SYNTHETIC GUARANTEED INVESTMENT CONTRACTS MODEL REGULATION

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Section 1. Authority

This rule is issued pursuant to the authority vested in the commissioner of the State of [insert state] under [insert citation for authority].

Section 2. Purpose

A. The purpose of this regulation is to prescribe:

(1) The terms and conditions under which life insurance companies may issue group annuity contracts and other agreements that in whole or in part establish the insurer's obligation by reference to a segregated portfolio of assets that is not owned by the insurer;

(2) The essential operational features of the segregated portfolio of assets; and

(3) The reserve requirements for these group annuity contracts and agreements.

B. This regulation is intended to aid in the timely approval of such products by the commissioner, and recognizes that timely approval is essential given the competitive nature of the market for these products.

Section 3. Scope and Application

A. This regulation applies to that portion of a group annuity contract or other agreement described in Section 4W and issued by a life insurer:

(1) That functions as an accounting record for an accumulation fund; and

(2) That has benefit guarantees relating to a principal amount and levels of interest at a fixed rate of return specified in advance.

B. The fixed rates of return:

(1) Shall be constant over the applicable rate periods;

(2) May reflect prior and current market conditions with respect to the segregated portfolio; and

(3) Shall not reference future changes in market conditions.

C. This regulation is applicable to all contracts issued after the effective date of this regulation. Contracts that have been negotiated prior to the effective date need not be refiled with the commissioner.

Drafting Note: This regulation is not intended to apply to contingent deferred annuities (CDAs), defined in the Contingent Deferred Annuity (A) Working Group recommendation on CDAs adopted by the Life Insurance and Annuities (A) Committee on April 7, 2013 (NAIC Proceedings, Spring 2013, Volume 1, pdf page 416) as "an annuity contract that establishes a life insurer's obligation to make periodic payments for the annuitant's lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually defined amount due to contractually permitted withdrawals, market performance, fees and/or other charges."

Drafting Note: This explanation of the fixed rate of return is intended to clarify the fact that the regulation excludes products such as those that guarantee the future performance of a stated index. It is recognized that versions of synthetics other than those described in the scope section may evolve over time; the intent of the regulation is not to preclude the issuance of such products, but rather to describe how a specific set of synthetics (those described in the scope) should be regulated.

Drafting Note: It is expected that individual regulators, where applicable, will retain the right to withdraw approval of previously filed contract forms for new issuance if they do not conform to the regulation. Therefore, no language explicitly withdrawing approval of previously filed forms was included.

Section 4. Definitions

As used in this regulation, the following terms shall have these meanings:

A. "Account assets" means the assets in the segregated portfolio plus any assets held in the general account or a separate account to meet the asset maintenance requirements.

B. "Actuarial opinion and memorandum" means the opinion and memorandum of the valuation actuary required to be submitted to the commissioner pursuant to Section 10B of this regulation.

C. "Affirmatively approved" means approval of an insurer's plan of operation for a class of contracts containing the form of contract under review, after the plan of operation associated with the class of contracts has been reviewed by the insurer's domiciliary insurance department, and the plan of operation has been found to be in compliance with the NAIC Synthetic Guaranteed Investment Contracts Model Regulation by the domiciliary insurance department. Affirmatively approved does not mean approval as a result of the deemer provision.

D. "Appointed actuary" means the qualified actuary appointed or retained either directly by or by the authority of the board of directors through an executive officer of the company to prepare the annual statement of actuarial opinion for the company as a whole pursuant to Section [insert reference to standard valuation law].

E. “Asset maintenance requirement” means the requirement to maintain assets to fund contract benefits in accordance with Section 10 of this regulation.

F. “Class of contracts” means the set of all contracts to which a given plan of operation pertains.

G. “Contract value record” means an accounting record, provided by the contract in relation to a segregated portfolio of assets, that is credited with a fixed rate of return over regular periods, and that is used to measure the extent of the insurer’s obligation to the contractholder. The fixed rate of return credited to the contract value record is determined by means of a crediting rate formula or declared at the inception of the contract and valid for the entire term of the contract.

H. “Crediting rate formula” means a mathematical formula used to calculate the fixed rate of return credited to the contract value record during any rate period and based in part upon the difference between the contract value record and the market value record amortized over an appropriate period. The fixed rate of return calculated by means of this formula may reflect prior and current market conditions with respect to the segregated portfolio, but may not reference future changes in market conditions.

I. “Date of filing,” with respect to a filing for approval of a contract form under this regulation, means the date as defined by the applicable statutes or regulations of the state of issue with regard to contract filings.

Drafting Note: Individual states may wish to insert a specific reference to the applicable statute or regulation.

J. “Duration” means, with respect to the segregated portfolio assets or guaranteed contract liabilities, a measure of price sensitivity to changes in interest rates, such as the Macaulay duration or option-adjusted duration.

K. “Fair market value” means a reasonable estimate of the amount that a knowledgeable buyer of an asset would be willing to pay, and a knowledgeable seller of an asset would be willing to accept, for the asset without duress in an arm's length transaction. In the case of a publicly traded security, the fair market value is the price at which the security is traded or, if no price is available, a price that appropriately reflects the latest bid and asked prices for the security. In the case of a debt instrument that is not publicly traded, the fair market value is the discounted present value of the asset calculated at a reasonable discount rate. For all other non-publicly traded assets, fair market value will be determined in accordance with valuation practices customarily used within the financial industry.

L. “Guaranteed minimum benefits” means contract benefits on a specified date that may be either:

(1) A principal guarantee, with or without a fixed minimum interest rate guarantee, related to the segregated portfolio;

(2) An assurance as to the future investment return or performance of the segregated portfolio; or

(3) The fair market value of the segregated portfolio, to the extent that the fair market value of the assets determines the contractholder’s benefits.

M. (1) "Hedging instrument" means:

(a) An interest rate futures agreement or foreign currency futures agreement, an option to purchase or sell an interest rate futures agreement or foreign currency futures agreement, or any option to purchase or sell a security or foreign currency, used in a bona fide hedging transaction; or

(b) A financial agreement or arrangement entered into with a broker, dealer or bank, qualified under applicable federal and state securities or banking law and regulation, in connection with investment in one or more securities in order to reduce the risk of changes in market valuation or to create a synthetic investment that, when added to the portfolio, reduces the risk of changes in market valuation.

(2) An instrument shall not be considered a hedging instrument or a part of a bona fide hedging transaction if it is purchased in conjunction with another instrument where the effect of the combined transaction is an increase in the portfolio's exposure to market risk.

N. "Investment guidelines" means a set of written guidelines, established in advance by the person with investment authority over the segregated portfolio, to be followed by the investment manager. The guidelines shall include a description of:

(1) The segregated portfolio's investment objectives and limitations;

(2) The investment manager's degree of discretion;

(3) The duration, asset class, quality, diversification, and other requirements of the segregated portfolio; and

(4) The manner in which derivative instruments may be used, if at all, in the segregated portfolio.

O. "Investment manager" means the person (including the contractholder) responsible for managing the assets in the segregated portfolio in accordance with the investment guidelines in a fiduciary capacity to the owner of the assets.

P. "Market value record" means an accounting record provided by the contract to reflect the fair market value of the segregated portfolio.

Q. "Permitted custodial institution" means a bank, trust company or other licensed fiduciary services provider.

Drafting Note: When adopting this regulation, individual regulators may wish to review their applicable state laws to ensure that this definition hasn't inadvertently authorized an entity to act as a custodial institution that it would not wish to do so.

R. "Plan of operation" means a written plan meeting the requirements of Section 5B(1) of this regulation.

S. "Qualified actuary" means an individual who meets the qualification standards set forth in [insert reference to section of the regulations related to actuarial opinions and memoranda].

T. “Rate period” means the period of time during which the fixed rate of return credited to the contract value record is applicable between crediting rate formula adjustments.

U. “Segregated portfolio” means:

(1) A portfolio or sub-portfolio of assets to which the contract pertains that is held in a custody or trust account by the permitted custodial institution and identified on the records of the permitted custodial institution as special custody assets held for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract; and

(2) Any related cash or currency received by the permitted custodial institution for the account of the contractholder and held in a deposit account for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract.

V. “Spot rate”

(1) “Treasury-based spot rate” corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable United States government obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing, non-callable and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operation.

(2) “Index spot rate” corresponding to a given time of benefit payment means the zero-coupon yield implied by (x) the Barclays Short Term Corporate Index (for a given time of benefit payment under one year) or (y) the zero-coupon yield implied by the Barclays U.S. Corporate Investment Grade Bond Index (for a given time of benefit payment greater than or equal to one year).

(3) “Blended spot rate” corresponding to a given time of benefit payment means a blend of 50% each of (i) the treasury-based spot rate, and (ii) the index spot rate. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rated in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner and are supported by investments denominated in the currency of the foreign country, the treasury-based spot rate component of the blended spot rate may be determined by reference to substantially similar obligations of the government of the foreign country. For liabilities other than those described above, the blended spot rate shall be determined on a basis mutually agreed upon by the insurer and the commissioner.

W. “Synthetic guaranteed investment contract” or “contract” means a group annuity contract or other agreement that establishes the insurer’s obligations by reference to a segregated portfolio of assets that is not owned by the insurer. The contract functions as an accounting record for an accumulation fund and the fixed rate of return credited to the fund reflects an amortization of the segregated portfolio’s market gains and losses based on the period specified in the crediting formula, subject to any minimum interest rate guarantee.

X. "Unilateral contract termination event" means an event allowing the insurer to unilaterally and immediately terminate the contract, without future liability or obligation to the contractholder.

Y. "United States government obligation" means a direct obligation issued, assumed, guaranteed or insured by the United States of America or by an agency or instrumentality of the United States government.

Z. "Valuation actuary" means the appointed actuary or, alternatively, a qualified actuary designated by the appointed actuary to render the actuarial opinion pursuant to Section 10. Written documentation of any such designation shall be on file at the company and available for review by the commissioner upon request.

Section 5. Financial Requirements and Plan of Operation

A contract may not be delivered or issued for delivery in this state unless the issuing insurer is licensed as a life insurance company in this state and is financially qualified under the provisions of Subsection A of this section. In addition, a domestic insurer may not deliver or issue for delivery, either in this state or outside this state, a contract belonging to a specific class of contracts unless the insurer has satisfied the requirements of Subsection B of this section with respect to that class.

A. An insurer will be financially qualified under this section if its most recent statutory financial statements reflect at least $1 billion in admitted assets or $100 million in capital and surplus, and its risk-based capital results do not place it at a regulatory level of action. In lieu of the requirements in the preceding sentence, the insurer may be required to satisfy such other financial qualification requirements set forth by the commissioner as having been deemed necessary or appropriate in a particular case to protect the insurer's policyholders and the public.

B. A domestic insurer will satisfy the requirements of this section with respect to a class of contracts if the insurer has filed a plan of operation pertaining to the class of contracts, together with copies of the forms of contract in the class, with the commissioner and the filing of the plan of operation has been approved or has not been disapproved within the sixty-day period following the date of filing, in which event the plan of operation shall be deemed approved.

(1) The plan of operation for a class of contracts shall describe the financial implications for the insurer of the issuance of contracts in the class, and shall include at least the following:

(a) A statement that the plan of operation will be administered in accordance with the requirements prescribed by the commissioner pursuant to this regulation, along with a statement that the insurer will comply with the plan of operation in its administration of the contract;

(b) A statement describing the methods and procedures used to value statutory liabilities for purposes of Section 10;

(c) A description of the criteria used by the insurer in approving the investment manager for the segregated portfolio of assets associated with a contract in the class, if the investment manager is an entity other than the insurer or its wholly owned subsidiary;

(d) A description of the insurer's requirement for reports concerning the assets in each segregated portfolio and transactions involving the assets, and a description of how the insurer can use the information in a report to determine that the segregated portfolio is being managed in accordance with its investment guidelines. The insurer shall require that the report be prepared no less frequently than quarterly, and include a complete statement of segregated portfolio holdings and their fair market value;

(e) A demonstration of financial results for one or more sample contracts from the class of contracts, showing at a minimum the projected contract value records, the applicable fixed rate or rates of return, and the projected market value records, describing how the investments in the segregated portfolio reflect provision for benefits insured by the contract and how the contract value and market values and the rates of return may be affected by changes in the investment returns of the segregated portfolio and reasonably anticipated deposits to and withdrawals from the segregated portfolio by the contractholder, as well as any advances made by the insurer to the contractholder. The sample contracts shall be chosen to reasonably represent the range of results that could be expected from possible combinations of contract provisions of all contracts within the class. The demonstration shall include at least three (3) hypothetical return scenarios (level, increasing and decreasing) and for each of these scenarios, at least three (3) withdrawal scenarios (zero, moderate and high) shall be modeled. The commissioner may require additional scenarios if deemed necessary to fully understand the risks under the class of contracts. The demonstration period shall be the greater of five (5) years or the minimum period the insurer must underwrite the risk;

(f) A statement that all contracts in the class of contract satisfy the requirement of Section 9 regarding unilateral contract terminations, together with a description of all termination events, discontinuation triggers and options, notice requirements, corrective action procedures, all other contract safeguards, and the procedures to be followed when a unilateral contract termination event occurs;

(g) A description of the allowable investment parameters (such as objectives, derivative strategies, asset classes, quality, duration and diversification requirements applied to the assets held within the segregated portfolio) to be reflected in the investment guidelines applicable to each contract issued in the class to which the submitted plan of operation applies; and a description of the procedures that will be followed by the insurer in evaluating the appropriateness of any specific investment guidelines submitted by the contractholder. If the insurer chooses to operate a contract in accordance with investment guidelines not meeting the criteria established pursuant to this subparagraph, the non-conforming set of investment guidelines shall be filed with the commissioner in accordance with the filing requirements of this subsection;

(h) A description of the criteria used by the insurer in approving for contract issuance a pooled fund representing multiple employer-sponsored plans and in approving the investment manager for the segregated portfolio of assets associated with such pooled fund contract;

Guidance Note: A pooled fund is an arrangement in which multiple, unaffiliated employer sponsored plans invest in a shared trust. Pooled funds generally allow plan sponsors the right to exit the fund at book value subject to advance notification requirements. In describing the criteria used by the insurer in evaluating the potential issuance of a contract, discuss the insurer's advance notification requirements and how any actual advance notifications will be monitored and reflected in the risk management of the contract.

(i) A description of risk-mitigation techniques used by the insurer in connection with contracts issued to pooled funds representing multiple employer-sponsored plans;

(j) An unqualified opinion by a qualified actuary with expertise in these matters as to the adequacy of the consideration charged by the insurer for the risks it has assumed with respect to the contracts in the class to which the plan of operation applies;

(k) A statement that the actuarial opinion and memorandum required by Section 10 shall include, with respect to the class of contracts to which the plan of operation applies:

(i) If a payment has been made by the insurer in the prior reporting period under a contract in the class, the amount of aggregate risk charges (net of administrative expenses) for contracts in the class, and the aggregate amount of any losses incurred; and

(ii) An inventory of all material unilateral contract termination events in the class that have not been cured within the time period specified and that have occurred during the prior reporting period but where the company decided not to terminate the contract.

(2) Review of the plan of operation by the commissioner may necessitate requests for information to supplement that furnished pursuant to Paragraph (1). Replies made in compliance with this paragraph should be made in sufficient detail that any follow-up correspondence can be held to a minimum.

Section 6. Required Contract Provisions and Filing Requirements

Drafting Note: This section may be omitted in its entirety if a state does not require contracts to be filed for approval, and the state wishes to eliminate required contract provisions. Subsection B of this section may be omitted if a state does not require contracts to be filed for approval, but wishes to maintain required contract provisions.

A contract may not be delivered or issued for delivery in this state unless the contract satisfies the requirements of Subsection A of this section and the issuing insurer has satisfied the requirements of Subsection B of this section with respect to the contract.

A. The contract shall:

(1) Provide that the assets to which the contract pertains and for which a contract value record is established will be maintained in a segregated portfolio of a permitted custodial institution;

(2) Grant the insurer the right to perform audits and inspections of assets held in the segregated portfolio from time to time upon reasonable notice to the permitted custodial institution;

(3) Provide that the insurer will receive prior notice of and the right to approve any appointment or change of investment managers;

(4) Give a description of how the contract value record will be determined, and, where applicable, adjusted by a crediting rate formula;

(5) State the maximum rate period between crediting rate formula recalculations that will be permitted, if any;

(6) Provide the insurer with the right to refuse to recognize any new deposits to the segregated portfolio unless there is a written agreement between the insurer and the contractholder as to the permissible levels and timing of new deposits;

(7) Clearly identify all circumstances under which insurer payments or advances to the contractholder are to be made;

(8) Clearly identify the types of withdrawals made on a market value basis;

(9) Provide either a fixed maturity schedule or a settlement option permitting the contractholder to receive the contract value record over time, provided that no unilateral contract termination event has occurred; and

(10) Include a provision stating, or substantially similar to, the following:

"No waiver of remedies by the insurer that is a party to this agreement, following the breach of any contractual provision of the agreement or of the investment guidelines applicable to it, or failure to enforce the provisions or guidelines, which constitutes grounds for termination of this agreement for cause by the insurer, and is not cured within thirty (30) days following the insurer's discovery of it, shall be effective against an insurance commissioner in any future rehabilitation or insolvency proceedings against the insurer unless approved in advance in writing by the commissioner."

Drafting Note: An adopting state may wish to add an "entire contract" provision in this section if such a provision is not required elsewhere in the adopting state's insurance code.

B. An insurer will satisfy the filing and approval requirements of this section with respect to a contract if the insurer has filed the form of the contract with the commissioner and it is accompanied by the items specified in Paragraphs (1), (2), and (3) of this subsection, and the form has been approved or has not been disapproved within the thirty-day period following the date of filing, in which event the form of contract shall be deemed approved. Notwithstanding the foregoing, the requirement for filing and approval of the form of contract may be waived at the discretion of the commissioner.

(1) The form of contract filed for approval shall be accompanied by a statement that the contract meets the conditions of Subsection A of this section.

(2) The form of contract filed for approval shall be accompanied by a statement:

(a) Specifying the range of variation of variable contract provisions, if any, that could have a material effect on the risk assumed by the insurer under the contract, including withdrawal methodology, crediting rate formula and termination events;

Drafting Note: Contract forms covered by this regulation frequently incorporate variable provisions. The statement required by this subparagraph is intended to provide the information regulators need to evaluate the risks associated with such variability.

(b) Describing how the fair market value will be determined, including a description of the rules for valuing securities and other assets that are not publicly traded;

(c) Describing the crediting rate formula, if any, and how it will operate to take into account the difference between the market value record and the contract value record over time; and

(d) Listing events that give the insurer the right to terminate the contract immediately.

(3) (a) In the case that the plan of operation pertaining to the class of contracts to which the contract belongs has been affirmatively approved by the commissioner of the state in which the issuing insurer is domiciled, the form of contract filed for approval shall be accompanied by a statement indicating the receipt of approval, and that the approval was an affirmative approval.

(b) In the case that the plan of operation pertaining to the class of contracts to which the contract belongs has been deemed approved in the state in which the issuing insurer is domiciled, the form of contract filed for approval shall be accompanied by a statement indicating that the issuing insurer has met the requirements for deemed approval.

(c) In the case that the plan of operation pertaining to the class of contracts to which the contract belongs has not been approved, either affirmatively or by deemer, in the state in which the issuing insurer is domiciled, the form of contract filed for approval shall be accompanied by a statement of this fact, together with a plan of operation pertaining to the contract.

Drafting Note: The state of filing may request the plan of operation for informational purposes and may take it into account in deciding whether to approve the form. It is not anticipated that the state of filing would review and approve the plan of operation, but may use it in connection with the review of the form of contract.

Drafting Note: In the case that the plan of operation has not been approved, either affirmatively or by deemer, in the state of domicile of the issuing insurer, the state of issue, in issuing contract approvals, may wish to establish requirements to be met by the issuing insurer (e.g., notice requirement if the plan of operation subsequently changes, or requirement that the contract be operated in compliance with the plan of operation) in order to maintain its approval.

Section 7. Investment Management of the Segregated Portfolio

A. The investment manager must have full responsibility for, and control over, the management of all segregated portfolio assets within the constraints specified in the investment guidelines.

Drafting Note: In the event that the segregated portfolio has multiple managers, all of these managers will be covered by the investment guidelines.

B. The investment guidelines shall be submitted to the insurer for underwriting review before the contract becomes effective.

C. If the insurer accepts a proposed change to the investment guidelines or allows the contract to operate in accordance with investment guidelines not meeting the criteria established in Section 5B(1)(g), approval of the non-conforming investment guidelines must be obtained pursuant to Section 5B.

Section 8. Purchase of Annuities

For contracts that are group annuity contracts, and that make available to the contractholder the purchase of immediate or deferred annuities for the benefit of individual members of the group, an annuity may not be purchased without the delivery of the contractually agreed upon consideration in cash to the insurer from the segregated portfolio for allocation to the insurer's general account or a separate account. The insurer shall collect adequate consideration for the cost of annuities purchased under contract option by transfer from the segregated portfolio.

Section 9. Unilateral Contract Terminations

A contract subject to this regulation shall allow the insurer to unilaterally and immediately terminate, without future liability of the insurer or obligation to provide further benefits, upon the occurrence of any one of the following events that is material and that is not cured within thirty (30) days following the insurer's discovery of it:

A. The investment guidelines are changed without the advance consent of the insurer and the investment manager is not controlling, controlled by or under common control with the insurer;

B. The segregated portfolio, if managed by an entity that is not controlling, controlled by or under common control with the insurer, is invested in a manner that does not comply with the investment guidelines; or

C. Investment discretion over the segregated portfolio is exercised by or granted to anyone other than the investment manager.

Section 10. Reserves

A. Asset maintenance requirements for segregated portfolios governed by this regulation.

(1) At all times an insurer shall hold minimum reserves in the general account or one or more separate accounts, as appropriate, equal to the excess, if any, of the value of the guaranteed contract liabilities, determined in accordance with Paragraphs (6) and (7) of this subsection, over the market value of the assets in the segregated portfolio less the deductions provided for in Paragraph (2) of this subsection. The reserve requirements of this subsection shall be applied on a contract-by-contract basis.

(2) In determining compliance with the asset maintenance requirement and the reserve for guaranteed contract liabilities specified in Paragraph (1) of this subsection, the insurer shall deduct a percentage of the market value of an asset as follows:

(a) For debt instruments, the percentage shall be the NAIC asset valuation reserve "reserve objective factor," but the factor shall be increased by fifty percent (50%) for the purpose of this calculation if the difference in durations of the assets and liabilities is more than one-half year. The above notwithstanding, in the event that, under the terms of the synthetic guaranteed investment contract, the asset default risk for debt instruments is borne solely by the contractholder, there shall be no asset valuation reserve percentage deduction from the market value of an asset, for purposes of complying with the asset maintenance requirement and the reserve for guaranteed contract liabilities specified in Paragraph (1) of this subsection.

(b) For assets that are not debt instruments, the percentage shall be the NAIC asset valuation reserve “maximum reserve factor.”

(3) To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by segregated portfolio assets denominated in the currency of the foreign country, the percentage deduction for these assets under Paragraph (2) of this subsection shall be that for a substantially similar investment denominated in the currency of the United States.

(4) To the extent that guaranteed contract liabilities are denominated in the currency of the United States and are supported by segregated portfolio assets denominated in the currency of a foreign country, and to the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by segregated portfolio assets denominated in the currency of the United States, the deduction for debt instruments under Paragraph (2) of this subsection shall be increased by fifteen percent (15%) of the market value of the assets unless the currency exchange risk on the assets has been adequately hedged, in which case the percentage deduction under Paragraph (2) of this subsection shall be increased by one-half percent (.5%). No guaranteed contract liabilities denominated in the currency of a foreign country shall be supported by segregated portfolio assets

denominated in the currency of another foreign country without the approval of the commissioner. For purposes of this paragraph, the currency exchange risk on an asset is deemed to be adequately hedged if:

(a) It is an obligation of

(i) A jurisdiction that is rated in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner;

(ii) Any political subdivision or other governmental unit of such a jurisdiction, or any agency or instrumentality of jurisdiction, political subdivision or other governmental unit; or

(iii) An institution that is organized under the laws of any such jurisdiction; and

(b) At all times the principal amount of the obligation and scheduled interest payments on the obligation are hedged against the United States dollar pursuant to contracts or agreements that are:

(i) Issued by or traded on a securities exchange or board of trade regulated under the laws of the United States or Canada or a province of Canada;

(ii) Entered into with a United States banking institution that has assets in excess of $5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an independent, nationally recognized, United States rating agency, or with a broker-dealer registered with the Securities and Exchange Commission that has net capital in excess of $250 million; or

(iii) Entered into with any other banking institution that has assets in excess of $5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an independent, nationally recognized, United States rating agency and that is organized under the laws of a jurisdiction that is rated in one of the two (2) highest rating categories by an independent, nationally recognized United States rating agency.

(5) These contracts may provide for the allocation to one or more separate accounts of all or any portion of the amount needed to meet the asset maintenance requirement. If the contract provides that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurer, the insurer shall maintain in a distinct separate account that is so chargeable:

(a) That portion of the amount needed to meet the asset maintenance requirement that has been allocated to separate accounts; less

(b) The amounts contributed to separate accounts by the contractholder in accordance with the contract and the earnings on the contract.

(6) For purposes of this section, the minimum value of guaranteed contract liabilities is defined to be the sum of the expected guaranteed contract benefits, each discounted at a rate corresponding to the expected time of payment of the contract benefit that is not greater than the spot rate supportable by the expected return from the segregated portfolio assets, and in no event greater than the blended spot rate as described in the plan of operation (pursuant to Section 5) or the actuary's opinion and memorandum, (pursuant to Section 10B), except that if the expected time of payment of a contract benefit is more than thirty (30) years, it shall be discounted from the expected date of payment to year thirty (30) at a rate of no more than eighty percent (80%) of the thirty-year blended spot rate and from year thirty (30) to the date of valuation at a rate not greater than the thirty-year blended spot rate.

(7) In calculating the minimum value of guaranteed contract benefits:

(a) All guaranteed benefits potentially available to the contractholder on an ongoing basis shall be considered in the valuation process and analysis, and the reserve held must be sufficient to fund the greatest present value of each independent guaranteed contract benefit. For purposes of this subparagraph, the right granted to the contractholder to exit the contract by discharging the insurer of its guarantee obligation under the contract and taking control of the assets in the segregated portfolio shall not be considered a guaranteed benefit.

(b) To the extent that future guaranteed cash flows are dependent upon the benefit responsiveness of an employer-sponsored plan, a best estimate based on company experience, or other reasonable criteria if company experience is not available, shall be used in the projections of future cash flows.

(c) The minimum value of guaranteed contract benefits under a contract issued to a pooled fund representing multiple employer-sponsored plans shall be determined so as to reflect projected plan sponsor contract value withdrawals available to the member plans in the pooled fund.

Projections of such future cash flows shall take into account (i) known plan sponsor withdrawals, and (ii) a prudent estimate of future plan sponsor withdrawals. The prudent estimate shall be based on company experience and other relevant criteria.

Drafting Note: Other relevant criteria include, but are not limited to, the pooled fund’s profile (e.g. number of employer-sponsored plans, and the minimum, maximum and average size of such plans), the minimum notice that plan sponsors are required to give in order to effectuate a plan sponsor withdrawal, the percentage of the pooled fund that is investment-only and that is full service, and economic conditions.

A single valuation rate shall be determined, consistent with Paragraph (6) of this subsection, equal to the lesser of:

(i) The expected return from the segregated portfolio of assets, or

(ii) The blended spot rate based on the duration of the segregated portfolio of assets.

This single valuation rate shall be used to model future market values of the segregated portfolio of assets. Future credited interest rates shall be modeled according to the contractually defined crediting rate formula. Modeled future contract values shall reflect modeled future market values, modeled future credited interest rates, known future plan sponsor withdrawals, the prudent estimate of future plan sponsor withdrawals, future withdrawals consistent with Paragraph (7)(b) of this subsection and any remaining final payment at the modeled contract termination date. All such modeled withdrawals and termination payments shall be discounted using the single valuation rate and the modeled times of those withdrawals and payments. The sum of these present values shall be deemed the minimum value of the guaranteed contract liabilities for a pooled fund contract.

B. Actuarial opinion and memorandum for segregated portfolios governed by this regulation.

(1) An insurer that issues a synthetic guaranteed investment contract subject to this regulation shall submit an actuarial opinion and, upon request, a memorandum to the commissioner annually by March 1 following the December 31 valuation date showing the status of the accounts as of the prior December 31. The actuarial opinion and memorandum shall be in form and substance satisfactory to the commissioner.

Drafting Note: The state may wish to include the information contained in the actuarial opinion and memorandum as a part of its overall filing requirements, rather than mandating a separate filing for synthetic guaranteed investment contracts.

(2) The actuarial memorandum required by this regulation is deemed to be confidential to the same extent, and under the same conditions, as the actuarial memorandum required by [insert reference to state law equivalent to Section 3 of the NAIC Model Standard Valuation Law].

Drafting Note: A thorough review should be performed of the specific laws and regulations in a state which may affect the confidential status of the memorandum.

(3) Except in cases of fraud or willful misconduct, the valuation actuary shall not be liable for damages to any person (other than the insurance company and the commissioner) for any act, error, omission, decision, or conduct with respect to the actuary's opinion.

(4) The statement of actuarial opinion submitted in accordance with Section 10B(1) shall consist of:

(a) A paragraph identifying the valuation actuary and his or her qualification;

(b) A scope paragraph identifying the subjects on which the opinion is to be expressed and describing the scope of the valuation actuary's work;

(c) A reliance paragraph describing those areas, if any, where the valuation actuary has deferred to other experts in developing data, procedures or assumptions;

(d) An opinion paragraph expressing the valuation actuary's opinion with respect to the matters described in Subparagraphs 5A and 5B below; and

(e) One or more additional paragraphs may be needed in individual company cases as follows:

(i) If the valuation actuary considers it necessary to state a qualification of his or her opinion;

(ii) If the valuation actuary must disclose an inconsistency in the method of analysis used at the prior opinion date with that used for this opinion;

(iii) If the valuation actuary chooses to add a paragraph briefly describing the assumptions which form the basis of the actuarial opinion.

(5) Contents of the opinion paragraph of the actuarial opinion.

(a) The actuarial opinion shall state that, after taking into account any risk charge payable, the segregated portfolio assets, and the amount of any reserve liability with respect to the asset maintenance requirement, the account assets make adequate provision for contract liabilities.

(b) The opinion shall also state that:

(i) Reserves for contract liabilities are calculated pursuant to the requirements of Section 10A(1);

(ii) After taking into account any reserve liability with respect to the asset maintenance requirement, the amount of the account assets satisfied the asset maintenance requirement;

(iii) The fixed-income segregated portfolio conformed to and justified the rates used to discount contract liabilities for valuation pursuant to Section 10A(6);

(iv) Whether any rates used pursuant to Section 10A(6) to discount guaranteed contract liabilities and other items applicable to the segregated portfolio were modified from the rate or rates described in the plan of operation filed pursuant to Section 5; and

(v) The level of risk charges, if any, retained in the general account was appropriate in view of such factors as the nature of the guaranteed contract liabilities and losses experienced in connection with account contracts and other pricing factors.

(6) The opinion shall be accompanied by a certificate of an officer of the insurance company responsible for monitoring compliance with the asset maintenance requirements for synthetic guaranteed investment contracts describing the extent to and manner in which, during the preceding year:

(a) Actual benefit payments conformed to the benefit payment estimated to be made as described in the plan of operation;

(b) The determination of the fair market value of the segregated portfolio conformed to the valuation procedures described in the plan of operation, including a statement of the procedures and sources used during the year; and

(c) Any assets were transferred to or from the insurer's general account, or any amounts were paid to the insurer by any contractholder to support the insurer's guarantee.

(7) The actuarial memorandum shall:

(a) Substantially conform with those portions of Section [insert reference to section of the regulations related to actuarial memoranda] of these regulations that are applicable to asset adequacy testing and either:

(i) Demonstrate the adequacy of account assets based upon cash flow analysis, or

(ii) Explain why cash flow testing analysis is not appropriate, describe the alternative methodology of asset adequacy testing used, and demonstrate the adequacy of account assets under that methodology;

(b) Clearly describe the assumptions the valuation actuary used in support of the actuarial opinion, including any assumptions made in projecting cash flows under each class of assets, and any dynamic portfolio hedging techniques utilized and the tests performed on the utilization of the techniques;

(c) Clearly describe how the valuation actuary has reflected the cost of capital;

(d) Clearly describe how the valuation actuary has reflected the risk of default on obligations and mortgage loans, including obligations and mortgage loans that are not investment grade;

(e) Clearly describe how the valuation actuary has reflected withdrawal risks, if applicable, including a discussion of the positioning of the contracts within the benefit withdrawal priority order pertaining to the contracts, the impact of any dynamic lapse assumption and the results of sensitivity testing the prudent estimate of future plan sponsor withdrawals pursuant to Section 10A(7)(c);

(f) If the plan of operation provides for investments in segregated portfolio assets other than United States government obligations, demonstrate that the rates used to discount contract liabilities pursuant to Section 10A(6) conservatively reflect expected investment returns, taken into account any foreign exchange risks;

(g) If the contracts provide that in certain circumstances they would cease to be funded by a segregated portfolio and, instead would become contracts funded by the general account, clearly describe how any increased reserves would be provided for if and to the extent these circumstances occurred;

(h) State the amount of account assets maintained in a separate account that are not chargeable with liabilities arising out of any other business of the insurance company;

(i) State the amount of reserves and supporting assets as of December 31 and where the reserves are shown in the annual statement;

(j) State the amount of any contingency reserve carried as part of surplus;

(k) State the market value of the segregated asset portfolio; and

(l) Where separate account assets are not chargeable with liabilities arising out of any other business of the insurance company, describe how the level of risk charges payable to the general account provides an appropriate compensation for the risk taken by the general account.

C. When the insurer issues a synthetic guaranteed investment contract and complies with the asset maintenance requirements of Section 10A, it need not maintain an asset valuation reserve with respect to those account assets.

D. This section describes the reserve valuation requirements for contracts subject to this regulation.

(1) Reserves for synthetic investment contracts subject to this regulation shall be an amount equal to the sum of the following:

(a) The amounts determined as the minimum reserve as required under Section 10A(l);

(b) Any additional amount determined by the insurer's valuation actuary as necessary to make adequate provision for all contract liabilities; and

(c) Any additional amount determined as necessary by the commissioner due to the nature of the benefits.

(2) The amount of any reserves required by Paragraph (1) of this subsection may be established by either:

(a) Allocating sufficient assets to one or more separate accounts; or

(b) Setting up the additional reserves in the general account.

Section 11. Severability

If any provision of this regulation or its application to any person or circumstances is judged invalid by a court of competent jurisdiction, the judgment shall not affect or impair the validity of the other provisions of this regulation.

Section 12. Effective Date

This regulation shall take effect [insert date].

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

1998 Proc. 4th Quarter 16, 17, 609, 638-647 (adopted).
2015 Proc. 3rd Quarter Vol. I 115, 128, 135-138, 182-200, 344 (amended).

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SYNTHETIC GUARANTEED INVESTMENT CONTRACTS MODEL REGULATION

This chart is intended to provide readers with additional information to more easily access state statutes, regulations, bulletins or administrative rulings related to the NAIC model. Such guidance provides readers with a starting point from which they may review how each state has addressed the model and the topic being covered. The NAIC Legal Division has reviewed each state's activity in this area and has determined whether the citation most appropriately fits in the Model Adoption column or Related State Activity column based on the definitions listed below. The NAIC's interpretation may or may not be shared by the individual states or by interested readers.

This chart does not constitute a formal legal opinion by the NAIC staff on the provisions of state law and should not be relied upon as such. Nor does this state page reflect a determination as to whether a state meets any applicable accreditation standards. Every effort has been made to provide correct and accurate summaries to assist readers in locating useful information. Readers should consult state law for further details and for the most current information.

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KEY:

MODEL ADOPTION: States that have citations identified in this column adopted the most recent version of the NAIC model in a **substantially similar manner**. This requires states to adopt the model in its entirety but does allow for variations in style and format. States that have adopted portions of the current NAIC model will be included in this column with an explanatory note.

RELATED STATE ACTIVITY: Examples of Related State Activity include but are not limited to: older versions of the NAIC model, statutes or regulations addressing the same subject matter, or other administrative guidance such as bulletins and notices. States that have citations identified in this column **only** (and nothing listed in the Model Adoption column) have **not** adopted the most recent version of the NAIC model in a **substantially similar manner.**

NO CURRENT ACTIVITY: No state activity on the topic as of the date of the most recent update. This includes states that have repealed legislation as well as states that have never adopted legislation.

NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Alabama	NO CURRENT ACTIVITY	
Alaska	NO CURRENT ACTIVITY	
American Samoa	NO CURRENT ACTIVITY	
Arizona	NO CURRENT ACTIVITY	
Arkansas	NO CURRENT ACTIVITY	
California		CAL. INS. CODE § 10507.5 (1996); BULLETIN 95-10 (1995).
Colorado	NO CURRENT ACTIVITY	
Connecticut		CONN. AGENCIES REGS. §§ 38a-459-1 to 38a-459-9 (2002) (previous version of model).
Delaware	NO CURRENT ACTIVITY	
District of Columbia	NO CURRENT ACTIVITY	
Florida	NO CURRENT ACTIVITY	
Georgia	NO CURRENT ACTIVITY	

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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Guam	NO CURRENT ACTIVITY	
Hawaii	NO CURRENT ACTIVITY	
Idaho	NO CURRENT ACTIVITY	
Illinois	NO CURRENT ACTIVITY	
Indiana	NO CURRENT ACTIVITY	
Iowa		IOWA ADMIN. CODE R. §§ 191-96.1 to 191-96.12 (2012).
Kansas	NO CURRENT ACTIVITY	
Kentucky	NO CURRENT ACTIVITY	
Louisiana	NO CURRENT ACTIVITY	
Maine	NO CURRENT ACTIVITY	
Maryland	NO CURRENT ACTIVITY	
Massachusetts	NO CURRENT ACTIVITY	
Michigan	NO CURRENT ACTIVITY	
Minnesota		BULLETIN 97-3 (1997).
Mississippi	NO CURRENT ACTIVITY	
Missouri	NO CURRENT ACTIVITY	
Montana	NO CURRENT ACTIVITY	
Nebraska		210 NEB. ADMIN. CODE § 80 (2005) (previous version of model); NEB. REV. STAT. § 44-708.01 (2004).
Nevada	NO CURRENT ACTIVITY	
New Hampshire	NO CURRENT ACTIVITY	

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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
New Jersey		N.J. ADMIN. CODE §§ 11:4-46.1 to 11:4-46.8 (1997).
New Mexico	NO CURRENT ACTIVITY	
New York		CIRCULAR LETTER 1995-12; Supplement 1 (1995).
North Carolina	NO CURRENT ACTIVITY	
North Dakota	NO CURRENT ACTIVITY	
Northern Marianas	NO CURRENT ACTIVITY	
Ohio	NO CURRENT ACTIVITY	
Oklahoma	NO CURRENT ACTIVITY	
Oregon	NO CURRENT ACTIVITY	
Pennsylvania	NO CURRENT ACTIVITY	
Puerto Rico	NO CURRENT ACTIVITY	
Rhode Island	NO CURRENT ACTIVITY	
South Carolina	NO CURRENT ACTIVITY	
South Dakota	NO CURRENT ACTIVITY	
Tennessee	NO CURRENT ACTIVITY	
Texas	NO CURRENT ACTIVITY	
Utah	NO CURRENT ACTIVITY	
Vermont	NO CURRENT ACTIVITY	
Virgin Islands	NO CURRENT ACTIVITY	
Virginia		ADMIN LETTER 95-11 (1995) (Synthetic GICs are not insurance).
Washington	NO CURRENT ACTIVITY	

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NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
West Virginia	NO CURRENT ACTIVITY	
Wisconsin	NO CURRENT ACTIVITY	
Wyoming	NO CURRENT ACTIVITY	

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In the fall of 1993 a working group was formed and given the charge to look at issues related to synthetic guaranteed investment contracts (GICs). The three members of the working group decided to approach the problem in several phases. The first phase was information gathering. To properly address these issues, the working group agreed to first accumulate sufficient background information concerning synthetic GICs. The chair stated it was critically important to first achieve a base line understanding of these innovative products before regulators could properly evaluate the designs within the context of existing insurance laws. He noted that there are several different product designs. **1993 Proc. 4th Quarter 644, 658.**

After several meetings the chair said that numerous questions remained unanswered and the working group was organizing its questions so that it could begin addressing the fundamental question of whether synthetic GICs were a risk that could be sold by licensed insurance companies, particularly life insurance companies. Some of questions the working group were exploring were: (1) What is a reasonable legal definition of the risk? (2) If a trust is established as a part of the sale, should that trust be subject to regulation? (3) Should synthetic GICs be covered by state guaranty associations? **1994 Proc. 3rd Quarter 518.**

At the end of 1994, the working group made a recommendation that a model law and regulation be developed that grants life insurance companies the authority to sell what are currently described as synthetic GIC products. The working group further recommended that the actuarial task force be given a charge to examine the risks associated with the sale of synthetic GIC products and to provide suggestions on how best to incorporate the regulation of those risks into the proposed model law. **1994 Proc. 4th Quarter 654.**

A first draft was prepared for discussion at the fall meeting in 1996. The working group reviewed the draft section by section and noted that most of the language in this draft was from one state's administrative rules that had been developed with input from several major synthetic GIC writers. The language reflected a conscientious effort to give regulators control if the companies did not stand behind their contract rights designed to protect general account policyholders. This permitted the regulator as a rehabilitator or conservator to cancel the synthetic GIC contract and get it off the books so that the company was not drawn down into liquidation. **1996 Proc. 3rd Quarter 909.**

When the model was presented to the whole membership for adoption, the parent committee chair noted that the issues with the model regulation were similar to those with separate accounts funding and followed a parallel track. The concern was that such products may pose a risk to the general account. The model addressed the conditions for issue of such products, the operative features of the assets involved, and the kinds of reserves an insurer should be required to maintain. The approach was similar to the one adopted in the separate accounts funding guaranteed benefits model. The most controversial feature of this model was the question of who had to approve a company's plan of operation regarding the synthetic GIC. Originally, filing in every state where issued was considered, but was widely opposed by the industry. The resolution of that issue in the model was that the domiciliary state approved the plan of operation, and filing was required in nondomestic states only if the plan was not approved in the home state. However, the nondomiciliary could request a copy of the plan of operation to assist in reviewing the contract filing, and the contract must still be filed in those other states. The motion to adopt the model passed. **1998 Proc. 4th Quarter I 16**.

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Section 1. Authority

Section 2. Purpose

As the working group began discussion of a model law, an interested party said that concern about the ultimate exposure to the general account was appropriate. He also heard concerns about policy design and asked the working group to be mindful of the need not to put product design constraints in the regulation. The chair responded that regulators had no desire to standardize product design, but would focus on protecting the general account and on the reserving requirements. **1996 Proc. 1st Quarter 622.**

Section 3. Scope and Application

A member of the working group suggested that the group go forward with development of a model law to address five main areas: (1) reserves; (2) contract provisions, including termination; (3) investment guidelines; (4) plan of operations; and (5) reporting requirements to the department. **1996 Proc. 2nd Quarter 693.**

When interested parties reviewed the first draft of the model regulation, substantial comments were received on the scope of the regulation. The draft mostly applied to defined contribution plans that guaranteed principle. An interested party suggested a broader scope would be useful. **1996 Proc. 4th Quarter 1046.**

Technical resource advisors discussed what types of products were within the scope of the model. The chair said he thought that the best approach was to look at the nature and characteristics of synthetic guaranteed investment contract (GIC) and various traditional group annuity products, especially the need to properly evaluate the pension plan and its need to meet plan benefit requirements. As such, a conclusion could be justified that a synthetic GIC was substantially similar to a group annuity. The chair noted that some commentators from the industry wanted to expand the regulation specifically to include municipal obligations. In light of the existing Financial Guaranty Insurance Model Act, which specifically authorized municipal obligations to be underwritten by property/casualty insurers, addressing this issue in the synthetic GIC regulation may delay the adoption of the NAIC Synthetic GIC Model Regulation. The technical resource advisors felt that some issues were outside the scope of the project and gave the example of risk-based capital treatment, annual statement and guaranty fund assessments. A regulator noted that he would not want to see other products that were functionally the same as synthetic GICs not covered by the reserving requirements. He suggested that if a product looked like a synthetic GIC and acted like a synthetic GIC, it should have the same reserving requirements as a synthetic GIC. The chair agreed with a functional approach rather than a status approach. **1997 Proc. 1st Quarter 681.**

Later in the year the working group discussed whether the scope of the regulation was too broad. An interested party stated that it was the common understanding of the technical advisors that this model was not intended to cover equity-indexed products. He specifically noted that the words “in

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Section 3 (cont.)

whole or in part" were intended to address situations where insurers issued contracts that contained both synthetic GICs and general account/separate account products. After a lengthy discussion, none of the working group members proposed any changes to the purpose or scope section. The chair suggested that adding the word "segregated" in front of "portfolio of assets" in the definition of "synthetic guaranteed investment contract" would reinforce the intent of the drafters. **1997 Proc. 4th Quarter II 816.**

A lengthy discussion then ensued regarding the word "fixed." A regulator spoke against using the phrase "fixed rate of return" in the scope section and an interested party said the thinking of the drafters had been that, in the absence of the word "fixed," readers may mistakenly assume that equity-indexed products were covered by the model. The chair asked if the drafting note provided any clarity. **1997 Proc. 4th Quarter 817.**

Section 4. Definitions

C. Near the end of the drafting process a regulator renewed his request for a definition of the term "affirmative approval" and use of that concept. **1998 Proc. 4th Quarter I 302**.

H. The working group reviewed the definition of the crediting rate formula. The chair suggested it would be appropriate to delete the word "fixed" because some contracts, over time, may credit a floating rate. An interested party responded that the advisors did not want to describe a variable return based on an index and said some products have a fixed rate but it is not declared in advance. The chair responded that products may be developed that construct a rate of return based on something other than a fixed rate, such as the performance of the contract being wrapped. Another regulator added that a fixed rate of return might be changed every three months; it is not necessarily fixed for the whole contract. **1997 Proc. 2nd Quarter 660.**

I. Near the end of the drafting process, Sections 5A was modified to make it clear that the 60-day period began on the date of the filing. A regulator suggested that the language be further clarified to specifically note that the date of filing was based on the state's submission rules. Regulators decided to add that clarification to the definition. **1998 Proc. 4th Quarter I 303**.

L. During the drafting process changes were made to Subsection L to make it clear that in order for there to be an interest guarantee there had to be a principal guarantee. An interested party stated that some synthetic GICs do not cover defaulted securities, and he asked if Subsection L would eliminate such provisions. Another interested party agreed that there are provisions in many synthetic GICs that remove the principal guarantee from assets that do not maintain minimum requirements, and he said the model language was not intended to preclude those provisions. The chair asked if, typically, the "bad asset" would be replaced by a "good asset." The response was that there could be replacement, or the "bad asset" could simply "evaporate." The chair said he believed the language in Subsection L was broad enough to cover either situation. A regulator responded that a guarantee of principal in a synthetic GIC was a contradiction in terms. The chair stated that

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insurers did guarantee principal, but that they protected themselves against default risk. **1997 Proc 4th Quarter II 817.**

Section 4 (cont.)

M. A regulator questioned the inclusion of the term "synthetic investment" in the definition of hedging instrument. He suggested that the second half of the definition actually stepped away from a hedging transaction. Another regulator suggested that the synthetic investment was acting as a hedge for the entire portfolio. He said this type of product fit better in a separate account with a market value adjustment. **1997 Proc. 2nd Quarter 660.**

O. The working group discussed the definition of investment manager. One regulator said the revised definition in the draft from interested parties included no constraint on an investment manager, whereas the first draft had contained quite a few criteria for an investment manager. The technical resource advisors responded that they did not think it was appropriate to regulate who could be an investment advisor. A regulator asked if the interested parties were increasing the risk faced by the insurance company by eliminating the qualifications. He suggested it put an increased burden on the plan to be sure that it authorized appropriately. The chair suggested that it would be better to say that the person had fiduciary responsibility to manage the assets. **1997 Proc. 2nd Quarter 661.**

Q. A regulator pointed out that in the definition of permitted custodial institution, the reference to custodial relationship had been removed from the draft in the suggestions from technical resource advisors. They responded that the language was drafted so that insurance departments were not trying to regulate anything other than insurance. States had a variety of laws about custodians and the advisors tried to make this law general enough not to regulate the custodians within this synthetic GIC law. A regulator asked how an insurer would protect itself and an interested party responded that the company would do due diligence to make sure the custodian was authorized. Another working group member suggested asking legal counsel what the responsibility of a custodian was; whether he was a fiduciary or a bailee or an agent. The chair asked staff to research this and report to the working group. **1997 Proc. 2nd Quarter 661.**

Staff gave a brief report on whether the custodian of securities functions as a fiduciary or bailee with respect to the depositor of the securities. Under the NAIC Model Regulation on the Use of Clearing Corporations and Federal Reserve Book-Entry System by Insurance Companies and under most state laws, a custodian functions as a bailee rather than an agent with fiduciary responsibility. Agreement was reached to leave in the reference to fiduciary services. **1997 Proc. 3rd Quarter II 1274.**

W. The chair suggested that adding the word "segregated" in front of "portfolio of assets" in the definition of "synthetic guaranteed investment contract" would reinforce the intent of the drafters. **1997 Proc. 4th Quarter II 816.**

Z. Regulators talked about whether an actuary should be designated to render the opinion required in Section 10. The group decided to call this individual a valuation actuary and to require his designation by the company. **1998 Proc. 4th Quarter I 303, 637**.

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Section 5. Financial Requirements and Plan of Operation

A. The working group discussed the financial qualification requirements in Section 5. The chair stated that he thought these requirements were included out of a desire to be consistent with existing state standards. He noted that these standards would upset some of the excluded companies, and that it might be desirable to rely on the marketplace to determine the participants. An interested party said that both regulators and industry personnel should take comfort from knowing that "fly-by-night" insurers would not be permitted to market relatively new and evolving products. The proposed language would allow some commissioner discretion to establish other financial standards. A regulator protested that allowing commissioner discretion destroyed the uniform nature of the regulation. He said he had initially read that language as allowing the commissioner to set higher standards, not lower the explicitly listed financial standards. The chair asked why he was concerned about lowering the standards, since he had previously stated there was minimal risk to the insurer under these contracts. The regulator responded that these were minimal risks for sophisticated insurers, but it could be quite risky for someone who did not know what he was doing. **1997 Proc. 4th Quarter II 816.**

Another member of the working group asked how the contracts could be structured so as to pose a substantial risk to the insurer. An interested party responded that an insurer might offer a contract with a high interest guarantee, combined with high yield/low quality securities and generous withdrawal provisions. The regulator asked if the model adequately addressed the underwriting provisions that should be contained in the contracts, or if it would fall back to the state's judgement when reviewing each contract. A regulator from a state with requirements in place noted that in her state insurers were required to be authorized to write separate account business in order to write synthetic GICs. A provision allowing commissioner discretion would never be approved by the attorney general because it was too arbitrary. She also stated that she would prefer to have consistency with the financial requirements for writing separate account business, and she did not want to eliminate sophisticated companies through excessive financial requirements. **1997 Proc. 4th Quarter II 816.**

A lengthy discussion took place regarding the intent of Subsection A and whether it was the intent of the working group to allow the commissioner the flexibility to set financial standards without regard to the amounts specified. The chair opined that the subsection allowed the commissioner to set either higher or lower requirements, at the commissioner's discretion, which were applicable to specific companies. An interested party stated that the language had been included to give the commissioner the discretion to lower the amounts specified, but he agreed that the language gave the commissioner the authority to either raise or lower the amounts in specific cases. This would provide the commissioner some flexibility in allowing smaller companies to issue synthetic GICs on a company-by-company basis. At the conclusion of the discussion, the working group agreed that the commissioner should have the discretion to both raise and lower the suggested financial standards. **1998 Proc. 1st Quarter 757.**

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Section 5A (cont.)

The actuarial professional association suggested that the words "an unqualified opinion" should be substituted for "a statement certified." The actuary could not certify as to the adequacy of the consideration for risks in the usual sense of the word, which implied a guarantee. The actuary could opine as to the adequacy, with an unqualified opinion implying the same degree of positive assurance provided by the Actuarial Opinion and Memorandum Model Regulation. To provide the opining actuary with the appropriate guidance as to what constituted adequacy in this case, an Actuarial Standard of Practice, perhaps supplemented by Practice Notes, should be developed. There was no existing guidance available to the actuary; however, the association representative suggested that adoption of the model regulation not be delayed until the Standard was developed. **1998 Proc. 1st Quarter 744.**

When the model was presented to the parent committee for adoption, a spokesperson for a trade association said his association objected to the requirement of $1 billion in admitted assets. He said the quality of a company was not dictated by its size and his organization objected to any barriers placed on the market based on company size. He said he brought his request to the working group at each of its meetings and now asked the life insurance committee to consider removal of the language. An interested party drew the committee's attention to another part of the provision, which said that the commissioner could set other limits. He opined that this language, added to address the concerns of small companies, gave the commissioner flexibility to set other standards not based on company size. A regulator spoke against making a change to the draft as presented and said that the interested party's comments acknowledged that his concerns had been considered by the working group. He noted that it a state always has the option to change a model. The motion to adopt the model passed. **1998 Proc. 4th Quarter II 609**.

B. One regulator said one of the problems that he saw was that because of the competitive nature of the product, significant portions of the contract were subject to negotiation. He felt uncomfortable approving this type of filing and asked if the initial draft prepared by the chair dealt with this issue. The chair responded that the draft was written with a requirement that a plan of operation be filed for each contract, which would include the investment guidelines and that would allow the regulator to review the description of each contract. The regulator asked if it was possible to prepare a filing that included all the alternative acceptable plans of operation. The chair responded that for larger contracts the plan of operation investment guidelines would vary and noted that his state only accepted one-case filings. As drafted, the regulation was open on this issue. **1996 Proc. 3rd Quarter 909.**

The chair questioned the draft provision that allowed the commissioner to disapprove a filing for a contract issued in another state. He asked why the regulation adopted in one state would deal with contracts in another state. Another regulator responded that his state regulated contracts issued in another state because it was concerned about how the contracts a company issued would affect his state's policyholders. An interested party pointed out that the filing requirement for the domestic state included filing the plan of operation, whereas only the contract needed to be filed in the nondomiciliary state. Mr. Gorski questioned the provision that required only the filing of the plan of operation in the domestic state; he said filing the plan of operation without the contract would not be meaningful. **1997 Proc. 2nd Quarter 661.**

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Section 5B (cont.)

An interested party pointed out that the contract and plan of operation would be deemed approved if the company did not hear back in 60 days. He said the company would only use this approach if it was certain that the contract would be approved because otherwise it would have to go back and change existing contracts. The chair said there would be some risks to the insurer that, if it changed the contract, the company would lose money, but he concluded that the risk was much smaller than it appeared at first blush because the regulator would be reluctant to require a change in the contract. **1997 Proc. 2nd Quarter 661.**

A discussion then occurred regarding the extent to which a foreign company should be required to file a plan of operations. An interested party stated that requiring a foreign company to file a plan of operations with the state of filing was a "deal breaker." He stated that the contract itself needed to be filed with the state of filing of the contract, but since the plan of operations impacted the solvency of the company it should only be filed with the state of domicile. If the state of domicile had no law relative to synthetic GICs, then the plan of operation should be filed with the state of filing on an informational basis. A representative from an insurer said that he had encountered difficulties filing in multiple states, both from a legal and a logistical standpoint. The chair stated that, from a practical standpoint, the plan of operations needed to be available to the state of filing, because it was unlikely to be able to send an examiner to the company to obtain this information. **1997 Proc. 3rd Quarter II 1260.**

The chair stated that he was firmly convinced that the plan of operations should be filed with the state of filing. Other members of the working group expressed agreement but one regulator said he also understood the practical concerns the companies were expressing. One said that the state of filing could not be sure that the state of domicile would do a thorough job of reviewing the plan of operations. An interested party said that the state of filing should refrain from reviewing the plan of operations if the state of domicile has performed an adequate review and the regulator said that, as a practical matter that is what happens, but she still wanted the opportunity to ask for it. Another state regulator suggested that the review process by the state of filing would take less time if the company included information regarding the state of domicile's review (e.g., who reviewed it, when it was approved, and a summary of the key concepts). **1997 Proc. 3rd Quarter II 1260-1261.**

An association expressed concern that the plan of operation filing requirements set forth in early drafts of the model regulation added a new and potentially onerous layer of regulation for insurers that could impede the availability of new stable value synthetic products in the marketplace. The draft model regulation required that non-domestic companies file a plan of operation for approval, as part of the contract filing process, although this requirement could be waived at the discretion of the commissioner and would be waived if the insurer's home state has promulgated regulations substantially similar to the model regulation and had approved the plan of operation. If every state were to adopt the model regulation, this extraterritoriality provision would not be onerous but the association expressed concern that a number of states, including some of the largest ones, would not adopt the model regulation. **1998 Proc. 1st Quarter 755**.

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Section 5B (cont.)

Near the end of the drafting process, interested parties expressed concern about the filing and approval provisions of Section5. Insurers' competition, usually national banks, did not have similar regulatory constraints placed on them in marketing this business, and the banks exploited this difference to the detriment of the insurance industry. Interested parties said the model regulation provided a comprehensive regulatory framework for the review and approval of the plan of operation by the domestic regulator. The industry urged regulators not to include provisions for the foreign jurisdiction to go through the exact same process that had already been carried out by the domestic regulator. **1998 Proc. 3rd Quarter 271**.

Interested parties expressed concern about including language about a nondomiciliary regulator reviewing the plan of operation. If states that have not been actively involved in the process adopt the language because it is included in the model, regulators in those states may begin in-depth review of plans of operation simply because they believe they are supposed to, rather than because of a particular concern regarding a product filing. **1998 Proc. 3rd Quarter 272**.

When it appeared that there were irreconcilable differences between the desires and needs of regulators and insurers with regard to filing and approval of the plan of operation in the nondomiciliary state, interested parties proposed a new approach they said would address the concerns of both groups. They suggested dividing the plan of operation requirements in Section 5 into two parts. The revised Section 5 would focus on financial and other requirements to write group guaranteed separate accounts business, which would be filed for approval in the home state only. A new Section 6 would be added to include contractual features and would be geared toward nondomiciliary filings. **1998 Proc. 3rd Quarter 539-540**.

Near the end of the drafting process, Subsection A was modified to make it clear that the 60-day period began on the date of the filing. A regulator suggested that the language be further clarified to specifically note that the date of filing was based on the state's submission rules. Regulators decided to add that clarification to the definition. **1998 Proc. 4th Quarter I 303**.

Section 6. Required Contract Provisions and Filing Requirements

B. One comment on the first draft was that the proposed filing arrangement was cumbersome. Many of the commentors expressed a desire for a master or a prototype filing rather than having each plan filed with the insurance department. **1996 Proc. 4th Quarter 1046.**

Interested parties prepared an alternative draft for working group consideration. An important feature of that draft was a file and use provision that allowed companies to use policy forms quickly to react to the changing market. An interested party said the file and use provision was written very conservatively so that companies would not use it lightly. **1997 Proc. 2nd Quarter 660.**

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Section 6B (cont.)

An interested party said the file and use approach included would allow the companies to remain more competitive. It was intended to be used conservatively because it included a provision for the regulator to ask for changes anytime during the 60 days after filing. A regulator suggested this would not match the general filing statutes in many states so they would be reluctant to pass this model. She said she could not adopt these regulations in her state because the law had different requirements. A regulator suggested the model could be written to follow its provisions or the applicable state law. **1997 Proc. 2nd Quarter 661.**

An interested party said that Paragraph (3) addressed the requirements for filing the contract, depending on where the plan of operation had been filed and the status of that filing. He provided a chart showing what information would be provided to the nondomiciliary regulator under each of the different possible combinations of events. **1998 Proc. 4th Quarter I 302, 306-307**.

A regulator asked what would be the result if a domiciliary regulator required the filing of the plan of operations, but not in the form required by the model. The interested party responded that the nondomiciliary regulator could decide which form of the plan of operation would be most helpful in his review of the contract. **1998 Proc. 4th Quarter I 302**.

Another regulator asked what would happen where the domestic state did not approve plans of operations as a matter of practice, and subsequent to the nondomestic regulators' approval of a product filing, the company wanted to change the plan of operations. The interested party said approval of the contract filing could be made contingent on the plan of operations being followed. A regulator recommended adding a drafting note that described what would happen where the state of domicile did not approve filings of the plans of operations. **1998 Proc. 4th Quarter I 303**.

Section 7. Investment Management of the Segregated Portfolio

A regulator said he was not comfortable with the investment guidelines section of the contracts he had reviewed. He had concerns about the riskiness, but saw this as part of the evolution of the market. He felt that the products can be sold by life insurance companies, but he would like to see a regulatory framework established. **1994 Proc. 2nd Quarter 581**.

Interested parties suggesting adding a new section to address investment management. The chair asked if there was potential for "gaming" or confusion under this section through the use of more than one investment manager. He suggested that a drafting note should be developed that clarified the application of Section 7 in the event of multiple investment managers. A working group member expressed concern regarding the reference to the domiciliary insurance department in Subsection C. She pointed to the situation where the domiciliary state may have no regulation pertaining to synthetic GICs, so the domiciliary state may never have approved the original plan of operations. **1997 Proc. 3rd Quarter II 1274.**

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Section 8. Purchase of Annuities

A lengthy discussion of Section 8 ensued as to whether the word “cash” could be expanded to include “in kind” assets. The chair summarized the discussion by saying that, for practical reasons, the word “cash” would remain unchanged. **1997 Proc. 3rd Quarter II 1274.**

Section 9. Unilateral Contract Terminations

Section 10. Reserves

Several comments on reserving were included in the reactions to the first draft of the model regulation. Interested parties emphasized the importance of building on the existing regulations on separate accounts, risk-based capital, etc., as a starting point. **1996 Proc. 4th Quarter 1046.**

The working group decided to request input from the NAIC’s actuarial committee on Section 10 of the draft, and the chair reported that the committee voted to endorse the proposed language (which included a prospective approach for reserves). He also noted that one regulator submitted a memo expressing support for a retrospective approach similar to that in effect in his state. **1997 Proc. 4th Quarter 807.**

B. A regulator referred to Section 10B(4)(a) and asked when cash flow testing would not be appropriate and what would substitute for cash flow testing in those circumstances? An interested party stated that the primary point of this subparagraph was that sufficiency of assets must be demonstrated. However, the language also attempted to make clear that there were other acceptable methods for demonstrating that sufficiency beyond just cash flow testing. One member of the working group asked if a company could combine its synthetic GICs with other products in demonstrating sufficiency and the interested party responded that the language seemed to require the synthetic GICs to stand on their own merits. The chair noted that this was somewhat stronger than the normal asset adequacy analysis. **1997 Proc. 4th Quarter 807.**

The actuarial profession’s association recommended changes with respect to the actuarial opinion and memorandum required by the draft: The words “good and sufficient” should be replaced by “adequate” throughout the section to ensure consistency with the Actuarial Opinion and Memorandum Regulation, which uses only adequacy as the reserve criterion. “Good and sufficient” currently had no commonly agreed upon meaning. The list of officer-certified items in Paragraph (6) should not include any that require actuarial expertise. These should be transferred to the list of items required in the actuarial memorandum. The filing requirements for the actuarial opinion and memorandum should be made consistent with those for the company-wide actuarial opinion and memorandum. For example, the opinion would be filed annually, but the memorandum would be submitted to the commissioner only upon request. **1998 Proc. 1st Quarter 744.**

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Section 10B (cont.)

An interested party pointed out that the model draft did not include a provision for confidentiality of the memorandum. The memorandum would necessarily contain proprietary information. He also urged the working group to include a provision that would protect the actuary from liability. The Actuarial Opinion and Memorandum Regulation and Standard Valuation Law specifically released the appointed actuary from liability to anyone except the commissioner and his or her company. The actuary opining under the synthetic GIC draft did not appear to have the same protection. **1998 Proc. 1st Quarter 745.**

A representative from an actuarial association expressed concern that the exact form of the actuarial opinion was not used in the model regulation. Even placing the word "adequacy" in the text did not make clear that what the actuary should be opining on is that the reserves and related actuarial items, when considered in light of the assets hold by the company with respect to such reserves and related actuarial items and the assets held in the segregated portfolio and anticipated cash flows, and the considerations anticipated to be received and retained under such contracts, make adequate provision for the anticipated cash flows required by the contractual obligations and related expenses of the company. **1998 Proc. 1st Quarter 745.**

The working group considered the suggestions, which were intended to provide more consistency with the opinion required for the statutory annual statement. The working group agreed to draft language to incorporate the suggestions from the actuarial association. **1998 Proc. 1st Quarter 742.**

The chair stated that he personally has no problem with the actuarial memorandum being submitted to the commissioner only upon request and asked that language to that effect be included in the next draft. **1998 Proc. 1st Quarter 742.**

Section 11. Severability

Section 12. Effective Date

An interested party commented that there should be an allowable time period during which the companies currently issuing synthetic GICs on forms previously approved could continue to do business while providing the necessary time for refiling and state approval of the new standards. To force companies to discontinue operations as a result of a change in regulation solely would create an enormous hardship and greatly damage existing business relationships. The chair responded by saying that it would take considerable time for a state to adopt the regulation, and companies should use that period to file the plan of operations and other necessary documentation. **1998 Proc. 1st Quarter 757.**

Chronological Summary of Actions

March 1999: Model adopted.

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