AMERICAN ACADEMY of ACTUARIES

July 19, 2024

Rachel Hemphill
Chair, Life Actuarial (A) Task Force
National Association of Insurance Commissioners

Re: AAT Reinsurance 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 Reinsurance AAT Concepts and Reinsurance AAT Attribution Analysis " (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 balance our view that the Appointed Actuary should be able to apply principles and judgment in their Asset Adequacy Testing (AAT) and our understanding of the need for regulators to provide additional guidance on AAT in certain situations as outlined in the Exposure.

Further, we recognize that reinsurance has proved to be an effective risk mitigation tool and believe that any changes to AAT requirements should avoid dis-incenting insurance companies from implementing appropriate reinsurance solutions.

Our feedback on each of the specific topics outlined in the Exposure follows:

Need for Review Beyond Counterparty Risk/Collectability

1. Review of counterparty risk/collectability is an essential part of AAT. The Appointed Actuary (AA) is required to evaluate counterparty/collectability risk per the requirements of actuarial standards of practice (ASOP 7, ASOP 11 and ASOP 22). ASOP 11 states that an actuary should take into account "the ability of an entity to meet its

[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.

obligations…performance risk of…an investment manager not adhering to investment guidelines [and] the counterparty's…investment policy…." (Sections 3.5.c. and 3.5.f)

2. The review of counterparty risk (ASOP 11, Section 3.5) in AAT needs to be broad enough to address moderately adverse conditions (ASOP 22, Section 3.1) across all material risks. For example, the actuary should assess the likelihood and severity of a counterparty's non-compliance with the contractual terms of the treaty. Based on this assessment, the actuary should then evaluate the expected impact on the cedant's ability to cover future policyholder obligations.
3. When studying counterparty risk, it would be appropriate for the actuary to apply a risk-based approach, such as taking greater care, increasing the comprehensiveness of any analysis, or performing such analysis with an increased level of prudence when the counterparty risk is highest or exposure to the counterparty is particularly material.
4. We believe that the AAT assessment should include consideration of all material risks, including items such as risks associated with the adequacy of the invested assets (i.e., not just the reinsurance receivable asset) backing the ceded reserves, nature and financial condition of the counterparty, and reinsurance structuring considerations including the existence of collateral or similar risk mitigating features. For example, to address the risk associated with the counterparty's invested assets, the AA could perform traditional cash flow testing using the invested assets backing the ceded reserves or using a representative asset portfolio that mimics the invested asset characteristics for the ceded business.
5. Any requirements introduced by LATF should allow for judgment by the AA, since the AA must provide their individual professional opinion as to the adequacy of assets supporting reserves. Such judgment would encompass the approach used to assess adequacy, the assumptions and interpretation of results, and any limitations of the analysis.

Materiality

1. We support an exemption for immaterial treaties. A definition of immaterial could potentially be based on reinsurance reserve released due to the treaty as a specified maximum percentage of surplus. We note that the reinsurance reserve reported in Schedule S Part 3 may not reflect the actual reserve exposure of the reinsurance agreement and, therefore, may not be appropriate for determining materiality. Instead, it may be more appropriate to use a reserve calculated by the cedant as the difference between an aggregate reserve without consideration of the ceded reinsurance treaty and an aggregate reserve that does reflect the ceded reinsurance treaty.
2. We also recommend considering the materiality of a group of similar treaties. Doing so may help avoid a situation in which multiple immaterial treaties have the same outcome

as one material treaty but would otherwise be exempt from the requirements solely due to individual size.

3. We believe a key concern raised by regulators relates to reinsurance agreements involving the transfer of significant investment risk. Therefore, we believe it would be appropriate to exempt treaties that do not transfer significant investment risk from these new requirements.
4. It may also be appropriate to exempt treaties for which assets: (1) are segregated (for example, in a funds withheld), (2) were clearly adequate to support the business on a stand-alone basis prior to the transaction, and (3) are subject to investment guidelines that are not materially riskier than those applicable to the business prior to reinsurance. In this case, monitoring of the implementation of the investment guidelines after treaty inception would be needed to ensure continued exemption.
5. We discuss the timing of the implementation of new requirements below in the "Timing" section.

Risk-Based Rigor and Frequency

1. We believe that adjusting the degree of rigor based on the degree of risk, as outlined in the Exposure, is reasonable. See the criteria under Analysis Considerations for specific considerations of risk.

Analysis Considerations

1. We suggest that any requirements for more detailed analysis be a function of the specific risks of concern to the regulators. This could potentially be done via a grading process, whereby the level of analysis detail gradually increases as the level of risk increases. Alternatively, entire cohorts of treaties could be exempted, with the remaining treaties subject to additional requirements. In either case, we suggest that requirements be consistent across states.
2. Using the exempting process, we suggest limiting any new requirements to treaties that meet all of the following criteria:
    a. The reinsurance treaty is material to the cedant (see materiality section above);
    b. The reinsurance treaty transfers a material amount of investment risk;
    c. The reinsurer is not subject to VM-30 or does not voluntarily submit a report that fully complies with VM-30 that is made available to the ceding company's regulator;
    d. The cash flows associated with the reinsured business are expected to materially vary under different economic scenarios. Note that this criterion is important if the requirement involves cash flow testing. Under ASOP 22, "cash flow testing is generally appropriate where cash flows vary under different economic scenarios". Alternatively, if the new Actuarial Guideline requires cash flow testing, then we

recommend including criteria that require that the cash flows associated with the reinsured business are expected to materially vary under different economic scenarios. This is important, since “cash flow testing is generally appropriate where cash flows vary under different economic scenarios” per ASOP 22; per ASOP 22; and,

e. The reserves held by the reinsurer at treaty inception are less than the reserve needed under the cedant’s most recent, pre-reinsurance asset adequacy testing assessment of such business on a standalone basis. This reserve would come from the most recently performed AAT. In other words, the assets held by the reinsurer are less than the level of assets that were clearly adequate to support the business on a standalone basis prior to the transaction. This would eliminate scoping in business that has highly redundant statutory reserves but is otherwise not subject to undue risk.

3. For nonexempted situations, requiring the AA to opine that the total reserve amount is a reasonable estimate of liabilities under moderately adverse conditions. Without consideration of the assets supporting those reserves, the potential risks associated with invested assets supporting the business would not be addressed. Therefore, we believe that in nonexempted situations that involve material invested asset risks under moderately adverse conditions, it would be reasonable for the AA’s opinion to include an evaluation of the adequacy of the invested assets to support the policyholder obligations under moderately adverse conditions as part of the holistic assessment of reinsurance reserve adequacy.

Aggregation Considerations

1. The AA must comply with ASOP 22 in determining aggregation. Per ASOP 22, “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…the 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.” (Section 3.1.4)
2. New requirements could potentially include disclosure by the AA of the rationale for aggregation.

Frequency

1. In an approach where certain treaties are exempted from detailed analysis, the exemption determination could be revisited annually. Those that are not exempt would be subject to some form of additional AAT requirements. These additional requirements could involve a detailed level of analysis in the initial year of the Actuarial Guideline and then assessed

by the AA annually as to the appropriate level of testing based on changes in conditions since the prior year testing.

2. If the AA is required to opine on the adequacy of the invested assets to support the reinsured business each year, the AA could apply judgment as to how much analysis is needed based on past results and material changes in the business, the environment, the assets, and/or the treaty. We note, however, that the more judgement applied, the more it may be necessary for the AA to disclose limitations on the use of the results.

Attribution Analysis

1. Attribution analysis alone would not ensure adequate assets to cover policyholder obligations, and therefore we do not believe it will appropriately address regulatory concerns. Attribution analysis may be helpful in enhancing the understanding of the drivers of the transactions and the components of the statutory framework that may be resulting in reserve redundancy, but it will not indicate whether reserves are adequate for any given transaction, is highly dependent on the order the analysis is performed and may take a lot of time and effort to perform. Therefore, we suggest using a tool, like attribution analysis as part of a separate research initiative or a 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, allowances should be included to allow for reasonable approximations and judgment.

Timing

1. We believe implementation of a new standard should be done using a risk-based approach, as described in the Analysis Considerations section above. Depending on what requirements are implemented, we believe that data availability challenges are a significant practical consideration. For prospective treaties, companies may be able to incorporate required data collection elements into new treaty negotiations. Treaties completed before the finalization of new standards may not have provisions requiring reinsurers to supply the necessary information. In the event actual data is unavailable, the AA will need to use approximations and disclose the approximations used where detailed data was not available.

Although not explicitly addressed in the Exposure, we also have the following comment related to instances in which the business is retroceded:

1. If the reinsurer retrocedes some or all risk assumed under the treaty, the cedant's AA may need to use more judgment, and disclose the associated limitations associated with that judgment, than if the risk assumed under the treaty is not retroceded.

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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,

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Chairperson, Life Practice Council