Report to Executive (EX) Committee


The Executive (EX) Committee is asked to adopt this Task Force report, including adoption of the XXX/AXXX Reinsurance Framework in concept (Exhibit 1), the charges for other NAIC groups (Exhibit 2) and three model law development requests (Exhibit 3).

XXX/AXXX Reinsurance Framework

- The XXX/AXXX Reinsurance Framework (Framework) seeks to address concerns regarding reserve financing transactions and to do so without encouraging them to move off-shore. The changes would be prospective and apply only to the XXX term life insurance business and AXXX universal life with secondary guarantees (ULSG) business. The Framework does not change the statutory reserve requirements applicable to a ceding insurer; rather, the Framework addresses the types of security that can back those reserves in connection with reserve financing transactions.

- The Framework would require the direct ceding company for reinsurance financing transactions, in most instances, to:
  - Collateralize a portion of the total statutory reserve approximately equal to the principle-based reserving (PBR) level with hard assets such as cash and securities listed with the Securities Valuation Office (SVO).
  - Collateralize the remainder of the statutory reserve with other assets and forms of security identified as acceptable by regulators.
  - Disclose the assets and securities used to support the reserves.
  - Hold an RBC cushion as required for other business.

- The Framework would be codified through the Credit for Reinsurance Model Law (#785) with the creation of a new model regulation to establish requirements regarding the reinsurance of XXX/AXXX policies. A modification to the Actuarial Opinion and Memorandum Regulation (#822) will require the opining actuary for the ceding insurer to issue a qualified opinion if the Framework is not followed. Prior to the regulation being modified and adopted by the states, an actuarial guideline would be drafted and adopted. As another enforcement tool, a note to the annual audited financial statement would require the ceding insurer, and its independent auditor, to indicate whether the Framework is being followed.

- Expectations are that once PBR is implemented, the perceived reserving redundancies that have precipitated the use of captives for reserving purposes will be addressed and, therefore, the incentive to create these types of captives will be almost, if not fully, eliminated. Industry representatives have stated that if regulators can remove the excessively conservative reserves to get to the “right” reserve level, then financing transactions would no longer exist.

The entire Rector report is available at this link: [http://naic.org/documents/committees_ex_pbr_implementation_tf_140604_rector_report.pdf](http://naic.org/documents/committees_ex_pbr_implementation_tf_140604_rector_report.pdf)

Exhibit 1—XXX/AXXX Reinsurance Framework

1. The Framework applies only to reinsurance involving certain types of XXX and AXXX policies (those required to be valued under Sections 6 or 7 of the NAIC Valuation of Life Insurance Policies Model Regulation).

2. The Framework does not materially change the ability of insurers to obtain credit for reinsurance ceded to professional “certified” reinsurers or to obtain credit for reinsurance ceded to “licensed” or “accredited” reinsurers that follow statutory accounting and RBC rules. (See “Exemptions” below).

3. As a practical matter, therefore, the new Framework requirements apply to reinsurance ceded to captive insurers, special purpose vehicles, reinsurers that are not eligible to become “certified” reinsurers, reinsurers that deviate from statutory accounting and/or RBC rules, etc. In those situations, the ceding insurer may receive credit for reinsurance if, but only if:

   • The ceding insurer establishes gross reserves, in full, using applicable reserving guidance (currently, the “formulaic” approach).

   • The ceding insurer satisfies the Primary Security Requirement (i.e., the ceding insurer receives as collateral Primary Security in at least the amount determined pursuant to the Actuarial Method).

   • Portions of the statutory reserve exceeding the Primary Security Requirement may be collateralized by Other Security.

   • At least one party to the financing transaction holds an appropriate RBC “cushion”.

   • The reinsurance arrangement is approved by the ceding insurer’s domestic regulator.

4. The Framework also includes provisions to police and enforce the new requirements, and to determine whether any “exemptions” relied upon are warranted, including:

   • An Actuarial Guideline adopted pursuant to the Actuarial Opinion Memorandum Regulation (AOMR) as an interim step, and subsequent amendment to the AOMR or other regulation, to require the opining actuary for the ceding insurer to issue a qualified opinion if the Framework is not followed (absent an exemption).

   • A Note to the annual audited statement requiring the ceding insurer, and its independent auditor, to indicate whether the Framework is being followed (absent an exemption).
The following is a summary of each of the terms in bold above:

1. **Exemptions.** Other than certain limited disclosure provisions, the new requirements generally do not apply to reinsurance ceded to an assuming reinsurer meeting the definition of Section 2.A. (authorized insurers), 2.B. (accredited insurers), or 2.C (insurers domiciled in another state) of the Credit for Reinsurance Model Law, as revised pursuant to our modified recommendation, or to reinsurance ceded pursuant to Sections 2.D (reinsurers maintaining trust funds) or 2.E (certified reinsurers) of the Model Law.

2. **Primary Security Requirement.** The ceding insurer would need to receive as collateral (on a funds withheld, trust or modified co-insurance basis) Primary Security in at least the amount determined pursuant to the Actuarial Method.

3. **Actuarial Method.** We recommend that the Actuarial Method consist of VM-20\(^1\), modified to incorporate changes to mortality tables as developed by the American Academy of Actuaries and any other modifications suggested by LATF. *An open question is whether to alter or eliminate the “net premium reserve” component.*

4. **Primary Security.** We recommend that the types of assets listed in the Credit for Reinsurance Model Law Sections 3.A. (cash) and 3.B. (SVO-listed securities meeting certain characteristics) be allowed as Primary Security. *An open question is to what extent (if any) clean, irrevocable, unconditional “evergreen” letters of credit should be allowed as Primary Security.*

5. **Other Security.** We recommend that, so long as the Primary Security Requirement is satisfied, the ceding insurer may receive as collateral for the remainder of the statutory reserve any other security as to which the NAIC has determined an RBC “asset charge.” (We have recommended that the Capital Adequacy Task Force determine RBC “asset charges” for anticipated categories of Other Security and an appropriate “catch-all” charge to apply to assets that are not specifically listed.)

6. **RBC “cushion”**. This item is discussed further in our modified recommendations and in our February Report. We recommend that the details be worked out by the Capital Adequacy Task Force.

7. **AOMR.** This item is discussed in our modified recommendations. We recommend that the details be worked out by LATF.

8. **Note.** This item is discussed in our modified recommendations and in the February Report. We recommend that the details be worked out by the Statutory Accounting Principles Working Group.

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\(^1\) NAIC Valuation Manual, VM-20, Requirements for Principle-Based Reserves for Life Products.
XXX/AXXX Charges

**Life Actuarial (A) Task Force**

- Develop the actuarial method for the Principle-Based Reserving Implementation (EX) Task Force’s review and consideration in adopting items such as the XXX/AXXX Reinsurance Model Regulation and possible changes to the *Actuarial Opinion and Memorandum Regulation* (#822). The actuarial method should consist of the *Valuation Manual, VM-20, Requirements for Principle-Based Reserves for Life Products*, modified to incorporate changes to mortality tables as developed by the American Academy of Actuaries and any other appropriate modifications determined by the Life Actuarial (A) Task Force, and should explicitly keep (in current or modified form) or eliminate the "net premium reserve" component of the current VM-20.—*Essential*

**Blanks (E) Working Group**

- Adopt an XXX/AXXX reinsurance supplement to be filed by insurers ceding XXX/AXXX business beginning with the 2014 data year. The Principle-Based Reserving Implementation (EX) Task Force’s XXX/AXXX Reinsurance Framework Exhibit 5 should be considered for this supplemental filing requirement, modified as appropriate by the Working Group.—*Essential*

**Financial Analysis Handbook (E) Working Group**

- Develop for year-end 2014 a new section for the *Financial Analysis Handbook* that specifies procedures for domestic/lead/captive states’ review of XXX/AXXX reinsurance transactions with captives/special purpose vehicles to be performed initially and on an ongoing basis, consistent with recommendations from the Financial Analysis (E) Working Group. These procedures should be modified in the future as the detailed proposals from other work streams for the XXX/AXXX Reinsurance Framework are adopted by the NAIC.—*Essential*
XXX/AXXX Reinsurance Framework Charges

Life Actuarial (A) Task Force

- Develop an actuarial guideline to provide interim guidance for the Actuarial Opinion and Memorandum Regulation (#822) as it relates to XXX/AXXX reinsurance transactions. The actuarial guideline should specify that, in order to comply with Model #822, 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 transaction that does not adhere to the actuarial method and primary security forms adopted by the NAIC. The Principle-Based Reserving Implementation (EX) Task Force’s XXX/AXXX Reinsurance Framework Exhibit 3 should be considered for this actuarial guideline, modified as appropriate by the Task Force.—Essential

- Request permission from the Executive (EX) Committee to amend Model #822 and draft those amendments to specify that, in order to comply with Model #822, 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 reserve financing transaction that does not adhere to the XXX/AXXX Reinsurance Model Regulation and other aspects of the XXX/AXXX Reinsurance Framework, as adopted by the Task Force.—Essential

Capital Adequacy (E) Task Force

- Develop an appropriate “RBC cushion” for an insurer ceding XXX/AXXX policies when the assuming reinsurer does not file an RBC report using the NAIC RBC formula and instructions.—Essential

- Develop appropriate asset charges for the forms of “other security” used by insurers under the XXX/AXXX Reinsurance Model Regulation. These charges should then be considered for incorporation into the RBC cushion developed in accordance with the previous charge.—Essential

- Determine whether the current RBC C-3 treatment of qualified actuarial opinions is adequate for the purposes of the risks of XXX/AXXX reinsurance transactions that receive qualified actuarial opinions.—Essential

Reinsurance (E) Task Force

- Request permission from the Executive (EX) Committee to create a new model regulation to establish requirements regarding the reinsurance of XXX/AXXX policies. The Principle-Based Reserving Implementation (EX) Task Force’s XXX/AXXX Reinsurance Framework Exhibit 4 should be considered for this model regulation, modified as deemed appropriate by the Task Force.—Essential

- Request permission from the Executive (EX) Committee to amend the Credit for Reinsurance Model Law (#785) and draft the amendments to reference the new model regulation drafted in accordance with the previous charge.—Essential

Statutory Accounting Principles (E) Working Group

- Develop the proposed definition for “primary security” for use in the Principle-Based Reserving Implementation (EX) Task Force’s future consideration of a proposed XXX/AXXX Reinsurance Model Regulation.—Essential

- Develop a note to the annual audited financial statement regarding compliance with the XXX/AXXX Reinsurance Model Regulation.—Essential
Financial Condition (E) Committee

- Evaluate the risk-transfer rules applicable to XXX/AXXX reserve financing transactions to make sure they appropriately apply to situations such as those where parental/affiliate guarantees are used, resulting in the risk effectively being kept within the holding company system even though the reinsurance arrangement involves an unrelated third party.—Essential

Financial Regulation Standards and Accreditation (F) Committee

- As the various work products are adopted by the Principle-Based Reserving Implementation (EX) Task Force, the Executive (EX) Committee and Plenary, consider them for inclusion in the Part A and Part B standards of the NAIC Financial Regulation Standards and Accreditation Program.—Essential
XXX/AXXX Reinsurance Framework – Requests for Model Law Development

The Executive (EX) Committee is asked to approve model law development requests as detailed below. Once the various technical groups complete their draft models, hopefully before the end of 2014, the Principle-Based Reserving Implementation (EX) Task Force will combine them with other regulatory work as a final proposed XXX/AXXX Reinsurance Framework to be considered for adoption.

1. **New Model Regulation – XXX/AXXX Reinsurance**

   The Reinsurance (E) Task Force is charged with establishing the requirements regarding the reinsurance of XXX/AXXX policies, using the Principle-Based Reserving Implementation (EX) Task Force’s XXX/AXXX Reinsurance Framework Exhibit 4 as the starting point.

2. **Amendments to the Credit for Reinsurance Model Law (#785)**

   The Reinsurance (E) Task Force is charged with drafting amendments to Model #785 to reference the XXX/AXXX Reinsurance Model Regulation.

3. **Amendment to the Actuarial Opinion and Memorandum Regulation (#822)**

   The Life Actuarial (A) Task Force is charged with drafting amendments to Model #822 to specify that, in order to comply with Model #822, 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 reserve financing transaction that does not adhere to the XXX/AXXX Reinsurance Model Regulation and other aspects of the XXX/AXXX Reinsurance Framework.