Life Actuarial (A) Task Force/ Health Actuarial (B) Task Force

Amendment Proposal Form*

1. Identify yourself, your affiliation and a very brief description (title) of the issue.

   Joel Steinberg, Senior Vice President, Chief Actuary & Chief Risk Officer, New York Life Insurance Company;
   David Remstad, Senior Vice President & Chief Actuary, The Northwestern Mutual Life Insurance Company;
   VM-20 Treatment for Non-Guaranteed Reinsurance Premiums

2. Identify the document, including the date if the document is "released for comment," and the location in the document where the amendment is proposed:

   VM-20: Sections 8.C, 8.D; January 1, 2018 NAIC Valuation Manual

3. Show what changes are needed by providing a red-line version of the original verbiage with deletions and identify the verbiage to be deleted, inserted or changed by providing a red-line (turn on "track changes" in Word®) version of the verbiage. (You may do this through an attachment.)

   See attached.

4. State the reason for the proposed amendment? (You may do this through an attachment.)

   Under VM-20, as currently written, it is permissible for ceding and assuming parties in a YRT reinsurance agreement to assume different future YRT premium rates, which may result in inconsistent results among companies and, potentially, significant reserve differences. We believe it may be appropriate to reflect reserves differences due to differing views of mortality. However, assuming the same mortality assumption between both the reinsurer and cedent, we believe it is inappropriate to reflect reserve differences due to differing expectations of increases to future non-guaranteed premiums. The current language allows for the possibility of loss of total reserves upon the transfer of risk, as well as a need for significant reserve increases if non-guaranteed premiums are raised sometime in the future.

   As a solution, we suggest following Approach #2 laid out in the Academy Letter for the cedent, which is an increase in the YRT scale, if necessary, to achieve breakeven starting at the next date at which non-guaranteed premiums may be increased (raise reinsurance premiums such that the present value of future reinsurance premiums equals the present value of future reinsurance benefits). We believe this requirement is straightforward, while still embedding itself well within the broader principle-based reserving framework. This approach also reflects that changes in reinsurance premiums are subject to guarantees in the contract (for example, if a YRT reinsurance agreement includes a five-year premium guarantee, the modeled reinsurance premiums should only be increased after the fifth year). We are only proposing this adjustment for the cedent and not the reinsurer.

   As this change places an upper bound on the size of reinsurance reserve credit, we also suggest that the cedent has a lower bound on the reinsurance reserve credit of zero (the credit cannot be negative). Including a lower bound on reserve credit is also consistent with current practice, which effectively has a safe harbor credit of the one year mean reserve ('1/2Cx').

---

* This form is not intended for minor corrections, such as formatting, grammar, cross–references or spelling. Those types of changes do not require action by the entire group and may be submitted via letter or email to the NAIC staff support person for the NAIC group where the document originated.

NAIC Staff Comments:

Dates: Received	Reviewed by Staff	Distributed	Considered
Notes:			

W:\National Meetings\2010\...\TF\LHA\

VM-20: Section 8.C

8. Upon projecting non-guaranteed future premium rates in reinsurance arrangements, any projected cash flows for the direct-writing company that result in a reinsurance gain for the direct-writing company shall be accompanied by an increase to the reinsurance premium scale. This increase shall be made such that, starting at the next date at which non-guaranteed premiums may be increased, the present value of future death benefits associated with the reinsurance arrangement equals the present value of future reinsurance premiums net of expense allowances associated with the reinsurance arrangement, subject to any guaranteed maximum premiums of the reinsurance arrangement.

   If a company has multiple reinsurance arrangements on policies reflected in the PBR reserve, the adjustment to increase the reinsurance premium scale may be made in aggregate across all similar contracts. Yearly renewable term reinsurance arrangements shall not be aggregated with coinsurance-type arrangements for making such an adjustment. In addition, arrangements with current reinsurance premium rates set at the guaranteed level shall not be aggregated with current rates set below the guaranteed level for making such an adjustment.

~~8.~~9. Subject to Section 8.C.8, ~~T~~the company shall account for any actions that the ceding company and, if different, the direct-writing company have taken or are likely to take that could affect the expected cash flows of the reinsured business in determining assumptions for the modeled reserve.

> **Guidance Note:** Examples of actions the direct-writing company could take include: 1) instituting internal replacement programs or special underwriting programs, both of which could change expected mortality rates; or 2) changing NGE in the reinsured policies, which could affect mortality, policyholder behavior, and possibly expense and investment assumptions. Examples of actions the ceding company could take include: 1) the exercise of contractual options in a reinsurance agreement to influence the setting of NGEs in the reinsured policies; or 2) the ability to participate in claim decisions.

~~9.~~ For actions taken by the ceding company, and, if different, the direct-writing company, set assumptions in a manner consistent with Section 9.D. Note that these assumptions are in addition to, rather than in lieu of, assumptions as to the behavior of the underlying policyholders.

10. Subject to Section 8.C.8, ~~T~~the company shall use assumptions in determining the modeled reserve that account for any actions that the assuming company has taken or is likely to take that could affect the expected cash flows of the reinsured business.

> **Guidance Note:** Examples of such actions include, but are not limited to, changes to the current scale of reinsurance premiums and changes to expense allowances.

~~11.~~ The company shall consider all elements of a reinsurance agreement that the assuming company can change, and assumptions for those elements are subject to the requirements in Section 7.C. Appropriate assumptions for these elements may depend on the scenario being tested. The company shall take into account all likely consequences of the assuming company changing an element of the reinsurance agreement, including any potential impact on the probability of recapture by the ceding company.

> **Guidance Note:** The ability of an assuming company to change elements of a reinsurance agreement, such as reinsurance premiums or expense allowances, may be thought of as comparable to the ability of a direct-writing company to change NGE on policies.

~~12.~~11. The company shall set assumptions in a manner consistent with Section 8.C.~~8~~9, taking into account any ceding company option to recapture reinsured business. Appropriate assumptions may depend on the scenario being tested (analogous to interest-sensitive lapses).

> **Guidance Note:** The right of a ceding company to recapture is comparable to policyholder surrender options for a direct-writing company. Cash flows associated with recapture include recapture fees or other termination settlements.

~~13.~~12. The company shall set assumptions in a manner consistent with Section 8.C.10, taking into account an assuming company's right to terminate in-force reinsurance business. In the case in which the assuming company's right to terminate is limited to cases of non-payment of amounts due by the ceding company or other specific, limited circumstances, the company may assume that the termination option would be expected to have insignificant value to either party and, therefore, may exclude recognition of this right to terminate in the cash-flow projections. However, if a reinsurance agreement contains other termination provisions with material impact, the company shall set appropriate assumptions for these provisions consistent with the particular scenario being tested.

VM-20: Section 8.D

D. Determination of a Pre-Reinsurance-Ceded Minimum Reserve

1. The minimum reserve pursuant to Section 2 is a post-reinsurance-ceded minimum reserve. The company also shall calculate a pre-reinsurance-ceded reserve as specified in Section 8.D.2 below, for financial statement purposes where such a pre-reinsurance-ceded amount is required. Similarly, where a reserve credit for reinsurance may be required, the credit for reinsurance ceded shall be the greater of zero and the excess, if any, of the pre-reinsurance-ceded minimum reserve over the post-reinsurance-ceded minimum reserve. Note that due allowance for reasonable approximations may be used where appropriate. The zero floor shall be applied in aggregate across policies.