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Mind the Gaps: What Do New Disclosures Tell Us About Life Insurers' Use of Off-Balance-Sheet Captives?

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Some U.S. life insurance companies use wholly owned captive reinsurers to transfer risk and reduce regulatory requirements. Since 2002, such transfers have increased rapidly, and they now exceed $200 billion in reserve credit. This brief discusses recent policy measures and the data that insurers began reporting in 2015 about their captive transactions. Publicly available data are insufficient to analyze fully the risks from captives and the impact on insurers' financial condition. Regulators have revised reporting standards to improve the public data, but gaps remain. Because life insurers are a material part of the financial system, these gaps may mask financial stability vulnerabilities.

Beginning in 2000, state regulators increased the reserve requirements for a large portion of the life insurance industry.[2] The changes affected term life and universal life policies with secondary guarantees (ULSG).[3] Many life insurers, regulators, and rating agencies later agreed the new requirements were excessive.[4] As a result, some states allowed insurers to finance a portion of these reserves through captive reinsurance companies. In a captive reinsurance transaction, a life insurance company transfers risk to a captive reinsurer that is part of the same parent group.

The Office of Financial Research (OFR) has raised concerns about insurers' use of captives.[5] Many states do not hold captives to the same standards as traditional insurers because captive insurance laws were initially developed to address self-insurance by corporations. Some states have allowed captives to fund their reserves with nontraditional assets, such as bank letters of credit and parental guarantees. These assets are not diverse, high-quality investments and could be riskier than traditional assets.

The National Association of Insurance Commissioners (NAIC) implemented asset quality standards for new captives that reinsure term life and ULSG policies, effective Jan. 1, 2015.[6] The NAIC required insurers to disclose asset information for term life and ULSG captives, as of year-end 2014. The new disclosures are subject to exemptions, generally focused on traditional reinsurance.

The 2015 asset quality standards include the same exemptions as the 2014 disclosures. The NAIC enhanced the disclosure requirements for 2015 year-end data, narrowing some of the exemptions. Exemptions remain unchanged, however, for the asset quality standards.

This OFR brief analyzes the 2014 year-end financial data. Data for 2015 are not yet available. The analysis revealed that U.S. life insurers' use of captives totaled $213.4 billion

Figure 1. Life Insurance Financial Reporting Requirements

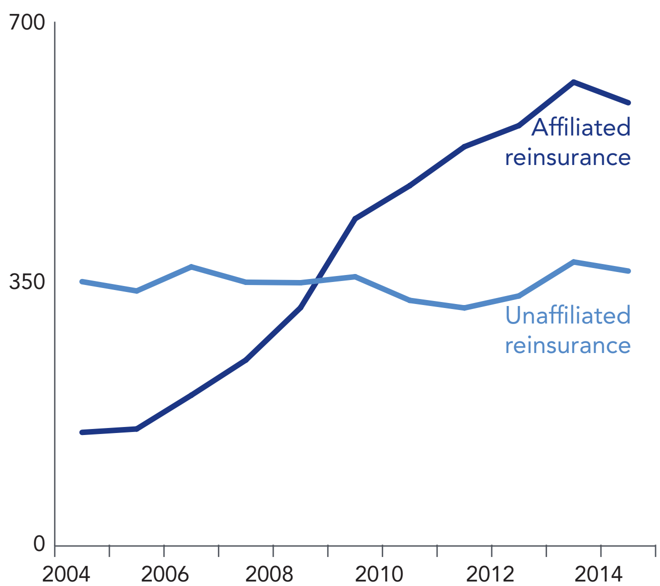
	Securities and Exchange Commission	State Insurance Filings
Insurance Company (Stock company)	Yes, if publicly-traded	Yes
Insurance Company (Mutual)[a]	No	Yes
Reinsurance Company	Yes, if publicly-traded	Yes
Captive Reinsurer[b]	No	No

[a] A limited number of mutual insurance companies, which are owned by policyholders, file financial statements with the Securities and Exchange Commission.
[b] Financial statements are generally not publicly available for captive reinsurers. Iowa-domiciled captive reinsurers' financial statements are available on the Iowa Insurance Division's website. Certain states require some captives to file financial statements with the National Association of Insurance Commissioners.

Source: OFR analysis

Figure 2. Aggregate Reinsurance Values by Affiliate Status ($ billions)

Reinsurance with affiliates exceeds the life insurance industry's use of third-party reinsurance



Note: Values represent reserve credit taken plus modified coinsurance reserves.

Sources: Statutory Annual Statements, Schedule S for 2004-14; SNL Financial L.C.

in reserve credit. Reserve credit is the dollar amount of credit a "ceding insurer" receives by using reinsurance. Reserve credit decreases the ceding company's required reserves by the same amount. A little more than a third of the reserve credit backs higher-risk product lines, such as variable annuities and long-term care.

The analysis also revealed:

- Insurers disclosed the quality of assets for only 55 percent of term and ULSG captives, measured by reserve credit, largely because of exemptions.
- For 2014 data, insurers were not required to report the impact of captives on their risk-based capital ratios. The risk-based capital ratio is one of the most important metrics for evaluating an insurer's financial health.[7]
- Some exemptions will remain in the 2015 data.

The brief concludes with a discussion of data and regulatory gaps for captives.

Lessons from the New Data on Captives

Insurers file detailed statutory financial statements with state regulators for each legal entity. Publicly traded insurance companies and certain other insurers also file financial statements with the Securities and Exchange Commission (SEC). However, many other insurance companies do not file financial statements with the SEC, such as mutual insurance companies and U.S. subsidiaries of foreign parents (see **Figure 1**).

Captives' financial statements are typically not public. In 2013, regulators for the first time required life insurers to identify their total captive reinsurance activity separately in annual statements.

Before 2013, captives could not be distinguished from other affiliated reinsurance activities.[8] The dark blue line in **Figure 2** shows the increase in all affiliated reinsurance since 2004. The growth resulted primarily from the increased use of captives.

Captives are subject to less stringent regulatory rules than the ceding insurers. The use of captives by life insurers began in 2002 and grew to $213.4 billion by 2014.

The NAIC required insurers to report additional information about captives that reinsure term life and ULSG policies. Insurers are required to file this information in a supplemental exhibit to the 2014 Statutory Annual Statement.

The new supplemental filing has four parts. All term life and ULSG insurers that use reinsurance file Part 1. Insurers that use captives are required to complete parts 2 through 4, subject to the exemptions discussed in the next section.

- **Part 1** lists the total statutory reserve credit taken and its allocation between term life and ULSG.
- **Part 2** lists summary information, including the reserve credit taken, required level of primary security, value of primary securities, and value of other securities.
- **Part 3** provides asset-level disclosures for reinsurance arrangements with collateral.
- **Part 4** discloses asset-level transactions for Part 2 that are not reported in Part 3.

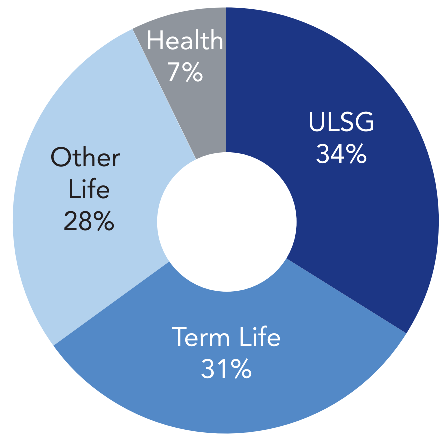
The asset-level disclosures report a captive's assets broken down into four summary categories: cash, securities,[9] letters of credit, and "other assets."

Figure 3 shows data from the 2014 annual statutory and supplemental filings. Term life and ULSG accounted for slightly less than two-thirds of the reserves that insurers ceded to captives. The remainder involved higher-risk product lines, such as variable annuities and long-term care. Ceded reserves reduce the ceding insurer's reported liabilities and the assets required to support these liabilities.

The 2014 year-end filings indicate that 42 U.S. life insurance and reinsurance firms used captives (see **Figure 5**). The table shows reserves ceded to captives relative to general account reserves. This metric shows certain insurers' reliance on off-balance-sheet affiliates' lower quality assets to finance a portion of reserves. Typically, this is the amount that insurers and their regulators deem excessive.[10] A number of large life insurers make little or no use of captives. These firms are generally large mutual life insurers. Four of the top five users of captives are reinsurers. The data in **Figure 5** suggest that reinsurers typically carry less in general account reserves than direct insurers do. As a result, reinsurers are larger captive users in

Figure 3. Captive Reserve Credit by Product Type ($213.4 billion)

Ceded reserves for lower-risk term life accounted for less than one-third of the total reserves ceded

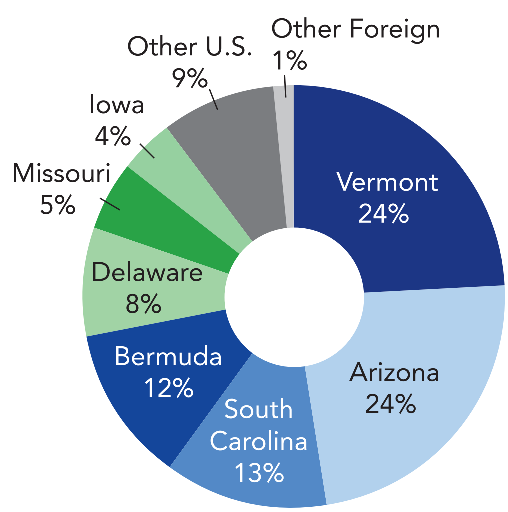


Note: ULSG = Universal life policies with secondary guarantees.

Sources: Statutory Annual Statements, Schedule S; Supplemental XXX/AXXX Reinsurance Exhibits (as of Dec. 31, 2014); SNL Financial L.C.

Figure 4. Captive Reserve Credit by Reinsurer Domiciliary Jurisdiction ($213.4 billion)

A handful of states with limited regulatory resources and Bermuda dominate captive domiciles



Sources: Statutory Annual Statements for 2014, Schedule S; SNL Financial L.C.

Figure 5. Reinsurance by Leading U.S. Life Insurance Groups Ranked by Captive Usage as of Dec. 31, 2014

U.S. Life Insurance Groups	Life Insurance In Force ($ millions)	General Account Reserves ($ millions)	Ceded Reserve Credits (percent) *Ceded Reserves / General Account Reserves + Reserve Credit*			
			Total Captive and Non-captive	Captive		
				Total	Term and ULSG	Other
Users of captive reinsurance						
SCOR	$1,667,974	$560	94.7%	69.8%	34.1%	35.7%
Munich Re	949,412	3,970	54.3%	36.9%	36.9%	0.0%
RGA	1,852,104	15,545	45.6%	34.4%	22.4%	12.0%
Sun Life	354,110	9,215	60.0%	33.3%	33.3%	0.0%
Swiss Re	1,290,512	4,056	68.0%	32.1%	32.0%	0.1%
Legal & General	634,315	1,085	85.3%	27.0%	27.0%	0.0%
Aegon	1,482,226	60,616	39.7%	23.2%	14.9%	8.3%
SBLI of Massachusetts	160,828	2,089	38.7%	21.9%	21.9%	0.0%
AXA	533,562	43,344	31.0%	20.7%	6.6%	14.1%
Unum	656,895	25,513	36.7%	17.0%	0.0%	17.0%
Berkshire Hathaway	446,879	11,587	19.0%	16.8%	0.0%	16.8%
Resolution Life	400,492	7,724	57.7%	15.8%	15.8%	0.0%
CPP Investment Board	147,359	8,396	29.8%	15.4%	15.4%	0.0%
Global Atlantic Financial	130,481	18,347	34.1%	14.9%	14.9%	0.0%
Manulife	636,994	80,129	30.0%	14.8%	4.2%	10.6%
Prudential	3,829,911	169,898	19.7%	14.6%	11.1%	3.5%
Voya	1,361,938	64,914	31.6%	13.5%	6.7%	6.7%
Plateau Group	2,698	9	64.8%	13.4%	0.0%	13.4%
Primerica	601,449	729	89.0%	11.7%	11.7%	0.0%
Protective Life	827,041	32,113	34.3%	11.1%	10.6%	0.6%
Penn Mutual	120,728	8,930	24.9%	10.8%	10.8%	0.0%
MetLife	4,437,927	250,378	17.0%	10.1%	5.7%	4.3%
Mutual of Omaha	289,445	15,342	11.9%	7.9%	7.9%	0.0%
Grange Mutual Casualty	21,929	279	46.0%	7.7%	7.7%	0.0%
Genworth Financial	1,026,898	42,761	50.0%	6.8%	6.8%	0.0%
Principal	463,306	50,155	12.1%	5.7%	5.7%	0.0%
Ohio National	243,686	8,685	28.3%	5.6%	5.2%	0.4%
Lincoln National	1,296,934	80,476	20.2%	5.2%	5.2%	0.0%
Great-West	1,151,916	27,710	15.8%	5.1%	5.1%	0.0%
Advantage Capital Partners	16	550	41.9%	5.0%	0.0%	5.0%
Nationwide Mutual	256,151	38,263	6.3%	3.0%	3.0%	0.0%
Deseret Management	16,765	2,212	7.4%	3.0%	3.0%	0.0%
CUNA Mutual	58,117	7,881	5.0%	2.7%	0.0%	2.7%
BRH Holdings GP	143,503	47,941	27.2%	2.5%	0.0%	2.5%
Pacific Life	497,607	48,107	5.5%	2.4%	2.4%	0.0%
Allstate	443,146	31,983	11.4%	2.0%	2.0%	0.0%
Sammons Enterprises	248,816	74,894	15.4%	1.7%	1.7%	0.0%
Torchmark	180,878	13,440	7.9%	1.2%	0.5%	0.8%

HRG Group	79,682	15,203	21.2%	0.7%	0.0%	0.7%
Symetra Financial	67,116	21,726	2.5%	0.7%	0.7%	0.0%
Allianz	28,814	78,434	5.5%	0.2%	0.2%	0.0%
Non-users of captive reinsurance - Large Life Insurance Companies						
Northwestern Mutual	1,534,358	166,796	2.1%	0%	0%	0%
New York Life	1,270,214	174,404	2.9%	0%	0%	0%
Minnesota Mutual	1,081,325	11,965	9.0%	0%	0%	0%
Hannover Reinsurance	992,479	308	96.6%	0%	0%	0%
Hartford	927,621	26,313	48.0%	0%	0%	0%
State Farm	819,807	51,637	0.0%	0%	0%	0%
CIGNA	651,581	9,824	48.6%	0%	0%	0%
Aetna	553,424	8,448	23.3%	0%	0%	0%
MassMutual	538,057	107,065	4.3%	0%	0%	0%
Guardian Life Insurance	529,273	39,097	13.5%	0%	0%	0%

Note: ULSG = Universal life policies with secondary guarantees.

Sources: Statutory Annual Statements for 2014, pp. 3, 22-23, Schedule S; Supplemental XXX/AXXX Reinsurance Exhibits (as of Dec. 31, 2014); SNL Financial L.C.; OFR analysis

percentage terms, while direct insurers are the largest captive users in dollar terms.

Four states — Vermont, Delaware, Arizona, and South Carolina — host the majority of captive insurers (see **Figure 4**). These states do not supervise a significant direct underwriting insurance market. Nationally, state insurance regulators have an average of 0.35 regulatory staff members per domestic insurance company.[11] In the four states with the most captive insurers, the figures are 0.31 (Vermont), 0.17 (Delaware), 0.12 (Arizona), and 0.10 (South Carolina).

OFR staff members evaluated the asset disclosures for the top five life insurers using captives that were not exempt from the reporting requirement. Reserve credits taken by this group totaled 28.8 percent of the total reserve credits of term and ULSG captive insurers at year-end 2014. The data show varying levels of conservatism in the quality of captives' assets. Some captives hold mostly high-quality investments,[12] but others hold "other assets." Asset quality can vary even among captives of the same life insurer. (See **Figure A-1** in the Appendix for a summary of the asset composition of the five captives we evaluated.)

The data also reveal that some captives report letters of credit from banks as assets. A letter of credit may help a captive reinsurer meet its liabilities to a ceding insurer.[13] However, letters of credit can also result in maturity mismatches because the term of the letter of credit may be shorter than the term of the insurer's liabilities to policyholders. If banks are unable or unwilling to roll over the letters of credit, the captives, ceding insurers, and policyholders may face risks.

Banks can seek and receive guarantees from an insurer's parent company when they provide letters of credit to captives. The parental guarantee can have regulatory benefits to the bank that issued the letter of credit. A bank can lower its capital requirements by obtaining a guarantee from the captive's more creditworthy parent.[14] As a result, the bank and the insurer can both claim risk transfer and obtain regulatory capital relief.

Remaining Data and Regulatory Gaps

Disclosure requirements adopted for year-end 2014 represented an important step forward in providing insight into captives' activities. However, many insurers were exempt from completing the asset disclosures. Although enhancements made to the 2015 filing instructions tightened certain exemptions, data gaps remain.

The NAIC allowed insurers to avoid completing the asset quality disclosures for exempt captives. The six categories of exemptions were for licensed, accredited, or certified

Figure 6. Captives Exempt from Asset Disclosures

In 2014, $62 billion in captive transactions (by reserve credit) of life insurers were exempt from the reporting requirements of Parts 2-4 of the Supplemental Reinsurance Exhibit

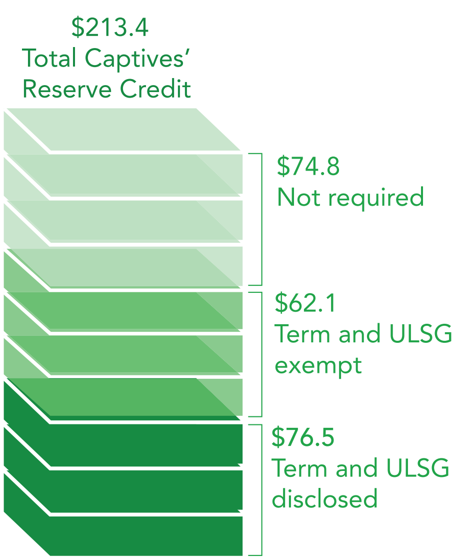
Exemptions Type	Reserve Credit Taken	
	$ billions	Percent of total
Licensed Reinsurer	20.9	15%
Reinsurer Maintains Trust Fund	17.2	12%
Multiple Exemptions	14.0	10%
Accredited Reinsurer	8.1	6%
Reinsurer Domiciled in Another Jurisdiction	1.9	1%
Certified Reinsurer	0.0	0%
Reinsurance Required by Law	0.0	0%
Total	**62.1**	**45%**

Note: As of December 31, 2014, reserve credit taken by life insurance companies totaled $213.4 billion, of which $138.6 billion was for term life and universal life secondary guarantee life insurance.

Sources: Statutory Annual Statements for 2014, Schedule S; Supplemental XXX/AXXX Reinsurance Exhibits (as of Dec. 31, 2014); SNL Financial L.C.; OFR analysis

Figure 7. Captives' Assets Disclosures ($ billions)

Only 35 percent (by reserve credit) of captives were required to disclose assets



Sources: Statutory Annual Statements for 2014, Schedule S; Supplemental XXX/AXXX Reinsurance Exhibits (as of Dec. 31, 2014); SNL Financial L.C.; OFR analysis

reinsurers; reinsurers domiciled in another jurisdiction with similar standards; reinsurers that maintain a trust fund; and reinsurance required by law.[15] In the 2014 filings, some reinsurers invoked multiple exemptions (see **Figure 6**).

Exemptions cover some of the sector's largest captive transactions (see **Figure A-2** in the Appendix). For the 42 insurer groups that use captive reinsurance, reserve credit taken for term life and ULSG totaled $138.6 billion. Of this amount, $62.1 billion, or 45 percent, was exempt from asset disclosures.

Figure A-2 in the Appendix shows that exemptions were mainly for licensed or accredited captives or for captives maintaining a trust fund. Although traditional licensed reinsurers face disclosure requirements, captives' financial statements generally are not publicly available.[16] As a result, the assets supporting some of the largest captive transactions continue to be exempt from any public disclosure.

In addition, the supplemental filing covers only term and ULSG. It does not cover some of the riskier insurance and annuity products. Together with the exemptions noted for term life and ULSG reporting, only 35 percent of all captive transactions, as measured by reserve credit, were required to disclose asset information in 2014 (see **Figure 7**).

In addition, the supplemental filing for the 55 percent of term and ULSG captives with asset disclosures, measured by reserve credit, does not provide as much detail as traditional insurance companies' filings. The asset quality disclosures in the supplemental filing are highly aggregated, or combined. The category "other assets" is vague and does not describe what is included. The data also do not shed light on the maturity mismatches that can occur when the term of a letter of credit is shorter than the term of an insurer's liabilities to policyholders.

Finally, the filing does not quantify the effect of captive transactions on an insurer's risk-based capital ratio — a key regulatory measure. In some cases, these effects can be material. For example, one insurer's 2014 annual report on Form 10-K indicates that without the inclusion of a letter of credit by its Vermont captive, one of the firm's life insurance subsidiaries would have been below its minimum required statutory capital level.

The recent NAIC guidance went beyond data and disclosure, establishing asset quality requirements for new term life and ULSG captives. However, similar exemptions to the 2014 supplemental filing allowed new captives to bypass the asset quality standards, limiting the effect on captives' asset quality.

Filling the Data Gaps: Recent Efforts and Limitations

Although the NAIC did not change the exemptions to the asset quality requirements for new captives, it did narrow asset disclosure exemptions for the 2015 annual filings. If captives use an approved nonstandard practice,[17] they would be barred from the exemptions allowed by three of the six categories. Those categories are licensed, accredited, or reinsurers domiciled in another jurisdiction with similar standards. However, reinsurers that meet the exemption requirements of any of the other three categories will continue to be exempt, even if they use approved nonstandard practices.

In addition, ceding insurers now must report if they would have breached a risk-based capital threshold without the benefit of a captive. Such a disclosure is required only for insurers that have used captives for term life and ULSG transactions. To help shed light on potential systemic risks, insurers could be required to disclose the actual level of risk-based capital without captives.

The 2015 supplemental filings are not yet available. Those data will show how much information is collected for previously exempt captives. However, gaps will continue to exist in available data because of the exemptions that remain.

The instructions to the 2015 Annual Statutory Statements require new disclosures about variable annuity business reinsured to captives. These requirements are similar to many of those adopted for term life and ULSG 2014 year-end disclosures, including asset disclosures, purpose of the captive, and type of benefits reinsured.

Conclusion

Use of captives by U.S. life and reinsurance companies has increased sharply since 2002. Captives can be an integral part of a life insurer's operations. They can also cloud regulatory reporting of an insurer's financial position and create "blind spots" in the monitoring of threats to financial stability.

Public disclosures on captives have been very limited until recently. The new NAIC filings would provide some additional visibility into the use of captives. However, the filings' scope and depth could be expanded to increase transparency about the resiliency of the sector. Only about 55 percent, by reserve credit, of term and ULSG captives were required to report 2014 year-end asset disclosures because of exemptions.

The NAIC has improved instructions for 2015 year-end disclosures, but some captive transactions may continue to be exempt. More information about the effect of captives on insurers' capitalization and the potential for maturity mismatches would be useful additions. Regulators should evaluate the case for exemptions to the asset quality requirements for new term and ULSG captives.

Only 65 percent of reserves ceded to captives were for term life and ULSG businesses. However, the NAIC's new Variable Annuities Issues Working Group has begun to address disclosures of captive transactions beyond those involving term life insurance and ULSG products. Helpful additional steps would be more disclosure and the adoption of asset quality requirements for captive use for other higher risk product lines, such as long-term care.

Appendix

Figure A-1. Composition of Assets Supporting Reserve Credit Taken for Top 5 Ceding Life Insurers ($ millions)

			Asset Composition									
Ceding Insurer	Captive Reinsurer	Part 1: Statutory Reserve Credit Taken	Part 2: Reserve Credit Taken	Supporting Assets	Cash	NAIC 1	NAIC 2	NAIC 3	NAIC 4+	Evergreen LOC	Other LOC	Other
Lincoln National Life Insurance Co.	Lincoln Re Co. of VT I	1,379	1,379	1,379	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	65.5%	34.5%
	Lincoln Re Co. of VT III	1,893	1,893	1,893	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	44.1%	55.9%
	Lincoln Re Co. of VT IV	1,023	1,023	1,023	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	98.9%	1.1%
	Lincoln Reinsurance Co. of SC	441	441	543	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	100.0%
Subtotal		4,737	4,737	4,839	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	56.9%	43.1%
Pruco Life Insurance Co.	Prudential Arizona Re Term Co.	1,694	1,694	2,461	0.0%	93.5%	6.4%	0.0%	0.0%	0.0%	0.0%	0.0%
	Prudential AZ Re Captive Co.	4,411	4,411	1,429	0.2%	60.5%	34.9%	4.2%	0.2%	0.0%	0.0%	0.0%
	Prudential AZ Re Universal Co.	10,824	10,824	8,420	5.4%	67.3%	24.0%	2.8%	0.3%	0.0%	0.0%	0.3%
	Prudential Term Re Co.	258	258	455	0.0%	99.1%	0.9%	0.0%	0.0%	0.0%	0.0%	0.0%
	Prudential Universal Re Co.	2,736	2,736	3,244	0.0%	87.9%	9.3%	1.7%	0.7%	0.0%	0.0%	0.4%
	Universal Prudential AZ Re Co.	1,387	1,387	2,023	0.0%	72.3%	24.7%	2.8%	0.2%	0.0%	0.0%	0.1%
Subtotal		21,309	21,309	18,032	2.5%	75.4%	19.3%	2.2%	0.3%	0.0%	0.0%	0.2%
RGA Reinsurance Co.	Castlewood Reinsurance Co.	1,551	1,551	1,406	0.1%	53.2%	8.0%	0.8%	0.2%	6.7%	0.0%	31.0%
	Parkway Reinsurance Co.	1,621	1,621	1,393	0.0%	26.3%	22.5%	2.1%	2.2%	29.3%	0.0%	17.5%
	RGA Re Co. (Barbados) Ltd.	148	148	343	0.9%	41.4%	16.4%	24.9%	0.2%	8.6%	0.0%	7.6%
	Rockwood Reinsurance Co.	2,032	2,032	1,243	0.0%	48.3%	28.6%	9.7%	1.6%	2.0%	0.0%	9.7%
Subtotal		5,352	5,352	4,385	0.1%	42.3%	19.1%	5.6%	1.2%	12.7%	0.0%	18.8%
Security Life of Denver Insurance Co.	Roaring River IV LLC	1,083	1,083	1,057	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	100.0%
	Sec Life of Denver Intl Ltd.	3,555	3,555	3,851	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	52.4%	47.6%
Subtotal		4,638	4,638	4,908	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	41.1%	58.9%
Swiss Re L&H America Inc.	Milvus I Reassurance Ltd.	2,196	2,196	2,254	0.0%	38.5%	6.0%	0.5%	0.0%	55.0%	0.0%	0.0%
	Sterling Re Inc.	1,856	1,856	1,917	0.0%	34.2%	12.3%	0.1%	0.0%	53.5%	0.0%	0.0%
Subtotal		4,052	4,052	4,172	0.0%	36.5%	8.9%	0.3%	0.0%	54.3%	0.0%	0.0%
Total		40,088	40,088	36,335	1.3%	46.7%	12.9%	1.8%	0.3%	7.8%	13.1%	16.1%

Sources: Statutory Annual Statements for 2014; Supplemental XXX/AXXX Reinsurance Exhibits (as of Dec. 31, 2014); SNL Financial L.C.; OFR analysis

Figure A-2. Captives Qualifying for Detailed Reporting Exemptions ($ millions)

Figure A-2 shows a list of captive transactions exempt from detailed reporting and the reason for the exemption. A transaction may qualify for more than one exemption. Regulators should consider modifying the supplement's instructions so that all insurers are required to complete the detailed disclosures for all term life insurance and ULSG captive transactions without exemptions.

					Exemptions			
Ultimate Parent	Captive Reinsurer	Statutory Reserve Credit Taken	Term - Statutory Reserve Credit Taken	ULSG Reserve Credit Taken	Licensed Reinsurer	Accredited Reinsurer	Domiciled Other Jurisdiction	Maintain Trust Fund
MetLife, Inc.	MetLife Reinsurance Co. of DE	1,586	438	1,148	X			
	Metlife Reinsurance Co. of SC	3,418	-	3,418				X
	MetLife Reinsurance Co. of VT	12,239	2,473	9,766				X
Aegon N.V.	LIICA Re I Inc.	717	717	-		X		
	LIICA Re II Inc.	2,145	171	1,974		X		
	TLIC Oakbrook Reinsurance Inc.	862	862	-	X			
	TLIC Riverwood Reinsurance Inc	2,580	2,580	-	X			
	Transamerica Pacfc Ins Co. Ltd	3,117	110	3,007		X		
Sun Life Financial Inc.	Sun Life Finl (U.S.) Re Co.	3,420	-	3,420		X	X	X
	Sun Life Finl (U.S.) Re Co. II	4,254	-	4,254	X			
Global Atlantic Financial Group Limited	Cape Verity I Inc.	1,076	-	1,076	X			
	Cape Verity II Inc.	2,138	42	2,097	X			
	Cape Verity III Inc.	610	47	562	X			
	Gotham Re Inc.	330	12	319		X		
AXA Group	AXA RE Arizona Co.	4,095	1,889	2,206			X	X
SCOR SE	SCOR Life Assurance Co.	2,788	2,788	-	X			
	SCOR Life Reassurance Co.	838	838	-	X			
Resolution Life L.P.	Lancaster Re Captive Ins Co.	2,888	58	2,829	X			
Genworth Financial, Inc.	River Lake Insurance Co.	1,210	1,210	-		X	X	X
	River Lake Insurance Co. II	984	984	-		X	X	X
	River Lake Insurance Co. IV Ltd	4	4	-				X
	Rivermont Life Insurance Co. I	377	377	-		X	X	X
Legal & General Group Plc	First British Amer Re Co. II	398	398	-			X	X
	First British Vermont Re Co II	1,591	1,591	-			X	
Power Corporation of Canada Group	Great-West Life & Annty Ins SC	1,665	1,665	-			X	X
Penn Mutual Life Insurance Company	PIA Reinsurance Co. of DE I	1,279	-	1,279	X			
Reinsurance Group of America, Incorporated	Timberlake Reinsurance Co. II	1,192	1,192	-		X		
Primerica, Inc.	Peach Re Inc.	507	507	-		X	X	
	Vidalia Re Inc.	266	266	-		X	X	

Figure A-2. Captives Qualifying for Detailed Reporting Exemptions - continued

Dai-ichi Life Insurance Company, Limited	Golden Gate II Captive Ins Co.	757	-	757				X
Savings Bank Life Insurance Company of Massachusetts	SBLI VT Re LLC	747	747	-		X	X	
Allstate Corporation	ALIC Reinsurance Co.	731	731	-				X
Ohio National Mutual Holdings, Inc.	Kenwood Re Inc.	334	334	-			X	
	Montgomery Re Inc.	298	159	139			X	X
Lincoln National Corporation	Lincoln Re Co. of VT V	557	557	-		X		
Grange Mutual Casualty Company	Grange Life Reinsurance Co.	40	27	13	X		X	
American International Group, Inc.	SunAmerica Life Reinsurance Co	12	-	12	X			

Note: ULSG = Universal life policies with secondary guarantees

Sources: Statutory Annual Statements for 2014, Schedule S; Supplemental XXX/AXXX Reinsurance Exhibits (as of Dec. 31, 2014); SNL Financial L.C.

Endnotes

[1] Jill Cetina, Associate Director for Policy Studies (jill.cetina@ofr.treasury.gov); Arthur Fliegelman, Senior Financial Analyst (arthur.fliegelman@ofr.treasury.gov); Jonathan Glicoes, Research Analyst (jonathan.glicoes@ofr.treasury.gov) and Ruth Leung, Senior Financial Analyst (ruth.leung@ofr.treasury.gov). Greg Feldberg provided helpful comments. We acknowledge valuable interactions with industry participants on this topic, and meaningful comments and suggestions from regulatory organizations on this brief.

[2] Reserve requirements are the amount of assets regulators require insurance companies to hold to satisfy obligations to policyholders.

[3] A ULSG (universal life policy with secondary guarantees) is a no-lapse insurance policy; universal life policies normally expire if the account value falls below a level necessary to maintain the policy. With the no-lapse feature or "secondary guarantee," the policies remain in effect as long as certain conditions are met, even if the cash value has run out. Reserve requirements were strengthened for ULSGs in 2003.

[4] See National Association of Insurance Commissioners, "Captives and Special Purpose Vehicles: An NAIC White Paper," July 2013 (available at www.naic.org/store/free/SPV-OP-13-ELS.pdf, accessed February 24, 2016) and Moody's Investors Service, "The Captive Triangle: Where Life Insurers' Reserve and Capital Requirements Disappear," August 23, 2013.

[5] OFR discussed the increasing use of captives in the *2014 Annual Report* and data gaps for captives in the *2015 Financial Stability Report*.

[6] Insurers are regulated by state insurance departments, which generally follow the statutory accounting policies and procedures approved by the NAIC.

[7] The 2015 enhancements only require an insurer to disclose if it would have breached a capital threshold without using captives. An insurer's risk-based capital ratio is a metric evaluating the relationship of an insurer's capital to the amount of risk it assumes.

[8] See Office of Financial Research, *2014 Annual Report,* Washington, p. 111. The 2013 NAIC Annual Statement filing instructions are available for purchase from the NAIC at www.naic.org/prod_serv_home.htm.

[9] Securities must have either an NAIC Securities Valuation Office (SVO) designation or a rating from a nationally recognized statistical rating organization.

[10] In a typical captive arrangement, the ceding insurer transfers excess reserves to its captive affiliate and retains the economic reserves to support obligations to policyholders. Although statutory reserves are subject to an actuarial standard, economic reserves were not subject to an actuarial standard before 2015. The NAIC implemented Actuarial Guideline 48 for new captives formed on or after January 1, 2015. A Standard & Poor's report indicates that roughly half of captive transactions account for their liabilities on a less conservative basis than permitted under Generally Accepted Accounting Principles. See S&P, "Peeking inside the Black Boxes: Why North American Life Insurers Are Using Captives and Why It Matters," May 12, 2015.

[11] See NAIC, "2014 Insurance Department Resources Report, Volume 1." The calculation includes all state insurance department financial regulation staffing including those designated as "Captive/Spec. Insurance" (available at www.naic.org/documents/prod_serv_naic_state_sta_bb_1.pdf, accessed February 24, 2016).

[12] High-quality assets are securities with an SVO designation of "1." This is equivalent to single-A to triple-A rated securities.

[13] A letter of credit can be drawn on if actual claims exceed the future expected claims.

[14] See Jill Cetina, John McDonough, and Sriram Rajan, "More Transparency Needed for Bank Capital Relief Trades," OFR Brief no. 15-04, June 11, 2015 (available at financialresearch.gov/briefs/files/OFRbr-2015-04-bank-capital-refief-trades.pdf, accessed February 24, 2016).

[15] Actuarial Guideline 48 specifically has certain exemptions covered under NAIC Model Law 785 – Credit for Reinsurance Model Law (available at www.naic.org/store/free/MDL-785.pdf, accessed February 24, 2016).

[16] Financial statements for captives domiciled in Iowa are posted on the state insurance department website.

[17] Approved nonstandard practices can be permitted practices or prescribed practices. A permitted practice is an exception to an insurer's statutory accounting permitted by a state regulator on a case-by-case basis. Prescribed practices apply to all insurance companies domiciled in the state and are incorporated directly or by reference to state laws, regulations, and regulatory authority.