CAPTIVES

Superintendent
Joe Torti

November 2015 CIPR Event – Session 3
DEVELOPMENT OF CAPTIVE STRUCTURE

- Pure captives developed as an official industry in the late 1970’s
- U.S. captive regulation/laws developed outside of the NAIC solvency framework
- Similarly, captives were excluded from the NAIC Accreditation Program
CONCERNS WITH DISPARATE REGULATION

- Inconsistent regulation of the transactions is an important concern
- Lack of transparency
- More Difficult to Assess Industry Position and Any Concerns
- Concerns Shared by Federal Gov’t – FSOC, FIO, OFR, Federal Reserve
- Significant Portion of Industry Is No Longer Using Consistent, Conservative Accounting
XXX/AXXX BUSINESS

- **Section 6, NAIC Model 830 (aka “XXX”)**
  - In general, XXX was developed to address a reserving issue with level term (and similar) products
  - Reserves based on a specified interest rate and specified mortality table

- **Section 7, NAIC Model 830 (aka AXXX)**
  - Addressed reserving issues for Universal Life Insurance policies that Contain a Secondary Guarantee
Industry’s Issue with XXX/AXXX

- Products are priced using expected assumptions
  - Premiums collected are not sufficient to fund the required statutory reserves
  - Companies are faced with a decision to fund this difference with surplus or look for other sources of capital

- XXX/AXXX Reserves were established too high, sometimes 3–4 times the “economic” reserve.

- Insurers began reserve financing transactions by ceding reserve values to captives and SPVs.
XXX/AXXX Reinsurance Framework

Require the direct ceding company for reinsurance financing transactions, in most instances, to:

- Book the full statutory reserve.
- Collateralize based on a tiered reserve.
- Disclose assets/securities supporting reserves.
- Hold appropriate RBC capital charge.

Rector & Associates, Inc.
Statutory Reserves
Minus PBR-Level Reserves

Primary Security:
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Acceptable Security

Primary Security:
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Acceptable Security

Primary Security:
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Acceptable Security

Primary Security:
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Acceptable Security

Primary Security:
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Acceptable Security

Primary Security:
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Acceptable Security

Primary Security:
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Acceptable Security
Means to Implement Framework

- Credit for Reinsurance Model Law
  - Will reference a new model regulation related to XXX/AXXX reinsurance transactions
  - This is the longer-term solution requiring state-by-state adoption.

- New Actuarial Guideline 48
  - AG 48 was created for quick implementation.
  - AG 48 will sunset once Credit for Reinsurance Model Law & new Regulation are implemented.

- Permanent Solution is PBR!!!!
Actuarial Guideline 48 (AG48)

Background Section Summary

- Purpose and intent of AG48 is to establish uniform, national standards governing XXX or AXXX reserve financing
  - AG48 defines the “Actuarial Method” used to determine the reserve level
  - AG48 defines “Primary Security”
  - AG48 may require a qualified actuarial opinion
  - AG48 states that the requirements of the actuarial guideline are minimum standards and are not a substitute for the diligent analysis of reserve financing arrangements by regulators and that a regulator should impose requirements in addition to those set out in this actuarial guideline if the facts and circumstances warrant such action.

- Effective Date
  - January 1, 2015 to all Covered Policies

- Sunset Provision
  - This Actuarial Guideline shall cease to apply as to ceding insurers domiciled in a jurisdiction that has in effect, as of January 1st of the calendar year immediately preceding the year in which the actuarial opinion is to be filed, a law and regulation substantially similar to the amendment to the Credit for Reinsurance Model Law and new Model Regulation adopted by the NAIC.
TRANSPARENCY & ANALYSIS FOR XXX/AXXX CAPTIVE TRANSACTIONS

- Increased Transparency:
  - 2014 Blanks Change
    - XXX/AXXX Reinsurance Supplement – Due by April 1

  - Sets forth procedures and other considerations when:
    - reviewing a new proposed XXX/AXXX transaction
    - when analyzing an existing XXX/AXXX transaction
  - Sets forth requirements related to holding company analysis

- Part B accreditation requirements related to the above
Our next priorities: Variable Annuities and Long-term Care (LTC).

- Remember, FSOC’s 2014 Annual Report identified variable annuity and LTC captive reinsurance transactions as priorities for state regulators to address, and some have suggested these and potentially other captive transactions are a systemic issue.

NAIC established the Variable Annuities Issues (E) Working Group, led by Commissioner Gerhart of Iowa, to “study and address, as appropriate, regulatory issues resulting in variable annuity captive reinsurance transactions.”

- Consultant hired to identify issues and possible solutions
- “Preliminary Findings and Conclusions” presented to the Working Group and Industry on September 10th
- Quantitative Impact Study (“QIS”) approved and funded
- Additional Disclosure being added to provide immediate transparency
Perception that captives are being used to reduce required reserves on a line of business that has had under reserving and underpricing issues.

NAIC staff and the primary regulators of insurers utilizing LTC Captives did an initial review of these transactions.

Reserving and/or assets to support reserves do not appear to be an issue at all.

Still on the E Committee Agenda
The Financial Regulation Standards and Accreditation (F) Committee is also considering language to scope in captive reinsurance transactions involving XXX/AXXX, variable annuity, and long-term care business.

Accreditation program is there to ensure that all states are regulating the companies writing multi-state coverages in a uniform and consistent manner.
Wrap Up

- Addressing regulatory concerns with Captive/SPV transactions paired with implementation of PBR is a priority issue for the NAIC Membership and Officers
- We have identified and made significant progress in addressing all of the major issues related to captives/SPVs
- Remaining implementation issues will be addressed promptly, including issues related to Accreditation
- The new E Committee process to identify national solvency framework issues should prevent future single state solutions
QUESTIONS OR COMMENTS