

STATE LEGISLATIVE BRIEF



The NAIC Term and Universal Life Insurance Reserve Financing Model Regulation

- *As some life insurers began using captive reinsurance arrangements to reduce perceived excessive reserves, concerns arose from regulators across the country about the consistency of regulation applied to such arrangements.*
- *To address these concerns, state regulators began development of the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (#787) to harmonize regulatory treatment of policy reserves for certain life insurance products.*
- *The NAIC is currently considering making the Term and Universal Life Insurance Reserve Financing Model Regulation (#787) an accreditation standard, with a recommended effective date of Jan. 1, 2020.*

Background

Captives were initially developed to allow non-insurer corporations to manage and self-insure their unique risks without having to buy traditional coverage from an insurer. Because it is a form of self-insurance, the regulation of captives has differed from that of traditional insurers. Over time, insurers themselves began to cede insurance risks to a captive reinsurance company primarily to address perceived excessive reserve requirements for certain life insurance products (term life with level premiums and/or benefits, and universal life products with secondary guarantees). Insurers complained that the regulatory reserve required for these products was often two to three times larger than the economic reserve (the amount the company expects to pay given current assumptions). Captives are allowed much more flexibility in the types of assets they use to back insurance reserves, so a wide variety of solutions developed to relieve the life insurers of the excessive reserve requirement. Over time, regulators became concerned regarding the inconsistency across states in reserving and other regulatory requirements for such transactions and the possibility of such inconsistency distorting the competitive landscape and creating opportunities for regulatory arbitrage.

As life insurers move to principle based reserving, the need to use captives to reduce excessive reserves will diminish, but some use of captives for this purpose will remain. To remedy these concerns, the NAIC adopted Actuarial Guideline 48, which has since been codified in the *Term and Universal Life Insurance Reserve Financing Model Regulation* (#787). It established a consistent method for calculating the economic reserve (plus a margin for conservatism) and the level of “primary security” (i.e., higher quality assets) even when held at a captive reinsurer. The remainder of the statutory reserve is allowed to be backed by a wider variety of assets, referred to as “other security.” Under this guideline, the ceding company’s appointed actuary is required to analyze transactions to determine: a) whether the required amount of high quality assets are being held to back the reserve, and b) whether the remainder of the reserve is sufficiently backed by other types of assets. If the reinsurance agreement does not meet these requirements, the commissioner can require the actuary to issue a qualified actuarial opinion, which would invite further scrutiny from both industry and from regulators. In addition to complying with the regulation, an insurer must still meet other standards including using the NAIC’s Valuation Manual’s method for calculating the reserve level, holding certain types of assets, complying with additional risk based capital requirements, and obtaining approval from the state insurance commissioner.

Key Points

- ✓ The intent of the model regulation is to establish consistent, national standards governing reserves relating to certain life insurance products in order to level the competitive playing field and eliminate opportunities for regulatory arbitrage.
- ✓ The regulation ensures that the assets backing the reserves are in the forms and amounts required.
- ✓ The regulation is just one of several regulatory requirements an insurer must meet to utilize a captive reinsurance transaction to address the perceived excessive reserving requirements.