Memo

To:	Rachel Hemphill, FSA, MAAA, FCAS, Life Actuarial Task Force
From:	Patricia Matson, FSA, MAAA, Partner, RRC Ben Leiser, FSA, MAAA, Director, RRC
Date:	April 24, 2025
Subject:	RRC Comments Regarding LATF's Reinsurance AAT Actuarial Guideline Draft Exposure

Background

The Life Actuarial Task Force (LATF) is requesting comments on the AAT for Reinsurance Actuarial Guideline Draft ("the Exposure"). LATF has asked that comments regarding specific items within the Exposure be provided by April 24th. Per LATF's request for earlier comments, RRC provided prior comment letters in 2024 on September 19th, October 3rd, and October 11th and in 2025 on January 15th and February 28th. We have not repeated those items in this comment letter unless directly applicable.

RRC appreciates the opportunity to offer our comments. Should you have any questions, we would be glad to discuss our comments with you and Task Force members.

We appreciate the work LATF has undertaken to address what we believe is a critical industry issue, namely the significant use of reinsurance, including offshore reinsurance, to provide US insurers with material reserve and capital relief.

RRC has assisted regulators in reviewing a variety of reinsurance transactions that result in material reductions in the total asset requirement (TAR) backing the policyholder obligations. We understand that while these transactions are executed for a variety of appropriate business and financial strategies, we also believe that in some cases they can result in reserves or capital that are reduced to a level that raises questions about their appropriateness from a policyholder protection perspective.

RRC Comments on Scope

RRC supports the defined scope. We have the following recommendations to improve clarity of the guidance:

1. In item B, move the phrase "ceded to entities" from after the word "regulators" to after the word "Transactions" (this would also create a parallel construction to item A)
2. In item B.ii., add reference to Actuarial Standard of Practice No. 11, *Treatment of Reinsurance or Similar Risk Transfer Programs Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports* (ASOP 11). While the Appointed Actuary is already required to evaluate counterparty risk under section 3.5 of ASOP 11, we believe that including reference to it in the Exposure would provide helpful clarity.

RRC Comments on Definitions

Regarding the definition of Asset Intensive Reinsurance Transactions, we support reference to A-791 for consistency with accounting guidance. However, we are aware of transactions associated with both long term care business and term business that result in the same concerns as business that is defined in A-791 as having high credit or reinvestment risk (i.e., the Post-reinsurance Reserve is excessively low, and potentially insufficient). Therefore, we suggest adding the following item to the end of the Scope section to address such transactions:

"Or

C. Other types of coinsurance arrangements involving long duration life or health insurance business ceded to entities that are not required to submit a VM30 memorandum to US state regulators, regardless of transaction establishment date, that result in a Post-reinsurance Reserve that, in the actuary's professional judgment and with consideration of the assets supporting the Post-reinsurance Reserve, may not be sufficient to cover policyholder obligations under moderately adverse conditions."

We have comments related to Similar Memorandum further below.

Regarding the definitions of Deficient and Sufficient Block, we believe the reference to interim surplus should be modified. In a reserve financing transaction, projections of the statutory balance sheet will show interim US Statutory surplus shortfalls, especially in early projection years. That is the reason the transaction is performed. We recommend focusing on ending Statutory surplus and interim **cash flow or economic** shortfalls. If the testing shows that there are insufficient cash flows during the projection to pay policyholder claims under moderately adverse conditions, that would be an indication that additional assets may be needed to cover those shortfalls.

<u>RRC Comments on Analysis and Documentation Expectations in Light of Risks</u>

We do not believe there should be specific exemptions for 2025, as indicated in Section 5.A. and 5.H. Our rationale for this is that any transaction may create risk to policyholder protection, and therefore we are in favor of only limiting the scope based on the risk profile as laid out in section 2. In addition, there may be unintended consequences if the requirement to perform cash flow testing varies across individual states.

We do not believe the Exposure should mandate disclosure only as an override to the use of sound reserving principles. We believe that if a transaction causes reserves to decline below a level that is needed to cover policyholder obligations under moderately adverse conditions, cash flow testing should be performed to determine if additional reserves are needed and the amount of additional reserves to be held. If the Exposure were to mandate disclosure only, the AA could consider disclosed cash flow testing results that show a large deficiency, but when considered alongside low counterparty (nonpayment) risk, decide not to hold any additional reserves. We understand that the regulator may override the AA's judgment in some cases, but since that is not required it may perpetuate the currently unlevel playing field (i.e. in which some state regulators may require additional reserves and others may not).

For this reason, we do not believe the following sections are necessary:

1. Section 5.A.i. – remove the end of the sentence that says "*except in certain cases described in Section 5.H.*"
2. Remove Section 5.B. in its entirety
3. Remove Section 5.C. in its entirety
4. Remove Section 5.H. in its entirety

If there is a desire to lighten the burden for the 1st year (year-end 2025 submissions), we do not believe it should be based on the criteria included in Section 5.H.i. or 5.H.iv., rather purely risk based, consistent with items in Section 4. And Section 5.H.ii. and 5.H.iii.

If the requirement to perform cash flow testing is viewed as overly burdensome by the industry, an alternative way to address that concern may be to add the criteria from 4.B.ii, 4.B.iii and 4.B.iv to the scope section, in other words only have the guidance apply in situations for which there is a significant risk such as a significant Reserve Decrease in relation to the Pre-reinsurance reserve, a significant use of non-Primary Security to support reserves or significant collectability risk associated with the reinsurer.

RRC Comments on Starting Asset Amount

RRC believes the guiding principle for starting assets should be consistent with existing AAT requirements for assets supporting the level of reserves being held. Actuarial Standard of Practice (ASOP) No. 22, **Statements of Actuarial Opinion Based on Asset Adequacy Analysis for Life Insurance, Annuity, or Health Insurance Reserves and Other Liabilities,** states "The actuary should use professional judgment in choosing assets that are appropriate for the analysis method *and are not used to support reserves and other liabilities other than those being tested by the actuary*. (emphasis added)" Therefore, the appointed actuary should consider whether any encumbered surplus is included by the reinsurer to support its capital levels, and if they are then these same assets would not be available to support the ceded business adequacy analysis. However, if those assets are not included in the required capital of the reinsurer, and not set aside for any other purpose other than to satisfy the ceded business claims under moderately adverse conditions, the appointed actuary may consider treating those assets as also included for purposes of performing the asset adequacy assessments. **The guiding principle should be that the same assets cannot support reserves and also be used for some other purpose**. We do not believe there is a need to include the allowance for an alternative run because the AA can already run any additional scenarios and analysis, and this guideline doesn't (and shouldn't) change that. The additional commentary on alternative runs may imply some type of safe harbor is being included. We believe it is most important for the guidance to say definitively that you can't count the same asset twice and to disallow the counting of non-Primary Security.

As an example of applying appropriate principles, consider the following situation involving modified coinsurance with funds withheld:

- Gross Statutory Reserve: $100
- Net Statutory Reserve: $0 (i.e. 100% coinsurance)
- Funds Withheld (FWH) Assets: $100
- Reinsurer Held Reserve for the Ceded Business: $30

Although the FWH assets are $100, these assets are owned by the reinsurer and not the cedant. Since the reinsurer is only setting aside assets of $30 to cover future policyholder obligations, only $30 can be included in the starting assets for AAT. The remaining $70, though retained in a FWH account, are not set aside to cover claim payments and may be supporting the reinsurer's other obligations or may support required or available capital.

The following example includes an additional specific case where the Reinsurer has non-primary assets (e.g., Deferred Acquisition Cost (DAC)) that should not be included in the starting assets for AAT:

- Gross Statutory Reserve: $100
- Net Statutory Reserve: $0 (i.e. 100% coinsurance)
- Funds Withheld (FWH) Assets: $100
- Reinsurer Held Reserve for the Ceded Business: $30

- Reinsurer Reported DAC for the Ceded Business: $20

In this example, the $20 DAC is a non-primary asset and the reinsurer is therefore only setting aside assets of $10 ($30-$20) to cover future policyholder obligations; therefore only $10 can be included in the starting assets for AAT.

We support the guidance contained in section 6.H. regarding approaches for instances in which the Appointed Actuary has limited data. If a Company is ceding business to a reinsurer, their standard controls and risk mitigation procedures should involve understanding the reinsurer's investment approach. While we understand that CUSIP-level asset information may not be available, we believe it is reasonable to require a best efforts approach for the Appointed Actuary to assess asset adequacy. We also recommend including guidance that when information is scarce and therefore modeling uncertainty increases, additional margins should be included. This is also required by ASOP 22, which states: "When determining the level of assumption margins, if any, the actuary should take into account the following: the level of uncertainty for the assumption, including sparsity of data". Recommended language is as follows:

"iv. Increase the level of prudence in the asset-related assumptions to account for sparsity of data."

RRC Comments on Similar Memorandum

We do not believe that an alternative of a Similar Memorandum is needed or that its definition should even be discussed. For all treaties meeting all scope definitions, the goal of this Exposure should be for the US regulator to obtain information regarding asset adequacy testing similar to what would be required under VM-30. Rather than create another regulatory submission or alternate document, the cedant should be able to easily and readily develop a filing for the US regulator that conforms to the form and substance of VM-30, and is consistent with it. This will also serve to keep AAT reporting for all purposes consistent with current requirements and more efficient to prepare and to review.

RRC Comments on Questions Regarding "less-rigorous" analysis, attribution analysis and GPV

We believe that transactions that are in scope based on the risk criteria and characteristics identified in the guidance should require CFT and those that would otherwise require less rigorous analysis would not be in scope.

Thank you for the opportunity to provide comments on this important topic. we can be reached at 860-305-0701/tricia.matson@riskreg.com or 201-870-7713/ben.leiser@riskreg.com if you or other members have any questions.