeling complexity | * + The APF should be practical to implement   + The APF should be auditable   + The APF should allow simplified methods   + The APF should provide a safe harbor (e.g. use ½ cx if a company has a de minimis amount of YRT reinsurance or. the product type (e.g. term) produces a small modeled reserve credit). This is in the spirit of the definition of PBR as reflecting risks that are “capable of materially impacting the reserve.” |
| 1. 3. Variation in interpretations leading to variation in results | * + The APF should contain an appropriate degree of alignment between the modeled reinsurance premiums paid by the ceding company and the modeled death claims paid by the assuming company.   + The APF should allow for variations in results due to treaty differences   + The APF should allow for variations in results from established relationships between a reinsurer and the ceding company that can be supported in the PBR Actuarial Report, and there should be appropriate application of ASOP 56 Section 3.1.6 (Assumptions used as Input)   + The APF should contain clear and unambiguous language   + The wording of the APF should not result in a wide range of company interpretations (i.e., there are clear requirements). It should produce similar reserve credits for two identical companies, (i.e. companies with the same products, inforce, mortality experience, reinsurance treaties, etc.). |
| 1. 4. Potential for asymmetry between assumed and ceded interpretation | * + Although mirror reserving is not a VM-20 requirement (VM-20 Section 8.C.1), the APF should provide guidance on modeling non-guaranteed reinsurance features to be considered by both ceding companies and assuming companies that promotes a reasonable relationship between 1) the ceding company’s pre-reinsurance reserves vs. 2) the ceding company’s post reinsurance ceded reserve + the reserve held by the assuming company.   VM-20 Section 8.C.1: The company shall use assumptions and margins that are appropriate for each company pursuant to a reinsurance agreement. In such instance, the ceding and assuming companies are not required to use the same assumptions and margins for the reinsured policies. |
| 1. 5. Defined level of risk sharing | * The APF should contain provisions for appropriate risk sharing between reinsurance counterparties such that the level of assuming company loss acceptance produced is realistic and consistent with the projected scenario and treaty provisions. * The approach for setting assumptions for non-guaranteed reinsurance elements under the APF should be consistent with the considerations in VM-20 Section 8.C.7. In addition to the economic environment considered in 8.C.7.b, the NGE assumptions should reflect other relevant moderately adverse conditions – including a moderately adverse mortality scenario. * The APF should reflect that assumptions used in determining the modeled reserve should account for any actions that the counterparty has taken or is likely to take (VM-20 Sections 8.C.8 and 8.C.10)   VM-20 8.C.7: The company shall assume that the counterparties to a reinsurance agreement are knowledgeable about the contingencies involved in the agreement and likely to exercise the terms of the agreement to their respective advantage, taking into account the context of the agreement in the entire economic relationship between the parties.In setting assumptions for the NGE in reinsurance cash flows, the company shall include, but not be limited to, the following:  a. The usual and customary practices associated with such agreements.  b. Past practices by the parties concerning the changing of terms, in an economic environment similar to that projected.  c. Any limits placed upon either party’s ability to exercise contractual options in the reinsurance agreement.  d. The ability of the direct-writing company to modify the terms of its policies in response to changes in reinsurance terms.  e. Actions that might be taken by a party if the counterparty is in financial difficulty.  VM-20 8.C.8: The company shall account for any actions that the ceding company and, if different, the direct-writing company have taken or are likely to take that could affect the expected cash flows of the reinsured business in determining assumptions for the modeled reserve.  VM-20 8.C.10: The company shall use assumptions in determining the modeled reserve that account for any actions that the assuming company has taken or is likely to take that could affect the expected cash flows of the reinsured business. |
| 1. 6. Consideration of mortality improvement beyond the valuation date | * Differences between the future mortality improvement assumption in the VM-20 prudent estimate mortality (currently not allowed) and any future mortality improvement assumption embedded in the current scale of YRT premiums should not be the primary driver to an undue reduction in the aggregate reserve for the business, that is the sum of the ceding company’s post-reinsurance reserve and the assuming company’s reserve |
| 1. 7. Requirements outside the Valuation Manual | * + The APF must coordinate and align with the Accounting Practices and Procedures Manual (APPM), or if needed, acknowledge that changes would be required     - The APF should consider SSAP No. 61R     - The APF should consider APPM Appendix A-791 |
| 1. 8. Other considerations not shown above | * + The APF should promote a level playing field (e.g. not favor large companies over small companies, not favor companies with YRT reinsurance over companies without YRT reinsurance)   + The APF should not encourage the use of captives   + The APF should not lead to market disruption (e.g. discouraging use of YRT reinsurance; greatly increasing cost to consumers)   + The APF should not discourage innovation   + The APF should handle all existing types of non-guaranteed reinsurance. While the most commonly considered non-guaranteed reinsurance feature is future YRT premium rates, other non-guaranteed features are also to be considered, such as non-guaranteed expense allowances.   + The APF should ideally contain language flexible enough to address emerging reinsurance structures that have not yet been seen in the marketplace |
| 1. 9. Outstanding Questions | * + Should negative reserve credits be avoided, i.e. should there be a floor on the reserve credit (such as ½ Cx)? |