Academy Reinsurance Work Group Survey to LHATF
Sept. 18, 2008

The American Academy of Actuaries' Life Reinsurance Work Group (Academy Work Group) would like to understand any concerns you as a regulator have with the current language in VM-20 relating to reinsurance provisions, specifically in how they relate to current risk transfer requirements. Your responses to the accompanying survey will help the Academy Work Group more fully incorporate your concerns in any future recommendations.

The survey consists of three sections. Section A has a few general questions regarding reinsurance in a Principle-based Reserves (PBR) environment. Section B contains several questions regarding the components of the current NAIC Model Life Reinsurance Agreements Regulation and their treatment under PBR Section C contains questions regarding your comfort with specific reinsurance designs. We ask that you at least respond to Sections A and C. We encourage you to also respond to Section B, or at least to those questions on which you have a strong opinion. The questions are specific to the language in the current exposure of VM-20 (Life PBR), but please consider other products that might be subject to PBR in your responses.

Please return the completed survey to Natalie Jones at the American Academy of Actuaries at jones@actuary.org.

While we believe that an open discussion is more valuable, if you would like your response to be kept confidential, let Natalie know and Academy staff will remove your name from the responses and compile your answers anonymously.

The Academy Work Group may want to contact you to discuss your responses more fully. Please indicate if that would *not* be acceptable to you.

A. Please respond to the following statements and elaborate on the rationale for your response.

1. Do you agree or disagree with the following statement:

   If principle-based reserves properly reflect a given provision in a reinsurance agreement, then the presence of that provision in a reinsurance treaty should not result in the elimination of reinsurance reserve credit and/or the required use of deposit accounting.

   RESPONSE:

2. Give your reaction to both of the following statements:

   a. It is not necessary for both the deterministic and stochastic reserve calculations to reflect all the provisions in a reinsurance agreement; it is sufficient for only the stochastic reserve to do so. For example, if a treaty contains a cap equal to the valuation mortality, then it is sufficient for the cap to be reflected in the stochastic reserve calculation by stochastically modeling the mortality assumption while the deterministic reserve calculation would not reflect the existence of the cap.

b. If a third formulaic reserve component consisting of a net premium calculation is developed, then additional consideration regarding the application of the current proposal for treatment of reinsurance within VM-20 to this new component will be needed (realizing that the details of this calculation is not yet available).

RESPONSE:

3. Are there comments on areas related to this topic that are not covered in Section A of the survey that you would like to make?

B. Below are the components of the current NAIC Model Life Reinsurance Agreements Regulation (Current Requirements), also known as risk transfer requirements, and the related treatment under a PBR proposal by the Academy's Life Reinsurance Work Group (Academy WG Proposal). In drafting its proposal, the Academy Work Group has carefully considered how the movement to PBR, and the cash flow modeling associated with such a move, would affect the historic rationale underlying each of the provisions in the Current Requirements.

For each of these components, please:

- Respond to the associated question(s);
- Elaborate and give examples of specific treaty provisions, potential modeling issues, and possible public policy concerns where possible; and
- Provide any suggestions you have for revisions to the components where you disagree with the Academy WG Proposal that could address your concerns.

We would prefer if you respond to each of the following components, but if you cannot respond to all, please respond to the components that give you the most concern.

1. Scope

   Current Requirements depend on the form of the reinsurance agreements to determine the accounting treatment (e.g., coinsurance agreements are subject to all risk transfer provisions while yearly renewable term agreements are only subject to some of them).

   The Academy WG Proposal does not differentiate between different forms of reinsurance.

   a. Do you agree that the scope of the Academy WG Proposal is appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

2. Renewal expense allowances

Current Requirements allow the ceding company to establish a liability for the present value of any shortfall between the anticipated renewal expenses and the renewal expense allowance provided by the agreement to avoid being out of compliance.

The Academy WG Proposal requires the inclusion of both projected renewal expenses and projected renewal expense allowances in the PBR calculation, such that any shortfalls are reflected in the ceding company's stochastic reserve and deterministic reserve .

a. Do you agree that the Academy WG Proposal's treatment of renewal expenses is appropriate within a PBR framework?

b. If not, we welcome any suggestions for revisions that could address your concerns below:

3. Deprivation of surplus or assets

   Current Requirements disallow reinsurance accounting in situations where the ceding company can be deprived of surplus or assets at the reinsurer's option or automatically upon the occurrence of some event. Highlighted in a Q&A in Appendix A-791 is an example of deprivation of assets in the situation where coinsurance with funds withheld or modified coinsurance can be converted at the assuming company's option to straight coinsurance at some future date.

   The Academy WG Proposal requires the agreement to be included in the PBR calculation for both the ceding and assuming company such that the minimum reserve is the greater of (1) the calculation assuming the event caused by the trigger has occurred; (2) the calculation assuming the event has not occurred but will occur at some future date, or (3) the calculation assuming the event has not occurred and will never occur.

   a. Do you agree that the Academy WG Proposal's treatment of reinsurance agreements where there is a possibility of deprivation of surplus or assets is appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

4. Reimbursement of negative experience

   Current Requirements disallow reinsurance accounting in situations where the ceding company is required to reimburse the reinsurer for negative experience.

   The Academy WG Proposal requires the PBR calculation to reflect any required reimbursement.

   a. Do you agree that the Academy WG Proposal's reimbursement of negative experience is appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

5. Specified termination or automatic recapture

   Current Requirements disallow reinsurance accounting in situations where the ceding company must, at specific points in time scheduled in the agreement, terminate or automatically recapture all or part of the reinsurance ceded.

   The Academy WG Proposal requires the PBR calculation for both the ceding and assuming company to reflect the termination or automatic recapture at the time it is specified in the agreement.

   a. Do you agree that the Academy WG Proposal's termination or automatic recapture provisions are appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

6. Amounts other than income realized from the reinsured policies

   Current Requirements disallow reinsurance accounting in situations where the agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from that income realized from the reinsured policies.

   The Academy WG Proposal requires the PBR calculation for both the ceding and assuming company to reflect any amounts that may not be realized from the reinsured policies (consistent with the treatment of renewal expenses).

   a. Do you agree that the Academy WG Proposal's treatment of amounts other than income realized from the reinsured policies is appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

7. All significant risks

   Current Requirements disallow reinsurance accounting in situations where the agreement does not transfer all of the significant risk (as defined in the requirements) inherent in the business being reinsured.

   The Academy WG Proposal requires the PBR calculation for both the ceding and assuming company to reflect all of the risks that are actually transferred, such that any risks that are not transferred do not result in a change to the reserve that would be held in the absence of the agreement.

   a. Do you agree that the Academy WG Proposal's inclusion of all significant risks is appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

8. Segregation of assets

   Current Requirements disallow reinsurance accounting in situations where the business has significant investment risk and where the agreement does not properly segregate the underlying assets.

   The Academy WG Proposal allows investment income calculations for funds withheld or modified coinsurance agreements to use any well-defined formula or methodology, as long as the resulting minimum reserve appropriately reflects the amount of asset and investment risk transferred.

   a. Do you agree that the Academy WG Proposal's segregation of assets is appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

9. Frequency of settlements

Current Requirements disallow reinsurance accounting in situations where settlements are made less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date. (Some states interpret the term "amounts due" to include any amounts owed by the reinsurer to the ceding company, regardless of when the reinsurance agreement specifies such amounts must be paid.)

Academy WG Proposal requires prescribed special treatment for such agreements (the current exposure contains a drafting note seeking further guidance on the prescribed treatment).

   a. Do you agree that the Academy WG Proposal's frequency of settlements provision is appropriate within a PBR framework?

   b. If not, we welcome any suggestions for revisions that could address your concerns below:

   c. How does your state interpret the term "amounts due"?

10. Representations and warranties not reasonably related

Current Requirements disallow reinsurance accounting in situations where the ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured.

The Academy WG Proposal requires the PBR calculation for both the ceding and assuming company to reflect the effect on cash flows resulting from such representations or warranties when possible and to reflect the legal consequence of breaching the representation or warranty when not possible. In such an event, the minimum reserve is required to be the greater of: (1) the calculation assuming the breach of the representation or warranty has occurred; or (2) the calculation assuming the breach has not occurred.

a. Do you agree that the Academy WG Proposal's representations and warranties provision is appropriate within a PBR framework?

b. If not, we welcome any suggestions for revisions that could address your concerns below:

11. Reasonably related representations and warranties

Current Requirements disallow reinsurance accounting in situations where the ceding insurer is required to make representations or warranties about future performance of the business being reinsured.

The Academy WG Proposal requires the PBR calculation for both the ceding and assuming company to reflect the effect on cash flows resulting from such representations or warranties.

a. Do you agree that the Academy WG Proposal regarding reasonably related representations and warranties is appropriate within a PBR framework?

b. If not, we welcome any suggestions for revisions that could address your concerns below:

12. Significant surplus aid

Current Requirements disallow reinsurance accounting in situations where the reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged.

The Academy WG Proposal requires the PBR calculation for both the ceding and assuming company to reflect the effect on cash flows resulting from such agreements. If the ceding company's risk profile is truly unchanged by the agreement, then the resulting minimum reserve would not provide the ceding company with any reserve reduction, and if an obligation is incurred, the resulting minimum reserve would increase.

a. Do you agree that the Academy WG Proposal regarding the treatment of agreements with significant surplus aid is appropriate within a PBR framework?

b. If not, we welcome any suggestions for revisions that could address your concerns below:

C. Please comment on which of the following should be recognized as a reinsurance agreement and be included in a PBR calculation:

1. Insurance Company ("IC") A finds that many of the stochastic scenarios produce negative cash flows in the first five years, followed by positive cash flows after five years, but due to the GPVAD calculation the positive cash flows are not recognized in the reserve calculation IC A borrows money from IC B and promises to start repayment after five years. If IC A can include the loan repayments in the PBR calculation (rather than setting up the loan liability directly on the balance sheet) there will be no impact on the resulting reserve level since the GPVAD calculation is still based on the deficiencies arising in the first five years. The impact is that the loan obligation is not recognized on the balance sheet, but assets are increased due to the loan proceeds, resulting in higher reported surplus until the loan is fully repaid
2. Same situation as in "a," but the repayment of the loan is contingent on profits emerging from the block of life insurance policies.
3. Same situation as in "a," but the repayment of the loan is contingent on the actual to expected mortality of a block of life policies not exceeding 300%, an event that has a very low probability of occurring.
4. IC A finds that its deterministic reserve is dominated by the cash value floor. It reinsures its cash value obligation for one day, December 31, so that its year-end deterministic reserve is not subject to the floor.
5. IC A issued a block of VAGLBs with guarantees originally priced at 50 basis points. However, experience has not been favorable and to avoid the risk of further deterioration IC reinsures just the living benefits at a cost of 75 basis points.
6. IC A reinsures just the secondary guarantee in a block of UL policies.

2. In March 2008, the Life Reinsurance Work Group provided a report to LHATF with specific examples of reinsurance agreements that did not transfer all of the significant risks. Do you believe the Academy WG Proposal would appropriately reflect the risks associated with the agreements in those examples in the PBR reserve calculations? Why or why not?

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