

# Memo

**To:** Rachel Hemphill, FSA, MAAA, FCAS, Life Actuarial Task Force

**From:** Patricia Matson, FSA, MAAA, Partner, RRC  
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**Date:** October 3, 2024

**Subject:** RRC Comments Regarding LATF's Reinsurance AAT Actuarial Guideline Draft Exposure

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## **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 the Scope and Aggregation sections of the Exposure be provided by October 3<sup>rd</sup>. Originally, comments on the Scope section were due by September 19<sup>th</sup>, and we submitted a comment letter on September 19<sup>th</sup>. Since both Scope and Aggregation will be discussed on the October 10<sup>th</sup> LATF call, we have included in this comment letter our previously submitted comments as well as comments on Aggregation. RRC intends to provide further comments on the full Exposure by the comment deadline.

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.

## **General Comments**

We believe that when an insurer makes a promise to its direct policyholders, it is critical for the insurer to set operational and financial standards that will enable it to meet that promise. One such standard would be to ensure there are sufficient assets to pay future claims. This does not change when the insurer chooses to reinsure the business.

Based on this important promise, in a case in which an insurer uses reinsurance to reduce reserve and capital requirements that it views as overly conservative, we believe it would be reasonable to expect the insurer to continue to hold *adequate* reserves and capital, based on US statutory requirements. Based on the overall statutory framework, reserve adequacy has tended to be viewed as the level that would be sufficient under moderately adverse conditions (which may equate to an 85% confidence level). Capital would then cover conditions beyond moderately adverse, up to a higher confidence level (such as 95%).

Therefore, we believe that a goal of the Exposure (which we recognize is focused on reserves) should be to set guardrails so that reserve financing transactions do not result in those reserves declining below a level that would be sufficient to cover policyholder obligations with approximately 85% confidence (or under moderately adverse conditions) based on the US statutory framework. This seems to be a fundamental minimum, under US statutory guidance, to meet policyholder protection while still allowing for the use of reinsurance to finance reserves.

### **RRC Comments on Scope Section**

With respect to the two options laid out in the Exposure, RRC is in favor of “Option 1: Narrow scope, some analysis expected for all treaties in the scope.” Our rationale for this is to address the areas of concern while avoiding creating significant work for Appointed Actuaries and regulators that does not materially address the areas of concern.

Based on our experience, it appears to be a relatively small subset of all reinsurance transactions that result in a material reduction in TAR. Therefore, we are in favor of limiting the scope of the new guidance to reinsurance transactions that result in such material reduction (or may result in such reduction in the future).

We are in favor of using a size threshold as laid out in the Exposure.

We agree with exempting treaties in situations in which the reinsurer is required by law to provide a VM-30 memorandum, since such treaties are unlikely to result in a significant reduction in TAR.

We agree with including any treaty that presents significant collectability risk. Potential approaches to defining such risk are:

1. Credit rating (however, we don’t believe that this alone is sufficient)
2. Solvency position (e.g. the reinsurer’s capital exceeds the regulatory intervention threshold in its jurisdiction)
3. Delays in payment on the reinsurance agreement that exceed a defined period such as 180 days

We also note that in the case of significant collectability risk, an appropriate reserve would need to take into account the potential need for the cedant to re-establish the full U.S. Statutory reserve if the reinsurer were to default. For example, if the U.S. Statutory reserve is materially higher than an 85<sup>th</sup> percentile reserve set solely based on the projected underlying asset and liability cash flows, and the reinsurer defaults, the cedant would have to hold the full statutory reserve. This should be considered by the cedant’s Appointed Actuary in their asset adequacy assessment.

LATF may want to consider exempting from scope treaties that meet the following criteria, since such treaties are unlikely to result in a significant reduction in TAR:

1. The treaty does not involve business with material investment risk (for example, YRT treaties)
2. The current and projected future reserves that will be held by the reinsurer are not materially less than those required under the U.S. Statutory framework

### **RRC Comments on Aggregation Section**

Based on our experience, the transactions that are generating regulatory concern are those in which the insurance company achieves a significant reduction in TAR. In other words, the treaty is entered into for the express purpose of reducing reserves and/or capital. While such a transaction may be done for good business reasons, we strongly believe that there should not be adverse impacts on policyholder protection. Therefore, we believe that the assets available to cover future policyholder obligations should

remain at a level that aligns with overall statutory principles. As described above, this would imply that the reserves backing the transferred business would still be set at approximately an 85% confidence level, and capital at a 95% confidence level. Therefore, we believe that standalone testing of the adequacy of the assets backing reserves for the transferred business is appropriate. Such testing would be used to ensure that the assets backing the reserves post-transaction are still adequate to cover policyholder obligations under moderately adverse conditions. This seems like an appropriate minimum standard, and would still allow companies to free up capital in situations in which formulaic statutory reserves are viewed as excessive (i.e. materially greater than an 85% confidence level). In other words, we do not support aggregation across treaties, counterparties, or with retained blocks of business.

While we recognize that current asset adequacy testing (AAT) allows for aggregation of business, the purpose of AAT is as a backstop test to ensure that the formulaic statutory reserves (which are intended to be conservative) continue to be sufficient. Therefore, the testing allows for aggregation of deficient blocks (i.e. blocks that have booked statutory reserves that are below the 85% confidence level) with sufficient ones as long as “the assets or cash flows from the blocks are available to support the reserves” (per ASOP 22, *Statements of Actuarial Opinion Based on Asset Adequacy Analysis for Life Insurance, Annuity, or Health Insurance Reserves and Other Liabilities*). We believe that in a situation in which an insurance company is proactively seeking surplus relief through a reinsurance treaty (typically because reserves are believed to be overly conservative), it is reasonable to expect that the post-transaction reserves continue to be sufficient on a standalone basis.

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.