Statutory Accounting Principles (E) Working Group
Dec. 17, 2024
Comment Letters Received – Agenda 2

TABLE OF CONTENTS

COMMENTER / DOCUMENT	PAGE REFERENCE
Comment Letters Received for Items Exposed for the Summer National Meeting	
ACLI – December 9, 2024 o Ref #2024-05: Appendix A-791 o Ref #2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts	2-6
Jeffrey G. Stevenson FSA (Sevenson Associates, Inc) Comments – December 11, 2024 o Ref #2024-06: Risk Transfer Analysis of Combination Reinsurance Contracts	7-10

December 9, 2024

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Request for Comments on SAPWG 2024-05 and 2024-06

Submitted Electronically

Dear Mr. Bruggeman:

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the above referenced items that were re-exposed for comment by the Statutory Accounting Principles (E) Working Group (SAPWG) during the NAIC Summer National Meeting in Chicago.

ACLI would like to express our sincere gratitude for your time and willingness to collaborate with us on these reinsurance matters. We value the open dialogue and believe it has contributed to a more informed and constructive regulatory process. Through our discussions, we have gained a deeper understanding of the concerns raised by SAPWG regulators while also conveying the perspectives of our members.

ACLI members continue to believe that the two proposals (Ref #2024-05 and Ref #2024-06) are inextricably linked and should be considered together.

Ref #2024-05: A-791 Paragraph 2.c.

ACLI members believe that retaining the language in Appendix A-791, paragraph 2c, is consistent with the statutory accounting requirement that reinsurance should not deprive a ceding insurer of surplus. With that said, we propose changes below to SAPWG 2024-06 that, if adopted, would address our concerns with the exposed changes in SAPWG 2024-05.

ACLI agrees that statutory risk transfer requires a careful evaluation of the facts and circumstances of a reinsurance agreement and should never rely on a simplistic application of “safe harbor” rules. Appendix A-791 already provides an objective standard by which to assess whether YRT premiums

The American Council of Life Insurers is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI’s member companies are dedicated to protecting consumers’ financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI’s 275 member companies represent 93 percent of industry assets in the United States.
acli.com

are excessive. That is, premiums are considered excessive if they result in the deprivation of ceding insurer surplus. The adoption of the change proposed by 2024-05 might be interpreted as introducing some other standard to determine whether premiums are excessive. However, no objective criteria have been provided by which to apply such other standards and, as a result, the adoption of the proposed change serves to create the potential for a range of interpretations as to what constitutes an excessive YRT premium. Such differences in interpretation are already surfacing with some parties interpreting the combination of the two SAPWG exposures to indicate that all combination Coinsurance-YRT (Co-YRT) agreements are non-proportional and therefore do not provide reserve credit; a conclusion that ACLI believes is inconsistent with SAPWG intent based on conversations we have had with regulators.

To avoid the potential for misinterpretation, ACLI proposes that the 2024-05 exposed changes only be adopted if done concurrently with the ACLI version of SAPWG 2024-06 proposed below.

Ref #2024-06: Risk Transfer Analysis for Combination Reinsurance Contracts

ACLI would like to thank SAPWG for the ongoing discussions regarding SAPWG 2024-06. During our discussions, we showed that combination Co-YRT agreements can be structured in ways that satisfy statutory risk transfer requirements as well as in ways that fail to satisfy statutory risk transfer requirements. We showed that when the YRT premiums were set at or below valuation level mortality, risk transfer was achieved (as ceding insurer surplus was protected against deprivation), but when YRT premiums were in excess of these amounts that risk transfer was not achieved (as ceding insurer surplus was not protected and could become negative). We concluded that taking a full proportional reserve credit for coinsured business and a ½ c_x credit for business ceded on a YRT basis (under a combination Co-YRT agreement) would be appropriate when agreements meet statutory risk transfer requirements such as having YRT premiums set at or below valuation mortality. To clarify SAPWG 2024-06 in order for it to recognize this result, we propose the following refinements to the exposure.

Proposed Risk Transfer Framework

ACLI proposes the following framework for assessing combination Co-YRT agreements for statutory risk transfer purposes:

- Any risk transfer assessment of combination Co-YRT agreements should be conducted in the context of applicable SAP guidance and based on the facts and circumstances of the relevant reinsurance agreement(s).
- SAP coinsurance guidance should be applied to the coinsurance component of the agreement(s) and SAP YRT guidance should be applied to the YRT component of the agreement(s).
- Additionally, an overall assessment of the combined agreement should be performed consistent with the requirement that “the agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder[.]”[1] to ensure that ceding insurer surplus is not deprived.

ACLI agrees that if any individual component of a combination Co-YRT agreement does not pass statutory risk transfer, then the aggregate transaction would not pass statutory risk transfer regardless of how it is structured. An overall assessment should include, among other things, an

[1] A-791 Page 6

evaluation of:

i) the coinsurance agreement(s) to ensure that all significant risks inherent in the reinsured business are transferred, and

ii) the YRT agreement(s) to ensure that the conditions described in Appendix A-791, paragraphs 2.b., 2.c., 2.d., 2.h., 2.i., 2.j. or 2.k. are not violated, and

iii) the entire agreement to confirm that, when assessed in aggregate, it does not deprive a ceding insurer of surplus or require payments other than from the statutory net gain before adjustments (i.e., as defined in the 2023 SAP life blank line 29, hereinafter "net gain") realized from the reinsured policies.

ACLI agrees that agreements that inappropriately preclude any possibility of reinsurance losses being incurred because of excessive YRT premiums would be of concern from a statutory risk transfer perspective. In evaluating whether this is the case, YRT premium levels should be assessed using statutory principles as any resulting reserve credit will also have been established using statutory principles. In applying statutory principles, statutory valuation assumptions serve as an acceptable benchmark when assessing whether YRT premiums are excessive. More specifically:

- YRT reinsurance results in the assumption of mortality risk for the lifetime of the underlying business. In such a context, the statutory valuation framework already defines a reasonably prudent valuation mortality basis for ceding insurers when reserving for such risks. As such, this same valuation mortality basis should also serve as a reasonable and prudent benchmark for reinsurers to consider when committing to the assumption of mortality risk for the lifetime of the underlying business.

- The determination of reserve credit relates to the underlying statutory reserves that are held by the ceding insurer and determined based on statutory principles and assumptions. It would be inconsistent to determine a reserve credit using GAAP principles and assumptions in relation to underlying reserves that are computed using statutory principles and assumptions.

Proposed Changes to SSAP61 and Appendix A-791

In response to SAPWG's request for specific recommendations, ACLI proposes the following changes to SSAP61 and the introduction of a new question to be added to Appendix A-791 in lieu of the exposed changes proposed in SAPWG 2024-06.

ACLI proposes the following paragraph be adopted in SSAP61. This proposal aims to maintain SAPWG's objective of evaluating agreements in aggregate and ensuring the appropriate application of current risk transfer principles.

18. *For purposes of evaluating whether a reinsurance agreement satisfies statutory risk transfer requirements, the determination of what constitutes an agreement is essentially a question of substance. Multiple agreements should be evaluated together for risk transfer purposes when they are entered into together to achieve one overall commercial effect and where considerations to be exchanged under one agreement depend on the performance of*

the other agreement(s). For individual agreements that contemplate reinsurance on both a YRT and coinsurance basis, each of the YRT and coinsurance reinsurance components need to satisfy risk transfer requirements on their respective bases. In addition, when evaluated in its entirety, such agreements cannot deprive the ceding insurer of surplus nor require payments to the reinsurer for amounts other than the net gain realized from the reinsured policies.

ACLI proposes a second question be added to Appendix A-791 2b:

Question

If business is reinsured under a combination reinsurance agreement where the reinsurer assumes certain risks on a coinsurance, modified coinsurance, and/or coinsurance funds withheld basis and other risks on a YRT basis, what conditions are required to ensure that the ceding insurer is neither deprived of surplus nor required to make payments to the reinsurer from other than the net gain realized from the reinsured policies such that risk transfer is achieved? How are these conditions impacted by the agreement having an experience refund formula?

a. *The reinsurance agreement cannot deprive the ceding insurer of surplus or assets. If treaty provisions limit payment of amounts to the reinsurer to the amount of net gain realized from the reinsured business, then the ceding insurer surplus is not deprived, and risk transfer is achieved.*

   For example, risk transfer requirements are satisfied when YRT premiums are contractually stipulated to be equal to or less than the level of valuation mortality used by the ceding insurer in calculating reserves for the reinsured business at the time of inception of the reinsurance agreement and are contractually constrained not to exceed this level.

b. *The fact that there is an experience refund does not, in itself, cause an agreement to fail risk transfer. However, an experience refund that requires that the ceding insurer reimburse the reinsurer for negative experience using amounts it has in surplus is a violation of risk transfer requirements, except that neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in-force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience.*

Summary

Ultimately, our primary concern remains that some may interpret the proposed 2024-06 exposure to indicate that all combination Co-YRT agreements are non-proportional and therefore should not provide reserve credit. Such an interpretation would affect in-force combination Co-YRT agreements and create the potential for material volatility in surplus levels for ceding insurers who have previously entered into such agreements. In addition, such an interpretation would effectively eliminate the ability to use such agreements going forward. Based on our discussions with SAPWG, it is our understanding that neither of these outcomes are intended.

Another concern is that some may interpret the proposed 2024-05 exposure to require an assessment of YRT premiums using a standard other than the existing standard provided in SSAP61 that precludes ceding insurer surplus deprivation. In such a case, there could be significant variation in regulatory interpretations as to what constitutes an “excessive” YRT premium leading to inconsistency rather than harmonization.

ACLI believes that one way to maintain the ability to use compliant combination agreements and not bring into question the reserve credits currently being taken by ceding insurers who are party to such agreements is by adopting proposed changes to SSAP61 and Appendix A-791 consistent with those proposed by ACLI above. Such changes aim to make clear that compliant agreements cannot charge “excessive” YRT premiums and provide a clear basis for how an assessment of YRT premiums anchored to existing SAP guidance is to be performed.

Along with the suggested changes above, we propose forming a small working group consisting of regulators and industry experts to finalize language consistent with the objectives noted above within a defined timeline.

Thank you for the opportunity to provide feedback on these two exposures. ACLI is committed to collaborating with the NAIC and state regulators and welcome further discussion.

Sincerely,

Marc Altschull, CFA, FSA, MAAA
Senior Actuary
marcaltschull@acli.com
202-624-2089

Shannon Jones, CPA
Senior Director - Financial Reporting Policy
Shannonjones@acli.com
202-624-2029

Jeffrey G. Stevenson
5 West Pine Court
St. Louis, MO 63108

H – 314-367-6771
M – 314-614-5583

December 11, 2024

To the Statutory Accounting Practices Accounting Working Group for issue 2024-06

I am a retired actuary with years of experience in reinsurance, primarily with respect to transactions where the primary motivations are not primarily risk transfer. Not long ago I was asked about a treaty arrangement involving combinations of coinsurance and YRT and was told there was some controversy with respect to the accounting.

Combination coinsurance and YRT agreements have been around forever; there shouldn't be much controversy.

Traditionally, the YRT combined in coinsurance agreements is YRT reinsurance inuring to the benefit of the reinsured block.

In this respect, the cash flows of the coinsurance (or Modco) treaty (principally of those intended for purposes other than risk transfer) have traditionally been:

+Premiums
-Claims
-Surrender & Maturity Benefits
-Commissions and Expense Allowances

-Ceded Reins Prems (on Inuring agreements)
+Ceded Reins Dbs (on Inuring agreements)
+Ceded reins Exp Refunds (on Inuring agreements)

-Modco Res Incr (if Modco)
+Modco Interest (if Modco)

- Experience Refunds (if included)

The above result may result in an expense and risk charge with favorable experience.

The inuring agreements in the above could be YRT of mortality risk or other coinsurance of reinsured business of the benefits or even catastrophic stop loss arrangements. The inuring agreements could be traditional YRT with an experience refund arrangement. They could also be YRT agreements of a more financially motivated arrangement, i.e., a high YRT premium based on a high percentage of the valuation mortality basis, combined with a large experience refund.

There is no reason the YRT couldn't be additional quota share of the same block as the coinsurance. Why would ceding companies do this? Well in past circumstances, perhaps they were reinsuring the business with two reinsurers and one reinsurer does not want to retain catastrophic mortality risk but the second reinsurer is willing to take that additional risk in addition to the risks in its own portion of the reinsurer. Including such reinsurance in the single tradition would be done for administrative convenience and if structured as YRT would include additional impacts on reserve and capital requirements. This type of arrangement would not be uncommon for divestiture of the business (might be referred to as administrative reinsurance). My first impression of the combo YRT treaties presented to me is that the additional YRT is nothing more than inuring reinsurance regardless of what the reinsured business is, just like these arrangements in the past.

My understanding of the new variations of combo treaties is that the YRT is indeed an additional quota share of the coinsured business but the interpretation is that the YRT is not inuring to the benefit of the coinsured business. In fact, in the new interpretations the YRT is treated as a separate agreement with its own cash flows. Moreover, the YRT mortality risk treaty might be on the basis of a high percentage of the valuation table thereby generating a generous experience refund under expected assumptions.

The interpretation being made that the extra YRT arrangement is more like a standalone rider produces a result that in the event of adverse investment scenarios, the high experience refund (on the YRT mortality component) can be combined with adverse experience on the coinsured business to merely produce a lower experience refund with the reinsurer not necessarily reimbursing the ceding company for the adverse experience of the coinsured business.

That might look okay with the arithmetic but in my opinion it is a clear violation of the life reinsurance model regulation. The reserve or capital credits associated with any treaty with such an arrangement (and with the YRT component not accounted for as inuring reinsurance) should be denied.

Here is the explanation.

Accounting requirements of the model regulation are:

1. Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period, a must be sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured
2. The ceding insurer can't be deprived of surplus or assets at the reinsurer's option or automatically upon the occurrence of some event
3. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement

4. The reinsurance agreement can't involve the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies.

The new interpretation of the added YRT component (an additional quota share of the underlying coinsured business) violates some of all of these accounting requirements.

First off, as for the YRT exemption from the requirements of the model regulation, the combo treaty "interpretation" does not allow for any YRT exemption because the surplus and capital aid of the combination exceeds that of a zero premium YRT treaty. The model regulation accounting requirements should apply to all the components of the treaty.

Let's assume the coinsured portion of the business produces negative cash flows as a result of poor investment experience and the additional YRT business produces an experience refund that more than offsets the negative experience.

Note that all reinsurance has a cost. The YRT portion of the business has a cost associated with it. The cost is Premiums minus Claims minus Experience Refund. (This typically nets to a cost equal to a risk fee or the profit margin of the reinsurer which may or not be a mere risk fee). But in this case the adverse experience of the coinsured business reduces the YRT portion's experience refund, that YRT reinsurance now has an additional cost in addition to the profit margin.

That cost is now a cost of the ceding company. Reinsurance costs of the ceding company have to be reimbursed by the reinsurer through the expense allowance. In this case then, the reinsurer has to reimburse its own charge, thereby resulting in a wash, so there is, in fact, no recovery of the adverse experience refund.

You can also think of the experience refund as an "optional experience refund". In this case a portion of the YRT experience refund is denied at the option of the reinsurer (it's automatically denied with the occurrence of the adverse experience on the coinsurance). So the use of the YRT as an offset to adverse experience is automatically denying the ceding company of surplus automatically on the occurrence of some event.

The recovery of the adverse experience on the coinsurance is also technically a payment that is not made out of the profits on that coinsured business. It is coming out of an additional premium payment to the reinsurer (the YRT premium).

I recognize that some might make nuanced arguments against these above arguments. However, and most importantly, let's look at the essential substance of the YRT portion of the transaction. The companion YRT arrangement typically has a YRT premium which is a high percentage of valuation mortality (let's say 90%) and any premiums in excess of the claims are experience refunded net of a risk charge. The substance of this transaction is that there is a risk charge paid and claims in excess of 90% of valuation mortality are experience refunded back to the ceding company. (Now this might be structured as YRT because there are other accounting entries such as face amount ceded and reserve credits accompanying the accounting, but the essence of the transaction is essentially a non-proportional stop loss arrangement). The YRT component of the transaction is basically a stop loss

arrangement with a risk charge for a premium. In exchange for this risk premium, the reinsurer will pay claims only if they exceed the percentage of the valuation basis mortality relating to the premium. It is an excess of loss structure.

So if we think of the companion YRT agreement in this true economic form, the companion treaty in addition to the coinsurance is nothing more than a risk premium paid to the reinsurer for catastrophic mortality. From this standpoint, the combo treaty arrangement's result in the event of adverse experience on the coinsurance is that the reinsurer is receiving a payment in addition to the risk charge from the ceding company to cover that adverse experience (as is argued above). This is because in order for the transaction to provide for an offset to the losses on the coinsurance, the ceding company would be required to make a payment to the reinsurer in addition to the risk charge! When viewed from this true economic perspective, this is clearly a violation of the model regulation.

To argue that merely changing the companion contract from a stop loss format to an equivalent YRT structure would change the above interpretation (that the contract violates the model regulation) seems just plain wrong.

One can also think of this additional payment as essentially the same as using an artificially high interest rate (like 12%) to calculate coinsurance experience refunds or modco profits. Everyone should recognize that this provision would be a violation of the model regulation as it would be an additional payment or a payment outside of profits in the business. Likewise, any additional premium paid, or reduction in experience refund of associated treaty provisions, would similarly be a violation of the model regulation.

In P&C arrangements, there is often reference to this type of arrangement as a "reinstatement premium". This has no place in a life reinsurance transaction.

This concluding argument of looking through to the substance of the transaction validates all the other above arguments that this new interpretation of the combo structure violates the model regulation!

If the additional YRT is, in essence, accounted for as an inuring agreement, just has it has always been done, the appropriate cash flows fall out in the treaty accounting and the reserve credits are justified.

Respectfully submitted,

Jeffrey G. Stevenson, FSA