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Mr. Larry Bruning, Chair
Life and Health Actuarial Task Force
Kansas Insurance Department
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Re Comments on VM-20 (3/29/08 Exposure) Amendment proposal VM-20_080329_005

Dear Larry

The American Council of Life Insurers (ACLI) is pleased to submit the following comments regarding the proposed amendment VM20_080329_005 to the VM20 Section of the Valuation Manual exposed on March 29, 2008 on behalf of our member companies. The ACLI represents three hundred fifty-three (353) member companies operating in the United States, of which three hundred forty-five (345) are legal reserve life insurance companies, and eight (8) are fraternal benefit societies. These 353 member companies account for 93 percent of total assets, 93 percent of the life insurance premiums, and 94 percent of annuity considerations in the United States.

The Amendment Proposal recommends changes to Section D of VM-20, Reinsurance. The amendment attempts to reinstate the concept of Deposit Accounting in PBR for reinsurance agreements that do not meet certain structure requirements currently found in Appendix A791 of the Accounting Practices and Procedures Manual. Moreover, for such treaties, it layers Deposit Accounting and PBR together in a complex way that imposes new burdens on companies and the insurance system.

The ACLI strongly opposes the changes to the Valuation Manual proposed in this amendment. Instead, the ACLI supports the current VM-20 language, which treats all reinsurance consistently under PBR modeling requirements.

ACLI notes that the American Academy of Actuaries Life Reinsurance Work Group, consisting of a broad cross section of regulator and industry actuaries, met for two years to carefully and thoroughly research the implications under PBR of the current reinsurance structure requirements in the APPM. The Work Group presented a well reasoned report to LHATF dated August 24, 2007 entitled *"Risk Transfer requirements under PBR"*. The report concludes: "Under PBR, the goal is to properly value reinsurance agreements in financial statements rather than to limit their structures to fit a rules-based system." The ACLI agrees with the Academy's conclusion and recommendations. We therefore support the existing VM-20 language unchanged, which implements the Academy's conclusions.

<u>Reasons for Valuation of all Reinsurance</u>

Deposit Accounting was introduced because certain reinsurance structures could not be valued properly in the limited rules-based reserve calculations currently used for life statutory accounting. In addition, by withholding reserve credit, Deposit Accounting acts as a deterrent against certain treaty provisions considered undesirable from a public policy perspective. Under PBR, with the guidance contained in the existing VM-20, all structures can be valued in a consistent, appropriate way,

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including structures that are now subject to Deposit Accounting simply because they cannot be properly valued under the current rules-based valuation system. The policy goal of deterring select undesired treaty provisions is still achieved in the unchanged VM-20 exposure by valuing such provisions using prescribed modeling assumptions in Section D.5 that ensure a very conservative result. The blanket rejection of change that is embodied in amendment VM-20_080329_005 is unnecessary.

The Amendment Proposal would disallow not only those treaties with undesired treaty provisions, but also many useful reinsurance structures that are not possible under current reserve methodology.

PBR modeling provides the tools to appropriately measure the value of the reinsurance, whatever the structure. If included in PBR cash flow models, the PBR results for treaties not meeting the A791 structure provisions will result in little or no reserve credit, wherever that is appropriate, and in some instances, will result in actually increasing reserves on ceded reinsurance. But proper valuation for both ceded and assumed reinsurance occurs only if all agreements are included in the PBR cash flow models. Use of Deposit Accounting will only complicate and confuse the straightforward presentation of reinsurance valuation. Including all agreements in the cash flow models is similar to the current treatment in required asset adequacy analysis, so it is a proven process. Furthermore, if an issue arises in practice, the PBR framework is structured to allow quick corrective changes to the Valuation Manual, and the industry stands ready to work with regulators to ensure that true principles-based results are achieved.

A primary goal of regulation is to encourage good risk management. We finally have an opportunity to permit a wide variety of reinsurance solutions to aid this goal, because we will not be hindered by an outdated reserve valuation methodology. By including reinsurance consistently in PBR along with all other asset and liability cashflows, VM-20 takes the right steps to create a level playing field for risk-mitigation methods. It is time to allow PBR to achieve its promise.

Technical Defects in Amendment Proposal

The Amendment Proposal language says the reinsurance shall be "…included in calculating the reported reserve if: a. the agreement or amendment complies with the APPM, and b. is not subject to deposit accounting." It is unclear what is meant by "complies with the APPM". The APPM is not a set of regulatory requirements, but rather a guide to accounting.

The Amendment Proposal recommends deleting the language proposed by the Academy to determine when reinsurance obligations are considered binding and therefore included in Valuation cash flow models. Current requirements are found in the Appendix A791 of the APPM and in the NAIC Life and Health Insurance Agreements Model Regulation. However, those requirements currently only apply to ceded coinsurance agreements. The Academy recommended including complete language in VM 20 to cover ceded reinsurance agreements other than coinsurance, and most importantly to cover assumed reinsurance. An alternative approach favored by many is for the requirement to be a legal "facts and circumstances" test left to each company. In any case, care should be taken so that binding obligations are included in Cash Flow models and resulting liabilities, even if a written agreement is not yet signed.

The approach in proposed new paragraph D.1.6 is to model all treaties, then only include a non-complying agreement if it increases liabilities. The proposal creates a totally inappropriate double counting of liabilities. The effect of the proposed language is that if the "right answer" is to lower reserves, don't count the treaty. If the "right answer" is to increase reserves, include the treaty. This typically will mean that on some treaties, ceding companies will be unable to take reinsurance credit, but the assuming companies will have to set up reserves. This is in contrast to the current rules, under which a given reinsurance agreement is either accounted for as reinsurance by both parties, or subject to Deposit Accounting by both parties. Double counting is not appropriate as it unnecessarily raises industry capital requirements. Consumer prices must be increased to pay for redundant capital.

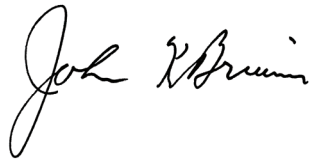
Similarly, the approach proposed in new D.1.6 of modeling all treaties but giving no credit if the right answer is to lower reserves shows scant concern for the cost to companies and consumers of performing reinsurance PBR valuations that will then be discarded by regulators. Including reinsurance in the PBR valuation is not "free" and should not be a throwaway. In fact, it is not uncommon for a policy to be subject to multiple reinsurance arrangements, and a requirement to value and test all possible combinations of treaties in such instances is far from trivial.

The proposal unfairly retains the conservative modeling rules of section D.5, which were recommended to replace existing treaty structure rules to discourage certain reinsurance provisions deemed difficult to model or of public policy concern. If

Deposit Accounting is carried forward into the PBR framework as the remedy for agreements that violate the current treaty structure rules, then it is unnecessary to also include the conservative modeling requirement in section D.5. In effect, the proposal as written retains all existing risk transfer requirements, and layers additional requirements on top.

We ask that you please reject Amendment Proposal VM-20_080329_005. We thank you for the opportunity to comment.



cc John Engelhardt

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