

Life Actuarial (A) Task Force/ Health Actuarial (B) Task Force Amendment Proposal Form*

1. Identify yourself, your affiliation and a very brief description (title) of the issue.

John Robinson, Director PBR – Valuation Actuary, MN

2. Identify the document, including the date if the document is “released for comment,” and the location in the document where the amendment is proposed:

Valuation Manual, January 1, 2021 Edition

3. Show what changes are needed by providing a red-line version of the original verbiage with deletions and identify the verbiage to be deleted, inserted or changed by providing a red-line (turn on “track changes” in Word®) version of the verbiage. (You may do this through an attachment.)

4. State the reason for the proposed amendment? (You may do this through an attachment.)

The purposes of this APF are to

(a) Clarify the responsibilities of the appointed actuaries of both the ceding and assuming companies for all forms of reinsurance, relative to both the SAO and asset adequacy analysis.

(b) Make a minor modification to the table headings in VM-30, Section 3.A.5.

Discussion of Rationale:

1. Every appointed actuary should be held accountable for ensuring that all the reserves covered by the actuary’s SAO are subjected to asset adequacy analysis. Usually, this requires the appointed actuary to perform the analysis; however, circumstances may exist where the appointed actuary can rely on work performed by the counterparty’s appointed actuary. In any event, whether relying on another actuary or not, this APF will require the appointed actuary to provide the results of the asset adequacy analysis, as evidence that the analysis was performed.

2. VM-30 Section 3.A.7.e includes the following required statement as part of the SAO:

“The reserves and related actuarial items, **when considered in light of the assets held by the company** with respect to such reserves and related actuarial items including, but not limited to, the investment earnings on the assets, and the considerations anticipated to be received and retained under the policies and contracts, make adequate provision, according to presently accepted ASOPs, **for the anticipated cash flows required by the contractual obligations** and related expenses of the company.”

In a situation where part or all of the risk is reinsured, the assets held by the company may only be in respect of the portion of the risk supported by the reserves held; however, the appointed actuary’s actuarial opinion must address all the contractual obligations. It follows that, while asset adequacy analysis can only be performed on the reserves and assets held (i.e. net of reinsurance), the appointed actuary’s responsibility may extend beyond the reserves and assets held.

3. In a recent Academy survey of appointed actuaries (“A Survey of Life Appointed Actuaries, December 4, 2020”, Question 66), most of them (50.38%) indicated that for the YE2019 AAT, “no special consideration for reinsurance recoverability will be added”.

This APF will provide guidance that should produce more clarity and uniformity on this issue.

4. The following excerpt is from ASOP 7, “Analysis of Life, Health, or Property/Casualty Insurer Cash Flows”:
3.8 Reinsurance—The actuary should consider whether reinsurance receivables will be collectible when due, and any terms, conditions, or other aspects that may be reasonably expected to have a material impact on the cash flow analysis.”

This APF will propose that similar guidance apply to the appointed actuary in meeting his/her responsibility beyond the reserves and assets held.

5. ASOP 11, Section 3.3, “Treatment of Reinsurance Ceded” states as follows: “Because the ceding entity and the assuming entity **each establish and test** statement liabilities and assets independently, it is possible for the value of the net statement liabilities held by the ceding entity, plus those held by the reinsurer on a reinsured contract, to be more or less than the amount that would have been held if the ceding entity had not reinsured the contract. For example, the two entities may have different investment strategies, resulting in the use of different interest rate assumptions.”

It is clear that both the ceding and assuming companies are expected to both establish and test their respective liabilities.

The proposed text is in the Appendix below.

* This form is not intended for minor corrections, such as formatting, grammar, cross-references or spelling. Those types of changes do not require action by the entire group and may be submitted via letter or email to the NAIC staff support person for the NAIC group where the document originated.

NAIC Staff Comments:

Dates: Received	Reviewed by Staff	Distributed	Considered
Notes: VM Maintenance Agenda 2019-34			

APPENDIX

1. It is proposed to add the following text as VM-30, Section 4:

Section 4: Asset Adequacy Analysis For Treaties Of Reinsurance

A. Each counterparty to a reinsurance treaty has established a reserve in respect of its obligations relative to the underlying policies. Furthermore, the appointed actuary's statement of actuarial opinion covers the reserves established for all of the company's reinsurance treaties currently in force in force as of the annual statement date. Consequently, a company's appointed actuary is required to perform asset adequacy analysis on the reserves, net of reinsurance when a reinsurance reserve credit is applicable, which the company has established in respect of the treaties into which the company has entered and which are currently in force in force as of the annual statement date.

Commented [RJW(1): Revise per VA.

Commented [RJW(2): Clarify that reserves subject to AAT are net of reinsurance. The AA is only accountable for the reserves to which his/her SAO applies, not reserves covered by another AA's SAO.

Commented [RJW(3): Revise per VA.

B. The results of the asset adequacy analysis shall be reported in the appointed actuary's actuarial memorandum, as required in Section 3.B.12.b.

C. Materiality considerations may influence the decision whether to perform the asset adequacy analysis. However, the size of the reserve must not be the sole materiality criterion.

D. The appointed actuary of a direct writer must perform a review of each reinsurance counterparty to assess

1. Whether reinsurance receivables will be collectible when due; and
2. Any terms, conditions, or other aspects that may be reasonably expected to have a material impact on the direct writer's ability to meet its obligations to policyholders.

Evidence of having performed such reviews shall be provided in the actuarial memorandum.

Guidance Note:

- (a) Under certain circumstances, for example, when risk is ceded under a modified coinsurance agreement, a counterparty may report a reserve of 0. This alone does not foreclose on the requirement for the asset adequacy analysis to be performed.
- (b) If an appointed actuary relies on the work of another actuary, such as the appointed actuary of the reinsurance counterparty, the guidance in Section 3.A.6 and Section 3.B.2 must be followed. ~~In relying on the work of another appointed actuary, an appointed actuary may not rely solely on the other actuary's statement of actuarial opinion.~~
- (c) When performing a review of a counterparty per Section 4.D, and providing evidence therefor, the appointed actuary is reminded to refer to ASOP 11 for guidance.

Commented [RJW(4): Delete. Was only intended to complement the preceding sentence, not provide new or conflicting guidance. Thank you, VA.

Commented [RJW(5): ASOP 11 is revised effective December 1, 2022. Section 3.7.1 addresses reinsurance ceded.

[Underlying principles:

1. The SAO itself
2. Each counterparty has its own perspective
3. Regulatory accountability]

Questions for commenters:

- (a) In 4., should there be more specificity as to what evidence should be provided? If so, what should be required?
- (b) It is widely believed that the counterparty that bears the risk should perform the testing. This perspective has been used by appointed actuaries as the rationale for not performing asset adequacy analysis. Please provide a reference to formal guidance that supports this point of view.

2. Revision to Section 3.A.5, Table Headings:

Asset Adequacy Tested And Not Tested Amounts—Reserves and Related Actuarial Items						
Statement Item	Formula Reserves (1)	Principle-Based Reserves (2)	Additional Reserves ^a (3)	Analysis Method ^b	Other Amount Not Tested (4)	Total Amount = (1)+(2)+(3)+(4) (5)

Response to Commenters:

1. Commenters have pointed out that there is guidance in place that covers this topic. I note that the VM states that a goal of developing the VM is “to promote uniformity among states’ valuation requirements”. In that spirit, the purpose of this APF is to establish a national standard of regulatory accountability which is currently lacking, as evidenced by the fact that actuaries are referring to the Practice Note for guidance. It is grounded in the current guidance. In particular, the intent of this guidance is not to address any particular risks.
2. This national standard pertains universally to the reserves set, and associated assets held, by the company, plus a requirement for direct writers. In particular, I hesitate to set a national standard for performing AAT on the gross reserve because I consider the value of an analysis based on hypothetical assets to be limited.
3. This guidance is meant to apply to all forms of reinsurance. However, CFW presents some interesting questions. Note that this guidance is applicable to whatever is covered by the SAO. So, the question is whether the FW liability is subject to the SAO. Currently, the conventional wisdom is that Exhs 5, 6, 7 and 8.1 are covered; however, guidance is lacking as to what must be covered.
4. Commenters have indicated that presenting the counterparty’s results may not be sufficient evidence of reserve adequacy. My response is that relying on the counterparty’s work is not required; therefore, it is up to the AA that is relying on the results to justify the use of said results. VM-30 is explicit as to the terms of reliance. The purpose of requiring that results be provided is to provide the regulator assurance that the work was performed.

5. Implementation of this APF will lead to some stand-alone analysis being required. This is a function of the aggregation restrictions. I note that aggregation is not a requirement; it is an option. However, the fact that it is stand-alone should not be a reason to not perform the analysis.

