NAIC Committee Adopts Asset Adequacy Testing Requirements with Significant Commercial Implications for Certain Reinsurance Transactions

July 31, 2025

On July 14, 2025, the National Association of Insurance Commissioners ("NAIC") Life Insurance and Annuities (A) Committee adopted Actuarial Guideline LV ("AG 55"), titled "Application of the Valuation Manual for Testing the Adequacy of Reserves Related to Certain Life Reinsurance Treaties." AG 55 is designed to enhance reserve adequacy requirements for life insurers by prescribing an asset adequacy testing ("AAT") methodology that evaluates ceded reinsurance as an integral component of asset-intensive business. The NAIC is expected to finalize adoption of AG 55 at a joint meeting of the Executive (EX) Committee and Plenary on August 13, 2025. Under AG 55, U.S. life insurers with in-scope reinsurance transactions will be required to perform, document and report an analysis of whether the assets supporting the ceded business continue to be adequate under moderately adverse conditions. If adopted as described, AG 55 will be effective for year-end 2025 and reporting will be due April 1, 2026. The adoption of AG 55, and the AAT requirements described therein, is likely to have commercial implications for asset-intensive reinsurance transactions. This alert provides a brief overview of AG 55 and a discussion of the commercial implications, including how the practical interests of both the ceding insurer and the reinsurer may be affected.

Purpose of AG 55

The initiative for AG 55 grew out of regulator concern that offshore reinsurers (i.e., entities not required to file a VM-30 actuarial memorandum) of asset-intensive business could potentially be holding reserves at lower amounts than U.S. statutory requirements. Regulators emphasized the risk to policyholders of a domestic life insurer entering a coinsurance transaction (inclusive of modified coinsurance and coinsurance with funds withheld) with an offshore reinsurer that materially lowers reserves. This is specifically an issue with coinsurance arrangements, which permit a ceding insurer to reduce its reserves by the amount of a reinsurance transaction and requires the reinsurer to post the reserves.

Scope

AG 55 only applies to "asset intensive reinsurance transactions" established on or after January 1, 2016, except in somewhat limited circumstances involving older transactions that present a significant reinsurance collectability risk; the NAIC estimates that only 100 treaties will be in scope of AG 55 for year-end 2025 reporting. Certain treaties, including non-affiliated treaties and transactions primarily comprised of older business, may be exempted from AAT requirements based on a determination by the U.S. cedent's domiciliary regulator.

AG 55 primarily targets affiliated reinsurance treaties. However, third-party treaties may also be included if they meet delineated risk criteria and are not explicitly exempted. AG 55 provides the following AAT exemption criteria for third-party treaties; however, the determination is ultimately at the discretion of the domiciliary regulator and includes consideration of additional risk criteria:

The assuming company is not

(a) An entity that otherwise meets the NAIC Model Act 440 definition of an Affiliate or meets the NAIC classification as a related party or has at any point on or after 1/1/2015;

(b) An entity for which greater than 25% of the assuming reinsurer's reserves have been assumed from the ceding company or entities in the same group as the ceding company; or

(c) An entity where the cedant or another entity in the cedant's group has 1% or greater ownership of the assuming company.

Cash Flow Testing Methodology

The purpose of AG 55 is to require asset adequacy analysis, for in-scope reinsurance transactions, using a cash flow testing ("CFT") methodology. Under AG 55, insurers will be required to use CFT as the basis for determining whether the assets supporting the business continue to be adequate under moderately adverse conditions. CFT involves modeling cash-flow testing scenarios, using reasonable assumptions, against U.S. statutory requirements for reserves and required capital.

Disclosure Only Regime

AG 55, in its presently adopted form, requires disclosure of AAT results but does not include prescriptive guidance as to whether additional reserves should be held (such determination is up to the appointed actuary). However, the domestic regulator will continue to have the authority to require additional reserves as deemed necessary. In the course of developing AG 55, regulators agreed to this approach, a disclosure-only regime, for year one of AAT for the in-scope transactions. The disclosure approach provides regulators with insight into assets and reserves supporting ceded business. Regulators have discussed a plan to reassess AG 55—with an emphasis on reconsidering the disclosure-only approach—based on the AAT results for year-end 2025.

Commercial Implications

There are commercial implications to consider both for relevant in-force treaties and prospective asset-intensive reinsurance transactions.

Review In-Force Treaties

As a practical matter, it is advisable to review in-force reinsurance treaties in light of AG 55 requirements. Generally, “transactions established 1/1/2016 or later” are the subject of AG 55. Based on the plain language of AG 55, it is not clear how regulators will view treaties established prior to and amended on or after 1/1/2016. While affiliated reinsurance transactions are a primary focus of AG 55, its scope is not exhaustively limited to affiliates. If a treaty represents sufficiently significant reinsurance collectability risk (based on the determination of the ceding company’s appointed actuary), then AG 55 AAT may apply regardless of the transaction date.

Reinsurer Reporting

The ceding insurer will need to ensure it has sufficient reporting from the reinsurer to allow it to conduct the enhanced AAT analysis under AG 55. Reinsurers will have an interest in tightly negotiated reporting requirements, rather than a broad obligation, which could be costly or burdensome. Reinsurers will not want to be at risk of failing to comply with broadly worded reporting covenants, potentially giving rise to recapture or other penalties.

Scope of Reinsured Reserves

The interest of the ceding insurer will be to have broad contractual rights to define reserves to include any need for enhanced AAT reserves as a result of regulatory guidance. Under AG 55, the ceding insurer's appointed actuary has the discretion to determine whether additional reserves should be held. The appointed actuary's determination is largely dependent on the reinsurer's information. As a result, parties may need to negotiate the scope of reinsured AAT reserves more extensively.

Change-in-Law Risk

In general, allocation of "change-in-law risk" will be a large area of focus for treaties going forward until the AAT regime is fully settled. Reinsurers will likely not be willing to take all the risk, especially if deals are not priced on the basis of reserves that could be required under the new regime. At the outset, parties should agree on the scope of covered reserves to ensure an appropriate alignment of pricing and risk. We would expect increased negotiation around the allocation of post-signing change-in-law risk related to the future developments regarding the AAT regime, in a manner similar to how credit for reinsurance issues are generally negotiated. Parties to a reinsurance transaction typically address change-in-law risk through negotiated obligations and limitations on the obligation to adjust the transaction to comply with the relevant change, potential recapture rights, economic adjustments or pre-agreed adjustments to specified terms and definitions. In the case of AG 55, a ceding insurer may, for example, seek broad reinsurance coverage to ensure all future liabilities are covered, and a recapture trigger if the treaty does not provide full reserve credit or satisfy its view of the enhanced AAT requirements (i.e., due to the lack of AAT reserves). Conversely, a reinsurer will seek to limit its obligations to reinsure incremental liabilities resulting from future regulatory changes that could materially alter its economic expectations at signing of the transaction.

Business Activity

The uncertainty of how AG 55 will play out in practice may have more general business ramifications. AG 55 creates obligations and regulatory exposure, even in a disclosure-only regime, for U.S. life insurers that cede large blocks of asset-intensive business to offshore reinsurers. The result for those ceding insurers is an increased incentive for negotiating more specific terms providing greater protection. However, reinsurers are likely to seek to expressly limit the scope of their obligations and avoid open-ended commitments. These opposing interests reflect an uptick in incentive misalignment, which can increase costs or otherwise burden transactions.

Despite certain concessions to the industry during the year-long exposure process, the adopted version of AG 55 imposes significant obligations on affected (re)insurers. Furthermore, the regulatory landscape for year-end 2026 is likely to remain unclear for the near-term, pending a review of 2025 AAT results by the NAIC. In sum, the unpredictable regulatory dynamics of AG 55 may impact the volume of asset-intensive reinsurance activity in the short term.

Regulatory Implications

Currently, AG 55, as a disclosure-only regime, does not explicitly require the posting of additional reserves based on AAT results. However, the ceding insurer's domiciliary regulator will continue to have discretion to act based on disclosed asset adequacy analysis, which may serve as a basis for it to require the posting of additional reserves. Although AG 55 does not currently include guidance on whether AAT results indicate that additional reserves should be posted, as a practical matter, a ceding insurer that reports analysis reflecting unfavorable results may still be requested by its regulator to implement such action. Indeed, AG 55 affirms that nothing inhibits the domiciliary regulator's authority to require CFT for individual treaties or counterparties, as it may deem necessary to understand and evaluate risk.

Takeaways

AG 55 establishes an AAT requirement that applies to U.S. life insurers ceding asset-intensive business to offshore reinsurers.

If AG 55 is adopted by vote of the NAIC Executive (EX) Committee and Plenary on August 13, 2025, it will take effect for 2025 year-end reporting. Reporting will be due annually on April 1 (first reports due April 1, 2026).

The NAIC plans to reassess AG 55 after it reviews AAT results for 2025; the NAIC is expected to evaluate AG 55's disclosure-only approach.

Adoption of AG 55 will have a number of knock-on commercial implications for asset-intensive reinsurance deals, as outlined above.

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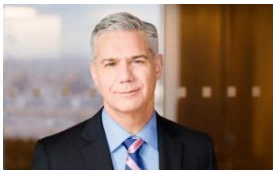
Please do not hesitate to contact us with any questions.



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