Yearly Renewable Term (YRT) Reinsurance Treatment Under VM-20

Life Practice Council Presentation to Life Actuarial (A) Task Force

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VM-20 YRT Reinsurance Treatment*

- NPR YRT reserve/reserve credit = ½ cx regardless of guarantee
- DR/SR reserve/reserve credit
  - Non-guaranteed YRT
    - No modeling—DR and SR = ½ cx
  - Guaranteed YRT
    - DR/SR—model treaty provisions
    - No judgment required related to future YRT rates
  - Partially Guaranteed YRT
    - Not covered by VM-20 as amended
    - VM-20 Section 8 requires professional judgment

* Applies to both cedant and assuming company

Examples of YRT Reinsurance Guarantee Designs

- Fully guaranteed—all years
- Specific period guarantee
- Guarantee for level term period
- Option for rate change triggered by
  - External event
  - Cedant policy actions
  - Assuming company experience with Most Favored Nation protection
- Guarantee unless cedant mortality deteriorates by [X]
- Non-guaranteed YRT (guarantee for single year only)

Reasons for Choosing a Guarantee

- Product features and risks
  - Uncertainty around new product features
  - Uncertainty around UW practices
  - Uncertainty around valuation practices
- Sensitivities in profit drivers
- Costs
- Risk tolerance of both parties
- Alignment of interests
- Predictability of cash flows

Possible Treaty Limits on YRT Reinsurance Rate Increases

- Percent of initial rates
- Percent of VBT
- Percent of CSO table or (valuation net premium)
- Formulaic change
- Proportionality to cedant's actions
- Only if increasing rates for all ceding companies

Actuarial Judgement Required for DR/SR Modeling

- Fully guaranteed YRT rates—no judgement required
- Fully non-guaranteed—no professional judgement
- Partial or guarantees with limits—needs actuarial professional judgement
  - Treatment as fully guaranteed or non-fully guaranteed may not be appropriate

VM-20 References

- “For life insurance coverage that the company has assumed on a YRT basis, the reinsurer’s net premium reserve shall be one half year’s cost of insurance for the reinsured net amount at risk.” (VM-20 Section 3.B.8)
- “Guidance Note: The credit taken under a coinsurance arrangement shall be calculated using the same methodology and assumptions used in determining its NPR, but only for the percentage of the risk that was reinsured. If the reinsurance is on a YRT basis, the credit shall be calculated using the assumptions used in determining the NPR, but for the net amount at risk.” (VM-20 Section 8.B.1)

VM-20 References (cont’d)

- “For non-guaranteed YRT reinsurance ceded or assumed, the cash-flow modeling requirements in Sections 8.C.1 through 8.C.14 below do not apply since non-guaranteed YRT reinsurance ceded or assumed does not need to be modeled; see Section 8.C.18 below. YRT shall include other reinsurance arrangements that are similar in effect to YRT.” (intro to VM-20 Section 8.C)
- “When the reinsurance ceded or assumed is on a non-guaranteed YRT or similar basis, the corresponding reinsurance cash flows do not need to be modeled. This includes retrocession arrangements covering non-guaranteed YRT reinsurance and similar agreements.” (VM-20 Section 8.C.18)

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VM-20 Section 8.C

“The company shall assume that the counterparties to a reinsurance agreement are knowledgeable about the contingencies involved in the agreement and likely to exercise the terms of the agreement to their respective advantage, taking into account the context of the agreement in the entire economic relationship between the parties. In setting assumptions for the NGE in reinsurance cash flows, the company shall include, but not be limited to, the following:

- The usual and customary practices associated with such agreements.
- Past practices by the parties concerning the changing of terms, in an economic environment similar to that projected.
- Any limits placed upon either party’s ability to exercise contractual options in the reinsurance agreement.
- The ability of the direct-writing company to modify the terms of its policies in response to changes in reinsurance terms.
- Actions that might be taken by a party if the counterparty is in financial difficulty.”

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Appendix A-791 of AP&P Manual

"Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

A – Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt because these do not normally provide significant surplus relief and therefore are outside the scope of this Appendix. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer's net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer.

Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP No. 61."

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Questions?

For more information, please contact

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