Swiss Re | Hannover Re | Reinsurance Association of America

Rachel Hemphill, Chair
Fred Andersen
Life Actuarial Task Force
c/o Scott O'Neal, soneal@naic.org

July 19, 2024

RE: Asset Adequacy Testing for Reinsurance

Dear Rachel and Fred,

Swiss Re, Hannover Re, and the Reinsurance Association of America (RAA) appreciate the opportunity to provide input on the Life Actuarial Task Force's (LATF) Reinsurance Asset Adequacy Testing (AAT) Concepts and Reinsurance AAT Attribution Analysis exposures. The cosigners of this letter represent some of the largest life and property-casualty reinsurers in the world. We provide reinsurance capacity that is vital to the basic mission of insurance regulation, protection of policyholders by assuring the solvency of insurers and facilitating a competitive marketplace.

We appreciate LATF's ongoing consideration of industry input, and we remain committed to providing LATF feedback on its efforts. To that end, you can find our previous comment letter attached as Appendix 1. As we stated in our prior letter, we respectfully urge the NAIC to ensure its various working groups coordinate and include the Reinsurance (E) Task Force in reinsurance-related discussions at the outset. Including reinsurance regulatory experts from the inception of proposals will avoid duplication of existing regulatory requirements and is more likely to achieve the intended result without discouraging or limiting the benefits that result from the appropriate use of reinsurance.

We continue to be concerned that LATF's current proposals would create unnecessary obstacles which will negatively impact the insurance marketplace without addressing regulators' fundamental concern with the lack of transparency in large, offshore or “third country” reinsurance transactions.

As an alternative, we agree with the other commenters, such as the American Academy of Actuaries and the American Council of Life Insurers, that an enhanced disclosure-based approach by the Appointed Actuary as part of the Actuarial Opinion would increase transparency and advance consistency regarding where existing safeguards exist.

Collectability is at the Core of Regulators' Concerns

In its AAT Concepts exposure, LATF postulates that the issue with asset intensive offshore reinsurance goes "beyond" the need for a rigorous collectability assessment and is one that also needs to focus on reserving levels. We respectfully disagree and submit that the issue is one of collectability of such reinsurance and not the investment or reserving rules of the country where the reinsurer is domiciled. While the level of reserves determined under a cashflow testing approach or reserve attribution approach can provide insight into the cedant's exposure to collectability risk, such efforts do not accurately assess the true measure of the reinsurer's ability to pay, because they do not evaluate the overall financial strength or solvency of the reinsurer.

Ceding companies that are party to reinsurance transactions already manage collectability risks using multiple safeguards including, but not limited to, trusts, investment policy restrictions, funds withheld arrangements, counterparty evaluation and ongoing monitoring, and recapture provisions. Management of reinsurance counterparty risk is disclosed within the ORSA filing. Currently, the ceding company's Appointed Actuary is required to consider such factors when performing any AAT and in providing the Actuarial Opinion.

We note that U.S. regulators already have multiple tools at their disposal to safeguard policyholders and provide transparency with respect to reinsurance transactions. For example, the use of captives has been addressed by the NAIC with the implementation of AG 48 and primary security requirements. Further, the domestic state regulator of a ceding company can adjudge the appropriateness of the reserve credits taken by the ceding company and can intervene and may reject or at least modify offshore reinsurance agreements that they find to be questionable. While this is true for any reinsurance transaction, to the extent affiliate reinsurance is involved, transparency and security are further enhanced by Form D requirements that require the domestic regulator's approval of the transaction.

Importantly, performing stand-alone AAT and attribution analysis of reinsured blocks in isolation does not ensure policyholder protection and may lead to false levels of comfort or unnecessary worry, and thus are inefficient methods to address the concerns regulators may have relating to offshore asset intensive reinsurance. These methods may require ceding companies, who often do not have access to a reinsurer's asset portfolio or policyholder behavior and reinvestment assumptions, to make hypothetical assumptions which produce results that may not be credible. Additionally, these methods ignore any factors beyond the ceded block's assets and reserves that support the reinsurer's ability to meet its obligations.

Focusing on standalone AAT, a well reserved cession from a strong company to a poorly capitalized reinsurer would not raise any concern despite increasing risk to the underlying policyholders. We further believe that imposing such a requirement would significantly increase the operational burden on companies without providing a commensurate benefit. Approaches that comprehensively assess a reinsurer's financial soundness such as reinsurance recovery analysis being performed in some European countries or Mr.

Routhenstein's May 17 alternative disclosure-based approach would be more effective at addressing the issue.

LATF's Efforts Fundamentally Contradict the Covered Agreement

The US-EU Covered Agreement, US-UK Covered Agreement, and reciprocal jurisdiction reinsurer frameworks established in US state credit for reinsurance laws would be contradicted by the LATF proposal. Article 3 of the US – EU Covered Agreement and the US-UK Covered Agreement provides in pertinent part as follows (emphasis added):

1. A Party shall not, and shall ensure that its supervisory authorities or any other competent authorities do not, as a condition to allow an assuming reinsurer which has its head office or is domiciled in the territory of the other Party to enter into a reinsurance agreement with a ceding insurer which has its head office or is domiciled in its territory:

   (a) *Maintain or adopt any requirement to post collateral in connection with cessions from a Host Party Ceding Insure*r to a Home Party Assuming Reinsurer and any related reporting requirements attributable to such removed collateral; or

   (b) *Maintain or adopt any new requirements with substantially the same regulatory impact on the Home Part Assuming Reinsurer* as collateral requirements removed under this Agreement or any reporting requirement attributable to such removed collateral.

We believe that the LATF proposal needs to be evaluated to determine if it would amount to a new requirement with the same regulatory impact on the Home Party Assuming Reinsurer as collateral requirements or any reporting requirements attributable to such removed collateral.

The NAIC reviews non-US regulatory regimes and only accepts those for collateral reduction whose rules prevent unreasonably low reserving levels through its Process for Evaluating Qualified and Reciprocal Jurisdictions. Where jurisdictions have been determined to not require appropriate reserving levels, the NAIC has the authority to remove the regime's Qualified or Reciprocal Jurisdiction status through its ongoing review process.

To recognize such jurisdictions would run contrary to the rule and spirit of the Covered Agreements and LATF's stated goal of not conflicting with the treatment of Reciprocal Jurisdictions. In other instances, regimes not determined to be qualified or reciprocal jurisdictions or not subject to a Covered Agreement would require collateral equal to the full U.S. statutory reserve to be posted and should not be a concern for regulators.

If the NAIC has concerns with transparency for certain offshore reinsurance transactions, specifically the adequacy of jurisdictional reserving requirements, we would ask that the NAIC first engage in dialogue with that jurisdiction's regulatory body to address these concerns. Should any concerns remain, we would recommend that the NAIC utilize its existing tools to analyze such regimes.

The Reserve Attribution Needs Additional Work

We appreciate LATF's work in creating the Reinsurance AAT Attribution Analysis worksheet (Worksheet) but note the following concerns with it:

- While attribution analysis may serve to provide regulators insight into the sources of reserving differences across different regimes, no amount of attribution analysis will increase policyholder protection.

- The worksheet assumes that the level of reserves held by the reinsurer is available to the cedent. For many transactions (other than potentially for affiliated transactions) this may not be the case. Further, in some cases the reinsurer may not calculate reserves at the individual treaty or cedent level. Additionally, the attribution worksheet does not account for the jurisdictional differences in accounting treatment.

Should regulators want to understand the differences between accounting or other treatments between the US and a Qualified or Reciprocal Jurisdiction, we recommend utilizing existing tools such as those identified earlier in this letter. We believe these tools provide regulators with the transparency they seek without creating an additional worksheet.

Conclusion

We urge a solution that effectively addresses the concerns identified by regulators, ensuring the collectability of reinsurance. This is a counterparty exposure management issue that is more effectively addressed through existing regulatory requirements and enhanced disclosure to regulators and not an issue of reserve adequacy for insurance risks.

To implement regulatory changes that look elsewhere risks the loss of needed reinsurance protection and the resulting opportunity to close the protection gap. Adding regulations that create friction and costs may discourage effective risk management through reinsurance without commensurate benefits. Proposals such as the AAT Concepts and Attribution Analysis exposures are overbroad, discourage the effective use of reinsurance, diminish opportunities to close the protection gap, and risk violating the exiting regulatory structures currently in place.

Swiss Re Hannover Re RAA REINSURANCE ASSOCIATION OF AMERICA

We urge LATF to consider its proposal further given the potential consequences of getting this wrong. Particularly, as addressing the issue of what are termed "structural changes in the life insurance industry" is emerging as a global concern. We suggest that the AAT proposal will not be an answer to this concern. Perhaps working at this through a consideration of the resolution authority approach that some regulatory regimes look to require from ceding insurers might be a more fitting, tailored solution that does not discourage reinsurance or the closing of the protection gap. There must be other, more tailored approaches as well worth exploring.

We stand ready to work to find an appropriate solution that addresses the problem without so severely disincentivizing the deployment of reinsurance capacity.

Sincerely,

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Appendix 1

Swiss Re

REINSURANCE ASSOCIATION OF AMERICA

May 30, 2024

Rachel Hemphill
Chair, Life Actuarial Task Force
c/o Scott O'Neal, soneal@naic.org

RE: Asset Adequacy Testing for Reinsurance

Dear Rachel,

Swiss Re and the Reinsurance Association of America (RAA) appreciate the opportunity to provide input on the Life Actuarial Task Force's Asset Adequacy Testing for Reinsurance Ceded by Life Insurers exposure. Swiss Re and the RAA represent the largest life and property-casualty reinsurers in the world. We provide reinsurance capacity that is vital to the basic mission of insurance regulation, assuring the solvency of insurers and promoting competition.

We note that LATF's efforts follow the Macroprudential Working Group's adoption of its Reinsurance Worksheet last year. Before delving into our formal comments, we respectfully request that the NAIC ensure its various working groups work together when crafting reinsurance proposals, and specifically include the Reinsurance (E) Task Force in discussions at the outset. Including reinsurance regulatory experts from the inception of proposals, we believe, will avoid duplication of any existing regulatory requirements.

Introduction

In its public remarks and the relevant exposed materials, LATF members have signaled a desire to glean additional transparency on reinsurance transactions. While we understand the regulators desire for additional transparency, we do believe many of the proposals being floated undermine the basic value proposition of reinsurance; making selling affordable insurance significantly more difficult for ceding companies. Reinsurance encourages the provision of affordable insurance, and the provision of risk-spreading and support services by reinsurers leads to more insurance.

Discouraging reinsurance reduces the benefits that otherwise are provided and thus poses to continue, if not expand, the global insurance protection gap. It is against this consideration that measures aimed at additional regulation on reinsurance must be considered. The expansion of offshore reinsurance, and in particular reinsurance of so called “asset-intensive reinsurance transactions,” should not be curbed unless done to address clearly identified threats to consumers.

LATF's Proposal Creates Unnecessary Friction

Reinsurance provides essential capacity to ceding companies and promotes competition in insurance markets. The current LATF proposal would set up unnecessary obstacles which will negatively impact the insurance marketplace without addressing the fundamental threat that is perceived to exist as the result of large, offshore or "third country" reinsurance transactions.

The perceived threat is that substantial amounts of reinsurance may become uncollectable by US domestic insurers. We respectfully submit that the issue is one of credit quality and the collectability of such reinsurance, not the investment or reserving rules of the country where the reinsurer is domiciled.

As reinsurers and other industry participants have voiced throughout this process, we believe there are existing safeguards in place for reinsurance transactions that will provide regulators the necessary transparency they seek and ceding companies the necessary warning systems to identify concerns. In instances where companies utilize reinsurance to exit a line or block of business, there are multiple safeguards including trusts, investment policy restrictions, and funds withheld arrangements, among others to provide the necessary level of policyholder protection. Likewise, the use of captives has been addressed by the NAIC with the implementation of AG 48 and primary security requirements.

The domestic state regulator of a ceding company adjudges the appropriateness of the reserve credits taken by the ceding company and can reject or at least modify offshore reinsurance agreements that they find to be questionable in nature. Such credits are also opined upon by the ceding company's Appointed Actuary (AA). These regulatory and internal insurer safeguards concerning reinsurance make an insurer stronger, not weaker.

The Imposition of the AAT Would Run Contrary to the US's Place in the Global Regulatory Scheme

In the exposed PowerPoint presentation, we were confused by the listed example on page six of cessions of asset intensive reinsurance to offshore or special purpose reinsurers. In the listed example, the NAIC is making note of the possibility of an offshore/captive holding capital & reserves that are below the best estimate valuation of a reinsurance block. If there is a local statutory reserving regime that universally accepts such a position (in which local reserves are less than a best estimate), then in such a position we would grant that those local reserves are too low. However, we would submit that it would be easier for a state regulator to deny reserve credit to such an entity/regime that allows for such artificially low local statutory reserves.

In contrast, the NAIC reviews such local regimes and only accepts those for collateral reduction whose rules prevent such low reserving levels. We submit that jurisdictions that do not require appropriate reserving levels would simply not be labeled qualified jurisdictions. To recognize such jurisdictions as qualified would run contrary to the rule and spirit of covered agreements and the LATF's stated goal of not conflicting the treatment of reciprocal jurisdictions.

<u>The Provided Methodology is Flawed</u>

On asset adequacy testing (AAT) methodology, other than policyholder dividends on participating business, it is uncommon for AA's to model statutory dividends as doing so would require the AA to fully distribute earnings perspective which includes required capital – prohibited in AAA/AAT work.

Thus the "surety" that the AA would assess from an AAT approach on these reserves ignores the reality of legal entity capital management and incorrectly assumes unlimited retained earnings perspective. The AA should determine the appropriate methodology and document in the Actuarial Memorandum the rationale for the choice and this should not be prescriptive.

<u>The Approach That Fits the Global Regulatory Scheme and Promotes Reinsurance</u>

The recommended approach is to find a solution that addresses credit quality and assures collectability of reinsurance. This is a matter of promoting counterparty credit risk management. The issue is the collectability of reinsurance. Assuring the collectability of reinsurance involves the assessment of the counterparty and its ability to make good on its obligations. Such an assessment should be made based upon the individual facts of the credit worthiness of the reinsurer and the exposure the ceding insurer has to the reinsurer.

In conclusion, we urge a solution to this problem that addresses the problem that has been identified; assuring the collectability of reinsurance. We insist that this is a counterparty exposure management issue and not an issue of reserving for insurance risks. To devise a solution for this problem that looks elsewhere risks the loss of needed reinsurance protection and the resulting opportunity to close the protection gap. Proposals such as the AAT are overbroad, discourage needed reinsurance, harm the insurance market and even run contrary to the US's scheme of insurance regulation as concerning the covered agreement and credit for reinsurance structures now in place.
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We stand ready to work to find an appropriate solution that addresses the problem without so severely disincentivizing the formation of reinsurance capacity.

We again thank you for the opportunity to comment and stand ready to assist LATF and the NAIC as it continues its work on these critical issues.

Sincerely,

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