Actuarial Guideline XLVIII

Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model 830)

Background

The NAIC Principle-Based Reserving Implementation (EX) Task Force (“PBRI Task Force”) serves as the coordinating body for all NAIC technical groups involved with projects related to the Principle-Based Reserves (PBR) initiative for life and health policies. The PBRI Task Force was also charged with further assessing, and making recommendations regarding, the solvency implications of life insurance reserve financing mechanisms addressed in the June 6, 2013 NAIC White Paper of the Captives and Special Purpose Vehicle Use (E) Subgroup of the Financial Condition (E) Committee. Some of these reinsurance arrangements have been referred to as “XXX / AXXX Captive arrangements,” although not all such arrangements actually involve reinsurers organized as captives. On June 30, 2014, the PBRI Task Force adopted a framework as found in Exhibits 1 and 2 of the June 4, 2014 report from Rector & Associates, Inc. (the “June 2014 Rector Report”). Exhibit 2 of the report included a charge to the Life Actuarial (A) Task Force (LATF) to develop a level of reserves (the “Required Level of Primary Security”) that must be supported by certain defined assets (“Primary Security”). The level of reserves is to be calculated by a method referred to as the “Actuarial Method.” Another charge to LATF is to promulgate an actuarial guideline specifying that, in order to comply with the Actuarial Opinion Memorandum Regulation as it relates to XXX/AXXX reinsurance arrangements, the opining actuary must issue a qualified opinion as to the ceding insurer’s reserves if the ceding insurer or any insurer in its holding company system has engaged in a XXX/AXXX reserve financing arrangement that does not adhere to the Actuarial Method and Primary Security forms adopted by the NAIC. This Actuarial Guideline is responsive to that charge.

The requirements in this Actuarial Guideline derive authority from Section 3 of the NAIC Actuarial Opinion and Memorandum Regulation, Model 822 (“AOMR”). Section 3 provides, the commissioner “shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner's judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items.” This Actuarial Guideline defines new terms, such as Primary Security and Required Level of Primary Security, specifies the Actuarial Method used to calculate the Required Level of Primary Security, and specifies other requirements that must be followed when reinsurance is involved in order for the appointed actuary to render an actuarial opinion that is not qualified.

No statute, regulation or guideline can anticipate every potential XXX/AXXX captive arrangement. Common sense and professional responsibility are needed to assure not only that the text of this Actuarial Guideline is strictly observed, but also that its purpose and intent are honored scrupulously. To that end, and to provide documentation to the appointed actuary as to the arrangements that are subject to review under this Actuarial Guideline, the appointed actuary may request from each ceding insurer, and may rely upon, the certification by the Chief Financial Officer or other responsible officer of each ceding insurer when reinsurance is involved in order for the appointed actuary to render an actuarial opinion that is not qualified.

The purpose and intent of this Actuarial Guideline are to establish uniform, national standards governing XXX or AXXX reserve financing arrangements and, in connection with such arrangements, to ensure that Primary Security, in an amount at least equal to the Required Level of Primary Security, is held by or on behalf of the ceding insurer. As described further in Section 4.B., the provisions of this Actuarial Guideline are not intended to apply to policies that were issued prior to 1/1/2015 if those policies were included in a captive reserve financing arrangement as of 12/31/2014. Further, the requirements of this Actuarial Guideline should be viewed as minimum standards and are not a substitute for the diligent analysis of reserve financing arrangements by regulators. A regulator should impose requirements in addition to those set out in this Actuarial Guideline if the facts and circumstances warrant such action.

1 In general, reserve financing arrangements are those where the security/assets backing part or all of the reserves have one or more of the following characteristics: such security/assets (1) are issued by the ceding insurer or its affiliates; and/or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; and/or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any if its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).
1. Authority

Pursuant to Section 3 of the NAIC Actuarial Opinion and Memorandum Regulation, Model 822 (“AOMR”), the commissioner shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner’s judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items.

2. Scope

This Actuarial Guideline applies to Covered Policies as that term is defined in Section 4.

3. Exemptions

This Actuarial Guideline does not apply to:

A. Risks ceded to an assuming insurer for policies eligible for exemption under Section 6.F or Section 6.G. of Model 830 or the portion of the reserve pursuant to Yearly Renewable Term (“YRT”) Reinsurance under Section 6.E. of Model 830; or

B. Risks ceded to an assuming insurer that meets the applicable requirements of (1) Section 2.E. of the NAIC Credit for Reinsurance Model Act, Model 785 (“Model 785”) and has been certified in the ceding insurer’s domiciliary state or, if that state has not adopted a provision equivalent to Section 2.E., in a minimum of five states, or (2) Section 2.D. of Model 785; or

C. Risks ceded to an assuming insurer that meets the applicable requirements of Sections 2.A., 2.B. or 2.C. of Model 785, and that, in addition:

1. prepares its statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer’s reported surplus and are material enough that they would need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 (“SSAP 1”), paragraph 7, if the assuming insurer were required to comply with SSAP 1; and

2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in the NAIC Risk-Based Capital (RBC) for Insurers Model Act, Model 312 when its RBC is calculated in accordance with the life risk-based capital report including overview and instructions for companies, as the same may be amended by the NAIC from time to time, without deviation.

D. Risks ceded to an assuming insurer if the ceding insurer’s domiciliary regulator, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines that all of the following apply: (1) such risks are clearly outside of the intent and purpose of this Actuarial Guideline (as described in the Background section above); (2) such risks are included within the scope of this Actuarial Guideline only as a technicality; and (3) the application of this Actuarial Guideline to such risks is not necessary to provide appropriate protection to policyholders under all the facts and circumstances. The domiciliary regulator shall publicly disclose any decision made pursuant to this Section 3.D. to exempt a reinsurance arrangement from this Actuarial Guideline, as well as the general basis therefor (including a summary description of the arrangement), although the domiciliary regulator may choose not to disclose the names of the parties to the arrangement.

4. Definitions
A. **Actuarial Method**: The methodology used to determine the Required Level of Primary Security, as described in Section 5 of this Actuarial Guideline.

B. **Covered Policies**: Subject to the exemptions described in Section 3 of this Actuarial Guideline, Covered Policies are those policies that are required to be valued under Sections 6 or 7 of the NAIC Valuation of Life Insurance Policies Model Regulation Model 830 ("Model 830") and that have risk ceded to an assuming insurer; provided, however, that Covered Policies shall not include policies that were both (1) issued prior to 1/1/2015 and (2) ceded so that they were part of a reinsurance arrangement, as of 12/31/2014, that would not qualify for exemption as described in Section 3 of this Actuarial Guideline.

C. **Required Level of Primary Security**: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies.

D. **Primary Security**: The following forms of security:

1. Cash meeting the requirements of Section 3.A. of Model 785;

2. SVO-listed securities meeting the requirements of Section 3.B. of Model 785, but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit; and

3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
   a. Commercial loans in good standing of CM3 quality and higher;
   b. Policy Loans; and
   c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.

E. **Other Security**: Any asset, including any asset meeting the definition of Primary Security, acceptable to the Commissioner of the ceding insurer’s domiciliary state.

   NOTE: The Capital Adequacy Task Force has been charged with the development of RBC asset risk charges for assets that may be held as “Other Security.”

F. **Section 8 Effective Date**: The operative date of the Valuation Manual under the Standard Valuation Law.

G. **Trust**: A reinsurance credit trust as defined by Section 11 of the Credit for Reinsurance Model Regulation (Model 786); provided, that notwithstanding Section 11(B)(13) of Model 786, (i) funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 5.C. hereof, be valued according to the valuation rules set forth in Section 5.C., as applicable; and (ii) there are no affiliate investment limitations with respect to funds consisting of Other Security held in such trust.

5. **Required Actuarial Analysis**

As to each reinsurance arrangement in which Covered Policies have been ceded, the appointed actuary must perform an analysis, on a treaty by treaty basis, of such Covered Policies to determine whether:

(i) funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of Section 3 of Model 785, on a funds withheld, Trust, or modified coinsurance basis; and

(ii) funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to subsection (i) above, are held by or
A. Actuarial Method

The Actuarial Method to establish the amount of the Required Level of Primary Security shall be “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the NAIC Valuation Manual (“VM-20”) with the modifications as provided below:

1. For Covered Policies required to be valued under section 6 of Model 830, the Actuarial Method is the greater of the Deterministic Reserve or the applicable percentage of the Net Premium Reserve (NPR) from Table 1 below based on the issue age range, sex and smoking status, subject to any additional modifications below. No exemption testing is allowed.

2. For Covered Policies required to be valued under section 7 of Model 830, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the applicable percentage of the NPR from Table 2 below based on the issue age range, sex and smoking status, subject to any additional modifications below. No exemption testing is allowed.

3. Except as provided in paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.

4. If the ceding insurer cedes less than 100% of its risk with respect to Covered Policies in a reinsurance arrangement that is subject to this Actuarial Guideline, and (x) retains a portion of the risk for its own account or (y) cedes a portion of the risk in an arrangement that qualifies for exemption pursuant to Section 3 of this Actuarial Guideline, then the Actuarial Method will be applied in the following manner:

   a. Prior to the Section 8 Effective Date, the Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:

      (i) For a quota share retained by the ceding insurer for its own account, the Required Level of Primary Security will be reduced by at most a percentage equal to the excess of 100% over the quota share ceded in the non-exempt reinsurance arrangement;

      (ii) For a non-exempt reinsurance arrangement in which only a secondary guarantee rider is ceded:

         (a) the Required Level of Primary Security will be calculated as the excess of (1) over (2), where (1) is the Required Level of Primary Security using the Actuarial Method applied to all risks under the Covered Policies including the ceded secondary guarantee rider (reduced by the amount specified pursuant to subsection (iv) below in the event any risk is ceded on a yearly renewable term basis in an exempt arrangement) and (2) is the statutory reserve retained by the ceding insurer on the Covered Policies (reduced by the amount specified pursuant to subsection (iv) below in the event any risk is ceded on a yearly renewable term basis in an exempt arrangement);

         (b) if the ceding insurer cedes risks with respect to Covered Policies in more than one non-exempt reinsurance arrangement, in no event will the aggregate amount of Primary Security held with respect to the Covered Policies including all riders be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in non-exempt reinsurance arrangements were ceded in a single non-exempt reinsurance arrangement.
(iii) For risks ceded on a coinsurance basis in an exempt arrangement, the Required Level of Primary Security will be reduced by at most a percentage equal to the quota share ceded in the exempt coinsurance arrangement;

(iv) For risks ceded on a yearly renewable term basis in an exempt arrangement, the Required Level of Primary Security will be reduced by at most \( \left( \frac{1}{2 \times \text{number of reinsurance premiums per year}} \right) \times c_x \), calculated using the mortality defined in the NPR; and

(v) For all other exempt arrangements, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

NOTE: It is possible for any combination of (i), (ii), (iii), (iv) and (v) above to apply.

The adjustments outlined in (ii), (iii) and (iv) above will be made only with respect to exempt arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by any of its assuming insurers.

Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8.C.11. shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.

b. On and after the Section 8 Effective Date, in lieu of the methodologies set forth in subsections 4.a(iii) and (iv), Section 8 of VM-20 (Reinsurance) in the Valuation Manual will be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, including risks written prior to the Section 8 Effective Date. The methodologies set forth in subsections 4.a(i), (ii) and (v) above will continue to apply.

Percentages Applicable to the NPR in Determination of the Actuarial Method

Table 1

<table>
<thead>
<tr>
<th>Issue Age</th>
<th>Male Non-Smoker</th>
<th>Female Non-Smoker</th>
<th>Male Smoker</th>
<th>Female Smoker</th>
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<td>60%</td>
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<td>70%</td>
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<td>25 – 34</td>
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<td>60%</td>
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<tr>
<td>85 +</td>
<td>75%</td>
<td>80%</td>
<td>75%</td>
<td>100%</td>
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(Derived From 2014 VBT / 2001 VBT Term Net Level Premium Mortality Ratios)
Table 2

(Derived From 2014 VBT / 2001 VBT Whole Life Net Level Premium Mortality Ratios)

<table>
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<tr>
<th>Issue Age</th>
<th>Male Non-Smoker</th>
<th>Female Non-Smoker</th>
<th>Male Smoker</th>
<th>Female Smoker</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 25</td>
<td>80%</td>
<td>80%</td>
<td>85%</td>
<td>85%</td>
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<tr>
<td>25 - 34</td>
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<td>85 +</td>
<td>85%</td>
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<td>85%</td>
<td>100%</td>
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B. Additional Modifications to Actuarial Method

Prior to implementation of PBR, the Actuarial Method shall include any amendments to VM-20 adopted by the Life Actuarial (A) Task Force (LATF) no later than the September 30th immediately preceding the year-end analysis required by this Actuarial Guideline. Notwithstanding, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by LATF no later than the December 31st of such year. The rules for incorporating the tables of asset spreads and asset default costs into the Actuarial Method should follow the same rules for incorporating those tables as set forth in VM-20.

After implementation of PBR, the Actuarial Method shall be the version of VM-20 included in the Valuation Manual applicable to such year, without modification.

NOTE: As provided in Section 5.A. above, a percentage of NPR is incorporated into the Actuarial Method initially to allow time for necessary calibrations to NPR to be made. From and after January 1, 2016, it is anticipated that this Actuarial Guideline will be amended to use 100% of the “recalibrated” NPR for the purposes of the Actuarial Method (including, for the avoidance of doubt, any reserves in-force as of such date pertaining to Covered Policies written in 2015 and certain policies written prior to 1/1/2015, as noted in Section 4.B).

C. Valuations used for Purposes of the Required Actuarial Analysis

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in Trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer’s general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken.

6. Actuarial Opinion and Memorandum Requirements

A. Qualified Actuarial Opinion

The appointed actuary must render a qualified actuarial opinion as described in Section 6.D. of the AOMR if:

1. As of the valuation date, and as to any reinsurance arrangement as to which the actuarial analysis required by Section 5 must be made:
(i) funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are not held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of Section 3 of Model 785, on a funds withheld, Trust, or modified coinsurance basis, unless the ceding insurer complies with one of the Remediation Options listed below; or

(ii) funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to subsection (i) above, are not held by or on behalf of the ceding insurer as security under the reinsurance arrangement within the meaning of Section 3 of Model 785, unless the ceding insurer complies with one of the Remediation Options listed below; or

2. The appointed actuary for any affiliated reinsurer of the ceding insurer issues a qualified actuarial opinion with respect to such an affiliated reinsurer where (i) the affiliate reinsures Covered Policies of the ceding insurer and (ii) the qualified actuarial opinion pertaining to the affiliated reinsurer results, in whole or in part, from the analysis required by this Actuarial Guideline.

3. Remediation Options:

   (i) In the case of Section 6.A.1.(i):

   (1) Add additional Primary Security on or before March 1 of the year in which the actuarial opinion is being filed in an amount that would have caused the Primary Security held by or on behalf of the ceding insurer, as security under the reinsurance contract, on a funds withheld, Trust, or modified coinsurance basis, to equal or exceed the Required Level of Primary Security on the valuation date; or

   (2) Establish a liability equal to the difference between the Primary Security held pursuant to Section 6.A.1(i) and the Required Level of Primary Security.

   (ii) In the case of Section 6.A.1.(ii):

   (1) Add additional Other Security on or before March 1 of the year in which the actuarial opinion is being filed in an amount that would have caused Other Security held by or on behalf of the ceding insurer, as security under the reinsurance contract, to be at least equal to the portion of the statutory reserve as to which Primary Security is not held pursuant to Section 6.A.1(i) (including any funds added pursuant to Section 6.A.3(i)), on the valuation date.

   (2) Establish a liability equal to the difference between (a) the portion of the statutory reserves that exceed the Primary Security held pursuant to Section 6.A.1(i) (including any funds added pursuant to Section 6.A.3(i)); and (b) Other Security held by or on behalf of the ceding insurer as security under the reinsurance contract.

B. Additional Requirements for the Actuarial Opinion and Memorandum for Companies that have Covered Policies Requiring the Analysis Pursuant to this Actuarial Guideline

1. In the statement of actuarial opinion, the appointed actuary must state whether (i) the appointed actuary has performed an analysis, as to each reinsurance arrangement under which Covered Policies have been ceded, of the security supporting the Covered Policies and whether funds consisting of Primary Security in an amount at least equal to the Required Level of Primary Security are held by or on behalf of the ceding insurer, as security under the reinsurance contract, on a funds withheld, Trust, or modified coinsurance basis and (ii) funds consisting of Primary Security or Other Security in an amount equal to the statutory reserves are held by or on behalf of the ceding insurer as security under the reinsurance arrangement.

2. In the actuarial memorandum as described by Section 7 of the AOMR, the appointed actuary must document the analysis and requirements applied by this Actuarial Guideline as to each reinsurance arrangement under which Covered Policies are ceded.
7. Effective Date

This Actuarial Guideline shall become effective as of January 1, 2015 to all Covered Policies.

8. Sunset Provision

This Actuarial Guideline shall cease to apply as to ceding insurers domiciled in a jurisdiction that has in effect, as of January 1\textsuperscript{st} of the calendar year immediately preceding the year in which the actuarial opinion is to be filed, a law and regulation substantially similar to the amendment to the Credit for Reinsurance Model Law and new Model Regulation adopted by the NAIC pursuant to Recommendation #5 of the June 2014 Rector Report.

Adopted by the Principle-Based Reserving Implementation (EX) Task Force on Nov. 17, 2014.

Adopted by the NAIC on Dec. 16, 2014.