February 28, 2025

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

Re: AAT for Reinsurance Actuarial Guideline Draft Exposure

Dear Chair Hemphill,

On behalf of the Life Practice Council (LPC) of the American Academy of Actuaries,[1] I appreciate the opportunity to provide comments to the Life Actuarial Task Force (LATF) regarding the Asset Adequacy Testing (AAT) for Reinsurance Actuarial Guideline (AG) Draft (the Exposure) exposed for comment until February 28, 2025[2]. The Council believes this is an important issue and appreciates LATF's consideration of public comments.

Consistent with our prior comment letters on this topic,[3] our feedback emphasizes that the Appointed Actuary (AA) should apply actuarial principles and judgment in AAT, while recognizing the need for appropriate documentation and regulatory guidance on specific risks. We emphasize that:

- Current guidelines on cash flow testing acknowledge its complexity. We suggest a comprehensive approach that considers all relevant information and analyses.
- Depending on the circumstances, multiple actuarial methods may be reasonable for evaluating reserve adequacy.

We believe new requirements should protect policyholders by focusing on areas where existing protections may fall short and address specific regulatory concerns. Additionally, we encourage changes to AAT that target only material reinsurance risks of concern to avoid deterring effective risk mitigation strategies, thereby minimizing adverse impacts on policyholders.

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[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 60 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.

[2] AG ReAAT 013025

[3] See LPC Comments to LATF on Reinsurance Exposure (1/15/24), LPC Comments to LATF on Reinsurance Exposure (10/10/24), and LPC Comments to LATF on Reinsurance Issues (7/19/24)

A. *Comments on Associated Party designation*

We believe the designation "Associated Party" and its associated definition introduced in Section 3.C of the Exposure are a reasonable effort to differentiate certain treaties for purposes of the Exposure (e.g., riskiness, data availability), and support that in certain cases an exemption from cash-flow testing may be provided by the ceding company's domestic regulator according to the criteria in Section 5.H of the Exposure.

B. *Comments on disclosure-only wording*

We support the disclosure-only wording from our prior comment letter that was added to Section 5.B of the Exposure.

C. *Comments on starting asset amount (Exposure Section 6.B)*

We recommend that the NAIC consider revising the term "Post-reinsurance Reserve." Actuaries may interpret this as the gross reserve minus the reinsurance reserve credit, which does not align with the definition in the proposed AG. To improve clarity, we suggest using a more descriptive term, such as "Tested Reserve Amount."

We believe it is reasonable to require the AA to perform a mandatory run of cash flow testing analysis using assets equal to the Post-Reinsurance Reserve (which, per our comment above, we would suggest renaming to "Tested Reserve Amount").

The AG discusses other optional alternative runs the AA may perform. We support the AA being able to use their judgment in determining the optional alternative runs to be performed, and allowing these runs to use non-Primary Securities offset by appropriate risk margins.

ASOP No. 11, Section 3.10 (Accounting Guidance), states that "When preparing values in the financial report that reflect the terms of a reinsurance program, the actuary should take into account applicable accounting guidance." When assessing whether a reinsurer holds sufficient reserves and supporting assets to meet future obligations, the AA should take into account the accounting framework applicable to the reinsurer's regulatory requirements. For instance, if business is ceded to an offshore reinsurer, the analysis should take into account the reinsurer's solvency balance sheet. We note that some situations will complicate the required cash flow testing exercise. For example, if only a portion of the business is ceded offshore you may have a situation where the retained business follows a book value accounting framework while the ceded business follows a different market value accounting framework, requiring cash flows from different projection models (one for each accounting basis) to be appropriately aggregated in order to determine interim deficiencies. Other complicating factors include situations involving multiple reinsurers (e.g., company A cedes to company B who then cedes to company C), and situations where the accounting framework applicable to the reinsurer's regulatory requirements does not line up against the Exposure's requirements and U.S. statutory accounting framework in

a straightforward manner. In these situations, it may be of benefit for the AA to explain how the reinsurance transaction is designed to function in a non-U.S. regulatory environment.

Section 6.B.(2) of the Exposure says that for the mandatory run of cash-flow testing the Starting Asset Amount shall equal the Post-Reinsurance Reserve. As an additional consideration here, we note the accounting basis used to calculate starting reserves and assets should align with the entity's solvency accounting framework. For U.S. retained business, this is the NAIC statutory accounting basis. For business ceded offshore, the assuming company's solvency accounting basis may differ from the NAIC approach and could, for example, be based on reserves and supporting assets valued on a market value basis. For example, consider a U.S. insurer that cedes $100 million of a $200 million block of business on a coinsurance basis to an offshore reinsurer. If the reinsurer's solvency accounting basis is market value-based and it holds $90 million in reserves, the starting assets would include $100 million in statutory book value assets held by the ceding company and $90 million in market value assets held by the reinsurer. This example assumes no non-Primary assets.

Section 6.B.(3).(i) of the Exposure lists principles that would tend to lead to a higher Starting Asset Amount in Alternative Runs, but then 6.B.(3).(i).(c).(*1*) describes a situation where the Starting Asset Amount should be reduced. Perhaps a new and separate section 6.B.(3).(ii) should be inserted to cover principles and situations that would tend to lead to a lower Starting Asset Amount. Also, Section 6.B.(3).(i).(c).(*1*) of the Exposure says that the Starting Asset Amount should be reduced, if necessary, to allow for appropriate capital to support the support the block in circumstances that go beyond the moderately adverse conditions contemplated by U.S. Risk Based Capital. We note that in this situation the AA may have to use significant judgment in estimating the amount by which Starting Assets should be reduced.

We support section 6.B.(3).(ii) of the Exposure which says that in lieu of an optional Alternative Run a company can instead provide an explanation of the amount and type of assets in excess of the Post-Reinsurance Reserve that would be available to support the cash-flow tested business.

We find the examples in 6.B.(3).(iii) of the Exposure helpful in understanding what is meant by Alternative Run, and would support enhancing the examples further and adding additional examples for clarity. The Academy can assist with this effort but would need more time than the current 28-day exposure period.

D. Comments on similar memorandum (Exposure Sections 3.K and 5.G)

The "similar memorandum" portion of the exposure is unchanged from the prior draft. The comments we made in our prior comment letter still apply. In summary, we stated that the proposed AG seeks to address concerns about inappropriate reserve reductions through reinsurance. These concerns cannot be addressed by disclosure alone. We believe reinsurance agreements where the reinsurer already files a VM-30 memoranda should be scoped out of the AG. Further, in the event asset adequacy testing analysis and results similar to VM30 are

already documented in another submission (for example, a filing with the reinsurer's regulator), the needs of the U.S. regulator could be met via the reinsurer filing this document with the cedent's domiciliary regulator. This approach would simplify the process while ensuring proper regulatory oversight and would obviate the need for defining a new term (i.e., "Similar Memorandum").

E. Comments on where CFT is mandatory

We support the potential for requesting exemptions in certain low-impact, non-Associated Party circumstances outlined in Section 5.H of the Exposure and suggest the process for requesting exemptions be handled by the company's state of domicile. We believe exemptions should be risk-focused and suggest removing the size basis for not granting non-Associated Party exemptions.

F. Comments on New York 7 risk-free scenario testing being required

Depending on the nature of the underlying business and other treaty characteristics, other scenarios besides the New York 7 may do a better job of stressing risky aspects of the treaty. The AA should be able to select and justify the most appropriate economic scenarios for testing cashflows and evaluating reserve adequacy.

G. Comments on new Definitions

As stated in Section C above, to improve clarity and avoid confusion we suggest using a different term, such as "Tested Reserve Amount," instead of "Post-reinsurance Reserve." At this time, we do not have further comments on the new Definitions added to the Exposure but do suggest additional examples of "Alternative Runs" be added to help clarify the new definition.

H. Other Comments

We note that the end of the Exposure's cover letter lists several "Issues for later," which LATF intends to discuss at some point after the exposure period ends on February 28. While the iterative nature of past exposures and comments have allowed for targeted progress on various sections of language in the draft Actuarial Guideline, we suggest another "issue for later" be to step back and review the pros/cons of the draft Actuarial Guideline in its entirety.

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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 policy project manager, life.

Sincerely,

Jason Kehrberg, MAAA, FSA
Chairperson, Life Practice Council
American Academy of Actuaries