

## **Modified Recommendations—June 4, 2014**

The NAIC received approximately 20 comment letters pertaining to the Report of Rector & Associates, Inc. to the Principle-Based Reserving Implementation (EX) Task Force, dated February 17, 2014 (“the February Report”). We found the letters, and the testimony before the Task Force,<sup>1</sup> to be extremely helpful, and we thank those who took the time to read the February Report carefully and to provide such thoughtful comments.

Based on the comments received, and on further reflection and discussion, we have made some modifications to the recommendations set out in the February Report. Although the conceptual underpinnings of the proposed XXX/AXXX Reinsurance Framework (the “Framework”) are relatively straightforward, the actions needed to “codify” the Framework and to prevent attempts to avoid it are more complex. Our modified recommendations (below) consist of a number of individual items that are designed to work together to implement the Framework. It is important that all of the items be adopted; the list below is not a menu from which we ask the Task Force to pick and choose.

As noted below, some of the items will necessitate changes to laws and/or regulations, and it may take several years for those items to become effective in all states. Other items are designed to encourage adherence to the Framework even while states are in the process of adopting the recommended changes to laws and regulations.

**It is also important to point out that the attached Exhibits should be viewed merely as “starting points” for the various task forces and working groups. We ask readers of this document to hold for now any detailed comments regarding the Exhibits and to focus, instead, on the general approach underlying our modified recommendations.** Readers will have the opportunity to provide detailed comments later regarding the Exhibits and other items as they are further developed by the various task forces and working groups.

The following are our modified recommendations:

1. **Adopting the Framework Approach.** We recommend that the Task Force adopt the Framework approach, in concept, as soon as practicable, even before all of the details are finalized. Although adoption of the Framework in concept would not in and of itself have any legal effect, it would operate to promote greater uniformity and consistency by generally describing the “right way” to engage in reserve financing transactions. As

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<sup>1</sup> In general, capitalized terms used here have the same meaning as they did in the February Report. However, in many cases, specific details regarding those defined terms remain to be worked out by various technical groups of the NAIC pursuant to charges from the Task Force, as described. Further, the word “Security” has replaced the word “Asset” in several of the defined terms.

such, states could begin to use certain of the concepts that are part of the Framework, as their laws allow, even before all of the items below are finalized.

Key elements of the Framework are described in **Exhibit 1**. As noted, the most significant items still to be determined are: (a) whether clean, irrevocable, unconditional, “evergreen” letters of credit should be allowed as Primary Security<sup>2</sup> and (b) whether the “net premium reserve” component of current VM-20 should be included as part of the Actuarial Method (either in current or in modified form)<sup>3</sup>. We recommend that the Task Force hold an interim meeting, in-person or telephonically, to facilitate adoption of the Framework.

2. Actions to be taken by the Task Force. As described in **Exhibit 2**, we recommend that the Task Force take certain actions to move toward implementation of the Framework, including adopting charges to various NAIC task forces and working groups.
3. Actuarial Opinion Memorandum Regulation (AOMR). Section 3 of the AOMR provides, in part:

[T]he commissioner shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner’s judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items.

We recommend that the NAIC rely on this language as an interim step to adopt an Actuarial Guideline that specifies that the opining actuary for a ceding insurer (1) must follow the methods and assumptions developed as individual components of the Framework to determine whether the ceding insurer’s net reserves are appropriate, and (2) must issue a qualified actuarial opinion if the ceding insurer has entered into a reserve financing transaction that does not adhere to the Framework. The draft Actuarial Guideline attached hereto as **Exhibit 3** could be a starting point for further work. We also recommend that the NAIC evaluate whether the current RBC “charge” relative to qualified actuarial opinions is appropriate.

The AOMR is required pursuant to the Accreditation Program. Accordingly, the recommended Actuarial Guideline—providing guidance relative to the AOMR—could be made to be effective in most states on a very timely basis, with the specific timing to be determined by the Task Force after work on the Guideline is complete. As such, we believe this is an important step to encourage and monitor compliance with the Framework in the near-term, as well as in the long-term.

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<sup>2</sup> Our current thoughts regarding the use of letters of credit as Primary Security are set out in Exhibit 4, Section 4.B.(3).

<sup>3</sup> We believe an appropriately-calibrated “net premium reserve” (NPR) would help ensure consistency between transactions and would help prevent the Primary Security Requirement from deviating substantially from what the reserve would be under principle-based reserving (PBR), which has an NPR component. However, we would like to receive input from the Life Actuarial (A) Task Force (LATF), including how to properly calibrate the NPR if one were used, before making our final recommendations to the Task Force on the matter.

As noted above, we recommend adoption of the Actuarial Guideline as an interim step. To further lock-in the proposed approach, we recommend that the NAIC add the same provisions to a regulation (either as an amendment to the AOMR or an addition to the draft regulation attached as **Exhibit 4**), and that such regulation become an Accreditation Standard.

4. Specific Provisions Relative to Reserve Financing Transactions Involving Licensed and Accredited Reinsurers and Reinsurers Domiciled in a State other than that of the Ceding Insurer. The Credit for Reinsurance Model Law does not include collateral requirements in connection with reinsurance ceded to “licensed” or “accredited” reinsurers or those “domiciled in ... a state that employs standards regarding credit for reinsurance substantially similar” to those applicable in the state where the ceding insurer is domiciled. Accordingly, a change to the Model Law would be needed to apply the Framework collateral requirements in instances where one of those types of reinsurers does not follow statutory accounting or comply with RBC. We recommend such a change to the Model Law. In order not to risk opening up the Model Law to unrelated changes—which could complicate and delay adoption—we recommend that the change to the Model Law itself be specific and narrow. In essence, we recommend that Sections 2.A., 2.B. and 2.C. of the Credit for Reinsurance Model Law be amended to allow the commissioner to specify, by regulation, any other requirements a reinsurer involved with reserve financing transactions must meet in order for it to qualify as a reinsurer within the meaning of those three sections of the Model Law. We then recommend that a regulation be drafted, containing provisions similar to section 5 of the attached **Exhibit 4**, that specifies that an assuming reinsurer cannot be considered to be one of the types of reinsurers referenced by those sections of the Model Law unless it complies with NAIC RBC requirements and prepares its financial statements in material conformity with NAIC statutory accounting practices and procedures. We recommend that the changes to the Model Law and the new Model Regulation be required pursuant to the Accreditation Program. We anticipate that it would take several years before these changes become effective in all states.
5. Specific Provisions Relative to Reinsurance Financing Transactions Involving Unauthorized Reinsurers. Under the Credit for Reinsurance Model Law, commissioner approval is needed before any asset other than cash, SVO-listed securities and certain types of letters of credit<sup>4</sup> can be used to collateralize reinsurance ceded to unauthorized reinsurers. Accordingly, commissioners have the authority to deny the use of Other Security as collateral in connection with unauthorized reinsurers unless the Primary Security Requirement has been met. We recommend that the NAIC adopt a model regulation, containing provisions similar to those in sections 6 and 7 of the attached **Exhibit 4**, to incorporate this concept. We recommend that the regulation be required pursuant to the Accreditation Program. We anticipate that it would take several years before this regulation becomes effective in all states.

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<sup>4</sup> Those that are clean, irrevocable, unconditional and “evergreen” and that meet the other requirements of the Model Credit for Reinsurance Regulation, Section 10.A.(3).

6. Disclosure of Key Aspects of XXX/AXXX Reinsurance Arrangements. As described in our February Report, we recommend that the NAIC require public disclosure of key information pertaining to reserve financing transactions. Our understanding is that the NAIC is working on disclosure requirements separate from our work relative to the Framework, and we encourage those efforts. Although our work in this area (outlined on **Exhibit 5**) may help the NAIC's Blanks (E) Working Group in its work relative to appropriate disclosure, we do not intend to imply that we believe the NAIC should be limited to the types of disclosures outlined on **Exhibit 5** if it determines that broader disclosure would be helpful. We recommend that the supplemental filing provisions be made effective for filings as of December 31, 2014.
7. Risk-Based Capital (RBC) Changes. As described in our February Report, we recommend (1) that the RBC instructions be amended to ensure that at least one party to the reserve financing transaction holds an appropriate RBC "cushion," and (2) that the Capital Adequacy Task Force determine appropriate RBC "asset charges" relative to Other Assets. We continue to recommend that these items be made effective as of December 31, 2015.

Further, as described above, we recommend that the NAIC evaluate whether the current RBC "charge" relative to qualified actuarial opinions is appropriate. We recommend that this item be made effective as of December 31, 2014.

8. Evaluate risk-transfer rules. We recommend that the NAIC evaluate the risk-transfer rules applicable to reserve financing transactions pertaining to XXX/AXXX business to make sure they appropriately apply to situations such as those where parental/affiliate guarantees are used to keep insurance risk within the holding company system even if the reinsurance arrangement involves an unrelated third party.
9. Financial Analysis Handbook. We recommend that the NAIC prepare a new section of the Financial Analysis Handbook to set out procedures and provide guidance to insurance regulators as they evaluate reserve financing transactions. We recommend that this new section be available effective as of December 31, 2014.
10. Note to Audited Financial Statement. As described in our February Report, we recommend that a note to the ceding insurer's annual audited financial statement be adopted to indicate whether reserve financing transactions entered into by a ceding insurer adhere to the Framework.

## **Exhibit 1—XXX/AXXX Reinsurance Framework**

1. The Framework applies only to reinsurance involving certain types of XXX and AXXX policies (those required to be valued under Sections 6 or 7 of the NAIC Valuation of Life Insurance Policies Model Regulation).
2. The Framework does not materially change the ability of insurers to obtain credit for reinsurance ceded to professional “certified” reinsurers or to obtain credit for reinsurance ceded to “licensed” or “accredited” reinsurers that follow statutory accounting and RBC rules. (See “**Exemptions**” below).
3. As a practical matter, therefore, the new Framework requirements apply to reinsurance ceded to captive insurers, special purpose vehicles, reinsurers that are not eligible to become “certified” reinsurers, reinsurers that deviate from statutory accounting and/or RBC rules, etc. In those situations, the ceding insurer may receive credit for reinsurance if, but only if:
  - The ceding insurer establishes gross reserves, in full, using applicable reserving guidance (currently, the “formulaic” approach).
  - The ceding insurer satisfies the **Primary Security Requirement** (i.e., the ceding insurer receives as collateral **Primary Security** in at least the amount determined pursuant to the **Actuarial Method**).
  - Portions of the statutory reserve exceeding the Primary Security Requirement may be collateralized by **Other Security**.
  - At least one party to the financing transaction holds an appropriate **RBC “cushion”**.
  - The reinsurance arrangement is approved by the ceding insurer’s domestic regulator.
4. The Framework also includes provisions to police and enforce the new requirements, and to determine whether any “exemptions” relied upon are warranted, including:
  - An Actuarial Guideline adopted pursuant to the Actuarial Opinion Memorandum Regulation (**AOMR**) as an interim step, and subsequent amendment to the AOMR or other regulation, to require the opining actuary for the ceding insurer to issue a qualified opinion if the Framework is not followed (absent an exemption).
  - A **Note** to the annual audited statement requiring the ceding insurer, and its independent auditor, to indicate whether the Framework is being followed (absent an exemption).

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The following is a summary of each of the terms in bold above:

1. **Exemptions.** Other than certain limited disclosure provisions, the new requirements generally do not apply to reinsurance ceded to an assuming reinsurer meeting the definition of Section 2.A. (authorized insurers), 2.B. (accredited insurers), or 2.C (insurers domiciled in another state) of the Credit for Reinsurance Model Law, as revised pursuant to our modified recommendation, or to reinsurance ceded pursuant to Sections 2.D (reinsurers maintaining trust funds) or 2.E (certified reinsurers) of the Model Law.
2. **Primary Security Requirement.** The ceding insurer would need to receive as collateral (on a funds withheld, trust or modified co-insurance basis) Primary Security in at least the amount determined pursuant to the Actuarial Method.
3. **Actuarial Method.** We recommend that the Actuarial Method consist of VM-20<sup>1</sup>, modified to incorporate changes to mortality tables as developed by the American Academy of Actuaries and any other modifications suggested by LATF. *An open question is whether to alter or eliminate the “net premium reserve” component.*
4. **Primary Security.** We recommend that the types of assets listed in the Credit for Reinsurance Model Law Sections 3.A. (cash) and 3.B. (SVO-listed securities meeting certain characteristics) be allowed as Primary Security. *An open question is to what extent (if any) clean, irrevocable, unconditional “evergreen” letters of credit should be allowed as Primary Security.*
5. **Other Security.** We recommend that, so long as the Primary Security Requirement is satisfied, the ceding insurer may receive as collateral for the remainder of the statutory reserve any other security as to which the NAIC has developed an RBC “asset charge.” (We have recommended that the Capital Adequacy Task Force determine RBC “asset charges” for anticipated categories of Other Security and an appropriate “catch-all” charge to apply to assets that are not specifically listed.)
6. **RBC “cushion”.** This item is discussed further in our modified recommendations and in our February Report. We recommend that the details be worked out by the Capital Adequacy Task Force.
7. **AOMR.** This item is discussed in our modified recommendations. We recommend that the details be worked out by LATF.
8. **Note.** This item is discussed in our modified recommendations and in the February Report. We recommend that the details be worked out by the Statutory Accounting Principles Working Group.

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<sup>1</sup> NAIC Valuation Manual, VM-20, Requirements for Principle-Based Reserves for Life Products.

## **Exhibit 2—Summary of Actions to be taken by the Task Force Relative to the XXX/AXXX Reinsurance Framework**

### ***Pre-Framework Actions: Immediate action needed, even before the Task Force adopts the Framework***

1. Adopt the following charge to the Blanks (E) Working Group:

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

**NOTE:** *The goal of the supplemental filing is for the ceding insurer to provide transparency regarding the assets and reserves pertaining to reinsurance of XXX/AXXX policies, especially when the assuming reinsurer is not subject to public disclosure requirements for these data points.*

- *Tables 2 and 3 reference terms that will not be authoritative until the adoption of the NAIC XXX/AXXX Reinsurance Model Regulation. If the model is not adopted as anticipated during 2014, the Blanks (E) Working Group will need to consider using other terms or issuing guidance to companies as to how to complete the Supplement until the Model Regulation is adopted.*

2. Adopt the following charge to the Financial Analysis Handbook (E) Working Group:

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

**NOTE:** *The Financial Analysis Handbook (E) Working Group should consider developing a recommendation to the Financial Regulation Standards and Accreditation (F) Committee regarding Part B standards related to the above procedures.*

3. Adopt the following charge to the Life Actuarial (A) Task Force (LATF):

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

**NOTE:** *This should be completed as soon as possible and sent back to the Principle-Based Reserving Implementation (EX) Task Force for adoption. In the event the NAIC XXX/AXXX Reinsurance Model Regulation is not completed as planned in 2014, this Actuarial Method may be used by states on a voluntary basis in the interim period. Even before the Model Regulation is implemented, this Actuarial Method proposal may be considered for inclusion in the Financial Analysis procedures referenced in item 2 above as an appropriate and consistent method for determining whether the ceding insurer has received sufficient collateral to support its policy obligations.*

**Next step: Action to take on the Framework**

4. Adopt the XXX/AXXX Reinsurance Framework and Summary of Actions (Exhibits 1 and 2), in concept, and submit them to the NAIC Executive Committee for approval.

**NOTE:** *At this stage, the Framework would be adopted in concept to propose an overall plan to address concerns with XXX/AXXX reinsurance transactions and to provide direction to the various work streams regarding the details that are to be finalized. As the detailed solution for a particular work stream is completed and the results sent back to the Task Force, consideration for final adoption will be made at that time by the Task Force, the Executive Committee and Plenary.*

**Framework Actions: Other charges to be considered for adoption as part of the XXX/AXXX Reinsurance Framework**

5. Adopt the following charges to LATF:
  - a. “Develop an Actuarial Guideline (AG) to provide interim guidance for the Actuarial Opinion Memorandum Regulation (AOMR) as it relates to XXX/AXXX reinsurance transactions. The AG should specify that, in order to comply with the AOMR, the opining actuary must issue a qualified opinion as to the ceding insurer’s reserves if the ceding insurer or any insurer in its holding company system has engaged in a XXX/AXXX reserve financing transaction that does not adhere to the Actuarial Method and Primary Security forms adopted by the NAIC. The Principle-Based Reserving Implementation (EX) Task Force’s XXX/AXXX Reinsurance Framework Exhibit 3 should be considered for this AG, modified as appropriate by the Task Force.”—Essential

**NOTE:** *The AG will be able to be effective on an interim basis through inclusion in the NAIC Accounting Practices and Procedures Manual and thus will have an earlier effective date of implementation than the following change to the actual AOMR. As new work products of the XXX/AXXX Reinsurance Framework are adopted by the NAIC, the provisions should be considered for inclusion in the Actuarial Guideline.*

- b. “Request permission from Executive Committee to amend the AOMR and draft those amendments to specify that, in order to comply with the AOMR, the opining actuary



must issue a qualified opinion as to the ceding insurer's reserves if the ceding insurer or any insurer in its holding company system has engaged in a reserve financing transaction that does not adhere to the NAIC XXX/AXXX Reinsurance Model Regulation and other aspects of the XXX/AXXX Framework, as adopted by the Task Force."—Essential

6. Adopt the following charge to the Reinsurance (E) Task Force:

- a. "Request permission from Executive Committee to create a new Model Regulation to establish requirements regarding the reinsurance of XXX/AXXX policies. The Principle-Based Reserving Implementation (EX) Task Force's XXX/AXXX Reinsurance Framework Exhibit 4 should be considered for this model regulation, modified as deemed appropriate by the Task Force."—Essential
- b. "Request permission from Executive Committee to amend the Credit for Reinsurance Model Law and draft the amendment to reference this new regulation."—Essential

7. Adopt the following charges to the Statutory Accounting Principles (E) Working Group:

- a. "Develop the proposed definition for 'Primary Security' for use in the Principle-Based Reserving Implementation (EX) Task Force's future consideration of a proposed NAIC XXX/AXXX Reinsurance Model Regulation."—Essential

*NOTE: Based on comments received to the initial draft Framework, the Working Group should explicitly consider the appropriateness of the extent to which, if any, a letter of credit (LOC) may be included as "Primary Security."*

- b. "Develop a Note to the Audited Financial Statements regarding compliance with the NAIC XXX/AXXX Reinsurance Model Regulation."—Essential

*NOTE: Based on comments received to the initial draft Framework, the Working Group should consider the appropriate audit procedures for this note.*

8. Adopt the following charges to the Capital Adequacy (E) Task Force:

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

*NOTE: The proposed XXX/AXXX Reinsurance Framework anticipates this as a 2015 year end filing requirement for RBC reports to be submitted March 1, 2016.*

- b. "Develop appropriate asset charges for the forms of 'Other Security' used by insurers under the NAIC XXX/AXXX Reinsurance Model Regulation. These charges should then be considered for incorporation into the 'RBC Cushion' developed per the previous charge."—Essential

**NOTE:** *This should be accomplished in the same timeframe as the “RBC Cushion.”*

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

**NOTE:** *This should be accomplished no later than effective December 31, 2015.*

9. Adopt the following charge to the Financial Condition (E) Committee:

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

**NOTE:** *The Financial Condition (E) Committee should determine the appropriate group(s) to work on this charge as well as the appropriate timing; it may be appropriate to delay this work until other work products of the XXX/AXXX Reinsurance Framework are completed and adopted.*

10. Adopt the following charge to the Financial Accreditation Standards and Accreditation (F) Committee:

“As the various work products are adopted by the Principle-Based Reserving (EX) Task Force, Executive Committee, and Plenary, consider them for inclusion in the Part A and Part B Accreditation Standards.”—Essential

### **Exhibit 3—Actuarial Guideline AOMR**

#### **Treatment of Reinsurance for Policies required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation in the Actuarial Opinion**

Pursuant to Section 3 of the Actuarial Opinion and Memorandum Regulation (AOMR), the commissioner has the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner's judgment, such specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items. The purpose of this Actuarial Guideline is to specify a specific method of actuarial analysis and actuarial assumptions that must be used when the Appointed Actuary is rendering an Actuarial Opinion for a company that cedes certain policies that are required to be valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Regulation XXX, Model 830).

In addition to the requirements of Section 5, Paragraph D, *Standards for Asset Adequacy Analysis*, and except as provided below, the asset adequacy analysis required by this regulation shall include an analysis of reinsurance ceded on or after [insert effective date] to entities that reinsure life insurance policies required to be valued under Section 6 of the NAIC Valuation of Life Insurance Policies Regulation (#830), commonly referred to as Regulation XXX, or ULSG policies required to be valued under Section of Regulation XXX as further clarified by the NAIC Actuarial Guideline XXXVIII-The Application of the Valuation of Life Insurance Policies Model Regulation (AG 38), commonly referred to as AXXX. Such analysis shall be based on the standards specified in the remainder of this Actuarial Guideline.

The additional analysis described in this Actuarial Guideline is not required relative to:

- A. Policies eligible for exemption under Sections 6.E, 6.F, or 6.G. of Regulation XXX (Model 830); or
- B. Policies issued to an assuming insurer that meets the applicable requirements of [[insert provisions of state laws equivalent to Sections 2.D. or 2.E. of the NAIC Credit for Reinsurance Model Law]]; or
- C. Policies issued to an assuming insurer that meets the applicable requirements of [[insert provisions of state law equivalent to Sections 2.A., 2.B., or 2.C. of the NAIC Credit for Reinsurance Model Law]], and that, in addition:
  - 1. prepares its statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures that are material enough that they would need to be disclosed in the financial statement of the assuming insurer pursuant to Statement

- of Statutory Accounting Principles No. 1 (“SSAP 1”), paragraph 7, if the assuming insurer were required to comply with SSAP 1; and
2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Level Control Event as those terms are defined in [insert provision of state law equivalent to the NAIC Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the NAIC Life Risk-Based Capital Report including Overview and Instructions for Companies, as the same may be amended by the NAIC from time to time, without deviation.

I. DESCRIBE ACTUARIAL METHOD FOR PRIMARY SECURITY REQUIREMENT

*Define Primary Security Requirement based on modified version of VM-20, to be developed by LATF.*

II. DESCRIBE REMEDIES FOR FAILURE TO MEET PRIMARY SECURITY REQUIREMENT IN ORDER TO AVOID QUALIFIED OR ADVERSE OPINION

- A. *Add additional security on or before March 1 of the year in which the Actuarial Opinion is being filed in an amount that would have caused the Primary Security Requirement to be met on the valuation date.*
- B. *Reduce the reserve credit for reinsurance ceded by the difference between the Primary Securities and the Primary Security Requirement.*

III. DESCRIBE ADDITIONAL REQUIREMENTS FOR ACTUARIAL OPINION AND MEMORANDUM FOR COMPANIES THAT MUST TEST THEIR REINSURANCE AGREEMENTS PURSUANT TO THIS ACTUARIAL GUIDELINE

- A. *In statement of Actuarial Opinion, the Appointed Actuary must state whether the appointed actuary has performed an analysis of the types of reinsurance transactions specified above and whether the reinsurance conformed to the requirements of the Actuarial Method for the Primary Security Requirement.*
- B. *If the reinsurance does not conform to the requirements of the Actuarial Method, the Actuary must issue a qualified or adverse opinion as described in Section 6.D. of the AOMR.*
- C. *The Appointed Actuary may not issue a non-qualified actuarial opinion if one of the company’s affiliated reinsurers issues a qualified actuarial opinion.*

## **Exhibit 4—Licensed, Accredited, Unauthorized and Other Reinsurers**

### **Section 1. Authority.**

This regulation is adopted and promulgated by [title of supervisory authority] pursuant to Section [applicable section] of the [name of state] Insurance Code.

### **Section 2. Preamble.**

- A. Sections [insert provision of state law equivalent to Section 2.A., 2.B., and 2.C of the Credit for Reinsurance Model Law] provide that credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded to assuming insurers meeting the requirements set out in those sections.
- B. Sections [insert provision of state law equivalent to Section \_\_ of the Credit for Reinsurance Model Law (providing that the commissioner may specify, by regulation, requirements other than those listed in Sections 2.A., 2.B., and 2.C)]
- C. Section [insert provision of state law equivalent to Section 3.D of the Credit for Reinsurance Model Law] provides that reinsurance ceded pursuant thereto may be collateralized by “any other form of security acceptable to the commissioner.”
- D. Certain reinsurance arrangements pertaining to term life insurance and universal life insurance with secondary guarantees (ULSG) have given rise to significant regulatory concern.
- E. The Commissioner recognizes that reinsurance arrangements referenced above should be structured such that they appropriately protect the ceding company’s policyholders and the citizens of this state.

### **Section 3. Applicability.**

This regulation shall apply to any life insurance company domiciled in this state with respect to cessions of those life insurance policies required to be valued under the Section 6 of the NAIC Valuation of Life Insurance Policies Model Regulation (#830), commonly referred to as Regulation XXX, or to ULSG policies required to be valued under Section 7 of Regulation XXX as further clarified by the NAIC Actuarial Guideline XXXVIII-The Application of the Valuation of Life Insurance Policies Model Regulation (A.G. 38), commonly referred to as AXXX.

[Drafting Note: In Regulation XXX, Section 3.B,(1), it is stated that “... the minimum valuation standard for policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits (other than universal life policies), or both, shall be in accordance with the provisions of Section 6.” And in Regulation XXX, Section 3.B,(2), it is stated that “... the minimum valuation standard for flexible premium and fixed premium universal life insurance policies, that contain provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period shall be in accordance with the provisions of Section 7.” Companies ceding these two classes of policies are the companies to which this regulation is intended to apply.]

### **Section 4. Definitions.**

- A. "Actuarial Method" shall mean a calculation made pursuant to Actuarial Guideline \_\_\_, as the same shall be amended from time to time. *[Note: this AG has not yet been adopted]*.
- B. "Primary Security" shall mean the following:
  - (1) Cash;
  - (2) Securities listed by the Securities Valuation Office of the NAIC, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets; and
  - (3) Clean, irrevocable, unconditional and "evergreen" letters of credit meeting the requirements of [insert provision of state law equivalent to Section 10.A.(3) of the Credit for Reinsurance Model Regulation]; provided, however, that (i) such letters of credit may not constitute Primary Security until at least one year after the reinsurance arrangement it relates to was entered into, and provided further that (ii) such letters of credit shall in no event constitute more than 10% of the Primary Security Level as of any calendar year end.
- C. "Primary Security Level" shall mean the dollar amount resulting from applying the Actuarial Method to reserves for insurance business within the scope of Section 3 of this regulation.

**Section 5. Additional Requirements Pertaining to Reinsurance Ceded to Certain Assuming Insurers.**

No credit for reinsurance shall be allowed pursuant to [[insert provisions of state law equivalent to Sections 2.A., 2.B., or 2.C. of the NAIC Credit for Reinsurance Model Law]], unless the assuming insurer, in addition to meeting the applicable requirements of those Sections, also:

- 1. prepares its statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures that are material enough that they would need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"), paragraph 7, if the assuming insurer were required to comply with SSAP 1; and
- 2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Level Control Event as those terms are defined in [insert provision of state law equivalent to the NAIC Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the NAIC Life Risk-Based Capital Report including Overview and Instructions for Companies, as the same may be amended by the NAIC from time to time, without deviation.

[Drafting Note: This section pertains only to whether the ceding insurer can get credit for reinsurance pursuant to Sections 2.A., 2.B., or 2.C. of the NAIC Credit for Reinsurance Model Law. Even if credit cannot be obtained pursuant to those Sections—for example, if the assuming insurer has a material permitted practice—it is possible that credit for reinsurance ceded to that same assuming insurer could be obtained pursuant to other provisions. For example, credit for reinsurance could be allowed pursuant to Sections 6 and 7 of this Regulation, pursuant to Section 3 of the Model Law if the

reinsurance is fully collateralized by assets described in Sections 3.A., 3.B, and/or 3.C. of the Model Law, etc.]

**Section 6. Other Forms of Security Acceptable if the Ceding Insurer Receives Primary Security at the Primary Security Level.**

Any [[asset as to which the NAIC has developed an RBC “asset charge”]] is a form of security acceptable to the Commissioner for the purposes of [insert provision corresponding to Section 3.D of the Credit for Reinsurance Model Act] with respect to reinsurance arrangements within the scope of Section 3 if, and only if, the following conditions are satisfied:

- A. The ceding insurer’s statutory policy reserves with respect to such life insurance are established in full in accordance with the applicable requirements of [insert provisions of state law equivalent to the NAIC Standard Valuation Law and related regulations and actuarial guidelines];
- B. The ceding insurer determines the Primary Security Level with respect to such reserves and provides support for its calculation as determined to be acceptable to the commissioner;
- C. The ceding insurer receives collateral on a funds withheld, trust, or modified coinsurance basis consisting of Primary Security in not less than an amount equal to the Primary Security Level, such value to be determined in a manner consistent with valuation requirements applicable to reinsurance collateral under the NAIC Accounting Practices and Procedures Manual; and
- D. The reinsurance arrangement has been approved by the commissioner.

[Drafting Note: This Section pertains only to whether certain forms of security are acceptable to the commissioner within the meaning of Section 3.D. of the NAIC Credit for Reinsurance Model Law. As such, this Section does not apply to reinsurance arrangements that only use as collateral forms of security described in Sections 3.A., 3.B. and/or 3.C. of the NAIC Credit for Reinsurance Model Law.]

*[Note: Although RBC asset charges have not yet been developed as to assets likely to be used pursuant to this section, they should be developed by the time this Regulation is effective. It is anticipated that the NAIC Capital Adequacy Task Force will list categories of such assets and the RBC asset charge relative to them, and will then also include a “catch-all” category—and corresponding RBC asset charge—for assets that do not fit within one of the listed categories.]*

**Section 7. Other Forms of Security Acceptable if the Ceding Insurer Does Not Receive Primary Security at the Primary Security Level.**

Except as provided in Section 6, no other forms of security are acceptable to the Commissioner for the purposes of [insert provision corresponding to Section 3.D of the Credit for Reinsurance Model Act] with respect to reinsurance arrangements within the scope of Section 3.

**Section 8. Severability.**

If any provision of this regulation is held invalid, the remainder shall not be affected.

**Section 9. Transactions Affected.**

- A. This regulation shall apply to all cessions with respect to any life insurance within the scope of Section 3 written by the ceding insurer on or after \_\_\_\_\_, regardless of when the reinsurance arrangement was entered into.
- B. This regulation shall apply to all cessions with respect to any life insurance within the scope of Section 3, regardless of when written, under any reinsurance arrangement that is entered into on or after \_\_\_\_\_.

**Section 10. Prohibition against Avoidance.**

No insurer shall take any action or series of actions, or enter into any transaction or arrangement or series of transactions or arrangements, involving reserves within the scope of Section 3, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this Regulation.

**Section 11. Effective Date**

This regulation shall become effective [insert date].



**EXHIBIT 5**

SUPPLEMENT FOR THE YEAR OF THE

SUPPLEMENTAL XXX/AXXX REINSURANCE EXHIBIT

For the Year Ended December 31, [XXXX]  
(To be filed by April 1)

OF THE.....  
NAIC GROUP CODE ..... NAIC COMPANY CODE.....

TABLE 1 – ALL XXX AND AXXX CESSIONS									
A	B	C	D	E	F	G	H	I	J
Name of Company	Related Party Captive/SPV	Inception Date	Statutory Reserve	XXX statutory policy reserves ceded	AXXX statutory policy reserves ceded	Authorized Reinsurer	Accredited Reinsurer	Certified Reinsurer	Reinsurer Domiciled in Another State

**TABLE 1 INSTRUCTIONS**

Table 1 applies to all cessions of those certain life insurance policies required to be valued under the Section 6 of the NAIC Valuation of Life Insurance Policies Model Regulation (#830), commonly referred to as Regulation XXX, or to ULSG policies required to be valued under Section 7 of Regulation XXX as further clarified by the NAIC Actuarial Guideline XXXVIII-The Application of the Valuation of Life Insurance Policies Model Regulation (A.G. 38), commonly referred to as AXXX by the reporting entity. As to each cession:

*Column A* – Provide the name and NAIC code of the assuming insurer

*Column B* – Check box if the assuming insurer identified in Column A is a related party captive or special purpose vehicle

*Column C* – Provide the inception date of the reinsurance ceding arrangement

*Column D* – Provide the dollar amount of the full statutory reserve amount for all products included in the ceded reinsurance contract (not just the XXX/AXXX products).

*Column E* – Provide the dollar amount of XXX statutory policy reserves ceded

*Column F* – Provide the dollar amount of AXXX statutory policy reserves ceded

*Column G* – Check box if the reinsurance was ceded to an assuming insurer licensed to transact insurance or reinsurance in the reporting entity's state of domicile within the meaning of Section 2.A. of the NAIC Credit for Reinsurance Model Law (Model 785), as adopted in the reporting entity's state of domicile.

*Column H*—Check box if reinsurance was ceded to an assuming insurer that is accredited by the commissioner of the reporting entity's state of domicile within the meaning of Section 2.B. of the NAIC Credit for Reinsurance Model Law (Model 785), as adopted in the reporting entity's state of domicile.

*Column I*—Check box if reinsurance was ceded to an assuming insurer that has been certified by the commissioner as a reinsurer in this state within the meaning of Section 2.C. of the NAIC Credit for Reinsurance Model Law (Model 785), as adopted in the reporting entity's state of domicile.

*Column J*—Check box if reinsurance was ceded to an assuming insurer that is domiciled in another state within the meaning of Section 2.C. of the NAIC Credit for Reinsurance Model Law (Model 785), as adopted in the reporting entity's state of domicile.

TABLE 2 – RELATED PARTY CAPTIVE/SPV TRANSACTIONS SUBJECT TO TABLE 2 DISCLOSURE														
	As of Inception Date or Prior Year’s Annual Statement Date							As of Current Year’s Annual Statement Date						
A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
Name of Company	Inception Date or Prior Year Annual Statement Date	Reserve Credit Taken	Primary Security Level	Primary Security	Primary Security - trust	Primary Security – funds withheld	Other Security	Reserve Credit Taken	Primary Security Level	Primary Security	Primary Security Adjustment	Primary Security-trust	Primary Security – funds withheld	Other Security

**TABLE 2 INSTRUCTIONS**

Table 2 applies to all cessions to related party captives/SPVs in Table 1. The terms “Primary Security Level”, “Primary Security” and “Other Security” shall have the meaning given to them in the NAIC XXX/AXXX Reinsurance Model Regulation as adopted in the reporting entity’s state of domicile (prior to that adoption, the Blanks (E) Working Group guidance should be used). As to each cession:

*Column A* – Provide the name and NAIC code of the assuming insurer

*Column B*—Provide the letter of (a) the inception date of the cession or (b) the annual statement date immediately preceding the current annual statement date

*Column C* – State the dollar amount of the reserve credit taken by the reporting entity as of the date reported in Column B

*Column D*—State the Primary Security Level applied to the statutory policy reserves as of date reported in Column B

*Column E*—State the fair value as of the date reported in Column B of the Primary Security forms received by the reporting entity as collateral

*Column F*—State the fair value as of the date reported in Column B of any part of the collateral reported in Column E that is held in trust for the benefit of the reporting entity

*Column G*—State the fair value as the date reported in Column B of any part of the collateral reported in Column E that is held by the reporting entity on a funds withheld basis or on a modified coinsurance basis.

*Column H*—State the fair value as of the date reported in Column B of all collateral that is not reported in Column E

*Column I*— State the dollar amount of the reserve credit taken by the reporting entity as of the current annual statement date

*Column J*—State the Primary Security Level applied to the statutory policy reserves as of the current annual statement date

*Column K*—State the fair value as of the current annual statement date of the Primary Security forms received by the reporting entity as collateral

*Column L*—If Column J is greater than Column K, state the fair value as of the current annual statement date of any additional Primary Assets received by the reporting entity as collateral to cover the difference

*Column M*—State the fair value as of the current annual statement date of any part of the collateral reported in Column K or Column L that is held in trust for the benefit of the reporting entity

*Column N*—State the fair value as of the current annual statement date of any part of the collateral reported in Column K or Column L that is held by the reporting entity on a funds withheld basis or on a modified coinsurance basis..

*Column O*—State the fair value as of the current annual statement date of all collateral with respect to the transaction that is not reported in Columns K or L

**TABLE 3 – COLLATERAL FOR ALL XXX/AXXX REINSURANCE TRANSACTIONS WITH CAPTIVES/SPVS REPORTED IN TABLE 1**

TABLE 3 – COLLATERAL FOR ALL XXX/AXXX REINSURANCE TRANSACTIONS WITH CAPTIVES/SPVS REPORTED IN TABLE 1								
Entity ID	A Name of Company	B Inception Date or Prior Year Annual Statement Date	As of Inception Date or Prior Year Annual Statement Date			As of Current Annual Statement Date		
			C Category	D Assets	E Affiliate or Parental Guarantee	F Category	G Assets	H Affiliate or Parental Guarantee
1.			Cash held as Primary Security			Cash held as Primary Security		
			NAIC 1 SVO-listed securities held as Primary Security			NAIC 1 SVO-listed securities held as Primary Security		
			NAIC 2 SVO-listed securities held as Primary Security			NAIC 2 SVO-listed securities held as Primary Security		
			NAIC 3 SVO-listed securities held as Primary Security			NAIC 3 SVO-listed securities held as Primary Security		
			NAIC 4 SVO-listed securities held as Primary Security			NAIC 4 SVO-listed securities held as Primary Security		
			NAIC 5 SVO-listed securities held as Primary Security			NAIC 5 SVO-listed securities held as Primary Security		
			NAIC 6 SVO-listed securities held as Primary Security			NAIC 6 SVO-listed securities held as Primary Security		
			Evergreen, Unconditional LOCs held as Primary Security			Evergreen, Unconditional LOCs held as Primary Security		
			Other Security—Cash			Other Security—Cash		
			Other Security— NAIC 1 SVO-listed securities			Other Security— NAIC 1 SVO-listed securities		
			Other Security— NAIC 2 SVO-listed securities			Other Security— NAIC 2 SVO-listed securities		
			Other Security— NAIC 3 SVO-listed securities			Other Security— NAIC 3 SVO-listed securities		
			Other Security— NAIC 4 SVO-listed securities			Other Security— NAIC 4 SVO-listed securities		
			Other Security— NAIC 5 SVO-listed securities			Other Security— NAIC 5 SVO-listed securities		
			Other Security— NAIC 6 SVO-listed securities			Other Security— NAIC 6 SVO-listed securities		
			Other Security— Other Investments Admissible per the NAIC AP&P Manual			Other Security— Other Investments Admissible per the NAIC AP&P Manual		
			Other Security— Other LOCs			Other Security— Other LOCs		
			Other Security— All other assets			Other Security— All other assets		
			<b>Totals</b>			<b>Totals</b>		

2.		Cash held as Primary Security			Cash held as Primary Security		
		NAIC 1 SVO-listed securities held as Primary Security			NAIC 1 SVO-listed securities held as Primary Security		
		NAIC 2 SVO-listed securities held as Primary Security			NAIC 2 SVO-listed securities held as Primary Security		
		NAIC 3 SVO-listed securities held as Primary Security			NAIC 3 SVO-listed securities held as Primary Security		
		NAIC 4 SVO-listed securities held as Primary Security			NAIC 4 SVO-listed securities held as Primary Security		
		NAIC 5 SVO-listed securities held as Primary Security			NAIC 5 SVO-listed securities held as Primary Security		
		NAIC 6 SVO-listed securities held as Primary Security			NAIC 6 SVO-listed securities held as Primary Security		
		Evergreen, Unconditional LOCs held as Primary Security			Evergreen, Unconditional LOCs held as Primary Security		
		Other Assets—Cash			Other Security—Cash		
		Other Security— NAIC 1 SVO-listed securities			Other Security— NAIC 1 SVO-listed securities		
		Other Security— NAIC 2 SVO-listed securities			Other Security— NAIC 2 SVO-listed securities		
		Other Security— NAIC 3 SVO-listed securities			Other Security— NAIC 3 SVO-listed securities		
		Other Security— NAIC 4 SVO-listed securities			Other Security— NAIC 4 SVO-listed securities		
		Other Security— NAIC 5 SVO-listed securities			Other Security— NAIC 5 SVO-listed securities		
		Other Security— NAIC 6 SVO-listed securities			Other Security— NAIC 6 SVO-listed securities		
		Other Security— Other Investments Admissible per the NAIC AP&P Manual			Other Security— Other Investments Admissible per the NAIC AP&P Manual		
		Other Security— Other LOCs			Other Security— Other LOCs		
		Other Security— All other assets			Other Security— All other assets		
		<b>Totals</b>			<b>Totals</b>		

...		Cash held as Primary Security		Cash held as Primary Security	
		NAIC 1 SVO-listed securities held as Primary Security		NAIC 1 SVO-listed securities held as Primary Security	
		NAIC 2 SVO-listed securities held as Primary Security		NAIC 2 SVO-listed securities held as Primary Security	
		NAIC 3 SVO-listed securities held as Primary Security		NAIC 3 SVO-listed securities held as Primary Security	
		NAIC 4 SVO-listed securities held as Primary Security		NAIC 4 SVO-listed securities held as Primary Security	
		NAIC 5 SVO-listed securities held as Primary Security		NAIC 5 SVO-listed securities held as Primary Security	
		NAIC 6 SVO-listed securities held as Primary Security		NAIC 6 SVO-listed securities held as Primary Security	
		Evergreen, Unconditional LOCs held as Primary Security		Evergreen, Unconditional LOCs held as Primary Security	
		Other Security—Cash		Other Security—Cash	
		Other Security— NAIC 1 SVO-listed securities		Other Security— NAIC 1 SVO-listed securities	
		Other Security— NAIC 2 SVO-listed securities		Other Security— NAIC 2 SVO-listed securities	
		Other Security— NAIC 3 SVO-listed securities		Other Security— NAIC 3 SVO-listed securities	
		Other Security— NAIC 4 SVO-listed securities		Other Security— NAIC 4 SVO-listed securities	
		Other Security— NAIC 5 SVO-listed securities		Other Security— NAIC 5 SVO-listed securities	
		Other Security— NAIC 6 SVO-listed securities		Other Security— NAIC 6 SVO-listed securities	
		Other Security— Other Investments Admissible per the NAIC AP&P Manual		Other Security— Other Investments Admissible per the NAIC AP&P Manual	
		Other Security— Other LOCs		Other Security— Other LOCs	
		Other Security— All other assets		Other Security— All other assets	
		<b>Totals</b>		<b>Totals</b>	

**TABLE 3 INSTRUCTIONS**

Table 3 applies to all cessions of XXX/AXXX reinsurance with captives and SPVs as identified in Table 1. As to each cession:

*Column A* – Provide the name and NAIC code of the assuming insurer

*Column B*—Provide the letter of (a) the inception date of the cession or (b) the prior year’s annual statement date immediately preceding the current annual statement date

*Column C*—Column C identifies categories of assets in which collateral supporting the cession may be held [[Note: the instructions will need to define or cross reference to definitions for each category of assets]]

*Column D*—State the fair value as of the date reported in Column B for collateral held in each category identified in Column C. Report cash, SVO securities, and evergreen, unconditional LOCs held as Primary Assets separately from cash, SVO securities and evergreen, unconditional LOCs held as Primary Assets.

*Column E*—Check box as to any asset identified in Column D as to which an affiliate of the reporting entity has issued a guarantee

*Column F*—Column F identifies categories of assets in which collateral supporting the cession may be held [[Note: the instructions will need to define or cross reference to definitions for each category of assets]]

*Column G*—State the fair value as of the date reported in Column E for collateral held in each category identified in Column F

*Column H*—Check box as to any asset identified in Column G as to which an affiliate of the reporting entity has issued a guarantee