AG 53
The More You Know…

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Objectives

- Learn about the AG effective for AAT this year
- Learn more about AG53 requirements
- Learn how the industry is responding
- What to watch out for in 2023 and beyond

Background

The Life Actuarial Task Force (LATF) exposed the initial draft of the guideline in February 2022. Five drafts were exposed before the guideline was approved at the Summer, 2022 NAIC meeting in August.

LATF worked diligently to create a guideline which companies could implement based on year-end 2022 information. In doing so, LATF softened some of the guidance which was included in earlier drafts of the guideline.

AG 53 partially addresses four risks in the "Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers" that was approved by the NAIC in August

The AAT requirements in AG53

Impacts most of the life insurance industry

Applicability

All life and annuity insurers with…

- $**5bn+** general account actuarial reserves and non-unitized separate account assets **OR**
- $**100mm+** general account actuarial reserves and non-unitized separate account assets and **over 5% of supporting assets are PHNYs**

Examples of complex assets

- Equities
- Structured securities – e.g., MBS, ABS, CLOs
- Mortgage loans
- Private bonds
- Floating rate corporates
- Real estate
- Assets originated by an affiliate

Assets under Scope

- Only assets supporting asset adequacy are under scope
- Guidance is directed to assets currently held and assets assumed in reinvestment strategy

Purpose

- Help identify reserve adequacy
- Clarify elements to consider in establishing margins
- Ensure recognition that higher expected gross returns from assets are associated with higher risk
- Require sensitivity testing
- Identify expectations regarding the valuation of complex assets within asset adequacy analysis
- Require additional documentation of investment fee income relationships

Documentation Requirements

- In many cases, sensitivities and analysis are needed to support the documentation.
- You'll need to collaborate with your investment team/portfolio managers.

Criteria	Assets
Net Return	All, with emphasis on Projected high net yield (PHNY) assets
Model Rigor	PHNY assets where risks are not adequately captured with traditional modeling techniques
Fair Value Determination	Assets whose fair value is determined internally
Non-publicly traded assets	Non-publicly traded assets originated by the company
Investment expenses and fees	All
Borrowing	All

- And reinsurance … more about this later.

Sensitivity Analysis – Section 5A

- Section 5A addresses sensitivities on reinvestment assets.
- The sensitivity is based on capping asset spreads using the prescribed spreads.
- Format defined by LATF template:

Section 5a: Sensitivity Test assuming Investment Grade Net Spread Benchmark

Asset Type	Percentage of Assets with Reduced Spread[1]	Spread Reduction[2]
Treasuries and Agencies	N/A	N/A
Public Non-Callable, Non-Convertible Corporate Bonds[4]	N/A	N/A
Callable Bonds	0.0%	0.0%
Convertible Securities[5]	0.0%	0.0%
Floating Rate Corporate Notes	0.0%	0.0%
Municipal Bonds	0.0%	0.0%
Other Private Bonds	0.0%	0.0%
Non-Convertible Preferred Stock	0.0%	0.0%
Agency Mortgage Backed Securities	0.0%	0.0%
Non-Agency Commercial Mortgage Backed Securities	0.0%	0.0%
Non-Agency Residential Mortgage Backed Securities	0.0%	0.0%

Cash Flow Testing Present Value of Market Value of Surplus under Level Scenario[3]		
Investment Grade Net Spread Benchmark: Section 5ai(a) Test	Baseline	0
	Sensitivity Test	0
	Change (%)	0%
Equity Sensitivity: Section 5ai(b) Test	New Baseline	0
	Sensitivity Test	0
	Change (%)	0%
Total Impact	Baseline	0
	Sensitivity Test	0
	Change (%)	0%

- A sensitivity test is also required on assets whose fair value is determined internally in Section 4C.

Attribution Analysis

The templates provided by LATF are for documenting the attribution analysis of the Guideline Excess Spread.

Section 5B requires an attribution analysis of both current assets and assets to be purchased in the future.

Section 5B requires the actuary to attribute the Guideline Excess Spread into components related to various risks.

Section 5b: Attribution for Asset Adequacy Testing Guideline Excess Spreads - Initial Assets

				Excess Spread Components Related to Each Risk					
Asset Type	**Net Market Spread**	**IG Net Spread Benchmark[1]**	**Guideline Excess Spread**	**Credit Risk**	**Illiquidity Risk**	**[Other Risk Component #1]**	**[Other Risk Component #2]**	**[Other Risk Component #3]**	**[Other Compo #4]**
Treasuries and Agencies	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Public Non-Callable, Non-Convertible Corporate Bonds[2]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Callable Bonds	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Convertible Securities[3]	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Floating Rate Corporate Notes	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Municipal Bonds	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other Private Bonds	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Non-Convertible Preferred Stock	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Agency Mortgage Backed Securities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

In Addition …Reinsurance!

- The guideline also asks that the memorandum address reinsurance, consistent with requirements of ASOP 11.
- ASOP 11 was revised and approved by the Actuarial Standards Board in 2021 with a December 2022 effective date.
- ASOP 11 includes more much explicit guidance than the prior version and, by design, applies to actuarial services with respect to asset adequacy analysis reports.
- Offshore reinsurance and affiliated sidecar vehicles was the topic of Point #13 from the NAIC's "Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers". AG 53 is seen as a partial solution to this risk associated with offshore reinsurance and affiliated sidecar vehicles.
- The guideline seeks assurance that **counterparty and collectability risk** are considered in asset adequacy analysis and documented.

In Summary - Observations

- Guidance pertaining to documentation, sensitivity runs, and analysis will impact content in the actuarial memorandum. AG 53 also contains guidance which could impact the results of the asset adequacy analysis.
  - The increased attention on complex, high-yielding assets may cause the appointed actuary to take a fresh look at the overall methodology and assumption setting process (e.g., revising the amount of PHNY assets assumed in the reinvestment assumption, revising the assets assumed in the disinvestment hierarchy, overall approach to the setting of assumptions, etc.).
  - Several sections specify the establishment of margins (Section 4.A.ii(b) and Section 4.B.i(b) and (c)) to be used in asset adequacy analysis.
  - Several sections provide guidance relating to methodology (2nd paragraph of Section 4.D.iii, Sections E-G) to be used in asset adequacy analysis.
- The guideline allows judgement to be used by the appointed actuary in complying with the guideline.
- Companies should be well on their way in implementing AG 53 by now. Actuarial and investment teams will need to collaborate on meeting the requirements of the guideline.
- Based on LATF minutes, it is highly likely additional guidance will be prescribed in the future.

Helpful links ... as you prepare

AG 53	AG 53.pdf (naic.org)
LATF Templates	AAT AG Templates - LATF - 090822.xlsx (live.com)
AAA "Cover your assets"	Cover Your Assets: The Changing Asset Profile of Insurers and Implications for Actuaries | American Academy of Actuaries (actuary.org)
ASOP 11	Microsoft Word - asop011_199 updated_ver2.docx (actuarialstandardsboard.org)

Thank you

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