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Reinsurance Codification

by Richard H. Browne

The primary codification documents covering life and health reinsurance are:

- Statement of Statutory Accounting Principles No. 74 (SSAP 74), Life, Deposit-Type and Accident and Health Reinsurance,
- Appendix A-791, Life and Health Reinsurance Agreements, and
- Appendix A-785, Credit For Reinsurance.

SSAP 74, together with Appendix A-791, are in subject and format quite similar to the NAIC reinsurance model regulation, covering both the rules of accounting for reinsurance and deposit-type contracts and the rules for determining whether a particular treaty should be classified as reinsurance or deposit-type.

One interesting change from the NAIC reinsurance model regulation is the incorporation by direct reference of the GAAP accounting's FAS 113 provision, with several differences specifically noted. These differences include:

A. Netting of reserve credits for reinsurance against direct reserves is appropriate for statutory accounting.
B. Initial ceding commissions are to be recognized as income in the initial gain or loss calculations.
C. Statutory rules of risk transfer do not necessarily require that there be transfer of significant mortality or morbidity risk in order for a contract to qualify as reinsurance. For example, a reinsurance treaty that covers investment annuity contracts that have some mortality risk that is not significant, and that does not transfer any of the mortality risk to the reinsurer may qualify as reinsurance under SSAP 74. Such a treaty would not qualify under GAAP.
D. There are unique statutory accounting rules for reinsurance of in-force blocks of business that are different from GAAP.
E. Statutory accounting prohibits any gain or loss to be recognized in connection with sale or reinsurance of blocks of business between affiliates in non-economic transactions.
F. Specific liabilities are required for unsecured reinsurance recoverables from unauthorized reinsurers.
G. Statutory accounting prescribes off setting of certain reinsurance premiums, which GAAP accounting does not.

Four specific issues related to life and health reinsurance have received considerable discussion in recent meetings of the NAIC Life and Health Actuarial Task Force (LHATF). A recent memorandum from the chairman of the reinsurance subgroup examining these issues, Sheldon Summers, summarized these issues and the current position of the subgroup with regard to these issues. The following four issues relate to provisions in Appendix A-791.

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Conversion to Coinsurance

A-791 DISALLOWS REINSURANCE credit to be taken by the ceding company if the ceding company can be deprived of assets at the reinsurer's option, or automatically upon the occurrence of some event. A treaty that allows either a coinsurance/modified coinsurance (co/modco) or a coinsurance/funds withheld (co/fw) treaty to be converted to coinsurance at the reinsurer's option is of concern.

The subgroup recommendation is that such a provision be permitted as long as:

I. the triggers for conversion are limited to ceding company violations of treaty provisions,
II. the ceding company surplus is not changed immediately following the conversion,
III. the invested assets to be transferred upon conversion do not exceed the modco reserve (or funds withheld), and such assets have been maintained in a trust account, and
IV. the reinsurance otherwise complies with Credit for Reinsurance requirements.

YRT Exemption

YRT IS SPECIFICALLY exempted from provisions of A-791. This exemption was included because YRT treaties do not typically provide significant amounts of surplus relief. There is a concern among some regulators that some treaties that provide surplus relief are called "YRT treaties" in order to qualify for this exemption. In fact, therse are YRT treaties in name only. The recommendation of the subgroup is to require that a YRT treaty not provide surplus relief in the first year which exceeds the surplus relief that would be provided by a YRT treaty with a zero first-year premium and no additional allowances.

Segregation of Assets

UNDER CERTAIN REINSURANCE treaties covering investment products on a modco or funds withheld basis, it is required that assets backing the reinsured business be segregated for purposes of crediting investment results to the reinsurer. The issue is whether or not the ceding company should be allowed to mix assets supporting reinsured business with assets supporting non-reinsured business in such segregated asset portfolios.

The industry (ACLI) position is that forcing the segregated asset portfolios to include only assets specifically supporting

reserves on the reinsured contracts will unduly restrict the ability to invest prudently. A ceding company may be forced to manage asset pools so small they would be unable to accomplish A/L matching techniques or proper diversification.

Certain regulators have been quite strong in voicing opposition to the industry position. The reinsurance subgroup is willing to compromise somewhat by allowing asset mixing in certain limited situations. The subgroup noted several areas where mixing of assets is felt not to be proper—such as mixing assets covering both flexible premium and single premium annuities.

Since consensus on this issue has not been reached among industry and regulators, the subgroup recommended that language further clarifying this issue not be included in A-791, which some feel will be interpreted to disallow any mixing of assets.

Modco with Funds Withheld

THIS ISSUE IS whether or not funds withheld by the reinsurer violate provisions in A-791 that require payments of amounts owed by the reinsurer to be made within 90 days of the settlement date. The industry position is that modco treaties with funds withheld are really identical to co/modco treaties, the only difference being the recording of the reinsurance credit as a receivable asset in the case of co/fw and as a reserve credit in the case of co/modco.

The reinsurance subgroup believes that the original intent of the drafters of the reinsurance model regulation was to disallow reinsurance accounting for modco/fw treaties, and has therefore taken the position that the proposed industry wording making exception of the 90-day requirement for modco/fw treaties not be accepted.

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Actuarial Guideline XXXIV

by Cherri R. Divin

Variable annuities generally provide a minimum guaranteed death benefit (MGDB) in the event of an untimely death that occurs when the fund values of the variable annuity have dropped. Examples of MGDB's are a return of premium at interest or the highest fund value on any previous anniversary. Actuarial Guideline XXXIV (AG 34) provides a clarification of the commissioners annuity reserve valuation method (CARVM) for variable annuities with MGDB's and specifically defines a reserve for the risk associated with any potential excess, if any, of the MGDB over the fund value of the annuity. AG 34 is effective as of December 31, 1998.

Although AG 34 addresses the additional risk related to a minimum guaranteed death benefit, it does not, however, specifically address the risk associated with a minimum guaranteed "living" benefit, such as a guaranteed minimum income benefit (GMIB) or a guaranteed minimum annuity benefit (GMAB). The GMIB can provide a guaranteed minimum income benefit that is derived from the guaranteed annuitization rate and the value of an accumulation of premiums at guaranteed interest rate. Alternatively, the GMAB might provide a guaranteed floor value (e.g., 90% of premiums) that is available upon surrender. Working in conjunction with the NAIC, a work group of the American Academy of Actuaries is looking at reserving methods for the types of risk exposure related to these benefits.

The AG 34 minimum reserve is the greatest present value in any one calculation period of the following three integrated benefit streams:

1. Unreduced benefit streams paid on

(continued on page 15, column 2)

From the Editor
continued from page 1

game. As this year rolls on, we will be watching the product trends to see if this atmosphere for the future can be predicted.

The Life Disclosure Working Group is evaluating the impact of the Illustration Actuary Model Regulation. As mentioned in the the article, they are seeking input on any perceived problems. So those of you who want to, can have an impact.

The Unified Valuation System (UVS), a sweeping proposed revision of the Standard Valuation Law, is discussed on page 10. This is making progress. I attend some meetings and keep up-to-date. Although not an immediate priority, it will produce significant change if and when it is passed.

Many small companies perceive the current AOMR as troublesome and expensive, but there are attempts being made to revise it some more. Norm Hill is keeping us abreast of that. Cherri Divin discusses Guideline 34, which affects annuity valuation.

In order for there to be a *small talk,* there must be small companies. Based on big moves in mergers and acquisitions during the past year, this sometimes appears in doubt. We have a condensation of an article by Jacqueline Bitowt on the darker side of these activities.

All in all, this issue covers many different subjects because there are lots out there. We are trying to emphasize the ways each affects the smaller companies.

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