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AG ReAAT – Draft 11/15/24

Background

The NAIC Valuation Manual (VM-30) contains actuarial opinion and supporting actuarial memorandum requirements, including requirements for asset adequacy analysis.

State insurance regulators have identified the need to better understand the amount of reserves and type of assets supporting long duration insurance business that relies substantially on asset returns. In particular, there is risk that domestic life insurers may enter into reinsurance transactions that materially lower the amount of reserves and thereby facilitate releases of reserves that prejudice the interests of their policyholders. The purpose of this referral is to propose enhancements to reserve adequacy requirements for life insurance companies by requiring that asset adequacy testing (AAA) use a cash flow testing methodology that evaluates ceded reinsurance as an integral component of asset-intensive business.

This Guideline establishes additional safeguards within the domestic cedent to ensure that the assets supporting reserves continue to be adequate based on moderately adverse conditions.

Text

1. Effective date

   This Guideline shall be effective for asset adequacy analysis of the reserves reported in the December 31, 2025, Annual Statement and for the asset adequacy analysis of the reserves reported in all subsequent Annual Statements.

   Guidance Note: It is anticipated that the requirements contained in this Guideline will be incorporated into VM-30 at a future date, effective for a future valuation year. Requirements in the Guideline will cease to apply to annual statutory financial statements when the corresponding or replacement VM-30 requirements become effective.

2. Scope

   This Guideline shall apply to all life insurers with:

   A. Asset Intensive Reinsurance Transactions ceded to entities that are not required to submit a VM-30 memorandum to US state regulators *{consider alternative reports or language}* in treaties established 1/1/2016 or later (perhaps 1/1/2020 or later for nonaffiliated treaties) that meet any of the criteria determined <u>by counterparty</u> in subsections (1) through (4) below:

      (1) In excess of $5 billion of reserve credit or funds withheld or modified coinsurance reserve

      (2) Combined reserve credit, funds withheld, and modified coinsurance reserve in excess of:

(a) $1 billion and

(b) 2% of ceding company gross Exhibit 5 gross life insurance plus gross annuity reserves

(3) Combined reserve credit, funds withheld, and modified coinsurance reserve in excess of:

(a) $100 million and

(b) 10% of ceding company gross Exhibit 5 gross life insurance plus gross annuity reserves

(4) Combined reserve credit, funds withheld, and modified coinsurance reserve in excess of:

(a) $10 million and

(b) 20% of ceding company gross Exhibit 5 gross life insurance plus gross annuity reserves

B. Asset Intensive Reinsurance Transactions ceded to entities, regardless of treaty establishment date, that results in significant reinsurance collectability risk.

(1) For year-end 2025, significant reinsurance collectability risk is determined according to the judgment of the ceding company's Appointed Actuary

(2) For year-end 2026, [placeholder for more objective guidance?]

3. Definitions

A. Affiliate – Only for purposes of this Guideline means an entity that otherwise meets the NAIC Model Act 440 definition of an Affiliate or has 1 percent or higher ownership of the assuming reinsurer.

B. Asset Intensive Reinsurance Transactions - Coinsurance arrangements involving life insurance products that transfer significant, inherent investment risk including credit quality, reinvestment, or disintermediation risk as determined by Appendix A-791 of the Life and Health Reinsurance Agreements Model Regulation.

~~B~~C. Attribution Analysis – A step-by-step estimate of the proportion of reserve decrease from the pre-reinsurance U.S statutory reserve to Total Reserve attributable to factors such as differences in individual key assumptions.

~~C~~D. Deficient Block – When a block of business shows negative present value of ending surplus in cash-flow testing scenarios using reasonable assumptions under moderately adverse conditions such that additional reserves would be needed in the absence of aggregation.

~~D~~E. Pre-reinsurance Reserve – The U.S. statutory reserve that would be held by the ceding company for the business reinsured in the absence of the reinsurance transaction.

~~E~~F. Primary Security – [As defined in Section 4.D. of Actuarial Guideline 48] *{or replace with another term to describe a stable asset supporting reserves}*

~~F~~G. Reserve Decrease – If the Total Reserve is lower than the Pre-reinsurance Reserve, the difference between the two.

H. Similar Memorandum – An actuarial report that is not a VM-30 submission to a state that contains at least the following elements:

(1) Asset descriptions

(2) Assumption documentation

(a) "Such that an actuary reviewing the actuarial memorandum could form a conclusion as to the reasonableness of the assumptions" (from VM-30)

(b) "And (form a conclusion) on whether the assumptions contribute to the conclusion that reserves make provision for 'moderate adverse conditions'" (from VM-30)

(c) Indication that key assumptions are reasonably set.

(3) Methodology

(4) Rationale for degree of rigor in analyzing different blocks of business.

(5) Include in the rationale the level of "materiality" that was used in determining how rigorously to analyze different blocks of business.

(6) Criteria for determining asset adequacy

(a) Indication of whether New York 7 risk-free rate scenarios are being modeled, presented and passed

(7) Changes from the prior year's analysis

(8) Summary of results

(9) Conclusions

(10) Relevant aspects of Actuarial Guideline 53 documentation and analysis.

(a) Indication of whether high-yield assets are being modeled with a reasonable reflection of their risk

(11) Indication of the scope, e.g., assuming company wide, counterparty (ceding company) specific, treaty specific.

(12) The actuarial report shall be prepared by a qualified actuary and be subject to relevant Actuarial Standards of Practice.

~~F~~I. Sufficient Block – When a block of business shows positive present value of ending surplus in cash-flow testing scenarios using reasonable assumptions under moderately adverse conditions.

~~G~~J. Total Reserve – The reserve held by the ceding company plus the reserve held by the assuming company minus the amount of reserves held by the assuming company supported with assets other than Primary Security.

Other definitions?

4. Risk Identification for Purposes of Establishing Analysis and Documentation Expectations

   A. General guidance - The higher the risk, the more rigorous and frequent the analysis and documentation that should be performed by the ceding company's Appointed Actuary.

   B. Relevant risks – For the purpose of determining the amount of rigor and frequency of analysis and documentation, relevant risks include one or more of the following:

      (1) A VM-30 actuarial memorandum not being provided by the assuming company to a U.S. regulator.

      (2) A significant Reserve Decrease in relation to the Pre-reinsurance Reserve.

      (3) A significant use of non-Primary Security to support reserves.

      {Is there another metric besides "Primary Security" that can provide comfort that appropriately stable assets are supporting reserves?}

      (4) Significant collectability risk associated with the reinsurer, for reasons including:

         (a) Rating of counterparty

         (b) Capital position and trend of capital position

         (c) Regulatory actions against counterparty

         (d) Liquidity ratios

         (e) Late payments on the agreement

         (f) Decline in quality of invested assets

      (5) Any potential risks associated with affiliated transactions should be discussed and considered.

   C. Risk mitigation - Any potential risks or risk mitigants associated with protections such as trusts or funds withheld, particularly with respect to non-affiliated transactions, may be discussed and considered.

   {A process would need to be developed involving approval of less-rigorous analysis for treaties that would otherwise be in the scope, including establishment of criteria and consideration from the domestic state with assistance from VAWG}

   D. Risk identification for this purpose may involve reinsurance transactions within or outside the U.S.

5. Analysis and Documentation Expectations in Light of Risks

A. Generally, cash flow testing the Total Reserve is most appropriate when there is higher risk, and less rigorous analysis may be appropriate if there is lower risk.

{In what types of cases should CFT be mandatory? Should safeguards such as trusts and funds withheld be considered as a reason not to perform CFT even for the largest, most impactful treaties?}

B. Examples of less rigorous analysis include:

(1) Gross premium valuation or other asset adequacy analysis techniques described in Actuarial Standard of Practice #22

{Is there an example of a type of case where GPV would be expected instead of CFT or attribution analysis if the focus of the AG is on asset-intensive business?}

(2) Attribution analysis

{Are the instances of "moderate risk" where attribution analysis could be the only form of analysis performed?}

C. Some aggregation may be allowed between treaties for a single counterparty subject to the considerations in Section 7.

D. The domestic commissioner continues to have the option to require cash flow testing for individual treaties or counterparties, as they may deem necessary to understand and evaluate risk.

E. Where information on cash flows or any aspect of the analysis is not available, the appointed actuary may use simplifications, approximations, and modeling efficiency techniques if the appointed actuary can demonstrate that the use of such techniques does not make the analysis results more favorable.

F. A Similar Memorandum submitted to the cedant's domestic regulator may be an appropriate alternative to cash-flow testing following VM-30 standards in some instances, if based on the Similar Memorandum the cedant's domestic regulator finds that they are able to determine whether the assets are adequate to support the liabilities, with the assistance of the Valuation Analysis (E) Working Group.

6. Attribution Analysis

A. To perform an Attribution Analysis, for each relevant treaty, start with the Pre-reinsurance Reserve and document adjustments from that reserve to get to the Total Reserve.

(1) Adjustments may include the following:

(a) Differences in key assumptions

(i) Policyholder behavior assumptions

(ii) Mortality or longevity assumptions

(iii) Investment return assumptions versus US statutory discount rates

{Is it important to analyze investment risks if the company is not reliant on aggressive asset return assumptions?}

(iv) Other key assumptions, e.g., taxes

(b) Other reserve adjustments due to:

(i) Removal of cash surrender value floor

(ii) Market value / book value difference due to change in interest rates

(iii) Moderately adverse to less adverse (or best estimate) conversion

(iv) Other, including other changes to fair value or future cash flows

(2) Please comment on the order of the Attribution Analysis adjustments, where a different order could significantly change the impact of an adjustment.

{Would attribution analysis be the sole analysis required for AG ReAAT purposes in certain moderate-risk cases, or would it only supplement other analysis?

B. Use the template or provide similar information in a user-friendly format explaining reasons for any reserve decrease.

C. It may be helpful to perform attribution analysis first between the Pre-reinsurance Reserve and another basis utilized by the cedant (e.g., the cedant's economic basis for the portion of the block ceded) and then from that basis to the Total Reserve.

(1) Please ensure comparison of dollar amounts of different reserves reflect the combined reserve held by the ceding and assuming companies.

D. Provide a narrative explanation, if necessary, to accompany the numbers provided in the attribution analysis template or similar format.

7. Aggregation Considerations

A. Aggregation through subsidy of a Deficient Block by a Sufficient Block should only apply within a counterparty.

{Are there cases where aggregation within a counterparty is inappropriate, such as between certain lines of business?}

B. Provide an explanation if additional asset adequacy analysis reserves are not posted related to a Deficient Block, where the reason is aggregation with a Sufficient Block.

C. Where applicable, explain the stability and reliability of a Sufficient Block when it is being used to subsidize a Deficient Block.

8. Documentation

   A. If cash-flow testing is performed, present New York 7 results and key assumptions, along with other results the company selects to disclose.

   B. If Attribution Analysis is performed, present the results in the template or in a user-friendly form providing similar information as in the template.

   C. If performing other analysis, present results as appropriate.

   D. Provide any narrative explanation to accompany the numerical results, including support for decisions to hold or not hold additional asset adequacy analysis reserves.