



AMERICAN ACADEMY *of* ACTUARIES

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September 17, 2014

Mike Boerner
Chair, Life Actuarial Task Force
National Association of Insurance Commissioners (NAIC)

Dear Mike:

The American Academy of Actuaries¹ Principle-Based Reserves Strategy Subgroup (PBRSS) appreciates the opportunity to comment on the August 7, 2014 exposure draft of Actuarial Guideline 48 (AG 48). We have comments in three general areas:

1. Qualified Actuarial Opinion

We continue to believe that introducing a regulatory requirement by broadly specifying what constitutes a “qualified opinion” is inconsistent with purpose of the Actuarial Opinion Memorandum Regulation (AOMR), which is to impose on the appointed actuary the responsibility to issue an opinion as to the overall adequacy of reserves, and therefore would establish a bad precedent.

The AOMR is designed to ensure the overall adequacy of an insurer’s reserves based on asset adequacy analysis and is not designed or intended to implement new transaction-specific calculation requirements. The appointed actuary’s opinion is to be based on state insurance laws and regulations, Actuarial Standards of Practice, experience, analysis and professional judgment.

Proposed AG48 quotes Section 3 of the AOMR correctly: that the commissioner “shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner's judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items.” However, the reference should be read in full:

¹ The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

This regulation shall be applied in a manner that allows the appointed actuary to utilize his or her professional judgment in performing the actuarial analysis and developing the actuarial opinion and supporting memoranda, consistent with relevant actuarial standards of practice. However, the commissioner shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner's judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items. [AOMR, Section 3, first paragraph]

We interpret the full statement to mean that the commissioner can require certain analysis and/or assumptions, but not that the commissioner can compel the appointed actuary to arrive at and attest to a certain actuarial professional opinion. For example, if a company is using a single scenario gross premium analysis to test the adequacy of fixed annuity reserves, a commissioner could require a company to test using more sophisticated scenario or cash flow testing analysis, to the extent that, after a review of the work supporting the actuarial opinion, he/she believes the earlier approach is insufficient for an acceptable opinion. However, the opinion on asset adequacy should remain that of the actuary, subject to actuarial professional standards and review.

Alternatives to a requirement of a qualified opinion that would still create a strong incentive for companies to meet the primary security requirement should be considered. One such alternative would be to consider reducing the total adjusted capital (TAC) used in the calculation of the ceding company's risk-based capital (RBC) ratio by any shortfall from the primary security requirement. This change in TAC could be implemented by the NAIC in a relatively timely fashion through a change to the RBC instruction, and we believe it would give ceding companies a strong incentive to meet the primary security requirement, while not compromising the integrity of the actuarial opinion. In addition to reduction of the TAC for any shortfall, consideration might be given to requiring specific disclosure in the actuarial opinion as to whether the primary security requirement was met and, if not, the amount of any shortfall.

2. Actuarial Method to be Applied on a Gross Basis

Section 5(A)4 of the August 7 exposure draft states "The Actuarial Method is to be applied on a gross basis to reserves ceded with respect to Covered Policies." We believe that this statement could be read in a way that, in certain situations, would produce an amount of primary security that is mismatched to the risks being transferred to a captive, and is significantly in excess of the amount of primary security that we believe is intended by the August 7 exposure draft.

We expect that there will be captive transactions where only part of the original risk is ceded to the captive. For example, consider a block of policies with direct plus assumed reserves of \$100 million, of which a 40% quota share, or \$40 million, is ceded to third-party reinsurers, and the remaining \$60 million is ceded to a captive. The current phrasing of Section 5(A)4 could be read as instruction to calculate a required level of primary security based on the full \$100 million of reserves, the "gross basis" obligation at the ceding company, rather than on the 60% share ceded to the captive.

We suggest that it would be clearer to avoid the ambiguous phrasing, "gross basis," and instruct the actuary to calculate the required level of primary security by "applying the actuarial method

to the risks that are ceded to the assuming insurer, without regard to any further retrocession of the risk from the assuming insurer." We believe that this instruction generalizes well to all situations where less than 100% of the risk at the ceding company is transferred to the captive, such as when there is existing coinsurance or yearly renewable term (YRT) ceding part of the risk to a third party before cession to the captive, or simply retention of part of the risk by the ceding company, etc.

3. Net Premium Reserve

Consistent with our previous comment letters,² we do not believe that the net premium reserve (NPR), or a percentage of "today's" NPR as a proxy for a future, recalibrated NPR, should be included in the VM-20 calculation used to determine the primary security requirement. Our original concerns about use of the NPR remain unchanged. The PBRSS believes that the inclusion of the NPR as a component in the determination of the primary security level is not actuarially justified.

We hope these comments are helpful. Please contact Brian Widuch, the Academy's life policy analyst (widuch@actuary.org; 202-223-8196), if you have any questions.

Sincerely,

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Chairperson
PBR Strategy Subgroup
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Cc: Mark Birdsall, Chair, Life Risk Based Capital Working Group

² See PBRSS letters dated [March 21](#), [April 11](#), [April 23](#), [June 25](#) and [August 12](#).