Reinsurance Asset Adequacy Testing

Life Actuarial Task Force

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Agenda

1. Background
2. Timeline
3. Progress made
4. Current topics
5. Exposure (after consideration of discussion)

Background

- Reminder of goals:
  - Provide US state regulators what is needed to review the reserves & solvency of US life insurers.
    - Transparency into reserves and supporting assets even if business is ceded
  - Steer clear of conflict with reciprocal jurisdiction / covered agreement issues.
  - Prevent work by US ceding companies where there's immaterial risk.

Timeline

- May 1, 2025 – LATF discussion as follow up to March 23 exposure & comments
- May 2, 2025 - New exposure, reflecting decisions made on May 1 call
- May 22, 2025 – End of comment period
- May 29, 2025 – LATF discussion, fatal flaws 5-day exposure
- June 3, 2025 – Final comments due
- June 5, 2025 – Final LATF discussion and vote for adoption
- July 2025 – A Committee consideration of adoption
- August 13, 2025 – Exec / Plenary consideration of adoption
- April 1, 2026 – First reports due

Topics – progress previously made

- Disclosure only
- Narrow scope
- Focus on asset intensive reinsurance
- Potential for lesser analysis for older treaties and certain non-affiliated treaties with substantial risk protections
- Potential reliance on reports similar to VM-30 / AG 53

Other recent topics

- NY 7 Treasury rate scenarios – or similar
- Associated Party – term removed
- Mandatory cash-flow testing (CFT) situations
- Disclosure wording – Academy wording
- Starting asset amount – mandatory and optional alternative runs

Today's topics

- Aggregation – of work (testing) and results
  - Categories of comments
  - Language
- Starting asset amount
  - Consistent with basis in jurisdiction (book value, market value)

Today's topics

- Attribution Analysis when CFT performed
  - Preferred but not required
  - Required to show book value / market value adjustment?
- Non-primary security
- Scope refinements
- NY 7 description (Guideline mentions NY 7 or something similar for display of results)
- Interim deficiency wording
- Similar Memorandum

Aggregation concepts

- Two aggregation concepts:
  - #1: Aggregation of analysis and presentation of results
    - Within counterparty – general agreement
    - Also for each PBR block within a counterparty? Discussion
  - #2: Aggregation of Deficient Block and Sufficient Block
    - For determination of whether additional AAT reserves should be held
    - Less of an issue since the Guideline is disclosure only
      - Any decision to hold or not to hold additional reserves based on the analysis can be provided by the company [Sections 8.C and 9.B.iii.(d)]

Aggregation wording

- Tighten up Section 8 wording to reflect separate concepts

  A. When determining whether a block is a Deficient Block or a Sufficient Block, cash-flow testing should be performed separately 1) by counterparty, 2) by significant product lines, consistent with, for example, the aggregation standards in VM-20, VM-21, and VM-22, and 3) by business on a PBR vs. non-PBR framework.

  B. Aggregation of the ~~deficiencies~~ deficient and/or ~~sufficiencies~~ sufficient results determined following 8.A, through subsidy of a Deficient Block(s) by a Sufficient Block(s) should only apply within a counterparty for any required testing.

  C. 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 or consistency with the guidance provided in Section 5.B.

- Section 8.A. – analysis and presentation of results by product lines / standalone by PBR line?

Aggregation wording

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A. When determining whether a block is a Deficient Block or a Sufficient Block, cash-flow testing should be performed separately 1) by counterparty, 2) by significant product lines, consistent with, for example, the aggregation standards in VM-20, VM-21, and VM-22, and 3) by business on a PBR vs. non-PBR framework.

B. Aggregation of the ~~deficiencies~~ deficient and/or ~~sufficiencies~~ sufficient results determined following 8.A, through subsidy of a Deficient Block(s) by a Sufficient Block(s) should only apply within a counterparty for any required testing.

C. 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 or consistency with the guidance provided in Section 5.B.

- Section 8.C.: add this wording or remove wording after Deficient Block?
  - It may be helpful to identify whether it's presence of a Sufficient Block or another reason for not posting additional reserves.

Aggregation wording

- Section 5.B reference

B. For year-end 2025, the Appointed Actuary should consider the analysis required to be performed by this Actuarial Guideline, along with other relevant information and analysis in forming their opinion regarding the potential need for additional reserves. In the event that the Appointed Actuary believes that additional reserves are required (based on their application of appropriate actuarial judgment), then the Appointed Actuary should reflect that in their Actuarial Opinion.

This Guideline does not include prescriptive guidance as to whether additional reserves should or should not be held. Such determination is up to the Appointed Actuary, and the domestic regulator will continue to have the authority to require additional reserves as deemed necessary.

Post-Reinsurance Reserve and Starting Asset Amount

- Background on calculation of reserves
  - Reserves = Present Value (PV) of future benefits minus PV of future premiums
  - For US Statutory reserves, the PV discount rate is the valuation interest rate set on the policy issue date
    - That discount rate does not change to align book value accounting for liabilities and assets
      - Assets are assumed to be purchased on the policy issuance date to support the policy's reserve
      - US balance sheet: book values for assets and liabilities
    - Theory is that market values of assets and liabilities will move together as Treasury rates move … if asset durations match liability durations

Post-Reinsurance Reserve and Starting Asset Amount

- Cash-flow testing ensures additional reserves are held if reserves are insufficient in moderately adverse scenarios
  - Due to asset durations not matching liability durations
  - Or other complexities show reserve insufficiency
- Mechanics of cash-flow testing:
  - Assets with book value = US statutory reserves (book value) are assigned to start the cash-flow projection
  - Immediately in the projection, the assigned assets are "marked to market"
    - Comes into play if assets are assumed to be sold during the projection
  - Cash flows from assets and liabilities (benefits, premiums from existing business, expenses) are projected
  - Key: testing adequacy of statutory reserve amount

Post-Reinsurance Reserve and Starting Asset Amount

- For Post-Reinsurance Reserve, what if the amount in a non-US jurisdiction is based on market value instead of book value?
- Key is apples to apples accounting of assets and liabilities
  - Reminder that the Starting Asset Amount = the Post-Reinsurance Reserve in the mandatory run
- Ok with this proposed wording in Section 6.B?

B. Starting Asset Amount

i. The lower the Starting Asset Amount, the lower the ending surplus in the projection, the more likely an actuary would determine additional reserves would be prudent, and therefore the more conservative the analysis.

ii. The Starting Asset Amount basis (book value or market value) should be consistent with the basis used in the assuming company's regulatory jurisdiction.

iii. For one mandatory run of cash-flow testing, the Starting Asset Amount shall be equal to the Post-Reinsurance Reserve.

Attribution Analysis

- Prefer attribution analysis even if performing cash-flow testing
  - Important to know reasons for any reserve decrease
  - But as accommodation in consideration of amount of work, not make it a requirement
  - Should be required to quantify book value to market value reserve, if applicable?
- Possible Section 7 wording:

E. <u>Attribution analysis is preferred, but not required, if cash-flow testing in accordance with this Guideline is already being performed for a treaty. Attribution analysis is required if a treaty otherwise within the scope of Section 2.A. is exempted through Section 2.C. or Section 5.H.</u>

Non-primary security

- Not included in Starting Asset Amount for Mandatory Run
- Potentially allow some non-primary security in Starting Asset Amount for Alternative Run
- Proposed Section 6.B wording:

~~i~~v. The Starting Asset Amount shall be reduced by the amount of any non-Primary Security supporting the Post-Reinsurance Reserve or alternative amount. An exception is for an Alternative Run when inclusion of non-Primary Security is explained, justified, and quantified.

Scope refinements

- Pre-2020 treaties
  - Current wording: non-affiliated (or similar) treaties may be eligible for exemption, subject to criteria and domestic regulator approval, including below a certain size
  - Proposed wording:
    - Expand to affiliated treaties subject to criteria
    - Expand to larger treaties if the treaty is comprised of older business

C. For transactions established 1/1/2016 through 12/31/2019 otherwise within the scope through Section 2.A., consideration for exemption can be requested from the domestic regulator based on criteria established in Sections 5.H.i., 5.H.ii., and 5.H.iii, or if insurance policies included in the reinsurance transaction are primarily comprised of older business, issued earlier than 2010.

Scope refinements

- Di minimis blocks when multiple treaties with a counterparty
  - Proposed wording for Section 5.A.i:

<u>Guidance note: In a case where there are multiple treaties between the ceding company and the counterparty, any treaty that has less than 5% of the total reserve credit or modified coinsurance reserve between the ceding company and counterparty can be excluded from this Guideline's cash-flow testing requirements.</u>

NY 7 Description

- Reference in Section 6.D: Projection on interest rate scenarios "such as the New York 7"
- Description added as appendix, taken from New York Regulation 126

Interim Negatives

- Mentions: Section 3D&L (definitions) and Section 9.B.iii.(c) (reporting):

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

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

(c) Interim cash-flow testing negative results

(1) Narrative and summary

(2) Negative surplus by year where significant

(3) Explanation of how interim negative results are addressed

  - Alignment with VM-30? (interim negatives do not indicate a deficient block)
  - Commentary on interim negatives sufficient?

Similar Memorandum

- Meeting with companies, perhaps leading to additional guidance