

## REINSURANCE (E) TASK FORCE

Reinsurance (E) Task Force April 4, 2016, Minutes

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Memo to Superintendent Eric A. Cioppa, Chair of the Financial Condition (E) Committee, From John Finston, Chair of the Reinsurance (E) Task Force, Dated April 4, 2016, Regarding Request for Extension on Revisions to *Credit for Reinsurance Model Law* and Drafting of the XXX/AXXX *Credit for Reinsurance Model Regulation* (Attachment Four)

Exposure of Revised Draft for the Model Regulation on *Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees* (Attachment Five)

Memo to Reinsurance (E) Task Force Members, Commissioner Representatives, Interested Regulators and Interested Parties From NAIC Staff Dated Feb. 26, 2016, Regarding Exposure of Revised Draft of the XXX/AXXX *Credit for Reinsurance Model Regulation* (Attachment Six)

Comment Letters Received from Maine Bureau of Insurance, Vermont Department of Financial Regulation, Connecticut Insurance Department, American Council of Life Insurers (ACLI), Northwestern Mutual, Claire Thinking Inc. and New York Life on Exposure of the Model Regulation (Attachment Seven)

Comment Letter to John Finston, Chair of the Reinsurance (E) Task Force, From Mike Boerner, Chair of the Life Actuarial (A) Task Force, Regarding the Exposure Draft of the Model Regulation on *Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees* (Attachment Eight)

Memo to the Honorable Dave Jones, Commissioner of the California Department of Insurance and Chair of the Reinsurance (E) Task Force; Dan Schelp, NAIC Managing Counsel; and Josh Arpin, NAIC Accounting and Reinsurance Policy Advisor, FRS; From Kevin Fry, Chair of the Valuation of Securities (E) Task Force and Bob Carcano, Senior Counsel, NAIC Investment Analysis Office; Dated Feb. 24, 2016; Regarding the Proposal to Expand the NAIC Bank List to Include Eligible Non-Bank Financial Institutions (Attachment Nine)

Memo to the Honorable John M. Huff, Chair of the Reinsurance (E) Task Force and Director of Insurance for the State of Missouri; Stewart Guerin, Chair of the Valuation of Securities (E) Task Force; and Members of the Reinsurance (E) Task Force and Valuation of Securities (E) Task Force; From Bob Carcano, Senior Counsel, NAIC Investment Analysis Office; Frank Meyers, NAIC Senior Analyst, SVO; Robert Johnson, NAIC Analyst 1, SVO; Dated Oct. 7, 2015, Regarding Recommendations for an NAIC List of Qualified U.S. Financial Institutions (List) (Attachment Ten)

## Draft Pending Adoption

Date: 4/11/16

Reinsurance (E) Task Force  
New Orleans, Louisiana  
April 4, 2016

The Reinsurance (E) Task Force met in New Orleans, LA, April 4, 2016. The following Task Force members participated: Dave Jones, Chair, represented by John Finston (CA); Bruce R. Ramage, Vice Chair, represented by Justin Schrader (NE); Lori K. Wing-Heier represented by Maxine Froemling (AK); Jim L. Ridling represented by Richard Ford (AL); Allen W. Kerr represented by Mel Anderson (AR); Katharine L. Wade represented by Kathy Belfi (CT); Karen Weldin Stewart represented by Dave Lonchar (DE); Kevin M. McCarty represented by David Altmaier, Eric Johnson and Katina Johnson (FL); Ralph T. Hudgens represented by Marc Ossi (GA); Anne Melissa Dowling represented by Kevin Fry (IL); Stephen W. Robertson represented by Cindy Donovan (IN); Ken Selzer represented by Tian Xiao (KS); James J. Donelon represented by Stewart Guerin (LA); Daniel R. Judson represented by Robert Macullar (MA); Eric A. Cioppa represented by Robert Wake (ME); John M. Huff represented by John Rehagen (MO); Mike Chaney represented by David Browning (MS); Monica J. Lindeen represented by Steve Matthews (MT); Wayne Goodwin represented by Tony Riddick (NC); Roger A. Seigny represented by Douglas Bartlett (NH); Richard J. Badolato represented by Richard Schlesinger (NJ); Barbara Richardson represented by Omar Akel (NV); Maria T. Vullo represented by Stephen Doody (NY); Mary Taylor represented by Dale Bruggeman (OH); John D. Doak represented by Joel Sander and Eli Snowbarger (OK); Elizabeth Kelleher Dwyer represented by Jack Broccoli (RI); Julie Mix McPeak represented by Mark Jaquish (TN); David Mattax and Mike Boerner (TX); Todd E. Kiser represented by Brett Barratt (UT); Jacqueline K. Cunningham represented by Doug Stolte (VA); Susan L. Donegan represented by David Provost (VT); Mike Kreidler represented by Jim Odiome (WA); and Ted Nickel represented by Randy Milquet (WI).

### 1. Adopted its Jan. 6, 2016, and Dec. 9, 2015, Minutes

Mr. Finston noted that since the Fall National Meeting, the Task Force met Jan. 6, 2016, and Dec. 9, 2015. He provided a summary of the activity that occurred during this meeting, which included adoption of revisions to the *Credit for Reinsurance Model Law* (#785) that provide the commissioner authority to adopt regulations with respect to: 1) life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits; 2) universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period; 3) variable annuities with guaranteed death or living benefits; 4) long-term care insurance (LTCI) policies; and 5) other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance. He further noted that the revisions to Model #785 were adopted by the NAIC Executive (EX) Committee and Plenary on Jan. 8, 2016. Mr. Rehagen made a motion, seconded by Ms. Donovan, to adopt the Task Force's Jan. 6, 2016, (Attachment One) and Dec. 9, 2015, (Attachment Two) minutes. The motion passed unanimously.

### 2. Received a Status Report from the Qualified Jurisdiction (E) Working Group

Mr. Barratt stated that since the Fall National Meeting, the NAIC has begun dialogue with one non-U.S. jurisdiction about possible consideration as a qualified jurisdiction; however, no jurisdictions have formally requested that the Working Group initiate the evaluation process at this time. He added that to date, the NAIC has approved seven jurisdictions for recognition as a Qualified Jurisdiction.

### 3. Adopted the Report of the Reinsurance Financial Analysis (E) Working Group

Mr. Rehagen stated that the Reinsurance Financial Analysis (E) Working Group met March 29, 2016, and Dec. 22, 2015, in regulator-to-regulator session pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings. Mr. Rehagen advised that on these conference calls, the Working Group completed the following work: 1) reviewed and recommended three renewals for certified reinsurer passporting purposes, which brings the total number of certified reinsurers recommended for passporting to 27; and 2) discussed and made revisions to the *Uniform Application Checklist for Certified Reinsurers* (Attachment Three), which addresses International Financial Reporting Standards (IFRS) to generally accepted accounting principles (GAAP) conversions, parameters on an acceptable age of ratings and a note regarding special filing requirements for certain qualified jurisdictions. He added that on the March 29 conference call, the Working Group agreed to refer the draft revisions to the *Uniform Application Checklist for Certified Reinsurers* to the Task Force, with a recommendation that the checklist be exposed for a 30-day public comment period. He further noted that at the 2015 Fall National Meeting, the Reinsurance (E) Task Force directed NAIC staff to develop a public Web

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page detailing the certified reinsurer and passporting process. On Feb. 22, this Web page became accessible to the public and can be accessed through links provided on the Task Force's Web page.

Mr. Finston summarized the certified reinsurer and passporting process and urged each state to take the initiative to become more proficient with the process and the materials provided, as it was developed to make the process more streamlined and efficient for all parties involved, including state insurance regulators and certified reinsurers. Mr. Rehagen made a motion, seconded by Mr. Johnson, to adopt the report of the Reinsurance Financial Analysis (E) Working Group and expose the revisions to the *Uniform Application Checklist for Certified Reinsurers* for a public comment period ending May 6. The motion passed unanimously.

#### 4. Requested a Model Law Development Extension from the Financial Condition (E) Committee

Mr. Finston advised that it is necessary to request an extension from the Financial Condition (E) Committee in order to continue working on the proposed XXX/AXXX Credit for Reinsurance Model Regulation (Model Regulation). Mr. Stolte made a motion, seconded by Mr. Wake, to direct NAIC staff to submit a memorandum (Attachment Four) to the Financial Condition (E) Committee requesting an extension until the Summer National Meeting, at which time the Task Force will re-evaluate if additional time is needed to complete the Model Regulation. The motion passed unanimously.

#### 5. Discussed Comments Received on the Feb. 26 Draft of the Model Regulation

Mr. Finston advised that at the 2015 Fall National Meeting, the Task Force directed NAIC staff and consultants to consider the comments received from the 2015 Summer National Meeting exposure of the proposed Model Regulation, as well as the discussion and actions taken by the Task Force, and proceed with making revisions to a revised draft of the Model Regulation that would be subsequently presented to the Task Force for consideration and discussion. He added that on Feb. 26, NAIC staff exposed the revised draft of the Model Regulation (Attachment Five) and the accompanying NAIC staff memorandum (Attachment Six), which details the revisions made from the prior exposure draft, for a public comment period ending March 27. Josh Arpin (NAIC) provided a summary of the comment letters received on the Feb. 26 exposure of the draft Model Regulation from the American Council of Life Insurers (ACLI), Claire Thinking Inc., Connecticut Insurance Department, Maine Bureau of Insurance, New York Life, Northwestern Mutual and Vermont Department of Financial Regulation (Attachment Seven).

Mr. Finston advised that over the past few years, affiliated captive reinsurance has become a significant focus area for several federal agencies, including the Federal Insurance Office (FIO), Federal Reserve Banks, Financial Stability Oversight Council (FSOC) and Office of Financial Research (OFR). Several reports have been published by these agencies detailing significant concerns with the use of affiliated captive reinsurance, including whether the practice as a whole should be allowed, as well as its impact on the financial solvency of life insurance companies. Mr. Finston noted the following common themes throughout the publications: 1) severe lack of transparency regarding a life insurer's use of affiliated captives; 2) since there are currently no uniform regulations governing captives, the use of affiliated reinsurance captives has significantly increased in popularity in recent years as a result of the captives releasing insurers from certain insurance regulations, in addition to providing the capital benefit achieved through traditional reinsurance; 3) a primary concern that using affiliated captive reinsurance leads to different reserve/capital requirements being applied to the same risks as the exposures move from ceding insurers to the affiliated captives; and 4) when risks are transferred to an affiliated reinsurance captive, statutory accounting requirements imposed on the ceding insurer no longer apply as the captive becomes subject to the laws and regulations of the captive's domiciled state, in which, captives generally have lower reserve and capital requirements than those imposed by statutory accounting and, therefore, allow for the relief of statutory capital to be used elsewhere in the organization.

Mr. Finston further noted that in addition to these common themes, in a 2014 report, the Federal Reserve Bank of Boston noted that extensive use of affiliated captives weakens the balance sheets of the ceding statutory insurers in several ways, including that reported capital and capital quality have not kept pace with reserve levels and the increased use of lower quality assets to back reserves held by their affiliated captives. He added that the report further stated that statutory minimum capital requirement levels have remained relatively static due to the significant reinsurance credit and risk-based capital (RBC) benefit that insurers receive for affiliated captive reinsurance transfers.

In response to the comment letters received on the consequence option, Mr. Finston stated that on the Task Force's Oct. 26 conference call, through a majority vote, the Task Force elected to proceed in drafting the Model Regulation using the consequence option currently proposed, which provides that if there is a shortfall in the required level of Primary or Other Security, after the remediation period provided in the regulation, then no credit for reinsurance is allowed. He added that since these are insurer-owned captive transactions, there needs to be a strong incentive for companies to meet the Primary

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Security reserve requirements. He further stated that as commented by New York Life, the proposed consequence approach will be an important provision once PBR is implemented and the best way to ensure full compliance after principles-based reserving (PBR) is to deny all credit for reinsurance when there is a shortfall, as this will serve as a strong deterrent against companies' attempts to circumvent the Primary Security requirements of the Model Regulation.

In response to the comment letter received from ACLI on the recommendation for an additional exemption for smaller reinsurers that meet a minimum 400% RBC ratio, Mr. Finston referred the Task Force members to their additional handouts packet, which contained a document summarizing the historical life industry RBC results, specifically noting that for year-end 2014, 91% of life insurers had an RBC ratio greater than 500%. On an inquiry by Mr. Finston, Mr. Boerner, chair of the Life Actuarial (A) Task Force, advised that after several discussions, the Life Actuarial (A) Task Force submitted a comment letter to the Reinsurance (E) Task Force with recommendations regarding the Actuarial Method. Mr. Boerner went on to summarize the comment letter, detailing both substantive and nonsubstantive recommendations (Attachment Eight).

Mr. Provost advised that Vermont's comments were intended to focus on providing the state insurance regulators flexibility to work with the company on the remediation process, specifically noting that 15 days may not be a sufficient amount of time for remediation. Mr. Schrader stated that Nebraska believes a pro-rata approach provides an appropriate incentive for compliance and reduces the possibility of artificially putting a company into solvency concerns. Mr. Johnson stated that Florida is supportive of the current consequence option, but in response to Mr. Provost's comments on the timing of remediation, they would propose a potential hybrid approach, in which a pro-rata consequence would be used initially, but if the company is out of compliance at the end of the next quarter, then no credit for reinsurance would be allowed. He added that this type of approach would still provide a strong enforcement mechanism.

Mr. Anderson stated his support for a small professional reinsurer exemption being added to the Model Regulation, because, as currently drafted, the Model Regulation would provide anti-competitive effects for small professional reinsurers, given the uncertainty about the possible future use of a permitted practice. He requested that the Task Force and drafting group consider an exemption that would provide the same treatment for small and large professional reinsurers. Ms. Belfi agreed with Mr. Anderson's comments, noting that the intent of this model regulation was never to include any professional reinsurer. Mr. Wake stated that he would be supported of fine-tuning a small professional reinsurer exemption and further exploring the hybrid approach proposed by Mr. Johnson. Mr. Barratt noted he would be supportive of further reviewing a small professional reinsurer exemption, but noted his concerns with the proposed five license and 400% RBC requirements. In response to Mr. Anderson's comments, Mr. Bruggeman noted that generally, for life insurers, there is a not specific reinsurance line with respect to licensing and, therefore, this life insurer could theoretically write direct business in every state but also assume business. Mr. Wake added that these exemptions are intended to focus on professional insurers and not captive insurers.

Mr. Finston noted that the issue and exemption being discussed arises from reinsurers, who are not captive reinsurers, which have a permitted practice. On an inquiry from Mr. Finston, Neil Rector (Rector & Associates) stated that he views this matter as strictly a policy decision and does not have a recommendation on whether an exemption should or should not be added. He added that there is already an exemption in the Model Regulation if the life insurance company is licensed or accredited in the state of the ceding company so long as it follows statutory accounting. The only entities not currently exempt under the Model Regulation and, therefore, affected by the additional professional reinsurer exemption being proposed, are those who do not follow statutory accounting in a manner that materially increases the insurer's surplus.

Paul Graham (ACLI) stated that regardless of the consequence option used in the Model Regulation, it has been communicated to the ACLI that the remediation of a shortfall may not be as easy as originally perceived due to risk transfer requirements with the reinsurer. He added that additional consideration needs to be given to the consequence option to avoid potential catastrophic consequences when an outside event, such as a financial crisis, that could stop a company from remediating the shortfall. He further noted that these concerns could be addressed by using a pro-rata consequence approach if the company cannot remediate the shortfall, as it would decrease the credit on a pro-rata basis back to the level of primary security that the company has posted.

Mr. Graham stated that the reason the professional reinsurer exemption adopted in Model #785 had significant requirements was to ensure that variable annuities captives would not be able to meet the requirements, as they operate differently from XXX/AXXX captives, which operate as reserve financing. He added that the recommended small reinsurer exemption is intended to provide a level playing field for all professional reinsurer and that the requirements of the regulations were established as a benchmark, but the ACLI is not set to the specific license requirement and RBC threshold. He further noted that consideration needs to be given to try to come up with a definition of entities we are not regulating, such as captives, as the consequence of the Model Regulation is significant for a traditional reinsurer.

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He added that in addition to the consequence option and reinsurer exemption, the ACLI has worked with Mr. Wake on a reorganization of the Actuarial Method and recommended additional revisions to the Model Regulation, including removal of the drafting note in Section 2, addition of real estate as Primary Security and other technical edits. The intent of the reorganization is to specify the section of the Model Regulation that applies once PBR is implemented, since it is likely that most states will not adopt the Model Regulation until after PBR is implemented, which appears likely to be Jan. 1, 2017. In response to the comment letter from the Life Actuarial (A) Task Force, Mr. Graham summarized the importance of Section 8 once PBR is implemented, which was something discussed and considered in detail previously. He noted that the ACLI will be working with the Life Actuarial (A) Task Force on this issue and will provide a revised recommendation in the coming weeks.

Mr. Finston stated that he would prefer the use of affiliated captive reinsurance not be used, specifically noting that all of the issues identified in this discussion stems from an insurance group electing to use affiliated captives for its own benefit. He added that several of the comments received emphasis not making it too difficult for these insurers to do these transactions, because it may provide additional risk in the future that they must address. He further noted that if these transactions were prohibited, these concerns would be eliminated. However, at this time, the NAIC has not elected to prohibit these transactions with affiliated captive reinsurers, but instead is trying to develop the Model Regulation to allow companies to use these transactions, as long they fully fund the required level of primary security and meet the safeguards established.

Mr. Graham stated that the main driver of the concerns being expressed is due to the Model Regulation being different from *Actuarial Guideline XLVIII—Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued Under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (AG 48)*, specifically noting that AG 48 allows for a dollar for dollar reduction in credit for reinsurance if there is a shortfall in primary security, whereas the proposed Model Regulation would require any shortfall to result in zero credit for reinsurance. Mr. Finston noted that AG 48 does have a proportional consequence for a shortfall; however, it also has other consequences for noncompliance including the qualified actuarial opinion. He added that one of the key issues that we are trying to address as we move from AG 48 to a credit for reinsurance structure in the Model Regulation is the appropriateness of the consequence for noncompliance. Mr. Wake stated that if we provided a more restrictive definition of the type of licenses, it would by omission, assist in identifying captives and other similar alternative vehicles. Mr. Johnson agreed with the ACLI's comment on removing the drafting note from Section 2.

Bryan Fuller (Examination Resources) recommended that the Task Force remove reference to quota share from the Actuarial Method and instead use the terms "proportional" and "nonproportional." Sheldon Summers (Claire Thinking Inc.) noted that the *Life and Health Reinsurance Agreements Model Regulation (#791)* states that a company may not take any reserve credit if any of the risk transfer requirements are not met. However, he added that *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance of the Accounting Practices and Procedures Manual* states that a reinsurance agreement that does not comply with risk transfer requirements shall follow Deposit Accounting. He recommended that if the current consequence option is used in the Model Regulation, the Task Force may want to consider amending SSAP No. 61R to clarify whether the treaty is subject to Deposit Accounting when/if the security requirements are out of compliance. Susan Callahan (Northwestern Mutual) stated her support of the current consequence option that provides zero credit for reinsurance if a shortfall exists, noting that a core issue the regulation is trying to address is the management of an insurer's use of captives. She added that once PBR is implemented, she hopes the Model Regulation will ensure the use of captive reinsurance is minimal, if not eliminated entirely. Doug Wheeler (New York Life) stated that the proposed consequence option only applies to companies that structure a deal to circumvent the rules and, therefore, losing all credit for reinsurance is appropriate if a shortfall exists. He added that once PBR is implemented, the proportional consequence option proposed by the ACLI will actually become a dollar for dollar consequence, an option the Task Force previously rejected, as PBR will no longer have "other security." He noted his support for allowing additional time for the remediation process if it means compliance with the Model Regulation.

Mr. Stolte made a motion, seconded by Mr. Wake, to direct NAIC staff and consultants to work with the XXX/AXXX Captive Reinsurance Regulation Drafting Group on drafting a revised Model Regulation, which considers the comments received and discussion held during the meeting, to be presented to the Task Force for future consideration and exposure.

### 6. Adopted the Recommendation of the Valuation of Securities (E) Task Force to Expand the NAIC Bank List to Include Eligible Non-Bank Financial Institutions

Mr. Arpin advised that the Securities Valuation Office (SVO) maintains the NAIC Bank List, which is used by insurers to identify letters of credit that can be used as collateral in reinsurance transactions under Model #785. Last year the Valuation

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of Securities (E) Task Force asked the Reinsurance (E) Task Force whether the list should include non-banks because the Model Law refers to financial institutions—a term that is broader than just banks. He added that the Reinsurance (E) Task Force asked the SVO to develop criteria for non-banks that includes or reflects how financial institutions are regulated, which was presented to the Valuation of Securities (E) Task Force during the 2015 Fall National Meeting and exposed for a 60-day public comment period, in which no comments were received. On a Feb. 22 conference call, the Valuation of Securities (E) Task Force adopted the SVO report and recommendations for revisions to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) with the intent of sending a referral to the Task Force for its review and consideration. He further noted that if the Task Force approves the recommendation, it is advised that the Valuation of Securities (E) Task Force implement the revisions to the P&P Manual. He advised that the recommendation from the Valuation of Securities (E) Task Force, including the proposed amendments to the P&P Manual (Attachment Nine), and an executive summary of the SVO considerations and recommendations (Attachment Ten) were provided in the meeting materials. Mr. Fry made a motion, seconded by Mr. Guerin, to adopt the recommendation from the Valuation of Securities (E) Task Force. The motion passed unanimously.

### 7. Discussed Reinsurance Collateral Next Steps

Mr. Finston provided a status report on the NAIC's reinsurance collateral efforts. Regarding the states' implementation of the revised Model #785 and *Credit for Reinsurance Model Regulation* (#786), to date 32 states have passed legislation to implement the revised Model #785, with 22 of those states enacting Model #786 as well. Insurers domiciled in these states represent more than 66% of the direct insurance premium written in the U.S. across all lines of business. An "SMI Dashboard" is maintained on the Financial Condition (E) Committee Web page reflecting the current status of this, and other solvency modernization-related, legislation throughout the states. Many states are now building their legislative proposals for 2016.

Having no further business, the Reinsurance (E) Task Force adjourned.

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Date: 1/27/16

Reinsurance (E) Task Force  
Conference Call  
January 6, 2016

The Reinsurance (E) Task Force met via conference call Jan. 6, 2016. The following Task Force members participated: John M. Huff, Chair (MO); Dave Jones, Vice Chair, represented by John Finston (CA); Jim L. Ridling represented by Richard Ford (AL); Allen W. Kerr represented by Mel Anderson (AR); Katharine L. Wade represented by Kathy Belfi (CT); Karen Weldin Stewart represented by Steve Kinion (DE); Kevin M. McCarty represented by Eric Johnson (FL); Ralph T. Hudgens represented by Mark Ossi (GA); Anne Melissa Dowling (IL); Stephen W. Robertson represented by Cindy Donovan (IN); Ken Selzer represented by Tian Xiao (KS); James J. Donelon represented by Stewart Guerin (LA); Daniel R. Judson represented by John Turchi and Robert Macullar (MA); Eric A. Cioppa (ME); Mike Chaney represented by Mark Cooley (MS); Bruce R. Ramge represented by Justin Schrader (NE); Roger A. Seigny represented by Douglas Bartlett (NH); Richard J. Badolato represented by Richard Schlesinger (NJ); Amy L. Parks represented by Omar Akel (NV); Andrew M. Cuomo represented by Martha Lees (NY); Joseph Torti III represented by Jack Broccoli (RI); Todd E. Kiser represented by Brett Barratt (UT); Jacqueline K. Cunningham represented by Doug Stolte (VA); Mike Kreidler represented by Steven Drutz and Tim Hays (WA); and Ted Nickel represented by Randy Milquet (WI). Also participating was: David Provost (VT).

1. Adopted Revisions to Section 2, Section 3 and Section 5 of Model #785

Director Huff informed participants that the meeting is a joint conference call of the Reinsurance (E) Task Force and the Financial Condition (E) Committee. He said the purpose of the call is to discuss the Dec. 15, 2015, exposed revisions to the *Credit for Reinsurance Model Law* (#785), which would provide the commissioner with the authority to adopt regulations with respect to certain captive reinsurance transactions, including the proposed XXX/AXXX Credit for Reinsurance Model Regulation. Director Huff noted that on the Dec. 9 conference call, the Task Force directed NAIC staff to create a new draft of revisions to Section 2 and Section 3 of Model #785 (Attachment One-A). During the call, a few regulators suggested putting the proposed revisions into Section 5 – Rules and Regulation, as opposed to substantially modifying Section 2 and Section 3. Director Huff added that subsequent to the call, he directed NAIC staff to draft an alternative proposal for consideration, which would revise Section 2, Section 3 and Section 5 of Model #785 (Attachment One-B), with the majority of the revisions incorporated into Section 5. He added that the language in both exposure drafts is substantially similar to one another.

Josh Arpin (NAIC) provided a summary of the exposure drafts to be considered by the Task Force, including discussion of how actions taken by the Task Force on its Dec. 9, 2015, conference call were incorporated into the exposure documents. This included: 1) use of the Option 2+ framework as proposed by New York Life and Northwestern Mutual; 2) inclusion of language suggested by the Life Actuarial (A) Task Force with respect to the specific policy types identified in Model #785; 3) inclusion of an exemption for large professional reinsurers as suggested by the American Council of Life Insurers (ACLI); and 4) inclusion of a grandfathering provision similar to that found in *Actuarial Guideline XLVIII—Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued Under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation* (AG 48), as suggested by the ACLI.

Mr. Arpin further provided a summary of the comment letters received from: 1) the Maine Bureau of Insurance; 2) the Vermont Department of Financial Regulation; 3) the Vermont Captive Insurance Association (VCIA); 4) New York Life and Northwestern Mutual; 5) the Reinsurance Association of America (RAA); and 6) the ACLI (Attachment One-C). He added that all comment letters received supported the exposure draft, which contains revisions to Section 2, Section 3 and Section 5 of Model #785.

In response to a comment from the RAA, Mr. Arpin noted that both exposure drafts would apply only to life and health insurance and that the professional reinsurer exemption would apply broadly to all regulations promulgated under the new authority. In response to a comment from the VCIA, Mr. Arpin clarified that additional model regulations or guidance would need to be adopted to regulate captive reinsurance transactions not specifically identified in Model #785, but that it would not be necessary to amend Model #785 to identify these transactions.

Mr. Arpin further stated that in its comment letter, the ACLI identified and proposed amendments to Model #785, noting that the grandfathering language exposed does not quite align with the grandfathering language incorporated into AG 48, which was the intent of this provision. Mr. Arpin added that this new language was discussed with various regulators and

determined that the benefit gained from the proposed language does not outweigh the potential confusion it could cause, and therefore, the consensus was to keep the language as exposed. Paul Graham (ACLI) noted that the intent of the proposed paragraph is not intended to just apply to grandfathering, but also the impact of the broader category of other exclusions included in AG 48.

Mr. Arpin recommended the Task Force adopt revisions to Section 2, Section 3 and Section 5 of Model #785 as exposed, with minor technical edits as outlined in the NAIC staff memorandum (Attachment One-D) and the inclusion of the ACLI suggested edit to the grandfathering provision drafting note, which states “[t]he preceding paragraph is not intended to change the scope of, or collateral requirements for policies and treaties covered under AG 48.” Mr. Graham stated that the inclusion of this edit is important. Mr. Finston stated that he is comfortable with the exposed language to Section 2, Section 3 and Section 5 of Model #785 and the addition of the ACLI proposed edit to the drafting note, but he proposed that if needed, any further clarifications to the grandfathering or other provisions in Model #785 can be addressed in the drafting of the model regulation. Mr. Provost also agreed with the inclusion of the ACLI edit to the drafting note.

Birny Birnbaum (Center of Economic Justice—CEJ) requested clarification on whether the reference to long-term care insurance (LTCI) policies in Section 5 applies to long-term care (LTC) coverage provided in both stand-alone and combination policies, or only with respect to stand-alone policies. Mr. Finston stated that the reference to LTC in Model #785 is broad enough to allow for the regulation, if adopted, to be specific as to what policies will be governed by the regulation. Mr. Birnbaum agreed with Mr. Finston’s comments.

Mr. Finston made a motion, seconded by Ms. Belfi, to adopt revisions to Model #785 as recommended by NAIC staff, with the inclusion of the drafting note edit proposed by the ACLI. The motion passed with objection from Mr. Kinion, who opposes adoption of these revisions as they do not address, nor has the Task Force considered, the impact these revisions have on consumers—specifically the impact to the cost of insurance. Mr. Kinion noted that this objection is further detailed in the Project History attachment provided in the meeting materials (Attachment One-E).

## 2. Directed NAIC Staff to Send a Referral to the Life Actuarial (A) Task Force

Mr. Arpin provided a summary of a memorandum submitted by NAIC staff with respect to the grandfathering provision included in the exposure drafts, which expressed concern that some state legislatures may not be permitted to adopt the grandfathering provision into their laws as currently written due to the potential for retrospective application (Attachment One-F). To address this concern, Mr. Arpin recommended that the Task Force direct NAIC staff to send a referral to the Life Actuarial (A) Task Force to consider amending the sunset provision of AG 48, so that: 1) it does not sunset until the time the state’s XXX/XXXX model regulation becomes effective with respect to those policies otherwise covered under AG 48; and 2) it remains in force with respect to those policies not covered under the new regulation. Mr. Graham and Neil Rector (Rector & Associates) expressed support for sending a referral to the Life Actuarial (A) Task Force, but also noted that there are additional complicating factors that will have to be addressed either by the Reinsurance (E) Task Force or the Life Actuarial (A) Task Force. As there were no objections, the Task Force directed NAIC staff to proceed as recommended.

Having no further business, the Reinsurance (E) Task Force adjourned.

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Reinsurance (E) Task Force

Draft: 12/14/2015

### REVISIONS TO SECTIONS 2 AND 3

**Staff Note: On its conference call of Dec. 9, the Reinsurance (E) Task Force directed NAIC staff to prepare revisions to Sections 2 & 3 of the *Credit for Reinsurance Model Law (#785)* in accordance with discussions and direction given by the Task Force on the call. NAIC staff has tracked all proposed revisions to Sections 2 and 3 from the current Model 785. In addition, technical edits were made based upon comments received from regulators and interested parties, where appropriate.**

## CREDIT FOR REINSURANCE MODEL LAW

### Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that in connection with reinsurance arrangements of a domestic ceding insurer pertaining to: (1) life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits; (2) universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period; (3) variable annuities with guaranteed death or living benefits; (4) long term care policies; or (5) such other life and health insurance and annuity products as to which the NAIC may adopt model regulatory requirements pursuant or related to the NAIC's Credit for Reinsurance Model Law, the commissioner may modify, supplement or supersede the requirements of Subsections A, B, C, D, E or F by adopting, by regulation, specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such policies and reinsurance arrangements.

A regulation pertaining to specific additional requirements adopted pursuant to this Section relating to (1) life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits or (2) universal life insurance policies with provisions resulting in the ability of a policyholder to keep such policy in force over a secondary guarantee period, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015.

**Drafting Note:** The NAIC's *Actuarial Guideline XLVIII* (AG 48) became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC *Credit for Reinsurance Model Law* is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to the NAIC model regulation currently under development. The preceding paragraph is intended to provide continuity of regulatory standards applicable to such policies and reinsurance arrangements, including continuity as to the policies covered by such regulatory standards.

Credit for Reinsurance Model Law

The commissioner may require such domestic ceding insurer, in calculating the amounts or forms of security required to be held under regulations promulgated under this authority, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.

A regulation pertaining to specific additional requirements adopted pursuant to this Section shall not apply to cessions to an assuming insurer that:

- (1) Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, in a minimum of five (5) other states; or
- (2) Maintains at least \$250 million in capital and surplus when determined in accordance with the NAIC Accounting Practices and Procedures Manual, including all amendments thereto adopted by the NAIC, without permitted or prescribed practices; and is
  - (a) licensed in at least 26 states; or
  - (b) licensed or accredited in at least 35 states with licenses in at least 10 states.

The authority to adopt regulations pertaining to specific additional requirements pursuant to this Section does not limit the commissioner's general authority to adopt regulations pursuant to Section 5 of this law.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

[Additional detail of Section 2 eliminated to conserve space]

**Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that in connection with reinsurance arrangements of a domestic ceding insurer pertaining to: (1) life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits; (2) universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period; (3) variable annuities with guaranteed death or living benefits; (4) long term care policies; or (5) such other life and health insurance and annuity products as to which the NAIC may adopt model regulatory requirements pursuant or related to the NAIC's Credit for Reinsurance Model Law, the commissioner may modify, supplement or supersede the requirements of this Section 3 by adopting, by regulation, specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

Reinsurance (E) Task Force

Draft: 12/14/2015

Drafting Note: This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such policies and reinsurance arrangements.

A regulation pertaining to specific additional requirements adopted pursuant to this Section relating to (1) life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits or (2) universal life insurance policies with provisions resulting in the ability of a policyholder to keep such policy in force over a secondary guarantee period, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015.

Drafting Note: The NAIC's Actuarial Guideline XLVIII (AG 48) became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC Credit for Reinsurance Model Law is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to the NAIC model regulation currently under development. The preceding paragraph is intended to provide continuity of regulatory standards applicable to such policies and reinsurance arrangements, including continuity as to the policies covered by such regulatory standards.

The commissioner may require such domestic ceding insurer, in calculating the amounts or forms of security required to be held under regulations promulgated under this authority, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.

A regulation pertaining to specific additional requirements adopted pursuant to this Section shall not apply to cessions to an assuming insurer that:

- (1) Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, in a minimum of five (5) other states; or
- (2) Maintains at least \$250 million in capital and surplus when determined in accordance with the NAIC Accounting Practices and Procedures Manual, including all amendments thereto adopted by the NAIC, without permitted or prescribed practices; and is
  - (a) licensed in at least 26 states; or
  - (b) licensed or accredited in at least 35 states with licenses in at least 10 states.

The authority to adopt regulations pertaining to specific additional requirements pursuant to this Section does not limit the commissioner's general authority to adopt regulations pursuant to Section 5 of this law.

Credit for Reinsurance Model Law

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

**Drafting Note:** There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer.

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Reinsurance (E) Task Force

Draft: 12/14/2015

## **REVISIONS TO SECTIONS 2, 3 AND 5**

**Staff Note:** On its conference call of Dec. 9, the Reinsurance (E) Task Force directed NAIC staff to prepare revisions to Sections 2 & 3 of the *Credit for Reinsurance Model Law (#785)* in accordance with discussions and direction given by the Task Force on the call. As noted on the call, a few regulators suggested putting the proposed Model Law revisions into Section 5 (Rules and Regulations), as opposed to substantially modifying Sections 2 and 3. Subsequent to the call, through discussions with regulators and interested parties, it was recommended that NAIC staff draft an alternative proposal for consideration, which would revise Sections 2, 3 and 5 of Model 785. NAIC staff has tracked all proposed revisions to these sections from the current Model 785. Please note, this language is substantially similar to the proposed revisions outlined in the Sections 2 and 3 exposure draft.

### **CREDIT FOR REINSURANCE MODEL LAW**

#### **Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

[Additional detail of Section 2 eliminated to conserve space]

#### **Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance

Credit for Reinsurance Model Law

arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

**Drafting Note:** There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer.

Reinsurance (E) Task Force

Draft: 12/14/2015

## Section 5. Rules and Regulations

A. \_\_\_\_\_ The commissioner may adopt rules and regulations implementing the provisions of this law.

**Drafting Note:** It is recognized that credit for reinsurance also can be affected by other sections of the enacting state's code, e.g., a statutory insolvency clause or an intermediary clause. It is recommended that states that do not have a statutory insolvency clause or an intermediary clause consider incorporating such clauses in their legislation.

B. \_\_\_\_\_ The commissioner is further authorized to adopt rules and regulations applicable to reinsurance arrangements described in Paragraph (1) of this Section 5B.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such policies and reinsurance arrangements.

(1) \_\_\_\_\_ A regulation adopted pursuant to this Section 5B, may apply only to reinsurance relating to:

(a) \_\_\_\_\_ Life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits;

(b) \_\_\_\_\_ Universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period;

(c) \_\_\_\_\_ Variable annuities with guaranteed death or living benefits;

(d) \_\_\_\_\_ Long-term care policies; or

(e) \_\_\_\_\_ Such other life and health insurance and annuity products as to which the NAIC may adopt model regulatory requirements pursuant or related to credit for reinsurance.

(2) \_\_\_\_\_ A regulation adopted pursuant to paragraph 1(a) or 1(b) of this Section 5B, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015.

**Drafting Note:** The NAIC's Actuarial Guideline XLVIII (AG 48) became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC Credit for Reinsurance Model Law is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to the NAIC model regulation currently under development. The preceding paragraph is intended to provide continuity of rules applicable to those policies and reinsurance arrangements, including continuity as to the policies covered by such rules.

(3) \_\_\_\_\_ A regulation adopted pursuant to this Section 5B may require the ceding insurer, in calculating the amounts or forms of security required to be held under regulations promulgated under this authority, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments

Credit for Reinsurance Model Law

- adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.
- (4) A regulation adopted pursuant to this Section 5B shall not apply to cessions to an assuming insurer that:
- (a) Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, in a minimum of five (5) other states; or
- (b) Maintains at least \$250 million in capital and surplus when determined in accordance with the NAIC *Accounting Practices and Procedures Manual*, including all amendments thereto adopted by the NAIC, without permitted or prescribed practices; and is
- (i). licensed in at least 26 states; or
- (ii). licensed or accredited in at least 35 states with licenses in at least 10 states.
- (5) The authority to adopt regulations pursuant to this Section 5B does not limit the commissioner's general authority to adopt regulations pursuant to Section 5A of this law.

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**Comments from Bob Wake (Maine Bureau of Insurance)**  
**on Proposed Revisions to Model Law 785: Credit For Reinsurance Act**

I support the proposed amendments to Model 785, which reflect a thoughtful effort to reconcile the interests of a wide range of stakeholders.

Of the two options, I strongly prefer the option that places the substance of the enabling law in a new Subsection 5(B). Placing it in the introductory clauses of Sections 2 and 3 is the proverbial “tail that wags the dog,” and it is impossible to mesh with the existing numbering format of those sections. The numbering scheme of proposed Subsection 5(B) is much clearer, makes it easy to see how the parts fit together and facilitates intelligible cross-references. In the other option, the *verbatim* repetition of page-long rulemaking clauses, in addition to being cumbersome and inefficient, makes it difficult for a reader unfamiliar with the drafting history to confirm that they are actually intended to be identical, since they could have been written with variations to fit the differences in subject matter between the two sections. Saying the same thing at length in two different places also poses the risk that at some future time, amendments might be made to one section but not the other.

I also have one technical comment on the certified reinsurer exemption, which is at Paragraph 5(B)(4) of the “Section 5” version and begins with the fourth(!) unnumbered paragraph in each of Sections 2 and 3 of the “Sections 2 & 3” version. Under this proposal, certified reinsurers are exempted from any regulations adopted under the new rulemaking authority, and the law specifies two ways a reinsurer may qualify for this exemption. One is to be certified in the state enacting the Model, and the other is to be certified in five other states, if the state enacting the Model does not have a certification process substantially similar to Subsection 2(E) of Model 785. Although it makes sense to spell out an alternative mechanism to use in states that have not enacted Subsection 2(E), it does not make sense to instruct Legislatures in states that do certify reinsurers to codify into their insurance laws the hypothetical solution they would have adopted to a problem they do not have. The usual way to describe such alternatives is through drafting notes, so I would propose the following replacement to proposed Subparagraph 5(B)(4)(a) (or its counterparts in the fourth proposed “clause (1)” in each of Sections 2 and 3 in the other version):

- (4) A regulation adopted pursuant to this Section 5B shall not apply to cessions to an assuming insurer that:
  - (a) Is certified in this state pursuant to [insert provision of state law equivalent to Section 2E of the Credit for Reinsurance Model Act]; or

**Drafting Note:** In states that have not enacted Section 2E of the Credit for Reinsurance Model Law, either reference the analogous law establishing a regulatory designation for nonadmitted reinsurers meeting capital requirements similar to the \$250 million required for certification, or, if no such law has been enacted, replace Subparagraph (a) with “is certified in at least five (5) states pursuant to laws substantially similar to Section 2E of the Credit for Reinsurance Model Law; or”



**State of Vermont**  
**Department of Financial Regulation**  
89 Main Street  
Montpelier, VT 05620-3101

For consumer assistance:  
[Banking] 888-568-4547  
[Insurance] 800-964-1784  
[Securities] 877-550-3907  
**www.dfr.vermont.gov**

December 31, 2015

The Honorable John M. Huff  
Director, Missouri Department of Insurance, Financial Institutions and Professional Registration  
and Chair, NAIC Reinsurance (E) Task Force  
c/o Josh Arpin, Accounting and Reinsurance Policy Advisor  
National Association of Insurance Commissioners

Via email: [Jarpin@naic.org](mailto:Jarpin@naic.org)

RE: Exposure draft of revision to Model Law #785

Dear Director Huff:

Vermont appreciates the opportunity to provide our comments on the recent (12/14/2015) exposure draft of proposed revisions to the Credit for Reinsurance Model Law.

Vermont has no objection to the proposed changes in principle. The option to incorporate most of the changes into an expanded section 5 provides for a much clearer, more succinct model, and we prefer that option.

Sincerely,

A handwritten signature in black ink that reads "David F. Provost".

David F. Provost  
Deputy Commissioner  
Captive Insurance Division



*Banking*  
802-828-3307

*Insurance*  
802-828-3301

*Captive Insurance*  
802-828-3304

*Securities*  
802-828-3420



December 30, 2015

**Via E-mail**

The Honorable John Huff  
Director, Missouri Department of Insurance  
Chair, NAIC Reinsurance (F) Task force

Attention: Josh Arpin ([jarpin@naic.org](mailto:jarpin@naic.org))  
Dan Schelp ([dschelp@naic.org](mailto:dschelp@naic.org))

Re: Exposure Draft of Proposed Changes to the Credit for Reinsurance Model Law  
(#785) Relating to Captive Reinsurers

Dear Director Huff:

The Vermont Captive Insurance Association (VCIA)<sup>1</sup> offers the following comments on the proposed revisions to the Credit for Reinsurance Model law (#785) relating to captive reinsurers of life and health insurance products.

VCIA has reviewed the two exposure drafts dated December 14, 2015 proposing amendments to the Model Law. VCIA has no objections to the substantive language limiting the applicability to captive reinsurers of life and health insurance products. This section also contains language that would permit insurance commissioners to regulate any life and health insurance and annuity products “as to which the NAIC may adopt model regulatory requirements pursuant or related to the NAIC’s Credit for Reinsurance Model Law” without going back to their legislatures to amend the law. We interpret this language to be operative only if the NAIC adopts requirements for life and health insurance products other than XXX/AXXX, variable annuities, and long-term care to be subject to special captive reinsurance requirements by amending the NAIC model law. If this understanding is correct, VCIA also does not object to this language.

<sup>1</sup> VCIA, with nearly 500 members, is the largest trade association for captive insurance in the world. Established in 1985, VCIA provides lobbying support on the federal and state levels for its member companies, and the association hosts and supports professional education opportunities for the industry at large.

With respect to whether the captive reinsurer provisions should be incorporated in Sections 2 and 3 or in a new Section 5(B), VCIA believes that placing the provisions in one place, Section 5(B), is preferable to avoid confusion.

Thank you for the opportunity to comment on the exposure draft.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard Smith". The signature is written in a cursive style with a large initial "R" and "S".

Richard Smith  
President

BY E-MAIL

December 24, 2015

The Honorable John M. Huff  
Chair, NAIC Reinsurance (E) Task Force

Attention: Josh Arpin ([jarpin@naic.org](mailto:jarpin@naic.org))  
Dan Schelp ([dschelp@naic.org](mailto:dschelp@naic.org))

Re: Captives-Related Revisions to the Credit for Reinsurance Model Law

Dear Director Huff,

New York Life and Northwestern Mutual offer the following comments in support of the revisions to the model credit for reinsurance law exposed on December 15.

We appreciate the hard work and substantial thought that the task force, NAIC staff and other interested parties have devoted to development of the proposed exposures.

We strongly support adoption of either of the exposed drafts. We appreciate in particular the task force's decision to empower state insurance departments to adopt nationally uniform regulations addressing all types of life insurer captives. This addition to the model law represents an important step forward for the state-based system of insurance regulation.

Between the two exposed drafts, we prefer the version that locates the majority of the proposed changes in Section 5 of the model law. This version is less repetitive and easier to read. It also makes good sense to add the new proposed regulatory authority in the section of the law that addresses regulatory authority more generally.

\* \* \* \* \*

We are grateful for your time and attention to our comments. Please let us know if you need any additional information or want to discuss.

Sincerely,

George Nichols, III  
Senior Vice President in Charge of the Office of Governmental Affairs  
New York Life Insurance Company

David R. Remstad  
Senior Vice President & Chief Actuary  
Northwestern Mutual



1445 New York Avenue N.W. 7<sup>th</sup> Floor Washington, DC 20005

Telephone: (202) 638 3690  
Facsimile: (202) 638 0936  
<http://www.reinsurance.org>

VIA EMAIL

December 31, 2015

The Honorable John Huff  
Chair  
NAIC Reinsurance (E) Task Force

**RE: Revisions to the Credit for Reinsurance Model Law (#785) – December 15<sup>th</sup> Exposures**

Dear Director Huff:

The Reinsurance Association of America (“RAA”) appreciates the opportunity to provide comments on the most recently exposed options for revisions to the NAIC Credit for Reinsurance Model Law (#785). The RAA applauds the NAIC’s efforts to reach a compromise related to the rulemaking authority necessary to address perceived problems with life insurer-owned captives. The RAA supports “Revisions to Sections 2, 3 and 5” as the option which most clearly limits the rulemaking authority to life and health products and establishes the “professional reinsurer” exemption.

The RAA is a national trade association representing reinsurance companies doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the US and those that conduct business on a cross border basis. The RAA also has life reinsurance company affiliates.

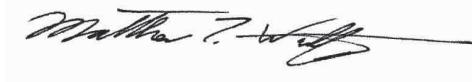
The RAA believes the “Revisions to Sections 2, 3 and 5” option is the option that reads most cleanly and (along with the drafting notes) most clearly delineates the scope of regulatory authority in the area of life and health insurance products. Limiting the scope of the authority to certain life and health products is a critical issue to the RAA and we believe the latest revisions accomplish that goal. Equally as important is the placement of the “professional reinsurer” exemption in the model law and the RAA commends the RTF for this choice. It is our understanding that the RTF intends for both of the exposure drafts to explicitly apply only to life and health and for the “professional reinsurer” exemption in both exposures to apply broadly to all regulations promulgated under the new authority. If this is not the case, please contact us to clarify the intent (or if you have any other questions).

The RAA appreciates the opportunity to provide input to the Task Force's work on the model law and recommends the Task Force move forward with the "Revisions to Sections 2, 3 and 5" option.

Sincerely,



Tracey W. Laws  
Senior Vice President &  
General Counsel



Matthew T. Wulf  
Vice President, State Relations &  
Assistant General Counsel

CC: Josh Arpin, Dan Schelp



**Paul Graham**  
Senior Vice President, Insurance Regulation & Chief Actuary  
(202) 624-2164 t (866) 953-4097 f  
paulgraham@acli.com

December 23, 2015

The Honorable John Huff  
Director  
Missouri Department of Insurance  
Fin. Institutions & Prof. Registration (DIFP)  
P.O. Box 690  
Jefferson City, Missouri 65102-0690

**RE: Exposure Drafts of Revisions to NAIC Credit for Reinsurance Model Law (#785)**

Dear Director Huff:

The ACLI<sup>1</sup> appreciates the opportunity to comment on the Exposure Drafts of revisions to the *NAIC Credit for Reinsurance Model Law (#785)* exposed by the Reinsurance (E) Task Force on its teleconference of December 9, 2015.

We have reviewed the two Exposure Draft documents, and believe that making changes to Sections 2, 3, and 5 is preferable to only making changes to Sections 2 and 3. Because Section 5 is the section that gives the commissioner the authority to adopt regulations pursuant to the law, it makes sense to include this additional commissioner authority regarding reinsurance with captives in that Section.

We note that the wording in Section 5B(2) that gives commissioners some limited retroactive authority does not quite align with the grandfathering incorporated in Actuarial Guideline 48 (AG 48). There are many reinsurance agreements that fall within the retrospective authority paragraph that would be grandfathered under AG 48. While we believe the drafting note helps to define the intended scope of the new Model Regulation, we believe that it should be clear that the law is not changing requirements on grandfathered policies. Therefore, we would make the following change to the limited retroactive authority paragraph (underlined language is new):

*A regulation adopted pursuant to paragraph 1(a) or 1(b) of this Section 5B , may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015, unless the NAIC Accounting Practices and Procedures Manual in effect as of December 31, 2015 excluded such pre-2015 policies from the requirements concerning the amount and forms of security supporting reinsurance arrangements that would otherwise be applicable to such policies.*

<sup>1</sup> The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 284 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums.



While we do not have any other substantive comments, we do have some additional suggested wording changes to help clarify the intent of the amendments to the Model Law. The suggested changes are shown in the attached Appendix A.

The ACLI thanks the Task Force for reviewing our previous comments in the development of these Exposure Drafts.

Sincerely,

A handwritten signature in black ink that reads "Paul S. Graham III". The signature is written in a cursive style with a stylized "P" and "G".

Paul S. Graham, III, FSA, MAAA

cc: Members, NAIC Reinsurance (E) Task Force  
Dan Schelp, Josh Arpin, NAIC

**Appendix A**  
**ACLI Suggested Changes for Clarification**

Note: Exposure Draft Amendments are highlighted in yellow.  
ACLI suggested wording changes are redlined.

**CREDIT FOR REINSURANCE MODEL LAW**

**Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

[Additional detail of Section 2 eliminated to conserve space]

**Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by,

and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

**Drafting Note:** There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer.

## Section 5. Rules and Regulations

- A. The commissioner may adopt rules and regulations implementing the provisions of this law.

**Drafting Note:** It is recognized that credit for reinsurance also can be affected by other sections of the enacting state's code, e.g., a statutory insolvency clause or an intermediary clause. It is recommended that states that do not have a statutory insolvency clause or an intermediary clause consider incorporating such clauses in their legislation.

- B. The commissioner is further authorized to adopt rules and regulations applicable to reinsurance arrangements described in Paragraph (1) of this Section 5B.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such policies and reinsurance arrangements.

- (1) A regulation adopted pursuant to this Section 5B, may apply only to reinsurance relating to:

- (a) Life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits;

- (b) Universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period;
- (c) Variable annuities with guaranteed death or living benefits;
- (d) Long-term care insurance policies; or
- (e) Such other life and health insurance and annuity products as to which the NAIC ~~may adopt~~ has adopted model regulatory requirements ~~pursuant or related~~ with respect to credit for reinsurance.

- (2) A regulation adopted pursuant to paragraph 1(a) or 1(b) of this Section 5B, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015, unless the NAIC Accounting Practices and Procedures Manual in effect as of December 31, 2015 excluded such pre-2015 policies from the requirements concerning the amount and forms of security supporting reinsurance arrangements that would otherwise be applicable to such policies.

**Drafting Note:** The NAIC's *Actuarial Guideline XLVIII (AG 48)* became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC *Credit for Reinsurance Model Law* is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to the ~~NAIC model regulation currently under development~~ Actuarial Guideline (such a NAIC model regulation is currently under development). The preceding paragraph is intended to provide continuity of rules applicable to those policies and reinsurance arrangements, including continuity as to the policies covered by such rules. The preceding paragraph is not intended to change the scope of or collateral requirements for policies and treaties covered under AG 48.

- (3) A regulation adopted pursuant to this Section 5B may require the domestic ceding insurer, in calculating the amounts or forms of security required to be held under regulations promulgated under this authority, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.
- (4) A regulation adopted pursuant to this Section 5B shall not apply to cessions to an assuming insurer that:
  - (a) Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, certified in a minimum of five (5) other states; or
  - (b) Maintains at least \$250 million in capital and surplus when determined in accordance with the NAIC *Accounting Practices and Procedures Manual*, including all amendments thereto adopted by the NAIC, without excluding the impact of any permitted or prescribed practices; and is
    - (i) licensed in at least 26 states; or
    - (ii) licensed or accredited in at least 35 states, of which at least 10 must be licenses. with licenses in at least 10 states.

- (5) The authority to adopt regulations pursuant to this Section 5B does not limit the commissioner's general authority to adopt regulations pursuant to Section 5A of this law.

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MEMORANDUM

**TO:** Reinsurance (E) Task Force  
**FROM:** NAIC Staff  
**DATE:** December 31, 2015  
**RE:** Technical Edits to Exposure Revisions to the Credit for Reinsurance Model Law (#785)

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**NAIC staff recommends that the Task Force adopt revisions to the Sections 2, 3 and 5 of the Credit for Reinsurance Model Law (#785), as exposed with the following technical edits:**

- Section 5.B.1.d — Long-term care insurance policies; or
- Section 5.B.1.e — Such other life and health insurance and annuity products as to which the NAIC ~~may~~ adopts model regulatory requirements with respect ~~pursuant or related to~~ credit for reinsurance.
- Section 5.B.4.a — Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, certified in a minimum of five (5) other states; or
- Section 5.B.4.b — Maintains at least \$250 million in capital and surplus when determined in accordance with the NAIC *Accounting Practices and Procedures Manual*, including all amendments thereto adopted by the NAIC, ~~without~~ excluding the impact of any permitted or prescribed practices; and is
- Section 5.B.4.b.ii — licensed in at least 10 states, and licensed or accredited in a total of at least 35 states ~~with licenses in at least 10 states.~~
- Section 5.B — **Drafting Note:** The NAIC's *Actuarial Guideline XLVIII (AG 48)* became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. . One regulation contemplated by this revision to the NAIC *Credit for Reinsurance Model Law* is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to ~~the NAIC model regulation currently under development~~ AG 48. The preceding paragraph is intended to provide continuity of rules applicable to those policies and reinsurance arrangements, including continuity as to the policies covered by such rules.

For your reference, NAIC staff has incorporated these technical edits into the exposure draft, which has been included in this memorandum (for ease of review, the technical edits have been shaded). **NAIC staff recommends that the revisions to Model #785 shown on the following pages be adopted by the Task Force.**

Reinsurance (E) Task Force

Draft: 12/31/2015

## **REVISIONS TO SECTIONS 2, 3 AND 5**

### **CREDIT FOR REINSURANCE MODEL LAW**

#### **Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

[Additional detail of Section 2 eliminated to conserve space]

#### **Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject

Credit for Reinsurance Model Law

to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

**Drafting Note:** There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer.

## Section 5. Rules and Regulations

- A. \_\_\_\_\_ The commissioner may adopt rules and regulations implementing the provisions of this law.

**Drafting Note:** It is recognized that credit for reinsurance also can be affected by other sections of the enacting state's code, e.g., a statutory insolvency clause or an intermediary clause. It is recommended that states that do not have a statutory insolvency clause or an intermediary clause consider incorporating such clauses in their legislation.

- B. The commissioner is further authorized to adopt rules and regulations applicable to reinsurance arrangements described in Paragraph (1) of this Section 5B.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially



Reinsurance (E) Task Force

Draft: 12/31/2015

similar in all material respects to NAIC adopted model regulations in the handling and treatment of such policies and reinsurance arrangements.

- (1) A regulation adopted pursuant to this Section 5B, may apply only to reinsurance relating to:
  - (a) Life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits;
  - (b) Universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period;
  - (c) Variable annuities with guaranteed death or living benefits;
  - (d) Long-term insurance care policies; or
  - (e) Such other life and health insurance and annuity products as to which the NAIC may adopts model regulatory requirements with respect pursuant or related to credit for reinsurance.
- (2) A regulation adopted pursuant to paragraph 1(a) or 1(b) of this Section 5B, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015.

**Drafting Note:** The NAIC's Actuarial Guideline XLVIII (AG 48) became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC Credit for Reinsurance Model Law is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to AG 48 the NAIC model regulation currently under development. The preceding paragraph is intended to provide continuity of rules applicable to those policies and reinsurance arrangements, including continuity as to the policies covered by such rules.

- (3) A regulation adopted pursuant to this Section 5B may require the ceding insurer, in calculating the amounts or forms of security required to be held under regulations promulgated under this authority, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.
- (4) A regulation adopted pursuant to this Section 5B shall not apply to cessions to an assuming insurer that:
  - (a) Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, certified in a minimum of five (5) other states; or
  - (b) Maintains at least \$250 million in capital and surplus when determined in accordance with the NAIC Accounting Practices and Procedures Manual, including all amendments thereto adopted by the NAIC, without excluding the impact of any permitted or prescribed practices; and is

Credit for Reinsurance Model Law

- (i). \_\_\_\_\_ licensed in at least 26 states; or
  - (ii). \_\_\_\_\_ licensed in at least 10 states, and licensed or accredited in a total of at least 35 states ~~with licenses in at least 10 states.~~
- (5) The authority to adopt regulations pursuant to this Section 5B does not limit the commissioner's general authority to adopt regulations pursuant to Section 5A of this law.

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Draft: 1/4/2016

## PROJECT HISTORY

### XXX/AXXX REINSURANCE FRAMEWORK

#### DRAFT REVISIONS TO NAIC *CREDIT FOR REINSURANCE MODEL LAW* (#785)

This memorandum will discuss the background and history of the changes proposed to the NAIC *Credit for Reinsurance Model Law* (#785). To provide a more complete picture as to why changes to Model #785 are needed, this memorandum will also provide an overview of the captive reinsurance finance issues that prompted a regulatory response, the framework adopted by the NAIC to respond to those issues, the development and adoption of Actuarial Guideline XLVIII (AG 48) to implement the framework, and the status of a new NAIC regulation being developed to replace AG 48. In summary, the revisions to Model #785 are designed to provide commissioners with the specific authority to adopt the new model regulation being developed to replace AG 48.

#### 1. Description of the Project, Issues Addressed, etc.

The NAIC Principle-Based Reserving Implementation (EX) Task Force serves as the coordinating body for all NAIC technical groups involved with projects related to the Principle-Based Reserves (PBR) initiative for life and health policies. This Task Force was also charged with further assessing, and making recommendations regarding, the solvency implications of life insurance reserve financing mechanisms addressed in the June 6, 2013 NAIC White Paper of the Captives and Special Purpose Vehicle Use (E) Subgroup of the Financial Condition (E) Committee. On its June 30, 2014 conference call, this Task Force adopted the recommendations in the report of Rector & Associates, Inc. dated June 4, 2014, regarding a proposal for an XXX/AXXX Reinsurance Framework (Framework). This Framework sought to address concerns regarding reserve financing transactions and to do so without encouraging them to move off-shore. The changes would be prospective and apply only to the XXX term life insurance business and AXXX universal life with secondary guarantees (ULSG) business; i.e., the Framework applies only to reinsurance involving XXX and AXXX policies required to be valued under Sections 6 or 7 of the NAIC *Valuation of Life Insurance Policies Model Regulation* (#830). The Framework would not change the statutory reserve requirements applicable to a ceding insurer; rather, the Framework addresses the types of security that can back those reserves in connection with reserve financing transactions.

The Framework does not materially change the ability of insurers to obtain credit for reinsurance ceded to “certified” reinsurers or to obtain credit for reinsurance ceded to “licensed” or “accredited” reinsurers that follow statutory accounting and RBC rules. As a practical matter, the Framework requirements apply to reinsurance ceded to captive insurers, special purpose vehicles, reinsurers that are not eligible to become “certified” reinsurers, or reinsurers that materially deviate from statutory accounting and/or RBC rules. In those situations, the ceding insurer may receive credit for reinsurance if:

- The ceding insurer establishes gross reserves, in full, using applicable reserving guidance (currently, the “formulaic” approach under the Standard Valuation Law);
- Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract, on a funds withheld, trust, or modified coinsurance basis;

- Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held are held by or on behalf of the ceding insurer as security under the reinsurance contract;
- At least one party to the financing transaction holds an appropriate RBC “cushion;” and
- The reinsurance arrangement is approved by the ceding insurer’s domestic regulator.

The NAIC Executive (EX) Committee adopted the Framework (in concept) on August 17, 2014. As an interim step to implementing the Framework, the NAIC adopted Actuarial Guideline XLVIII *Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model 830)* (AG 48) on December 16, 2014. Expectation was that AG 48 would eventually be replaced by effective codification through the *Credit for Reinsurance Model Law* (#785) and creation of a new model regulation to establish requirements regarding the reinsurance of XXX/AXXX policies. The Reinsurance (E) Task Force and Financial Condition (E) Committee will meet on a joint conference call on January 6, 2016, and will consider adoption of revisions to Model #785 to give the Commissioner authority to issue regulations codifying AG 48 and the XXX/AXXX Reinsurance Framework. At some future date, both the revisions to Model #785 and new model regulation (once approved by the NAIC) are intended to be adopted by the NAIC as a new accreditation standard.

## 2. Name of Group Responsible for Drafting the Model and States Participating

**Reinsurance (E) Task Force:** Missouri (Chair), California (Vice Chair), Alabama, Arkansas, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Kansas, Louisiana, Maine, Massachusetts, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, Oklahoma, Pennsylvania, Puerto Rico, Rhode Island, Utah, Virginia, Washington and Wisconsin.

## 3. Project Authorized by What Charge and Date First Given to the Group

On June 30, 2014, the Principle-Based Reserving Implementation (EX) Task Force adopted the XXX/AXXX Reinsurance Framework in concept, and adopted draft charges to the Reinsurance (E) Task Force with respect to implementation of the Framework. On August 17, 2014, the Executive (EX) Committee adopted the following charges to the Reinsurance (E) Task Force and a request for model law development with respect to these charges:

- Request permission from the Executive (EX) Committee to create a new model regulation to establish requirements regarding the reinsurance of XXX/AXXX policies. The Principle-Based Reserving Implementation (EX) Task Force’s XXX/AXXX Reinsurance Framework Exhibit 4 should be considered for this model regulation, modified as deemed appropriate by the Task Force.—*Essential*
- Request permission from the Executive (EX) Committee to amend the *Credit for Reinsurance Model Law* (#785) and draft the amendments to reference the new model regulation drafted in accordance with the previous charge.—*Essential*

## 4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

On a conference call on October 29, 2014, the Reinsurance (E) Task Force created the XXX/AXXX Model Regulation Drafting Group, which is an informal drafting group composed of members of the Task Force tasked with developing an initial draft of a model regulation incorporating the provisions of proposed AG 48 for discussion and consideration by the Task Force. The members of the Drafting Group were Doug Stolte (VA), Chair; John Finston and Monica Macaluso (CA); Kathy Belfi (CT); Linda Sizemore, David Lonchar and Steve Kinion (DE); Robert Wake (ME); John Rehagen (MO); Justin C. Schrader (NE); Richard Schlesinger (NJ); Mike Maffei (NY); and David Provost (VT). On that call, Director Huff directed the Drafting Group to refrain from beginning any drafting on the model regulation until the Principle-Based Reserving Implementation (EX) Task Force had finished its work on AG 48. Once this Task Force has completed its work on AG 48, the Drafting Group could determine whether it believes that any changes to the AG 48 approach should be made in the model regulation. If the Drafting Group is of the opinion that any substantive modifications should be made to the AG 48 approach as it finalizes the model regulation, it should submit these proposed changes back to the Principle-Based Reserving Implementation (EX) Task Force for further guidance. The overall objective is to implement the AG 48 approach unless there are significant issues with respect to this implementation.

The Drafting Group met via conference call in regulator-to-regulator session on Oct. 14, 2014, and then again on March 10, March 23, April 21, May 11, June 23, June 24, July 14, and Oct. 23, 2015. The Drafting Group, with assistance from Rector and Associates and NAIC staff, reviewed, discussed and drafted a proposed draft XXX/AXXX Model Regulation and proposed revisions to Model #785, which were presented to the Task Force at the 2015 Summer National Meeting.

**5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)**

As previously noted, AG 48 will be the basis for the new regulation currently being drafted, and provides the detail for what will ultimately be included in the new regulation. AG 48 went through its own separate public drafting process, with multiple exposure periods, public hearings and opportunities for the NAIC to receive public comment from industry, consumers, legislators and regulators. A general description of this due process will be found in the Project History for AG 48. The revisions to Model #785 will provide commissioners with the authority to adopt the new regulation that is based on AG 48.

At the 2015 Summer National Meeting, the Reinsurance (E) Task Force exposed a draft XXX/AXXX Model Regulation, revisions to Model #785 (Options 1 & 2), and a July 28 memorandum from NAIC staff listing key discussion topics that were identified during the drafting process for a 45-day public comment period ending Sept. 30, 2015. The Task Force received 17 comment letters, and a note from NAIC staff on the applicability of regulation on policies issued prior to adoption of Model #830. The Task Force met again via conference call on Oct. 26 to discuss the comment letters received, and agreed to expose a new Option 3 of the proposed revisions to Model #785 for a comment period ending Nov. 11, 2015. The Task Force received 7 comment letters from regulators and interested parties.

At the Fall National Meeting, the Task Force discussed Options 1, 2 & 3 to Model #785, and voted to expose five options of the proposed revisions to Model #785 for a public comment period ending Dec. 6, 2015. These five options can be summarized, as follows: 1) Option 1, which would limit the scope of commissioner authority to adopt regulations with respect to XXX/AXXX transactions; 2) Option 2, which would provide commissioner authority to adopt regulations with respect to variable annuities, long-term care and XXX/AXXX captive reinsurance transactions; 3) Option 3, which incorporates language suggested and comments received from New York Life and the American Insurance Association (AIA) and is broader in scope than either Option 1 or Option 2, as it would provide the commissioner with the

authority to adopt regulations in connection with particular types of reinsurance arrangements, or may specify by regulation that credit will be reduced or eliminated in connection with particular types of reinsurance arrangements. In addition, Option 3 clarifies that these revisions were not intended to impact P/C reinsurers; 4) New York Life's modified Option 2, which covers the same types of policies as Option 2 (i.e., XXX/AXXX, long term care and variable annuities), and in addition covers any other product for which the NAIC develops a model regulation related to Model #785; and 5) the American Council of Life Insurer's (ACLI) modified Option 2 that incorporates an exemption for professional reinsurers if they meet specific requirements, which includes maintaining, at minimum, \$250 million in capital and surplus determined in accordance with statutory accounting principles, without deviation, and is licensed in at least 26 states, or licensed and accredited in at least 35 states with a minimum of 10 licenses.

The Task Force received 7 comment letters, and discussed these along with the 5 proposed options for revisions to Model #785 on its conference call on Dec. 9, 2015. The Task Force directed NAIC to re-expose the revisions to Model #785 with comments due by Dec. 31. The Task Force further directed NAIC staff to draft these revisions made in accordance with the following determinations made on the call: 1) Option 4, which was New York Life's modified Option 2; 2) correct the "flaw" issue identified by the ACLI, that in specifically referencing Model #830, Actuarial Guideline 43, and the *Health Insurance Reserves Model Regulation* (#10) to define the scope of the policies covered, these changes to Model #785 would cease to have any effect after Principle-Based Reserving goes into effect, because those reserving requirements sunset for new business after the PBR Valuation Manual becomes operative; 3) professional reinsurer exemption should be included in Model #785, and not just in the new XXX/AXXX model regulation; and 4) AG 48 "grandfather" provision should also be included in Model #785, and not just the model regulation. Two updated revisions containing these changes were exposed for public comment on Dec. 15, 2015, the first document containing these revisions in Section 2 & 3 of Model #785, with the second document containing these revisions in Sections 2, 3 & 5 (Rules and Regulations) of Model #785. The Task Force has scheduled a joint conference call with the Financial Condition (E) Committee on January 6, 2016, to consider the exposed revisions to Model #785 for adoption, with the Executive (EX) Committee and NAIC Plenary to consider the revisions for final approval on a conference call scheduled for January 8, 2016.

## 6. **A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response)**

The following significant issues were discussed extensively with regulators and interested parties during the process:

- **Consequence Options for Non-Compliance with the XXX/AXXX Model Regulation.** The Drafting Group members proposed several potential credit for reinsurance "consequences" for ceding insurers that have a shortfall in either Primary Security or Other Security. These options include: 1) All or Nothing; 2) Dollar for Dollar Reduction in Credit for Reinsurance for any shortfall; 3) Percentage reduction in Credit for Reinsurance for any shortfall and 4) Primary Security limitation, which would allow credit for reinsurance up to the amount of Primary Security held. At the 2015 Summer National Meeting, the Drafting Group advised the Reinsurance (E) Task Force that it decided to draft Sections 7(A)(3) and 7(A)(4) of the Model Regulation under the all or nothing option, but the Task Force encouraged regulators and interested parties to review the four consequence options with respect to the Model Regulation and provide any comments or suggested language.

- **Scope of Authority.** The scope of the authority to be provided to the commissioner to adopt model regulations under Model 785, whether it is limited in nature to specific types of policies, or whether it is broad enough to permit regulation of other types of policies. These are exposure documents Options 1—5 described above. The Task Force decided upon Option 4, New York Life’s modified Option 2, which covers the same types of policies as Option 2 (i.e., XXX/AXXX, long term care and variable annuities), and in addition covers any other product for which the NAIC develops a model regulation related to Model #785.
- **ACLI Issue.** In specifically referencing Model #830, Actuarial Guideline 43, and the *Health Insurance Reserves Model Regulation* (#10) to define the scope of the policies covered, these changes to Model #785 would cease to have any effect after Principle-Based Reserving goes into effect, because those reserving requirements sunset for new business after the PBR Valuation Manual becomes operative. Specifically, the ACLI recommended referencing these types of policies, as follows: “in connection with reinsurance arrangements pertaining to certain term insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, and long term care insurance policies.” The Task Force agreed with this recommendation, in modified form.
- **Professional Reinsurer Exemption.** The draft XXX/AXXX Model Regulation currently provides for exemptions for certain reinsurers under Section 4, which includes an exemption for reinsurers that do not have a permitted practice under the NAIC *Accounting Practices and Procedures Manual*. The ACLI proposed alternative language for either the model that would permit an exemption for reinsurers that 1) maintain at least \$250 million in capital and surplus determined in accordance with statutory accounting principles, without deviation; and 2) is licensed in at least 26 states; or Licensed or accredited in at least 35 states with a minimum of ten licenses. The Task Force agreed with this recommendation, in modified form.
- **AG 48 Grandfathering Provision.** The ACLI recommended that a “grandfathering” provision similar to that found in AG 48 be included in the model law, because they believe that it is necessary to give the commissioner specific authority to adopt a regulation that contains some limited retroactive application. Currently, AG 48 does not apply to XXX/AXXX policies “that were both (1) issued prior to 1/1/2015 and (2) ceded so that they were part of a reinsurance arrangement, as of 12/31/2014, that would not qualify for exemption as described in Section 3 of this Actuarial Guideline.” In addition, AG 48 has a Sunset provision to the effect that AG 48 “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 pursuant to Recommendation #5 of the June 2014 Rector Report.” The Task Force agreed with this recommendation, in modified form.
- **Objections by Delaware and Captive Insurance Industry.** Delaware and many interested parties in the captive insurance industry opposed Option 3 with respect to the scope of authority, stating that the captive insurance industry is concerned with the impact these revisions will have not only on life insurance captives, but also all kinds of captives that the commissioner may deem to be classified as a particular type of reinsurance arrangement. In addition, Delaware has consistently asked for consideration to be given to the impact these actions have on consumers, specifically the impact to the cost of insurance.

**7. Any Other Important Information (e.g., amending an accreditation standard).**

The revisions to Model #785, if adopted, would be considered by the Financial Regulation Standards and Accreditation (F) Committee as an amendment to the existing standard for Reinsurance Ceded. In addition, it is intended under the XXX/AXXX Reinsurance Framework that these revisions, in addition to the proposed XX/AXXX model regulation, would become an accreditation standard.

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MEMORANDUM

**TO:** Reinsurance (E) Task Force  
**FROM:** NAIC Staff  
**DATE:** December 31, 2015  
**RE:** Revisions to Actuarial Guideline 48 Sunset Provision

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NAIC staff is providing the following comments with respect to the “grandfathering” provision under the proposed revisions to the Credit for Reinsurance Model Law (#785). Specifically, these draft revisions provide, in relevant part:

A regulation adopted pursuant to paragraph 1(a) or 1(b) of this Section 5B, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, whole or in part, on or after January 1, 2015.

**Drafting Note:** The NAIC’s *Actuarial Guideline XLVIII* (AG 48) became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC Credit for Reinsurance Model Law is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state’s adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to the NAIC model regulation currently under development. The preceding paragraph is intended to provide continuity of rules applicable to those policies and reinsurance arrangements, including continuity as to the policies covered by such rules.

It is NAIC staff’s concern that some state legislatures may not be permitted to adopt the grandfathering provision as currently written into their laws. Specifically, the model law has a potential retrospective effect, because it would permit the commissioner to adopt a regulation that would have an effect prior to the date the revisions to the law were adopted. For example, if the law is adopted in 2017, it would have an effect with respect to policies issued on or after January 1, 2015. We understand the reasoning for including such a grandfathering provision in the model law, and we are not advocating changing the draft at this time. However, for those states that may face problems with respect to retrospective application, we would recommend that the Reinsurance (E) Task Force make a referral to the Life Actuarial (A) Task Force to consider amending the Sunset Provision of *Actuarial Guideline XLVIII* (AG 48), which currently provides as follows:

8. 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 pursuant to Recommendation #5 of the June 2014 Rector Report.

Our recommendation would be that LATF revise AG 48 so that it does not sunset until the time the state’s XXX/AXXX model regulation becomes effective with respect to those policies otherwise covered under AG 48, and that it remains in force with respect to those policies not covered under the new regulation. This is a relatively simple change, and it would not have any effect on the current grandfathering revisions to the model law. In addition, when the NAIC Financial Regulation Standards and Accreditation (F) Committee reviews the accreditation standard for these revisions, it should take into account those states that may not be legally permitted to adopt such a grandfathering provision.

Draft: 2/16/16

Reinsurance (E) Task Force  
Conference Call  
December 9, 2015

The Reinsurance (E) Task Force met via conference call Dec. 9, 2015. The following Task Force members participated: John M. Huff, Chair (MO); Dave Jones, Vice Chair, represented by John Finston (CA); Jim L. Ridling represented by Richard Ford (AL); Allen W. Kerr represented by Mel Anderson (AR); Katharine L. Wade represented by Kathy Belfi and Jim Jakielo (CT); Karen Weldin Stewart and Steve Kinion (DE); Kevin M. McCarty represented by Eric Johnson (FL); Ralph T. Hudgens represented by Mark Ossi (GA); Anne Melissa Dowling represented by Kevin Fry and Eric Moser (IL); Stephen W. Robertson represented by Cindy Donovan (IN); Ken Selzer represented by Chris Buchanan (KS); James J. Donelon represented by Stewart Guerin (LA); Daniel R. Judson represented by John Turchi and Robert Macullar (MA); Eric A. Cioppa and Bob Wake (ME); Mike Chaney represented by Mark Cooley and Dave Browning (MS); Monica J. Lindeen represented by Steve Matthews (MT); Bruce R. Range represented by Christy Neighbors, Lindsay Crawford and Justin Schrader (NE); Roger A. Sevigny represented by Doug Bartlett (NH); Richard J. Badolato represented by Richard Schlesinger (NJ); Amy L. Parks represented by Omar Akel (NV); Anthony Albanese represented by Marc Tse (NY); John D. Doak represented by Frank Stone and Eli Snowbarger (OK); Joseph Torti III represented by Jack Broccoli (RI); Todd E. Kiser represented by Brett Barratt (UT); Jacqueline K. Cunningham represented by Doug Stolte (VA); Mike Kreidler represented by Timothy Hays (WA); and Ted Nickel represented by Randy Milquet (WI).

1. Discussed Fall National Meeting Exposure Drafts and Comments Received

Director Huff provided a summary of the remaining issues identified by NAIC staff and interested parties and stated his goals for the conference call, which included: 1) for the Task Force to make a decision regarding the scope of authority to be provided to the commissioner to adopt model regulations under the *Credit for Reinsurance Model Law* (#785), whether it is limited in nature to specific types of policies, or broad enough to permit regulation of other types of policies not specifically identified; 2) for the Task Force to address the issue identified by the American Council of Life Insurers (ACLI) with respect to the description of the policies provided in the exposure drafts and whether it is necessary to revise the currently drafted language in order to address this issue; 3) for the Task Force to decide whether the professional reinsurer exemption proposed by the ACLI should be included in Model #785 or the proposed XXX/AXXX Credit for Reinsurance Model Regulation (XXX/AXXX Model Regulation) and whether any further review of the proposed language is necessary; 4) for the Task Force to address whether the ACLI's proposed grandfathering provision, similar to that found in *Actuarial Guideline XLIII—CARVM for Variable Annuities* (AG 48), is necessary, and, if so, whether it should be included in Model #785 or the XXX/AXXX Model Regulation; and 5) for the Task Force to provide guidance to NAIC staff on these issues and any other issues discussed on the call. He added that his goal is for the Task Force to adopt revisions to Model #785 no later than early 2016.

Mr. Arpin provided a summary of the five options of revisions to Model #785 (Attachment Two-A) that were exposed at the Fall National Meeting: 1) Option 1 with staff technical edits, which would limit the scope of commissioner authority to adopt regulations with respect to XXX/AXXX transactions; 2) Option 2 with staff technical edits, which would provide commissioner authority to adopt regulations with respect to variable annuities, long-term care insurance and XXX/AXXX captive reinsurance transactions; 3) Option 3 with staff technical edits, which is broader in scope than either Option 1 or Option 2, as it would provide the commissioner with the authority to adopt regulations in connection with particular types of reinsurance arrangements, or may specify by regulation that credit will be reduced or eliminated in connection with particular types of reinsurance arrangements; 4) New York Life's modified Option 2 (Option 2+), which would provide a new category to limit the commissioner's discretion to only adopt a regulation related to other insurance and annuity products as to which the NAIC may adopt model regulatory requirements, making reference to the Model #785; and 5) the ACLI's modified Option 2, which incorporates an exemption for professional reinsurers if they meet specific requirements.

Mr. Arpin advised that the Task Force received 10 comment letters (Attachment Two-B) on the Fall National Meeting exposure options of revisions to Model #785 from: 1) Indiana Department of Insurance; 2) Maine Bureau of Insurance; 3) Active Captive Management; 4) Risk Management Advisors; 5) American Insurance Association (AIA); 6) New York Life and Northwestern Mutual; 7) Reinsurance Association of America (RAA); 8) ACLI; 9) Delaware Department of Insurance and 10) group of U.S. life reinsurers. He encouraged the commenters to bring up their comments during the Task Force's discussion of the previously identified key issues.

2. Discussed Key Issues Related to Revisions to Model #785

a. Scope of Authority

Mr. Schrader stated that, consistent with its response in previous comment letters, Nebraska continues to support Option 2. He added that he does not support Option 3 due to its broad authority, but would accept Option 2+ if revisions were made to just address the circular reference created by referencing Model #785 within Model #785. Dan Schelp (NAIC) and Mr. Wake stated that they have a potential solution that would address Mr. Schrader's concern. Mr. Wake stated that while he supports Option 3, he believes Option 2+ is likely the better approach, as it contains more guardrails than those provided in the other options.

Mr. Finston summarized the history and drafting of the five exposure options, noting that with respect to the scope of authority, the Task Force is just providing the authority to develop and adopt additional regulations, which would make changes and provide for the application of Model #785 and the *Credit for Reinsurance Model Regulation* (#786). Mr. Finston stated his support for Option 2+, noting that the authority is intended to address the four specified products and any new products that may be developed over time that may have an adverse financial impact by allowing state insurance regulators the flexibility to draft and implement regulations through the NAIC process. Mr. Stolte, Mr. Fry, Mr. Johnson, Mr. Slape and Mr. Milquet expressed their support for Option 2+ with modifications to address the concerns noted by Mr. Schrader. Mr. Kinion stated that, consistent with its response in previous comment letters, Delaware continues to oppose Option 3.

Paul Graham (ACLI) summarized the exposure options and expressed concern with how there could be different variations of regulations on the same product type and, if the scope of authority is too broad, it could possibly provide the commissioner the authority to override the law. He went on to state his support for Option 2, noting that it is important for the language to be limited to the specific products outlined in Option 2 and make as clear as possible that these revisions are intended to address captives. Steve Bennett (AIA) stated his opposition to all current options, as they can be interpreted to apply to P/C reinsurers, when the intent was to only apply to life reinsurers. Mr. Finston agreed that these revisions are not intended to impact P/C reinsurers and, if needed, additional amendments could be made to make this clear. Mr. Slape noted that the P/C industry is allowed to write some of these types of products, specifically long-term care insurance, and, therefore, any revisions need to be clear that they apply to the product types and not the industry affiliation.

Doug Wheeler (New York Life) stated his support for Option 2+, which was drafted in conjunction with Northwestern Mutual and took into consideration the concerns raised by the industry and state insurance regulators regarding Option 3. He added that the authority provided by Option 2+ allows state insurance regulators to initiate the process of developing a regulation that would follow the NAIC model regulation development process. Additionally, he stated that there is precedent for referencing NAIC publications in state laws, specifically highlighting the *Standard Valuation Law* (#820) and the *Accounting Practices and Procedures Manual*, while specifically noting that the Option 2+ revisions to Model #785 do not go as far as those publications and would still have to go through the state-by-state rulemaking process. On an inquiry from Mr. Kinion, Mr. Wheeler stated that, through a review of publicly available annual reports, New York Life has identified two new annuity-related captives.

Matt Wulf (RAA) stated his support for Option 2, noting that through his interactions with legislators, he believes they like to see upfront the specifics to which they are agreeing. Therefore, he believes the broad language in Option 2+ and Option 3 would likely cause difficulties in getting the revisions passed through state legislatures. In response to Mr. Wheeler's comments, he added that in other circumstances when NAIC publications are referenced in state laws, they tend to be of a more technical nature, whereas the revisions exposed and being discussed today appear to be a matter of public policy. Ms. Donovan stated her agreement with Mr. Wulf's comments, noting that these proposals might be difficult to pass in legislatures and, currently, Indiana has a moratorium on regulations. In response to the Mr. Wulf's comments on state legislatures possibly not enacting the revisions due to a lack of details, Susan Callahan (Northwestern Mutual) stated that a recent regulation on principle-based reserving (PBR) went through the states, in which legislatures adopted the new Model #820, which took away the states' authority and gave immense reference to the NAIC *Valuation Manual*. She added that this manual can be updated regularly without most states taking further action and differs from the Option 2+ revisions, which would require any new regulations to be addressed through the NAIC model regulation development and the state rulemaking processes.

Jeff Alton (CNA) agreed with the comments made by Mr. Wulf and Mr. Bennett and recommended that an amendment be made to Option 2+ to clarify that these revisions are intended to apply to life reinsurance, by including the word “life” into the phrase “such other insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the NAIC’s Credit for Reinsurance Model Law.” He added that he believes this revision would address the concerns identified by several commenters on the scope of authority. Mr. Wake agreed with the recommendation and noted he suggested a similar to revision in his comment letter. Mr. Schelp supported this revision and recommended a minor edit to include the word “health” because long-term care insurance is a health industry product.

Mike Consedine (Transamerica) noted that the 2011 revisions to Model #785 and Model #786 were a product of significant negotiation and compromise by all parties involved. He stated the importance of getting these new revisions correct, as one of the hallmarks of the models is the consistency in which they have been adopted and implemented throughout the states. He added that he is supportive of the Option 2+ approach, with modification as discussed on today’s call. Mr. Wake recommended, as outlined in his comment letter, that the Task Force consider revising the structure of the revisions to Model #785 by adding a new subsection to Section 5 (Rules and Regulations). Mr. Slape supported this approach.

Mr. Finston made a motion, seconded by Mr. Turchi, to direct NAIC staff to incorporate the language of Option 2+ into Model #785, with modifications to address the applicability to P/C insurers, the circular reference to Model #785 (as noted by Mr. Schrader), the applicability to other life and health insurance and annuity products (as noted by Mr. Alton) and other discussions from today’s call. The motion passed, with Delaware dissenting.

b. Description of Policies

Director Huff summarized the ACLI’s comments with respect to the description of policies in the exposed revisions to Model #785, noting that in specifically referencing the *Valuation of Life Insurance Policies Model Regulation* (#830), AG 48 and the *Health Insurance Reserves Model Regulation* (#10) to define the scope of the policies covered, the revisions to Model #785 would cease to have any effect after PBR is implemented, because those reserving requirements sunset for new business after the *Valuation Manual* becomes operative. Mr. Boerner stated that the Life Actuarial (A) Task Force met Dec. 8 via conference call in regulator-to-regulator session to discuss the concerns raised by the ACLI. On this call, the Life Actuarial (A) Task Force developed language and recommended that the Reinsurance (E) Task Force consider incorporating the language into the revisions of Model #785 (Attachment Two-C). Mr. Boerner added that the recommended language is drawn upon the more descriptive titles for policies found in Section 6 and Section 7 of Model #830. Mr. Wake supported the recommended language. Mr. Graham supported the recommended language, noting that it addresses the concerns raised by the ACLI. The Task Force unanimously agreed to direct NAIC staff to incorporate the language recommendation from the Life Actuarial (A) Task Force into Model #785.

c. Professional Reinsurer Exemption

Director Huff summarized the ACLI-proposed language to incorporate a professional reinsurer exemption in Model #785, noting that an exemption would be provided for reinsurers if: 1) they maintain at least \$250 million in capital and surplus, determined in accordance with statutory accounting principles, without deviation; and 2) is licensed in at least 26 states, or licensed or accredited in at least 35 states with a minimum of 10 licenses. Mr. Graham stated that it is important to ensure the scope of the regulatory authority is clear that it applies to captive reinsurance transactions and not traditional reinsurance arrangements.

Mr. Rector stated that with respect to XXX/AXXX products, he is comfortable with the proposed professional reinsurer exemption and believes it could be incorporated into either Model #785 or the proposed model regulation. He added that because his involvement has primarily focused on the XXX/AXXX products, he cannot speak with certainty on whether the exemption is appropriate in substance or its location with respect to variable annuity or long-term care insurance products. Mr. Wake noted that he agrees with the substance of the proposed language and including the exemption within Model #785. Mr. Finston stated his preference is to have it incorporated into the model regulations that are adopted for the specific products. Mr. Schrader noted his support for the exemption, but said he prefers for it to be in the proposed model regulations, specifically highlighting that \$250 million in capital and surplus is significant now, but 20 years from now, this might not be the case. Therefore, by incorporating the exemption into the model regulation, it would easier for amendments to be made. In response to an inquiry from Mr. Schrader, Mr. Graham clarified that the capital and surplus requirement of \$250 million was used, as this is the same requirement to become a certified reinsurer. He further added that the licensing and accreditation

requirement is intended to be a significant threshold, as it is unlikely a captive reinsurer would meet these requirements. Mr. Schelp noted that the 26-state minimum was established because it represents half of the NAIC-accredited jurisdictions. Paige Freeman (Munich Re) noted that from the beginning, professional life reinsurers have had concerns that traditional reinsurance arrangements would be scoped into an issue that relates to captive reinsurance transactions. She added that by putting this exemption into Model #785, it becomes clear to Munich Re's ceding clients that they receive reserve credit and do not have to look elsewhere to make this determination. Matt Wulf (RAA) stated the importance of including this exemption into Model #785, noting that it makes a statement about U.S. state-based insurance regulation and licensed U.S. companies.

Mr. Ossi made a motion, seconded by Mr. Bartlett to incorporate the proposed professional reinsurer exemption in Model #785. The motion passed without objection.

d. Grandfathering Provision

Director Huff summarized the ACLI recommendation to have a grandfathering provision, similar to that found in AG 48, be included in Model #785, specifically noting that this provision is intended to provide the commissioner with specific authority to adopt a regulation that contains some limited retroactive application. He added that a revised version of the ACLI's recommendation was distributed Dec. 8 (Attachment Two-D). Mr. Rector and Mr. Jakielo expressed support for the concept of a grandfathering provision being included in Model #785; however, due to the complexity of such a provision, they said additional amendments to the proposed language are likely needed. Mr. Rector added that one potential alternative would be to amend the sunset provision in AG 48 to address the concerns identified by the ACLI. Mr. Jakielo added that rather than incorporating a specific provision into Model #785, this language could be addressed through a drafting note to provide the authority of a state to adopt a regulation that contains some limited retroactive application. The Task Force unanimously agreed to direct NAIC staff to work with regulators and interested parties on revisions to the grandfathering provision.

The Task Force unanimously agreed to direct NAIC staff to incorporate the actions and discussions from today's call within a new draft of Model #785, which would be exposed for a public comment period ending Dec. 31. The Task Force is scheduled to meet Jan. 6, 2016, via conference call to further discuss the proposed revisions to Model #785.

Having no further business, the Reinsurance (E) Task Force adjourned.

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## OPTION 1 – WITH STAFF EDITS

Model Regulation Service—January 2012

Draft: 7-28-2015

### CREDIT FOR REINSURANCE MODEL LAW

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#### Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

#### Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may impose, by regulation, an approval requirement with respect to, and additional requirements relating to the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with, reinsurance arrangements pertaining to non-universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation. The commissioner may require a domestic ceding insurer, in calculating the amounts of or forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

## OPTION 1 – WITH STAFF EDITS

### Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may impose, by regulation, an approval requirement with respect to, and additional requirements relating to the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with, reinsurance arrangements pertaining to non-universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

**Drafting Note:** There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer

## OPTION 2 – WITH STAFF EDITS

Draft: 08-15-2015

### CREDIT FOR REINSURANCE MODEL LAW

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Section 4.	Qualified U.S. Financial Institutions
Section 5.	Rules and Regulations
Section 6.	Reinsurance Agreements Affected

#### Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

#### Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation. The commissioner may require a domestic ceding insurer, in calculating the amounts ~~or~~ forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.



## OPTION 2 – WITH STAFF EDITS

### Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation. The commissioner may require a domestic ceding insurer, in calculating the amounts ~~or~~ forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner

## OPTION 3 – WITH STAFF EDITS

Reinsurance (E) Task Force Draft: 10-26-2015

### CREDIT FOR REINSURANCE MODEL LAW

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Section 4.	Qualified U.S. Financial Institutions
Section 5.	Rules and Regulations
Section 6.	Reinsurance Agreements Affected

#### Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

#### Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, in connection with particular types of reinsurance arrangements, or may specify by regulation that credit will be reduced or eliminated in connection with particular types of reinsurance arrangements. With respect to policies required to be valued under Sections 6 or 7 of the NAIC *Valuation of Life Insurance Policies Model Regulation*, the commissioner may require a domestic ceding insurer in calculating the amounts ~~or~~ forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC *Standard Valuation Law*, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

### OPTION 3 – WITH STAFF EDITS

#### Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, in connection with particular types of reinsurance arrangements, or may specify by regulation that credit will be reduced or eliminated in connection with particular types of reinsurance arrangements. With respect to policies required to be valued under Sections 6 or 7 of the NAIC *Valuation of Life Insurance Policies Model Regulation*, the commissioner may require a domestic ceding insurer in calculating the amounts ~~or~~ forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC *Standard Valuation Law*, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner

NYL PROPOSED TWEAKS TO OPTION 2 (WITH STAFF EDITS)

**New York Life Proposed Tweaks to Option 2 (with technical staff edits): Expands Scope, but Requires NAIC Process for Uniformity**

**Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided that the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to non-universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, long-term care insurance valued under the Health Insurance Reserves Model Regulation, and such other insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the NAIC's Credit for Reinsurance Model Law. The commissioner may require a domestic ceding insurer, in calculating the amounts ~~or~~ forms of security required to be held under such regulations, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

**Subsection 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided that the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to non-universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, long-term care insurance valued under the Health Insurance Reserves Model Regulation, and such other insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the NAIC's Credit for Reinsurance Model Law. The commissioner may require a domestic ceding insurer, in calculating the amounts ~~or~~ forms of security required to be held under such regulations, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation

NYL PROPOSED TWEAKS TO OPTION 2 (WITH STAFF EDITS)

Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

ACLI OPTION 2 PROPOSAL – WITH STAFF EDITS

Draft: 08-15-2015

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Section 5.	Rules and Regulations
Section 6.	Reinsurance Agreements Affected

**Section 1. Purpose**

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

**Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation. The commissioner may require a domestic ceding insurer, in calculating the amounts of or forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable.

Such approval requirement and specific additional requirements in any such regulation shall not apply to cessions to an assuming insurer that

1. Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2D of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or

**ACLI OPTION 2 PROPOSAL – WITH STAFF EDITS**

2. Maintains at least \$250 million in capital and surplus determined in accordance with statutory accounting principles, without deviation; and is
- a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

ACLI OPTION 2 PROPOSAL – WITH STAFF EDITS

Credit for Reinsurance Model Law

**Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer.; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation. The commissioner may require a domestic ceding insurer, in calculating the amounts of or forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable.

Such approval requirement and specific additional requirements in any such regulation shall not apply to cessions to an assuming insurer that

1. Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2D of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
2. Maintains at least \$250 million in capital and surplus determined in accordance with statutory accounting principles, without deviation; and is
  - a) licensed in at least 26 states; or
  - b) licensed or accredited in at least 35 states with a minimum of ten licenses.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;



**ACLI OPTION 2 PROPOSAL – WITH STAFF EDITS**

- C. (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
- (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner

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*Received via email on Dec. 7, 2015,  
from Cindy Donovan, Chief Financial Examiner*

**Indiana Department of Insurance**

*Option 1 with staff edits:*

Read literally, the Commissioner could adopt any regulation that renders subsections A, B, C, D, E, and F of the model law meaningless. By including an exemption for reinsurance transactions with “professional” reinsurers as recommended by the ACLI, it is clear that there is no intent to override those subsections by regulation for the vast majority of reinsurance transactions.

*Option 2 with staff edits:*

With regard to the staff added language; it is simply confusing and clarifies nothing. It also makes what is already a complex sentence structure worse.

*Option 2 NYL proposed with staff edits:*

With regard to NYL proposed tweaks, to Option 2. Indiana questions whether state legislators would adopt such broad reaching regulatory authority. Also the language does not limit the commissioner to adopting the NAIC Model Regulation (or substantially similar regulation), so the question of non-uniformity remains, which would be difficult to support.

## Comments from Bob Wake (Maine) on the Five Model Law Options

### Exposed at the Fall 2015 Meeting

My preference, as discussed at the Fall Meeting, is for broad enabling language, so that the Model Law does not need to be amended piecemeal each time regulations are developed to address different product types. However, I understand the industry's desire for guardrails to ensure that regulators are not given unfettered discretion to undo the Model Law's general framework by regulation.

One approach would be to step back from the entire paradigm we have been considering, and adopt what might be called "ACLI Option 4," based on a comment Paul Graham made in passing at the Fall Meeting. If I understood his comment correctly, he explained that his preferred approach would have been for the regulation to address "captive reinsurance," but that foundered on a difficulty in defining "captive reinsurance." Because terminology can evolve as needed, I would use the catch-all term "alternative market reinsurance," and rather than defining it directly in terms of what it is, I would define it in terms of what it is not. Here's a first try:

#### **Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

The commissioner may establish by regulation the conditions, including the amount and types of security, under which credit may be granted for reinsurance ceded to special-purpose or alternative market reinsurers, meaning assuming insurers that are not fully subject to reporting requirements, investment standards, accounting principles, and risk-based capital requirements that are at least as stringent as those generally applicable to commercial insurers and professional reinsurers, either because they are licensed under a less stringent regulatory framework or because they are subject to permitted or prescribed practices that have the effect of a material exempting them from the generally applicable financial standards.

That broad-based approach would leave the professional reinsurance market alone while avoiding the need to specify particular lines of business. There would be no reason to limit it to life reinsurance. Although it would sweep in, for example, a traditional captive program where the captive is "capitalized" by an LOC and secures its liabilities with traditional collateral under Model 786, we already have a regulation that fits this purpose.

Alternatively, I prefer Option 3 or NYL Option 2½, but the P&C industry comments at the Fall Meeting make clear that it's imperative to wordsmith the document to make clear, for example, that it doesn't apply to P&C insurance. I think the best way to deal with this is to put the new material clearly in a

separate section – the rulemaking section is ideal for that purpose – rather than trying to fold a complex single-purpose clause into the preamble to a section of general applicability. This also avoids having to repeat the same language twice in two different sections.

Finally, for reasons discussed in earlier comments, the proposed “professional reinsurer exemption” would not be my optimal choice, but with the \$250 million surplus requirement, calculated without any accounting deviations, it seems like an appropriate compromise. But if we throw this into the mix, the organization becomes even more complex unless it gets pulled out into a separate section, along the following lines. I tried to redline it against the NYL and ACLI drafts, and added a few technical points in balloons:

## **Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; ~~provided that the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to nonuniversal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, long-term care insurance valued under the Health Insurance Reserves Model Regulation, and such other insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the NAIC’s Credit for Reinsurance Model Law. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under such regulations, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable.~~

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

\*\*\*\*\*

## **Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; ~~provided that the commissioner may adopt regulations that~~

~~impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to nonuniversal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, long-term care insurance valued under the Health Insurance Reserves Model Regulation, and such other insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the NAIC's Credit for Reinsurance Model Law. The commissioner may require a domestic ceding insurer, in calculating the amounts of or forms of security required to be held under such regulations, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable.~~

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

\*\*\*\*\*

## Section 5. Rules and Regulations

- A. The commissioner may adopt rules and regulations implementing the provisions of this law.
- B. Notwithstanding Sections 2 and 3, the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that and the conditions under which credit will may be reduced or eliminated, in connection with reinsurance arrangements pertaining to non-universal life insurance [RAW1] and universal life insurance with secondary guarantees required to be [RAW2] valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, long-term care insurance valued under the Health Insurance Reserves Model Regulation, and such other life and health insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the provision of the NAIC's Credit for Reinsurance Model Law corresponding to this Subsection. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under such regulations, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable. No regulation adopted under this Subsection shall apply to cessions to an assuming insurer that:
- (a) ~~Any regulation adopted under the foregoing authority to address the reinsurance of non-universal and universal life insurance, variable annuities, long-term care insurance or another specific product type shall not impose approval or other additional requirements on cessions to an assuming insurer that:~~
- (b)(a) is certified in this state pursuant to [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act]; or, if this state has not adopted provisions substantially equivalent to Section 2D of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
- Drafting Note:** [RAW3] In states that have not adopted Section 2D of the Credit for Reinsurance Model Law, replace Subparagraph (a) with "is certified in at least five (5) states pursuant to laws substantially similar to Section 2D of the Credit for Reinsurance Model Law; or"
- (e)(b) maintains at least \$250 million in capital and surplus determined in accordance with statutory accounting principles, without deviation; and is
- (i) licensed in at least 26 states; or

- (ii) licensed in at least 10 states and licensed or accredited in at least 35 states-  
~~with a minimum of ten licenses.~~

**Drafting Note:** It is recognized that credit for reinsurance also can be affected by other sections of the enacting state's code, e.g., a statutory insolvency clause or an intermediary clause. It is recommended that states that do not have a statutory insolvency clause or an intermediary clause consider incorporating such clauses in their legislation.



November 17, 2015

VIA EMAIL

Mr. John M. Huff, Chair  
Reinsurance (E) Task Force  
C/O Mr. Josh Arpin and Mr. Dan Schelp  
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS  
1100 Walnut Street, Suite 1500  
Kansas City, MO 64106

RE: Revisions to the Credit for Reinsurance Model Law (#785) – Option 3

Dear Mr. Huff:

Active Captive Management, LLC (“ACM”) appreciates the opportunity to comment on the National Association of Insurance Commissioners’ (NAIC) proposed revisions to the *Credit for Reinsurance Model Law (#785)*. ACM specializes in risk management solutions, including the formation and management of captive insurance companies for small and medium size companies. ACM provides risk transfer solutions for various industries and is an approved captive insurance manager in predominately on-shore domiciles.

We are writing today to express our opposition to the proposal, known as Option 3, to change the *Credit for Reinsurance Model Law (#785)*. We are aware of the comments submitted on behalf of the Insurance Commissioner of Delaware and hereby incorporate those comments by reference herein. We share in the concern that this proposal will have an adverse impact on a number of captive insurance companies. While the original intent of Option 3 may not be to ensnare all forms of captive reinsurance arrangements, its current wording has the clear potential to reduce the financial benefit a fronting company obtains from the credit for reinsurance when entering into a reinsurance transaction with a captive insurance company. Should you have any questions regarding this comment letter, please do not hesitate to contact us.

Sincerely,

A handwritten signature in blue ink, appearing to read "Dana Hentges Sheridan".

DANA HENTGES SHERIDAN, Esq.  
General Counsel and Chief Compliance Officer  
ACTIVE CAPTIVE MANAGEMENT

{00490315.DOC; 1}

24422 Avenida de la Carlota, Suite 400 | Laguna Hills, California 92653  
Phone: (800) 921-0155 | Fax: (949) 727-4770 | www.activecaptive.com



Cc: Fred Turner, ACM Founder  
Park Eddy, ACM President  
Deanna Gilpin, ACM Chief Financial Officer  
Terisa Anderson, ACM Regulatory Compliance Officer

{00490315.DOC; 1}

BY E-MAIL

December 6, 2015

The Honorable John M. Huff  
Chair, NAIC Reinsurance (E) Task Force

Attention: Josh Arpin ([jarpin@naic.org](mailto:jarpin@naic.org))  
Dan Schelp ([dschelp@naic.org](mailto:dschelp@naic.org))

Re: Captives-Related Revisions to the Credit for Reinsurance Model Law

Dear Director Huff,

New York Life and Northwestern Mutual appreciate the opportunity to offer the following comments on the revisions to the model credit for reinsurance law exposed during the task force's recent meeting in National Harbor.

*Authority to Regulate All Life Insurer Captives*

Two of the exposed options – Option 3 or the modified version of Option 2 put forth by New York Life and Northwestern Mutual (“Option 2+”) – would empower state insurance departments to adopt regulations addressing all types of life insurer captives. We support either of these options.

The other exposed options would restrict the authority of state regulators to the narrower categories of life insurer captives specifically identified in the model law. Under these options, if the NAIC decides in the future that further regulations around additional categories of life insurer captives are necessary, regulators would be compelled to return once again to their state legislatures to pursue additional incremental changes to their credit for reinsurance statutes – an approach we believe is short-sighted and inefficient. This concern is not merely hypothetical. Publicly available securities filings describe two new categories of life insurer captives that have recently appeared in the marketplace.

*Support for NAIC Staff Edits*

We support the edits that NAIC staff made to the exposures, particularly the addition of the phrase “or that specify that credit will be reduced or eliminated.” This language makes clear that there is statutory authority for the consequences provided for in the XXX/AXXX credit for reinsurance model regulation.

*Exempting Professional Reinsurers in the Law*

The exposed “ACLI Option 2” limits regulatory authority to XXX/AXXX, variable annuity and long-term care captives, and enshrines in the model law a provision intended to exempt professional reinsurers from the scope of new captives regulations.

While we disagree with the ACLI's proposal to limit the scope of the revisions to XXX/AXXX, variable annuity and long-term care captives, we support the substance of the professional reinsurer exemption. This exemption is compatible with a broader grant of authority to state

regulators. We believe it is feasible to combine the proposed exemption with one of the exposures that gives regulators the authority to address all types of life insurer captives. We have attached as Appendix A a proposal that would combine the professional reinsurer exemption, exposed within ACLI Option 2, with our exposed Option 2+. To ensure that the attached proposal is as current as possible, it also includes technical fixes to the ACLI's Option 2 that we understand the ACLI has shared with the Chair of the task force and NAIC staff as of the date of this letter.

\* \* \* \* \*

We are grateful for your time and attention to our comments. Please let us know if you need any additional information or want to discuss.

Sincerely,

George Nichols, III  
Senior Vice President in Charge of the Office of Governmental Affairs  
New York Life Insurance Company

David R. Remstad  
Senior Vice President & Chief Actuary  
Northwestern Mutual

## Appendix A

### *Combination of the professional reinsurer exemption with the exposed Option 2+*

#### **Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided that the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to certain term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, and long term care insurance policies. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under such regulations, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.

Without limiting any other authority of the commissioner to adopt regulations implementing this Act, if (i) the NAIC, with reference to the Credit for Reinsurance Model Act, adopts model regulatory requirements covering product types not specifically identified above, and (ii) the commissioner concludes that the adoption of substantially similar regulatory requirements is advisable in this state to protect its citizens and promote nationally consistent state-based insurance solvency regulation, then the commissioner may adopt such substantially similar regulatory requirements.

Any regulation adopted under the foregoing authority to address the reinsurance of term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, long term care insurance policies, or another specific product type shall not impose approval or other additional requirements on cessions to an assuming insurer that:

- (i) is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
- (ii) maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is
  - a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

The approval or other additional requirements in any such regulation also shall not apply to cessions of term life insurance policies and universal life insurance policies with secondary guarantees that were both (1) issued prior to January 1, 2015 and (2) ceded as of December 31,

2014 as part of a reinsurance arrangement that would be subject to the approval or other additional requirements if not for this exclusion.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

**Subsection 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided that the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to certain term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, and long term care insurance policies. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under such regulations, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.

Without limiting any other authority of the commissioner to adopt regulations implementing this Act, if (i) the NAIC, with reference to the Credit for Reinsurance Model Act, adopts model regulatory requirements covering product types not specifically identified above, and (ii) the commissioner concludes that the adoption of substantially similar regulatory requirements is advisable in this state to protect its citizens and promote nationally consistent state-based insurance solvency regulation, then the commissioner may adopt such substantially similar regulatory requirements.

Any regulation adopted under the foregoing authority to address the reinsurance of term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, long term care insurance policies, or another specific product type shall not impose approval or other additional requirements on cessions to an assuming insurer that:

- (i) is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
- (ii) maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is

- a. licensed in at least 26 states; or
- b. licensed or accredited in at least 35 states with a minimum of ten licenses.

The approval or other additional requirements in any such regulation also shall not apply to cessions of term life insurance policies and universal life insurance policies with secondary guarantees that were both (1) issued prior to January 1, 2015 and (2) ceded as of December 31, 2014 as part of a reinsurance arrangement that would be subject to the approval or other additional requirements if not for this exclusion.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

Appendix A

Combination of the professional reinsurer exemption with the exposed Option 2+

**Section 2. Credit Allowed a Domestic Ceding Insurer**

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided that the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to certain term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, and long term care insurance policies. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under such regulations, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.

**Comment [Comment1]:** Technical fix based on ACLI proposal. Eliminates cross-references to pre-PBR regulations, making clear that requirements extend both to the pre-PBR and post-PBR periods.

Without limiting any other authority of the commissioner to adopt regulations implementing this Act, if (i) the NAIC, with reference to the Credit for Reinsurance Model Act, adopts model regulatory requirements covering product types not specifically identified above, and (ii) the commissioner concludes that the adoption of substantially similar regulatory requirements is advisable in this state to protect its citizens and promote nationally consistent state-based insurance solvency regulation, then the commissioner may adopt such substantially similar regulatory requirements.

Any regulation adopted under the foregoing authority to address the reinsurance of term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, long term care insurance policies, or another specific product type shall not impose approval or other additional requirements on cessions to an assuming insurer that:

**Comment [Comment2]:** New stand-alone sentence addressing other captive types. Expanded wording makes clear that states are not delegating authority directly to the NAIC to make law. Instead, state rule-making processes are required before an NAIC model takes effect.

To promote uniformity, the sentence also specifies that individual state regulations should be substantially similar to any NAIC model regulation addressing other types of captives.

- (i) is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
- (ii) maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is
  - a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

**Comment [Comment3]:** This wording defines the scope of the professional reinsurer exemption. This scope wording tracks the scope wording that appears in the first paragraph, and extends the exemption to all potential types of captives regulations.

The approval or other additional requirements in any such regulation also shall not apply to cessions of term life insurance policies and universal life insurance policies with secondary guarantees that were both (1) issued prior to January 1, 2015 and (2) ceded as of December 31,

2014 as part of a reinsurance arrangement that would be subject to the approval or other additional requirements if not for this exclusion.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

**Subsection 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided that the commissioner may adopt regulations that impose approval and other additional requirements relating to the valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated, in connection with reinsurance arrangements pertaining to certain term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, and long term care insurance policies. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under such regulations, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.

Without limiting any other authority of the commissioner to adopt regulations implementing this Act, if (i) the NAIC, with reference to the Credit for Reinsurance Model Act, adopts model regulatory requirements covering product types not specifically identified above, and (ii) the commissioner concludes that the adoption of substantially similar regulatory requirements is advisable in this state to protect its citizens and promote nationally consistent state-based insurance solvency regulation, then the commissioner may adopt such substantially similar regulatory requirements.

Any regulation adopted under the foregoing authority to address the reinsurance of term life insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, long term care insurance policies, or another specific product type shall not impose approval or other additional requirements on cessions to an assuming insurer that:

- (i) is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
- (ii) maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is

**Comment [Comment4]:** Technical fix based on ACLI proposal. Brings XXX/AXXX grandfathering provision from AG 48 into the model statute.

**Comment [Comment5]:** Same wording change as above in Subsection 2.

**Comment [Comment6]:** Same new stand-alone sentence as above in Subsection 2.

**Comment [Comment7]:** Same wording change as above in Subsection 2.



- a. licensed in at least 26 states; or
- b. licensed or accredited in at least 35 states with a minimum of ten licenses.

The approval or other additional requirements in any such regulation also shall not apply to cessions of term life insurance policies and universal life insurance policies with secondary guarantees that were both (1) issued prior to January 1, 2015 and (2) ceded as of December 31, 2014 as part of a reinsurance arrangement that would be subject to the approval or other additional requirements if not for this exclusion.

Comment [Comment8]: Same wording change as above in Subsection 2.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C.
  - (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;
  - (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.



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December 4, 2015

Director John M. Huff  
Department of Insurance, Financial Institutions and Professional Registration  
State of Missouri  
Chair of the NAIC Reinsurance (E) Task Force

*Re: Proposed Revisions to the Credit for Reinsurance Model Law #785*

Dear Director Huff:

The American Insurance Association thanks you for the opportunity to comment on the Reinsurance Task Force's options of proposed revisions to the Credit for Reinsurance Model Law.

AIA filed comment letters on September 30, 2015 and November 11, 2015 in response to earlier iterations (Option 1, Option 2, and Option 3) of the task force's proposed revisions to the model law. AIA opposed these three options because each would apply not only to the limited life reinsurance product(s) at issue, but would apply to all reinsurance ceded by property and casualty insurers as well. AIA refers to and reincorporates by reference the arguments set forth in its two prior letters and in its testimony during the November 20 task force meeting in Maryland.

As set forth in AIA's comment letters, the new requirements, particularly Option 3, would give regulators unfettered discretion to add additional unspecified requirements relating to the valuation of assets and obligations and the amount and forms of security held in connection with not just certain life reinsurance products but all property and casualty reinsurance. This proposed request for statutory *carte blanche* authority to set forth additional, unspecified requirements for property and casualty credit for reinsurance essentially amounts to a repudiation of the agreement reached by all interested parties and regulators in crafting the model law as approved by the NAIC in 2011—after years of negotiations and concessions by all parties to the discussions. While AIA and others have advocated in the states for enactment of the credit for reinsurance model law and such efforts have been very successful, AIA would likely be forced to oppose any model law containing the proposals now under discussion by the

task force. This is deeply regrettable because a uniform credit for reinsurance model law should be of paramount importance to all stakeholders and regulators.

Now under consideration are Option 1, Option 2 and Option 3 with staff edits and a New York Life Option 2 proposal with staff edits and an ACLI Option 2 proposal with staff edits. Unfortunately, all five of these proposals contain the problematic language of the original Option 3 “that the commissioner may impose, by regulation, an approval requirement with respect to, and additional requirements relating to the amount and forms of security held, or that specify that credit will be reduced or eliminated:...” This language, applicable to all ceding insurers, including property and casualty insurers, gives too broad and unfettered discretion to the regulator and seems intended to renege on the agreements reached during the discussions and negotiations over the 2011 credit for reinsurance model law.

While AIA strongly opposes each of the options currently under discussion, a relatively simple textual modification could resolve the problem. Each of the proposals is in response to a certain, limited type of life reinsurance product. The issue AIA has with the proposals is that they are too broad in scope and apply to all insurance products, including all property and casualty insurance. However, a minor change in syntax clarifying that the proposed revisions to the model law apply only to the certain, limited type of life reinsurance product at issue could alleviate the concerns of property and casualty insurers.

Using the ACLI Option 2 proposal with staff edits for illustrative purposes, the relatively simple modification is to move the already existing proposed language of the phrase “in connection with reinsurance agreements pertaining to non-universal and universal life insurance with secondary guarantees...” to follow right after the original “provided further” language. This change does not add any new verbiage to the proposal but merely rearranges one of the proposed new clauses. The re-positioning of the clause clarifies that the proposal impacts only the intended specified life reinsurance products rather than all insurance products including property and casualty insurance. A second change would merely add the word “such’ to modify “a domestic ceding insurer” to again clarify that the proposed revisions apply only to certain life insurance products and not to all insurance products generally, including property and casualty insurance. Third, the same modifying language “in connection with reinsurance agreements pertaining to non-universal and universal life insurance with secondary guarantees...” would be added to the proposed new ACLI language regarding exempting cessions from certain professional reinsurers. These same modifications could be made to the other proposed alternative options if the task force decides to proceed with a different alternative.

Working off the ACLI Option 2 proposal with staff edits, AIA recommends the following revisions:

## Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, **that in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation** the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated; ~~in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation.~~ The commissioner may require such a domestic ceding insurer, in calculating the amounts of or forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable.

Such approval requirement and specific additional requirements in any such regulation **pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation** shall not apply to cessions to an assuming insurer that

1. Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2D of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
2. Maintains at least \$250 million in capital and surplus determined in accordance with statutory accounting principles, without deviation; and is
  - a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

### Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation, the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation. The commissioner may require such a domestic ceding insurer, in calculating the amounts of or forms of security required to be held under the regulation, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC through the date as of which the calculation is made, to the extent applicable.

Such approval requirement and specific additional requirements in any such regulation pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation shall not apply to cessions to an assuming insurer that

1. Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2D of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
2. Maintains at least \$250 million in capital and surplus determined in accordance with statutory accounting principles, without deviation; and is
  - a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

Similar clarifying modifications could be applied to the other proposed options depending on which particular option the task force decides to develop.

AIA thanks you for your consideration of these issues.

Sincerely,

A handwritten signature in black ink, appearing to read "S. A. Bennett", with a long horizontal flourish extending to the right.

Steven A. Bennett  
Associate General Counsel  
American Insurance Association



November 16, 2015

The Honorable John Huff  
Chair, NAIC Reinsurance Task Force  
Director of Insurance  
Missouri Department of Insurance, Financial Institutions and Professional Registration  
Truman State Office Building  
Room 530  
P.O. Box 690  
Jefferson City, MO 65102



Dear Chairman Huff:

As a captive insurance professional, I am writing today to express my opposition to the proposal, known as Option 3, to change the Credit for Reinsurance Model Act. It is my concern that this proposal will have an adverse impact on a number of captive insurance companies. While the original intent of Option 3 may not be to ensnare all forms of captive reinsurance arrangements, its current wording has the clear potential to reduce the financial benefit a fronting company obtains from the credit for reinsurance when entering into a reinsurance transaction with a captive insurance company.

Your consideration regarding my concern is appreciated.

Sincerely,

A handwritten signature in orange ink, appearing to read "RWS", with a long horizontal line extending to the right.

R. Wesley Sierk, III

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December 4, 2015

The Honorable John Huff  
Director  
Missouri Department of Insurance  
Fin. Institutions & Prof. Registration (DIFP)  
P.O. Box 690  
Jefferson City, Missouri 65102-0690

**RE: Exposure Drafts of Revisions to NAIC Credit for Reinsurance Model Law (#785)**

Dear Director Huff:

The ACLI<sup>1</sup> appreciates the opportunity to comment on the exposure drafts of revisions to the *NAIC Credit for Reinsurance Model Law (#785)* exposed by the Reinsurance (E) Task Force on November 20, 2015.

ACLI recommends that the Task Force adopt the wording contained in the Exposure Draft labeled “**ACLI Option 2 Proposal - with Staff Edits**” with the removal of the staff edit that added the phrase “or that specify that credit will be reduced or eliminated;”. We are also recommending inserting the specific grandfathering contained in Actuarial Guideline 48 and suggesting a change that helps promote national uniformity in regards to the authority granted to the commissioner in these two sections. We have also noted some technical changes, one of which we consider a fatal flaw.

Rationale for including exemption for professional reinsurers in the law

As we pointed out at the meeting of the Task Force, the language being inserted into Sections 2 and 3 of the *Credit for Reinsurance Model Law* does not reference life insurer-owned captive or captive-like arrangements of life insurers. Because there is no such reference, the language of the originally exposed Option 2 can be paraphrased as follows:

*Credit for reinsurance shall be allowed a domestic ceding insurer ...only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section, provided further that the commissioner may adopt by regulation additional requirements, or reduce or eliminate reserve credit, on reinsurance transactions for XXX/AXXX, VA, or LTC policies.*

If this language is read literally, the commissioner may adopt any regulation that renders Subsections A, B, C, D, E, and F of the model law meaningless. By including an exemption for reinsurance transactions with

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<sup>1</sup> The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 284 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums.



“professional” reinsurers, it is clear that there is no intent to override those Subsections by regulation for the vast majority of reinsurance transactions.

#### Rationale for removal of the staff edit

The staff edit that added the phrase “or that specify that credit will be reduced or eliminated;” is not needed, and makes the sentence confusing. The wording in Section 2 and 3 of the model law lays forth the conditions under which credit for reinsurance is allowed. It goes without saying that if the conditions are not met, reinsurance credit may not be fully allowed. The sentence is already unnecessarily long, and it is not clear how the portion of the sentence after the semi-colon is connected to the portion of the sentence before the semi-colon. We considered the possibility of replacing the semi-colon with a comma; however, the entirety of the sentence remains confusing. We recommend the easiest solution is to eliminate the staff edit, which we do not believe changes the intent of the sentence.

#### Suggested Change for Promoting Uniformity

As ACLI has reviewed all of the Exposure Drafts, it became quite clear that the suggested changes to the Model Law granted broad authority for the adoption of regulations that can override the long-established rules for determining the reserve credit for reinsurance. Unfortunately, there aren’t any guardrails that promote uniformity of those regulations. We suggest that a limitation be added to the authority that requires the regulation that is adopted be substantially similar to an NAIC Model Regulation. The NAIC and ACLI were able to ensure such uniformity by incorporating the XXX/AXXX Reinsurance Framework into an Actuarial Guideline that is uniformly adopted by way of the NAIC Accounting Practices and Procedures Manual. That uniformity may be lost if states adopt regulations that are not substantially similar to the requirements contained in Actuarial Guideline 48 and/or the NAIC Model Regulation. We suggest the following wording be inserted into Sections 2 and 3;

*In so doing, and without limiting existing authority of the commissioner to adopt regulations implementing this Act, the commissioner may adopt regulations substantively consistent with NAIC-adopted model regulations for the product types identified above. However, this specific authority shall be limited to situations where the NAIC, pursuant to the Credit for Reinsurance Model Act, adopts model regulatory requirements covering the product types identified above, and where the commissioner concludes that the adoption of such requirements (or requirements that are substantively similar in all material respects) is advisable in this state.*

#### Changes to Ensure Regulation Contains Appropriate Grandfathering Provision

We note that Actuarial Guideline 48 (AG 48) has a grandfathering provision to ensure that insurers do not lose reserve credit for policies issued and reinsured in a captive reinsurance arrangement prior to the effective date of the Actuarial Guideline. Since the Model Regulation will have a different effective date, we believe that the Model Law needs to have a provision that gives the commissioner specific authority to adopt a regulation that contains some limited retroactive application. Without it, many states will not allow the commissioner to adopt a regulation with retroactive application. And, AG 48 is designed to sunset once a state adopts the Model Law and Regulation, so it can’t be relied upon for requirements on policies issued between 2015 and the effective date of the regulation. For simplicity, we suggest adding the specific AG 48 grandfathering language after the professional reinsurer exemption (which describes another situation for which the regulation does not apply).

Comments on NYL Proposed Tweaks to Option 2 (with Staff Edits)

As discussed above, the general ambiguity of all the Options exposed arising from the lack of reference to life insurer-owned captive or captive-like arrangements of life insurers causes great concerns for ACLI. Needless to say, those concerns are only heightened when the scope includes “such other insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the NAIC’s Credit for Reinsurance Model Law”. This would likely be the broadest regulatory authority in any NAIC Model Law. We question whether state legislators will adopt such broad reaching regulatory authority. Furthermore, the language does not limit the commissioner to adopting the NAIC Model Regulation (or substantially similar regulation), so the question of non-uniformity remains. We ask the Task Force not to adopt NYL proposed Option 2.

Technical edits for ACLI Option2 Proposal – with Staff Edits

We have identified several technical edits that should be made to the Exposure Draft which we believe are needed to properly express the intent of the amendments to the Model Law.

1. After significant time reviewing the Exposure Drafts, we have found what we believe is a fatal flaw in all versions. By referencing the Valuation of Life Insurance Policies Model Regulation, Actuarial Guideline XLIII, and Health Insurance Reserves Model Regulation, these changes to the Model Law would cease to have any effect after PBR goes into effect and those requirements sunset for new business. While there isn’t a perfect way to fix this problem, we suggest the following language for Section 2 and Section 3 be inserted in place of the existing language:

*... in connection with reinsurance arrangements pertaining to certain term insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, or long term care insurance policies.*

The conjunction at the end of the list of policy types to which the regulation is applicable should be “or” rather than “and”. A reinsurance agreement does not have to cover all of those types of policies, but rather, any of them. This change should be made to both Section 2 and Section 3, and has been reflected in the recommended wording above.

2. We note that there is a mistake in the first paragraph of both Section 2 and Section 3 concerning amendments to the NAIC Valuation Manual. There are differences in timing between when an amendment to the Valuation Manual is adopted and when it becomes effective, which are spelled out within the Valuation Manual. Therefore, the wording of the last sentence of the first paragraph of each of these two sections should read:

*The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under such regulations, to use the valuation manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC ~~through the~~ and in effect on the date as of which the calculation is made, to the extent applicable.*

3. We note that there is an incorrect reference in regards to the section of the model law that defines certified reinsurer (which appears in both Section 2 and Section 3). The correct section of the model law to reference is Section 2E rather than Section 2D.

4. We note that clarity can be added to the second condition within the description of a professional reinsurer (which appears in both Section 2 and Section 3), and suggest the following wording;

*“2. Maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is”.*

This ensures that the language does not mean that the assuming insurer cannot have deviations in statutory accounting, but rather that, for the purposes of this condition, the capital and surplus calculation is performed according to statutory accounting, excluding the impact of permitted or prescribed practices.

5. We note that it should be clear that the authority being granted to use the Valuation Manual is limited to the specific regulation also being authorized. Therefore, we suggest the following change in Section 2 and Section 3:

*The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under ~~the~~ such regulation...*

6. The term “Valuation Manual” should be capitalized in Section 2 and Section 3. It is a formal publication of the NAIC.
7. The first portion of the newly inserted language in both Section 2 and Section 3 refers to “...specific additional requirements relating to valuation of assets and obligations...” Because this model law is in regards to credit for reinsurance, and not valuation of liabilities, the wording should be changed to read “...specific additional requirements relating to valuation of assets and reserve credits...”. The regulatory authority being granted does not extend to changing the actual reserve requirements.

### Conclusion

For the reasons stated above, we urge the Task Force to adopt the Exposure Draft entitled “ACLI Option 2 Proposal - with staff edits”, with the recommended edits that we have described above. We are opposed to all of the other Exposure Drafts. We have attached as Appendix A a marked draft that contains all of the changes that we have suggested, with the exception of the fatal flaw that we noted (we leave the task of fixing that fatal flaw to the Task Force and NAIC Staff). We look forward to discussing our concerns with you and the Reinsurance Task Force in more detail on the upcoming conference call of the Task Force.

Sincerely,



Paul S. Graham, III, FSA, MAAA

cc: Members, NAIC Reinsurance (E) Task Force  
Dan Schelp, Josh Arpin, NAIC

## Appendix A

Exposed changes to current Model Law (ACLI Option 2) are shown in blue  
ACLI recommended edits are shown in red

### CREDIT FOR REINSURANCE MODEL LAW

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#### Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

#### Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and ~~obligations-reserve credits~~, and the amount and forms of security held,~~or that specify that credit will be reduced or eliminated;~~ in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, ~~and or~~ long term care insurance valued under the Health Insurance Reserves Model Regulation. In so doing, and without limiting existing authority of the commissioner to adopt regulations implementing this Act, the commissioner may adopt regulations substantively consistent with NAIC-adopted model regulations for the product types identified above. However, this specific authority shall be limited to situations where the NAIC, pursuant to the Credit for Reinsurance Model Act, adopts model regulatory requirements covering the product types identified above, and where the commissioner concludes that the adoption of such requirements (or requirements that are substantively similar in all material respects) is advisable in this state. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under ~~the~~ such regulation, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard

Valuation Law, including all amendments adopted by the NAIC ~~through the~~ and in effect on the date as of which the calculation is made, to the extent applicable.

Such approval requirement and specific additional requirements in any such regulation shall not apply to cessions to an assuming insurer that

1. Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2~~ED~~ of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
2. Maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is
  - a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

Such approval requirement and specific additional requirements in any such regulation also shall not apply to cessions of term insurance policies and universal life insurance policies with secondary guarantees that were both (1) issued prior to 1/1/2015 and (2) ceded as of 12/31/2014 as part of a reinsurance arrangement that would be subject to the approval requirement and specific additional requirements if not for this exclusion.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

### **Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and ~~obligations-reserve credits,~~ and the amount and forms of security held, ~~or that specify that credit will be reduced or eliminated;~~ in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, ~~and or~~ long term care insurance valued under the Health Insurance Reserves Model Regulation. In so doing, and without limiting existing authority of the commissioner to adopt regulations implementing this Act, the commissioner may adopt regulations substantively consistent with NAIC-adopted model regulations for the product types identified above. However, this specific authority shall be limited to situations where the NAIC, pursuant to the Credit for Reinsurance Model Act, adopts model regulatory requirements covering the product types identified above, and where the commissioner concludes that the adoption of such requirements (or requirements that are substantively similar in all material respects) is advisable in this state. The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under ~~the~~ such regulation, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC ~~through the~~ and in effect on the date as of which the calculation is made, to the extent applicable.

Such approval requirement and specific additional requirements in any such regulation shall not apply to cessions to an assuming insurer that

1. Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2ED of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
2. Maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is
  - a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

Such approval requirement and specific additional requirements in any such regulation also shall not apply to cessions of term insurance policies and universal life insurance policies with secondary guarantees that were both (1) issued prior to 1/1/2015 and (2) ceded as of 12/31/2014 as part of a reinsurance arrangement that would be subject to the approval requirement and specific additional requirements if not for this exclusion.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C. (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;  
  
(2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner

ALCI's Revision to address the "Fatal Flaw" Outlined in Comment Letter

Exposed changes to current Model Law (ACLI Option 2) are shown in blue  
ACLI recommended edits are shown in red

CREDIT FOR REINSURANCE MODEL LAW

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Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; **provided further, that the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated; in connection with reinsurance arrangements pertaining to certain term insurance policies, universal life insurance policies with secondary guarantees, variable annuities with guaranteed death and/or living benefits, and long term care insurance policies.** ~~non-universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation.~~ The commissioner may require a domestic ceding insurer, in calculating the amounts or forms of security required to be held under **the such** regulation, to use the **Valuation Manual** adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC ~~through the~~ **and in effect on the** date as of which the calculation is made, to the extent applicable.

Such approval requirement and specific additional requirements in any such regulation shall not apply to cessions to an assuming insurer that

1. Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2ED of the Credit for Reinsurance Model Act, in a minimum of five (5) other states; or
2. Maintains at least \$250 million in capital and surplus when determined in accordance with statutory accounting principles, without deviation; and is
  - a. licensed in at least 26 states; or
  - b. licensed or accredited in at least 35 states with a minimum of ten licenses.

Such approval requirement and specific additional requirements in any such regulation also shall not apply to cessions of term insurance policies and universal life insurance policies with secondary guarantees that were both (1) issued prior to 1/1/2015 and (2) ceded as of 12/31/2014 as part of a reinsurance arrangement that would be subject to the approval requirement and specific additional requirements if not for this exclusion.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

DRAFT





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VIA EMAIL

December 4, 2015

The Honorable John Huff  
Chair  
NAIC Reinsurance (E) Task Force

**RE: Revisions to the Credit for Reinsurance Model Law (#785) – NAIC Fall National Meeting Exposures**

Dear Director Huff:

The Reinsurance Association of America (“RAA”) appreciates the opportunity to provide comments on the recently exposed options for revisions to the NAIC Credit for Reinsurance Model Law (#785). The RAA appreciates the NAIC’s efforts to try to and address perceived problems with life insurer-owned captives. However, nearly all options, particularly Option 3 with Staff Edits and the NYL Option 2 with Staff Edits, go far beyond the initial intended purpose of dealing with XXX/AXXX captive financing arrangements and, as written, could apply to all reinsurance transactions, including P&C agreements with professional reinsurers. Because the authority provided by the model law change options was not intended to apply to professional reinsurers or beyond life products with particular financing characteristics, the RAA supports ACLI Option 2 with Staff Edits.

The RAA is a national trade association representing reinsurance companies doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the US and those that conduct business on a cross border basis. The RAA also has life reinsurance company affiliates.

Both Option 3 with Staff Edits and the NYL Option 2 with Staff Edits would give a commissioner the authority to adopt rules impacting traditional reinsurance arrangements—life and property casualty—without appropriate legislative guidance or action and without regard to consistency among the states. For this reason, the RAA opposes these options.

Instead, the RAA supports ACLI Option 2 with Staff Edits for the following reasons. First, the RAA appreciates the RTF’s desire to move beyond the narrow focus of XXX/AXXX captive financing arrangements and understands that the majority of the US life industry has agreed to

expand the scope of the model law changes to include long term care and variable annuity captive financing transactions. Second, the ACLI Option 2 with Staff Edits is the only option that properly addresses the exemption for “professional reinsurers” in the law itself, rather than relegating it to the regulation. Providing for the exception based on certification or licensure and capital and surplus in the model law is essential to providing the certainty necessary for ceding and assuming insurers to conduct life reinsurance business. Given the diversity of state regulatory processes, incorporating the exception into the model law is the only way to ensure that the NAIC efforts in this area do not unintentionally sweep in traditional reinsurance agreements with life reinsurers.

Lastly, in order to address concerns raised by the P&C industry, including the RAA, the clauses in the first proposed amendment to Sections 2 and 3 should be swapped so that the amendments read as follows:

#### Section 2

Credit for reinsurance ...; provided further that, in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated. ...

#### Section 3

An asset or ... ; provided further that, in connection with reinsurance arrangements pertaining to non- universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation the commissioner may adopt by regulation an approval requirement and specific additional requirements relating to valuation of assets and obligations, and the amount and forms of security held, or that specify that credit will be reduced or eliminated. ...

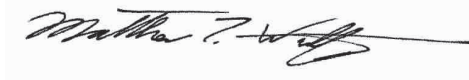
The RAA views such a change as technical and it makes clear the intention of the Task Force.

The RAA appreciates the opportunity to provide input to the Task Force's work on the model law. Please contact us with any questions you have on these comments.

Sincerely,



Tracey W. Laws  
Senior Vice President &  
General Counsel



Matthew T. Wulf  
Vice President, State Relations &  
Assistant General Counsel

CC: Josh Arpin, Dan Schelp

December 8, 2015

The Honorable John M. Huff  
Director, Missouri Department of Insurance,  
Financial Institutions and Professional Registration  
301 W. High St., Room 530  
Jefferson City, MO 65101

Re: Amendment of the NAIC Model Law on Credit for Reinsurance

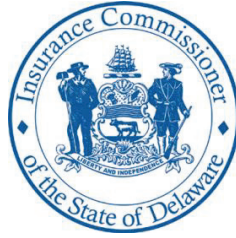
Dear Director Huff and Members of the NAIC Reinsurance Task Force

With members of the Task Force set to discuss and vote on amendments to the Credit for Reinsurance Model Law, we thought it important to underscore the need for — and appropriateness of — an exemption for reinsurance ceded to professional reinsurers. The Model Law exemption is important to (1) ensure contract certainty, (2) prevent the risk of loss of reinsurance credit for cessions to entities that are neither captives nor special purpose reinsurers, and (3) mitigate regulatory risk and assure uniformity among states.

- The exemption makes clear that traditional reinsurance transactions undertaken with professional reinsurers — reinsurers licensed and/or accredited in an expansive number of states and operating with \$250 million or more of statutory capital and surplus — will not inadvertently fall under the captive or special purpose vehicle treatment that has been the NAIC's focus. No captive or special purpose vehicle would meet the conditions for professional reinsurer exemption.
- Putting the exemption in the Model Law is appropriate because it provides a single source, and simple test, for understanding whether a traditional reinsurance cession to a professional reinsurer will receive captive/SPV treatment, without having to unnecessarily sort through and interpret complex regulation.
- Moreover, once set in law, ceding insurers and regulators will have assurance that a future change in regulation will not throw a traditional reinsurance cession into the new framework and potentially deprive a ceding insurer of reserve credit. Uncertainty is tantamount to regulatory risk, which should not be introduced into prudent, run-of-the-mill reinsurance transactions.

We therefore respectfully request that you include the reinsurer exemption in any amendment to the Model Law on Credit for Reinsurance that is adopted by the Task Force.

Swiss Re  
RGA  
Munich Re  
Hannover Re  
Canada Life Re  
SCOR



**KAREN WELDIN STEWART  
INSURANCE COMMISSIONER**

December 8, 2015

To: Director John Huff, Chairman, Reinsurance (E) Task Force  
From: Steve Kinion, Director, Bureau of Captive and Financial Insurance Products  
CC: Commissioner Stewart, Deputy Commissioner Drane, and Chief of Staff Reynolds  
Re: Comment to Table Proposed Amendments to the Credit for Reinsurance Model Act

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On behalf of Commissioner Stewart, I am submitting these comments for the purpose of requesting that the Reinsurance Task Force delay until 2016 for more deliberation any decision to further amend the Credit for Reinsurance Model Act. There are currently eight proposed options to amend the Model Act before the Task Force. The root of all of the options is the reinsurance framework for dealing with how life insurance companies use captive insurers to reinsure term life and universal life with secondary guarantees insurance policies. Term life is referred to as XXX reinsurance transactions and AXXX is referred to as universal life with secondary guarantees reinsurance transactions. These options have been exposed for comment at various times since last September. They are summarized as:

- A. Option 1 which applies only to life reinsurance transactions, i.e., XXX and AXXX.
- B. Option 1 with staff edits applies only to life reinsurance transaction, i.e. XXX and AXXX transactions and explicitly allows the reduction or elimination of the reserve credit known as the credit for reinsurance.
- C. Option 2 which applies only to XXX, AXXX, variable annuity, and long-term care captive reinsurance transactions.
- D. Option 2 with staff edits applies only to XXX, AXXX, variable annuity, and long-term care captive reinsurance transactions and explicitly allows the reduction or elimination of the reserve credit known as the credit for reinsurance.
- E. New York Life proposed tweaks to Option 2 with staff edits applies only to XXX, AXXX, variable annuity, and long-term care captive reinsurance transactions and explicitly

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*Delaware is the 3<sup>rd</sup> Largest U.S. and the World's 6<sup>th</sup> Largest Captive Insurance Domicile*

Director John Huff  
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Page 2

allows the reduction or elimination of the reserve credit known as the credit for reinsurance. The NYL proposal also allows the reduction or elimination for other unspecified reinsurance transactions and annuity transactions for which in the future the NAIC may adopt model regulations that apply to the Model Act. An unspecified reinsurance transaction can include a reinsurance transaction involving a captive that does not reinsure XXX, AXXX, variable annuity, or long-term care insurance.

- F. ACLI Option 2 with staff edits applies only to XXX, AXXX, variable annuity, and long-term care captive reinsurance transactions and explicitly allows the reduction or elimination of the reserve credit known as the credit for reinsurance, but exempts large commercial reinsurers that satisfy certain criteria such as being a certified reinsurer.
- G. Option 3 which can apply to any kind of reinsurance transaction, including captive insurance fronting transactions, and practically any other type of reinsurance arrangement.
- H. Option 3 with staff edits which can apply to any kind of reinsurance transaction, including captive insurance fronting transactions, and practically any other type of reinsurance arrangement, even with the staff edits.

Options D, E, F, and H had the most recent comment period ending on December 5. Delaware's position is that all of the above options are merely another step towards raising the cost of life insurance for consumers. Regardless of which option is selected, it will result in consumers paying more for life insurance. One reason that it will create this result is because many of the above options specifically allow for the reduction or elimination of the reserve credit. When faced with this possibility, insurance companies will purposely over capitalize a captive reinsurance transaction to ensure that the credit will not be reduced or eliminated. Overcapitalization can lead to increased premium rates paid by consumers. However, if the Task Force decides not to table these options for further deliberation and is compelled to set aside the interests of the consumer and move forward on December 9 with selecting an option, then Commissioner Stewart can only support Option A.

As of this date, neither this Task Force nor any other NAIC committee has considered the fact that the reinsurance framework will increase the costs of term life and universal life insurance products for more than 50 percent of the market. The end result of the reinsurance framework is that all life reinsurance captive insurers must increase the amount of their capital. While increasing capital is generally considered good, the need to do so must be weighed against whether doing so lessens the risk of insolvency, or if doing so is an exercise that provides little, if any, benefit for the consumer. In the context of life reinsurance captive insurers, no regulatory body has found either an individual or systemic risk of insolvency relating to the use of these captive insurers. Despite the absence of these risks, a majority of the NAIC's membership has voted in favor of imposing the mandates within the framework. These mandates will dictate an increase of capital at the captive reinsurer level and the source of that capital will be the life insurance company. It is a rational conclusion that when a life insurance

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company's cost of doing business increases, it will have to raise prices or discontinue the sale of certain products. This scenario raises the critical question of, "Does the framework's mandate to increase capital also increase the cost of life insurance and therefore make it less affordable for the consumer?" At a time when fewer Americans own life insurance compared to the ownership rates 50 years ago<sup>1</sup> and in a period when governmental social safety nets are under financial strain, this Task Force should not impose mandates that make term and universal life insurance products financially less attractive. The unfortunate consequence of making term and universal life insurance products financially less attractive is that families place their financial futures in jeopardy by not buying them.

Thank you for considering these comments.

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<sup>1</sup> Sandra Block, "Households with Life Insurance Hits Lowest Level in 50 Years" *USAToday*, December 3, 2010, accessed December 3, 2010, [http://usatoday30.usatoday.com/money/perfi/insurance/2010-12-03-1Alifeinsurance03\\_ST\\_N.htm](http://usatoday30.usatoday.com/money/perfi/insurance/2010-12-03-1Alifeinsurance03_ST_N.htm)

## Life Actuarial (A) Task Force Suggested Language on Reinsurance (E) Task Force 2015 Fall National Meeting Exposures

At the request of Director John M. Huff, members of the Life Actuarial (A) Task Force (LATF) were asked to provide comments on an issue identified by the American Council of Life Insurers (ACLI) in the comment letter. The issue is with respect to the use of the words “valued under” in the three Option 2 exposures of revisions to Model #785 by the Reinsurance (E) Task Force at the Fall National Meeting. These options would provide commissioners with the authority to adopt the proposed XXX/AXXX Credit for Reinsurance Model Regulation. LATF members reviewed and agreed with suggested language, as shown below, from Ern Johnson (VA) to address this issue. The suggested language replaces the struck language below which is found in each of the three Option 2 exposures and would be included in both Sections 2 & 3 of Model #785.

### Suggested Language:

“in connection with reinsurance arrangements pertaining to ~~life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits, universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period, variable annuities with guaranteed death and/or living benefits, or long term care insurance policies.~~ ~~non-universal and universal life insurance with secondary guarantees required to be valued under Sections 6 or 7 of the National Association of Insurance Commissioners (NAIC) Valuation of Life Insurance Policies Model Regulation, variable annuities valued under Actuarial Guideline XLIII-CARVM for Variable Annuities, and long term care insurance valued under the Health Insurance Reserves Model Regulation”~~

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*Received via email on Dec. 9, 2015, from  
Paul Graham, Senior Vice President,  
Insurance Regulation & Chief Actuary (ACLI)*

### **Grandfathering Provision – Additional Considerations Noted by ACLI and CT**

ACLI had a call with Kathy Belfi and Jim Jakielo of CT yesterday to discuss the ACLI comment letter. Jim rightfully pointed out that our language for the grandfathering provision didn't quite accomplish its intent of allowing some limited retroactive application of the regulation. We worked through some refined language for the provision to be put into the model law (see below). It also includes the LATF recommendation on how to describe XXX/AXXX policies (which was previously distributed).

Such approval requirement and specific additional requirements in any such regulation also shall not apply to cessions of life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits or universal life insurance policies with provisions resulting in the ability of a policyholder to keep such policy in force over a secondary guarantee period that were ceded as of 12/31/2014 as part of a reinsurance arrangement that would be subject to the approval requirement and specific additional requirements if not for this exclusion. The regulation may apply such requirements to reinsurance arrangements entered into on or after 1/1/2015, however, as long as those reinsurance arrangements have been subject to similar requirements for receiving full reserve credit since inception.

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**Uniform Application Checklist for Certified Reinsurers**  
**(Initial and Renewal Applications)**

DRAFT March 2016

**I. Applicant Information**

Company Name:
Address:
Primary Contact:
Domiciliary Jurisdiction / Supervisory Authority:
Applicable Lines of Business:

**II. Filing Requirements for Reinsurer Currently Certified by Another NAIC-Accredited Jurisdiction**

If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the [Commissioner] has the discretion to defer to that jurisdiction’s certification, and has the discretion to defer to the rating assigned by that jurisdiction; i.e., “passporting.”

- a. Has the applicant been certified by an NAIC accredited jurisdiction? (Yes or No) \_\_\_\_\_;  
 [If “Yes”, this state will confirm that the initial or renewal certification has been reviewed by the NAIC Reinsurance Financial Analysis (E) Working Group for passporting purposes.]
- b. If the answer to question II.a. is “No”, please proceed to Section III of this application.
- c. If the answer to question II.a. is “Yes”, the applicant shall provide the information required under Section II for consideration by the Commissioner:

<b>Citation to State Law / Regulation</b>	<b><u>Requirements</u></b>	<b>Y or N</b>	<b><u>Reference and Supporting Documents</u></b>
	<b>Status of Domiciliary Jurisdiction:</b> The applicant must be domiciled and licensed in a Qualified Jurisdiction, as determined by this state.		
	<b>Verification of Certification Issued by an NAIC Accredited Jurisdiction:</b> If the applicant is requesting that the Commissioner recognize the certification issued by another NAIC accredited jurisdiction (i.e., passporting), the applicant must provide a copy of the approval letter or other documentation provided to the applicant by such NAIC accredited jurisdiction. At a minimum, this letter must confirm the following information:		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

<b>Citation to State Law / Regulation</b>	<b>Requirements</b>	<b>Y or N</b>	<b>Reference and Supporting Documents</b>
	a. Name of state(s) in which applicant is currently certified. b. The rating and collateral percentage assigned with respect to the applicant. c. The effective and expiration dates with respect to the certification. d. The lines of business to which the certification is applicable. e. The applicant’s commitment to comply with all requirements necessary to maintain certification.		
	<p><b>Mechanisms Used to Secure Obligations Incurred as a Certified Reinsurer:</b>            The applicant must specify the mechanisms it will use to secure obligations incurred as a Certified Reinsurer. If the applicant intends to utilize a multibeneficiary trust for this purpose, the applicant must submit (1) the form of the trust that will be used to secure obligations incurred as a certified reinsurer; and (2) the form of the trust that will be used to secure obligations incurred outside of the applicant’s certified reinsurer status, i.e., the applicant’s 100% collateralized trust (if applicable). The form of each trust is required to be submitted pursuant to state law in order to ensure that security for these obligations will be kept separate and to ensure that each trust meets the requirements of the state’s Credit for Reinsurance statute and/or regulation.</p> <p><b><u>NOTE:</u></b>  <b><u>The MBT includes a provision that:</u></b>  <b><u>It shall be a condition to the grant of</u></b></p>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

Citation to State Law / Regulation	Requirements	Y or N	Reference and Supporting Documents
	<p><i>certification under Subsection E of this section that the certified reinsurer shall have bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each such trust account, to fund, upon termination of any such trust account, out of the remaining surplus of such trust any deficiency of any other such trust account.</i></p>		
	<p><b>Form CR-1 (For Initial and Renewal Applications):</b> The applicant must provide [insert name of state] Form CR-1, which must be properly executed by an officer authorized to bind the applicant to the commitments set forth in the form. [Insert link to copy of form on state web site.]</p>		
	<p><b>Fee:</b> [Insert \$ amount of the fee applicable in this state.]</p>		
	<p><b>Other Requirements:</b> The applicant must:</p> <ol style="list-style-type: none"> <li>a. Commit to comply with other reasonable requirements deemed necessary for certification by the certifying state. Failure to comply with such other requirement could disqualify the reinsurer from certification.</li> <li>b. Provide a statement that the applicant agrees to post 100% security upon the entry of an order of rehabilitation or conservation against the ceding insurer or its estate.</li> </ol>		
	<p><b>Public Notice Requirement:</b> The [Commissioner] is required to post notice on the insurance department's</p>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

Citation to State Law / Regulation	Requirements	Y or N	Reference and Supporting Documents
	website promptly upon receipt of any application for certification, including instructions on how members of the public may respond to the application. The [Commissioner] may not take final action on the application until at least [insert number of days required in the specific state] days after posting such notice. The [Commissioner] will consider any comments received during the public notice period with respect to this application.		

**III. Filing Requirements for Full Application**

- a. The applicant shall provide the information required under Section III if:
  - i. the applicant has not been certified by an NAIC accredited jurisdiction
  - ii. the Commissioner makes a determination not to recognize or defer to the certification issued by another NAIC accredited jurisdiction; or
  - iii. the applicant is renewing its certification by an NAIC accredited jurisdiction.
- b. Check appropriate box:
 

Initial Application

Renewal Application

Citation to State Law / Regulation	Requirements	Y or N	Reference and Supporting Documents
	<p><b>Status of Domiciliary Jurisdiction / Proof of Licensure and Good Standing:</b> The applicant must be domiciled and licensed in a Qualified Jurisdiction, as determined by this state. The applicant must be in good standing (or the jurisdiction’s equivalent classification) and maintain capital and surplus in excess of its domiciliary jurisdiction’s highest regulatory action level.</p> <p>The Commissioner will consider the following information with respect to the applicant’s domiciliary jurisdiction:</p>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

<b>Citation to State Law / Regulation</b>	<b>Requirements</b>	<b>Y or N</b>	<b>Reference and Supporting Documents</b>
	<p>a. Whether the domestic supervisory authority been approved as a Qualified Jurisdiction in this state.</p> <p>b. Confirmation as to whether the domestic supervisory authority is included on the NAIC List of Qualified Jurisdictions.</p> <p>The applicant must provide the following information:</p> <p>a. A copy of the certificate of authority or license to transact insurance and/or reinsurance from the applicant’s domiciliary jurisdiction.</p> <p>b. A certification from the applicant’s domestic supervisory authority affirming that the applicant is in good standing (or the jurisdiction’s equivalent classification) and maintains capital and surplus in excess of the jurisdiction’s highest regulatory action level.</p>		
	<p><b>Mechanisms Used to Secure Obligations Incurred as a Certified Reinsurer:</b></p> <p>The applicant must specify the mechanisms it will use to secure obligations incurred as a Certified Reinsurer. If the applicant intends to utilize a multibeneficiary trust for this purpose, the applicant must submit (1) the form of the trust that will be used to secure obligations incurred as a certified reinsurer; and (2) the form of the trust that will be used to secure obligations incurred outside of the applicant’s certified reinsurer status, i.e., the applicant’s 100% collateralized trust (if applicable). The form of each trust is required to be submitted pursuant to state law in order to ensure that security for these obligations will be kept separate and to ensure that each trust</p>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

Citation to State Law / Regulation	Requirements	Y or N	Reference and Supporting Documents
	<p>meets the requirements of the state’s Credit for Reinsurance statute and/or regulation.</p> <p><b><u>NOTE:</u></b>  <b><u>The MBT includes a provision that:</u></b>  <u>It shall be a condition to the grant of certification under Subsection E of this section that the certified reinsurer shall have bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each such trust account, to fund, upon termination of any such trust account, out of the remaining surplus of such trust any deficiency of any other such trust account.</u></p>		
	<p><b>Financial Strength Ratings:</b>            The applicant must maintain interactive financial strength ratings from two or more acceptable rating agencies. <u>Initial or Affirmed financial strength rating dates must be within 15 months of the application/renewal date.</u> The applicant must provide the following:</p> <ol style="list-style-type: none"> <li>a. Confirm all interactive financial strength ratings currently maintained by the applicant.</li> <li>b. Copies of full rating agency reports with respect to all financial strength ratings currently maintained by the applicant, if available. If a full report is not available, the applicant must provide a letter from the applicable rating agency <u>affirming its current financial strength rating. Initial or Affirmed financial strength rating dates must be within 15 months of the application/renewal date.</u></li> <li>c. A description of any changes within the last three years in the financial strength rating from an approved</li> </ol>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

Citation to State Law / Regulation	Requirements	Y or N	Reference and Supporting Documents
	<p>rating agency.</p> <p><b>NOTE:</b> Acceptable rating agencies include A.M. Best, Fitch Ratings, Moody’s Investor Service, Standard &amp; Poor’s, or any other Nationally Recognized Statistical Rating Organization.</p>		
	<p><b>Disputed and/or Overdue Reinsurance Claims / Business Practices:</b></p> <p>The Commissioner may consider the applicant’s business practices in dealing with its ceding insurers, including compliance with contractual terms and obligations. The applicant must provide the following if 1) applicant’s reinsurance obligations to U.S. cedents that are in dispute and/or more than 90 days past due exceed 5% of its total reinsurance obligations to U.S. cedents as of the end of its prior financial reporting year; or 2) the applicant’s reinsurance obligations to any of the top 10 U.S. cedents (based on the amount of outstanding reinsurance obligations as of the end of its prior financial reporting year) that are in dispute and/or more than 90 days past due exceed 10% of its reinsurance obligations to that U.S. cedent,</p> <p>Then, in either case, the applicant will provide:</p> <ol style="list-style-type: none"> <li>a. Notice of that fact to the Commissioner and a detailed explanation regarding the reason(s) for the amount of disputed or overdue claims exceeding the levels noted above; and .</li> <li>b. A description of the applicant’s business practices in dealing with U.S. ceding insurers and a statement that the applicant commits to comply with all contractual requirements</li> </ol>		



**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

<b>Citation to State Law / Regulation</b>	<b>Requirements</b>	<b>Y or N</b>	<b>Reference and Supporting Documents</b>
	<p>applicable to reinsurance contracts with U.S. ceding insurers.</p> <p>Upon receipt of such notice and explanation, the Commissioner may request additional information concerning the applicant’s claims practices with regard to any or all U.S. ceding insurers.</p>		
	<p><b>Schedules for Reinsurance Assumed and Reinsurance Ceded:</b>            The applicant must provide the following:</p> <p>a. For applicants domiciled in the U.S., provide the most recent NAIC Annual Statement Blank Schedule F (property/casualty) and/or Schedule S (life and health).</p> <p>b. For applicants domiciled outside the U.S. provide Form CR-F (property/casualty) and/or Form CR-S (life and health), completed in accordance with the instructions adopted by the NAIC [include link to instructions.]</p>		
	<p><b>Regulatory Actions:</b>            The applicant must provide a description of any regulatory actions taken against the applicant.</p> <p>a. Include all regulatory actions, fines and penalties, regardless of the amount.</p> <p>b. Provide a description of any changes in with respect to the provisions of the applicant’s domiciliary license.</p> <p>[NOTE: Reinsurance-FAWG requires this information for the last three years for passporting purposes.]</p>		
	<p><b>Financial/Regulatory Filings:</b>            The applicant must provide the</p>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

Citation to State Law / Regulation	Requirements	Y or N	Reference and Supporting Documents
	<p>following:</p> <p>a. A copy of the most recent report of the independent auditor.</p> <p>b. Copies of the audited financial statements for the last three years. Financial statements must demonstrate that the applicant has minimum capital and surplus, or the equivalent, of at least \$250,000,000. If the applicant is an association including incorporated and individual unincorporated underwriters, statements must demonstrate that the applicant has capital and surplus equivalents (net of liabilities) of at least \$250,000,000, and a central fund containing a balance of at least \$250,000,000. Please note the following requirements with respect to these financial statements:</p> <ul style="list-style-type: none"> <li>• Audited U.S. GAAP basis statements must be submitted if available.</li> <li>• Audited IFRS basis statements are acceptable but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis.</li> <li>• With the permission of the Commissioner, an applicant may be allowed to submit audited IFRS basis statements with reconciliation to U.S. GAAP certified by an officer of the applicant. <u>An audited footnote must be included within the IFRS audited financial statement. The footnote must include a reconciliation for adjustments equal to or greater than 1% of equity.</u></li> </ul>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

Citation to State Law / Regulation	Requirements	Y or N	Reference and Supporting Documents
	<ul style="list-style-type: none"> <li>• Upon the initial certification, the Commissioner may consider audited financial statements for the last three years as filed with the applicant’s non-U.S. jurisdiction supervisor. If the Commissioner accepts such statements in the initial filing, the applicant must acknowledge and commit that future financial statement filings will include the appropriate reconciliation to a U.S. GAAP basis, as indicated above.</li> </ul> <p>c. A copy of the Actuarial Opinion and other regulatory filings, as filed with the applicant’s domiciliary supervisor.</p> <p>[NOTE: Reinsurance-FAWG requires a stand-alone Actuarial Opinion for passporting purposes, or the functional equivalent under the Supervisor’s applicable Actuarial Function Holder Regime.</p>		
	<p><b>Solvent Schemes of Arrangement:</b>          The applicant must provide:</p> <ul style="list-style-type: none"> <li>a. A description of any past, present or proposed future participation in any solvent scheme of arrangement, or similar procedure, involving U.S. ceding insurers.</li> <li>b. A statement that the applicant commits to notify the commissioner of any future proposed participation in any solvent scheme of arrangement, or similar procedure, as soon as practicable.</li> </ul>		
	<p><b>Form CR-1 (For Initial and Renewal Applications):</b>          The applicant must provide [insert name</p>		

**Uniform Application Checklist for Certified Reinsurers (DRAFT – March 2016)**

<b>Citation to State Law / Regulation</b>	<b>Requirements</b>	<b>Y or N</b>	<b>Reference and Supporting Documents</b>
	of state] Form CR-1, which must be properly executed by an officer authorized to bind the applicant to the commitments set forth in the form. [Insert link to copy of form on state web site.]		
	<b>Fee:</b> [Insert \$ amount of the fee applicable in this state.]		
	<b>Other Requirements:</b> The applicant must: a. Commit to comply with other reasonable requirements deemed necessary for certification by the certifying state. b. Provide a statement that the applicant agrees to post 100% security upon the entry of an order of rehabilitation or conservation against the ceding insurer or its estate.		
	<b>Public Notice Requirement:</b> The [Commissioner] is required to post notice on the insurance department’s website promptly upon receipt of any application for certification, including instructions on how members of the public may respond to the application. The [Commissioner] may not take final action on the application until at least [insert number of days required in the specific state] days after posting such notice. The [Commissioner] will consider any comments received during the public notice period with respect to this application.		



To: Superintendent Eric A. Cioppa, Chair, Financial Condition (E) Committee

From: John Finston, Chair, Reinsurance (E) Task Force

Date: April 4, 2016

Re: Request for Extension on Revisions to Credit for Reinsurance Model Law and Drafting of the XXX/AXXX Credit for Reinsurance Model Regulation

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At the 2014 Summer National Meeting, the Executive (EX) Committee approved the Model Law Development Request to draft the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees (Model Regulation) and amend the *Credit for Reinsurance Model Law #785* (Model #785), which would provide state insurance commissioners the specific authority to adopt this new model regulation. At the 2015 Fall National Meeting, as the Task Force was nearing the one-year time period expected under the NAIC model law process, the Task Force requested and was granted an extension by the Financial Condition (E) Committee until the 2016 Spring National Meeting.

At this time, the Task Force has completed its work with respect to Model #785, in which revisions were adopted by the NAIC Executive (EX) and Plenary on January 8, 2016. With respect to the Model Regulation, there are topics still needing to be addressed. In order to complete this work and offer a reasonable period of public review, we anticipate needing until, at minimum, the 2016 Summer National Meeting to complete the drafting of the model regulation, with final adoption being completed during 2016.

We are mindful that we have been unable to complete our work within the one-year time period expected under the NAIC model law process and the extension period granted and therefore request an extension until the 2016 Summer National Meeting, at which time, the Task Force will reevaluate if additional time is needed to finalize the Model Regulation.

W:\National Meetings\2016\Spring\TF\Reinsurance\Spring National Meeting\Minutes\Minute Attachments\4 - RTF to E Committee - Request for Extension Memo.docx

Draft of 02/26/2016  
Reinsurance (E) Task Force  
*A new model*

The NAIC solicits comments on this draft. The working draft of the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees is available on the Reinsurance (E) Task Force Web page at [http://naic.org/committees\\_e\\_reinsurance.htm](http://naic.org/committees_e_reinsurance.htm).

**Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees**  
**on Universal Life and Universal Life With Secondary Guarantees Credit for Reinsurance Model Regulation**

**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. Purpose and Intent.**

The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing nonlevel gross premiums, nonlevel gross benefits and non-universal life insurance and universal life insurance with secondary guarantees required to be valued under [insert provisions of state law equivalent to Sections 6 or 7 of the -Valuation of Life Insurance Policies Model Regulation]; and to ensure that, with respect to each such financing arrangement in connection therewith, funds consisting of Primary Security and Other Security, as defined in Section 5, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance contract or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any if its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).

*Drafting Note: No statute or regulation can anticipate every potential nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance reserve financing arrangement. Common sense and professional responsibility are needed to assure not only that the text of this regulation is strictly observed, but also that its spirit and intent are honored scrupulously. It is expected that those who are subject to this regulation will not engage in any arrangement or series of arrangements involving reserves for nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this regulation.*

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### Section 3. Applicability.

This regulation shall apply to reinsurance contracts that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation] shall both apply to such reinsurance contracts~~Covered Policies~~; provided, that in the event of a direct conflict between the provisions of this regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation], the provisions of this regulation shall apply, but only to the extent of the conflict.

### Section 4. Exemptions from this Regulation.

This regulation does not apply to:

- ~~A. Reinsurance risks ceded to an assuming insurer for policies eligible for exemption under [insert provision of state law equivalent to Section 6F or Section 6G. of the Valuation of Life Insurance Policies Model Regulation] or the contracts ceding portion of the reserve ceded under Yearly Renewable Term (“YRT”) Reinsurance under [insert provision of state law equivalent to Section 6.E. of the Valuation of Life Insurance Policies Model Regulation]; or~~
- A. Reinsurance ceded to an assuming insurer:
1. for Yearly Renewable Term Insurance; or
  2. for n-Year Renewable Term Insurance with the following characteristics:
    - i. The policy consists of a series of n-year periods, where n is the same for each period except for the final renewal period, which may be no greater than the lessor of 2 times n or 10 years; and,
    - ii. For each period, the premium rates on both the initial current premium scale and the guaranteed maximum premium scale are level for the entire period; and,
    - iii. The guaranteed gross premiums in all n-year periods are not less than the corresponding net premiums calculated using the 1980 CSO Table with or without the ten-year select mortality factors; and,
    - iv. There are no cash surrender values in any policy year; or,
- ~~B. Reinsurance risks ceded to an assuming insurer that meets the applicable requirements of (1) [insert provision of state law equivalent to Section 2E of the Credit for Reinsurance Model Act], if the state has adopted such a provision and has been certified in this state or, if this state has not adopted a provision equivalent to Section 2E, in a minimum of five states.] or (2) [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act]; or~~
- ~~B.C. Reinsurance risks ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:~~
1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer’s reported surplus and are material enough that they need to be

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disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 (“SSAP 1”); and

2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the 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; or

D. Reinsurance ceded to an assuming insurer that meets the requirements of [insert provision of state law equivalent to Section 5B(4)(a) or Section 5B(4)(b)]; or

~~C.~~ Reinsurance risks ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4DE to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

*[Drafting Note: The exemption set forth in Section 4DE was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance arrangements where the ceding insurer was exiting the type of business ceded. The exemption should not be used with respect to so-called “normal course” reinsurance transactions; rather, such transactions should either fit within one of the standard exemptions set forth in Sections 4A, B, ~~C~~, or D or meet the substantive requirements of this regulation.]*

## Section 5. Definitions.

A. Actuarial Method: The methodology used to determine the Required Level of Primary Security, as described in Section 6.

B. Covered Policies: Subject to the exemptions described in Section 4, Covered Policies are those policies that are required to be valued under [insert provisions of state law equivalent to Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation] and that have risk ceded to an assuming insurer of the following policy types;

1. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium (universal life) policies; -or,
2. Flexible premium (universal) life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period, provided, however, that Covered Policies shall not include Grandfathered



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~~p~~Policies\_ that were both (1) issued prior to January 1, 2015 and (2) ceded so that they were part of a reinsurance arrangement, as of December 31, 2014, that would not qualify for exemption as described in Section 4 if that section would have been applicable.

~~B-C.~~ Grandfathered Policies: Grandfathered Policies are those policies that were (1) issued prior to January 1, 2015 and (2) ceded, as of December 31, 2014, as part of a reinsurance arrangement that does not meet one of the exemption criteria in Section 4.

~~C-D.~~ Required Level of Primary Security: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.

~~D-E.~~ Primary Security: The following forms of security:

1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];
2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and
3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
  - a. Commercial loans in good standing of CM3 quality and higher;
  - b. Policy Loans; and
  - c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.

~~E-F.~~ Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security.

~~F-G.~~ Valuation Manual: The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed. Before the Operative Date of the Valuation Manual, use the version of the Valuation Manual most recently adopted by the NAIC. through the effective date of this regulation and as subsequently amended by the NAIC.

*[Drafting Note: Section 5~~F~~G presumes that each State is permitted under its State laws to directly reference the valuation manual- adopted by the NAIC. If a State is required by its State laws to reference a State law or regulation, it should modify Section 5~~F~~G as appropriate to do so].*

~~G-H.~~ VM-20: “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.

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~~H-I~~ Operative Date of the Valuation Manual: The “Operative Date of the Valuation Manual” has the meaning that the term is given in [insert provision of state law equivalent to statutory definition of the term in the Standard Valuation Law, as amended by the NAIC in 2009]

*[Drafting Note: States that have not yet adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:*

1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;
2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.
3. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the following fifty-five (55) jurisdictions: The fifty States of the United States, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.”

*[Drafting Note: Sections 5E, ~~G and H~~ and I presume that each State is permitted under its State laws to “adopt” the valuation manual in a manner similar to how the Accounting Practices and Procedures Manual becomes effective in many States, without a separate regulatory process such as adoption by regulation. It is desirable that all States adopt the valuation manual requirements and that such adoption be achieved without a separate State regulatory process in order to achieve uniformity of reserve standards in all States. However, to the extent that a State may need to adopt the valuation manual through a formal State regulatory process, these sections may be amended to reflect any State’s need to adopt the valuation manual through regulation or otherwise.]*

## Section 6. The Actuarial Method.

**[[NOTE: The proposed edits to the Actuarial Method are subject to review and comment by LATF. One possibility under consideration is that some of the new provisions appearing below will instead be set forth in a new Actuarial Guideline. It is anticipated that, to ensure uniformity, any material changes to the Actuarial Method set forth in this Model Regulation will also be incorporated into AG48. The Maine Bureau of Insurance and the ACLI have proposed that, once all substantive changes to Section 6 have been made, Section 6 should be reorganized nonsubstantively to improve its readability. The proposed reorganization is set forth in Appendix 1]]**

### A. Actuarial Method – Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, applied on a treaty-by-treaty basis, with the modifications as provided below:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the

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Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.

2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6A1 & 2 above may need to be modified.]*

3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.

4. If the reinsurance treaty ceding insurer cedes less than one hundred percent (100%) of ~~its~~ the risk with respect to the Covered Policies in a reinsurance arrangement that is subject to this regulation, and (a) retains a portion of the risk for its own account or (b) cedes a portion of the risk in an arrangement that qualifies for exemption pursuant to Section 4, then the Actuarial Method will be applied in the following manner:

- a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:

- (i) If a reinsurance treaty cedes only For a quota share of the Covered Policy, retained by the ceding insurer for its own account, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsections (ii) or (iii) below; by at most a percentage equal to the excess of one hundred percent (100%) over the quota share ceded in the non-exempt reinsurance arrangement;

- (ii) If the For a non-exempt reinsurance treaty cedes only arrangement in which only a secondary guarantee rider is ceded:

- (a) The Required Level of Primary Security is reduced by will be calculated as the excess of (1) over (2), where (1) is the Required Level of Primary Security using the Actuarial Method applied to all risks under the Covered Policies including the ceded secondary guarantee rider (reduced by the amount specified pursuant to Subsection (iv) below in the event any risk is ceded on a yearly renewable term basis in an exempt arrangement) and (2) is the statutory reserve not ceded to the assuming insurer retained by the ceding

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~~insurer~~ on the Covered Policies (reduced by the amount specified pursuant to Subsection ~~(iv)~~(iii) below in the event that any risk is ceded to a different reinsurer on a yearly renewable term basis in an exempt arrangement);

(b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one ~~non-exempt reinsurance~~ contract subject to this Regulation arrangement, in no event will the aggregate Required Level amount of Primary Security held with respect to the Covered Policies including all riders for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in ~~non-exempt reinsurance arrangements~~ those contracts were ceded in a single contract subject to this Regulation non-exempt reinsurance arrangement.

~~(iii)~~ For risks ceded on a coinsurance basis in an exempt arrangement, the Required Level of Primary Security will be reduced by at most a percentage equal to the quota share ceded in the exempt coinsurance arrangement;

~~(iii)~~ If a portion of the Covered Policy risk is ceded to another reinsurer ~~For risks ceded on a yearly renewable term basis in an exempt arrangement, the Required Level of Primary Security will be reduced by~~ the credit granted for the yearly renewable term reinsurance treaty, not to exceed at most  $cx / (1 + (2 * \text{number of reinsurance premiums per year}) * \text{where } cx \text{ is calculated using the same mortality table used in calculating the Net Premium Reserve, defined in the NPR; and$

(iv) For any other arrangement ceding a portion of risk to a different reinsurer, all other exempt arrangements, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i), (ii), (iii), and (iv) and ~~(v)~~ above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

The Adjustments for other reinsurance outlined in Subsections ~~(ii)~~, ~~(iii)~~ and ~~(iv)~~ above will be made only with respect to ~~reinsurance exempt~~ arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by ~~the any of its~~ assuming insurers.

b. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.

5. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:

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- a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
- b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies

#### B. Actuarial Method – At and After the Operative Date of the Valuation Manual

At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant definitions, from the Valuation Manual as then in effect, without modification. In lieu of the methodologies set forth in Subsections A4a(iii) ~~and (iv)~~, Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, including risks written prior to the Operative Date of the Valuation Manual. The methodologies set forth in Subsections A4a(i), (ii) and ~~(iv)~~, as well as Subsection A5, -will continue to apply.

#### C. Valuation used for Purposes of Calculations

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

### **Section 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

#### A. Requirements

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to risks ceded under Covered Policies pursuant to [insert provisions of state law equivalent to Sections 2 or 3 of the Credit for Reinsurance Model Law] if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer's statutory policy reserves with respect to the Covered Policies are established in full in accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law and related regulations and actuarial

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guidelines], and credit claimed for any reinsurance contract subject to this Regulation does not exceed the proportionate share of those reserves ceded under the contract;

2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance contract subject to this Regulation ~~such reserves~~ and provides support for its calculation as determined to be acceptable to the commissioner;
3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;
4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Subsection 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of Model Credit for Reinsurance Act];
5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
  - a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and
  - b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and
  - c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the fair market value (according to the valuation rules set forth in Section 6C) of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section 7A3), below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and
  - ~~e.~~ d. The determination of reserve credit under [insert provision of state law equivalent to Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation] shall be determined according to the valuation rules set forth in Section 6C, as applicable; and
6. The reinsurance arrangement has been approved by the commissioner.

#### B. Requirements at Inception Date; Annual Review and Remediation

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15<sup>th</sup> in the calendar year immediately following the calendar year in which this regulation becomes effective], and on

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or before each February 15<sup>th</sup> thereafter, each life insurance company within the scope of Section 3 shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive credit for reinsurance as of the valuation date, it shall, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.

**Section 8. Severability.**

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

**Section 9. 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 Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.

**Section 10. Effective Date**

This regulation shall become effective [insert date] and shall pertain to all Covered Policies in force as of and after that date.

**APPENDIX 1**

**Proposed reorganization of Section 6 (assumes revisions included in the main body of the regulation above have been adopted).**

**Section 6. The Actuarial Method.**

**A. Actuarial Method**

The Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant, from the Valuation Manual as then in effect, without modification except for the following:

1. Except as provided in Paragraph 2 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies ceded under the treaty as originally issued or assumed by the ceding insurer. However, the Required Level of Primary Security resulting from application of the Actuarial Method shall not exceed the amount of statutory reserves ceded.
2. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:

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a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:

(i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsection (ii) below;

(ii) If the reinsurance treaty cedes only a secondary guarantee rider:

(a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies;

(b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation; and

(iii) For any other arrangement ceding a portion of the risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i) through (iii) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.

3. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:

a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and

b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.



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~~A.~~ B. Actuarial Method – Temporary Adjustments Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, in addition to the adjustments provided by Section 6A above, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, applied on a treaty by treaty basis, with the modifications as provided below: will include the following adjustments:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer company may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreementcontract.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections ~~6B~~A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections ~~6B~~A1 & 2 above may need to be modified.]*

- ~~3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.~~
- ~~4. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:~~
  - ~~a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:~~
    - ~~(i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsections (ii) or (iii) below;~~
    - ~~(ii) If the reinsurance treaty cedes only a secondary guarantee rider:~~

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~~(a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies (reduced by the amount specified pursuant to Subsection (iii) below in the event that any risk is ceded to a different reinsurer on a yearly renewable term basis in an exempt arrangement);~~

~~(b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;~~

3. (iii)—If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $c_x / (2 * \text{number of reinsurance premiums per year})$ , where  $c_x$  is calculated using the same mortality table used in calculating the NPR; and. This adjustment is to be made in combination with lieu of the adjustment in Section 6A2(iii) above, as applicable.

~~(iv) For any other arrangement ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.~~

~~It is possible for any combination of Subsections (i), (ii), (iii), and (iv) above to apply.~~

~~Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.~~

4. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

~~C. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:~~

~~D. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and~~

~~E. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the~~

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~~requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.~~

~~F. Actuarial Method— At and After the Operative Date of the Valuation Manual~~

~~G. At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security shall be VM 20, including all relevant definitions, from the Valuation Manual as then in effect, without modification. In lieu of the methodologies set forth in Subsections A4a(iii), Section 8 of VM 20 (Reinsurance) in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, including risks written prior to the Operative Date of the Valuation Manual. The methodologies set forth in Subsections A4a(i), (ii) and (iv), as well as Subsection A5, will continue to apply.~~

~~H.C. Valuation used for Purposes of Calculations~~

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

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To: Reinsurance (E) Task Force Members, Commissioner Representatives, Interested Regulators and Interested Parties

From: NAIC Staff

Date: February 26, 2016

Re: Exposure of Revised Draft of the XXX/AXXX Credit for Reinsurance Model Regulation

On January 8, 2016, the NAIC Executive (EX) and Plenary adopted revisions to the Credit for Reinsurance Model Law (#785), which provide the commissioner authority to adopt regulations with respect to 1) life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits; 2) universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period; 3) variable annuities with guaranteed death or living benefits; 4) Long-term care insurance policies; and 5) other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance.

John Finston, Chair of the Reinsurance (E) Task Force, has directed NAIC staff to expose for a public comment period ending March 27, 2016 (30-days) the revised draft for the *Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees* (Model Regulation). This comment deadline was established to allow for discussion of any comments received on the revised draft Model Regulation at the 2016 Spring National Meeting. The Model Regulation was previously exposed at the 2015 Summer National Meeting for a 45-day public comment period ending September 30, 2015, with additional discussion on the Model Regulation occurring on an October 26, 2015 interim conference call and at the 2015 Fall National Meeting. The information below is not an exhaustive listing of all the revisions made to the Model Regulation, but for ease of review and facilitation of discussion, the revisions have been grouped into four categories. Please note the following revisions to this draft:

**1. Revisions to the Model Regulation to be consistent with the recently adopted Model #785 amendments**

Regulation Title

- To be consistent with the descriptions used for XXX/AXXX products in the revisions to the *Credit for Reinsurance Model Law* (#785) that was adopted by the NAIC Executive (EX) and Plenary on January 8, 2016, the title of the draft regulation has been revised. Additional references have been updated throughout the regulation to reflect these new descriptions.

Section 4—Exemptions from the Regulation

- A new Subsection 4.D has been added to mirror the professional reinsurer exemption included in the revisions to the *Credit for Reinsurance Model Law* (#785) that was adopted by the NAIC Executive (EX) and Plenary on January 8, 2016. Additionally, the certified reinsurer exemption has been removed from Section 4.B.1 and relocated to Section 4.D.1 to better track the language used in the adopted revisions to the *Credit for Reinsurance Model Law* (#785).

## **2. Model #830 References and Impact of PBR Implementation**

### Section 4—Exemptions from the Regulation

- ACLI and NAIC staff recommended revisions to Section 4.A to eliminate references to Model 830 because the Valuation Manual, not Model 830, will be used to value XXX/AXXX policies after the Operative Date of the Valuation Manual. Additional corresponding revisions are made throughout the regulation. These revisions are not intended to be substantive.

### Section 5—Definitions

- The definition of Covered Policies has been revised to eliminate the reference to Model 830.

## **3. Revisions to the Actuarial Method in Section 6 (and related provisions in Section 7)**

### Section 6—The Actuarial Method

- Both ACLI and the Maine Bureau of Insurance offered a number of revisions to Section 6 during the initial comment period for the Model Regulation. After the comment period, both commenters, in consultation with Mike Boerner, Chair of the Life Actuarial (A) Task Force, jointly refined and combined their comments for consideration by the Task Force. Among other things, the revisions address how the Actuarial Method works for multi-product treaties and treaties covering only a portion of the risk under Covered Policies.
- The Virginia Bureau of Insurance recommended the provision, inserted at the end of Section 6.A.4, requiring ceding insurers to document the rationale and steps used when allocating Required Level of Primary Security among individual treaties.
- In addition to the substantive revisions to Section 6, ACLI and Maine have suggested a non-substantive reorganization of Section 6. This non-substantive reorganization is attached to the draft regulation as Appendix 1.

### Section 7—Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation

- Revisions to Section 7.A.1 and Section 7.A.2 were proposed by ACLI and Maine, and correspond to their proposed Section 6 revisions relating to the treatment of treaties covering only a portion of the risk under Covered Policies.

## **4. Other Revisions to the Model Regulation**

### Section 2—Purpose and Intent

- New York Life recommended that, consistent with the third paragraph of the Background section of AG 48, language regarding compliance with the spirit, as well as the letter, of the regulation be added to Section 2 the proposed model regulation. The revised draft regulation contains this recommended language in a drafting note to Section 2.

### Section 5—Definitions

- Instead of describing grandfathered policies as part of the definition of Covered Policies, a separate definition of Grandfathered Policies has been added. This is not intended as a substantive change; rather, the goal is to improve the readability of the definitions and to avoid the confusion arising from the previous language.

- ACLI recommended revisions to Section 5.F. (now renumbered to Section 5.G.) to address what occurs if the Valuation Manual is operative, but the state has not yet adopted the new Standard Valuation Law that implements PBR.

Section 7—Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation

- ACLI recommended revisions to Section 7.A.5 to address the exposed regulation’s mixing of book value and market value accounting for trust assets. The revised draft regulation addresses these comments in revisions to Section 7.A.5.c and Section 7.A.5.d.

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Reinsurance (E) Task Force  
*A new model*

The NAIC solicits comments on this draft. The working draft of the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees is available on the Reinsurance (E) Task Force Web page at [http://naic.org/committees\\_e\\_reinsurance.htm](http://naic.org/committees_e_reinsurance.htm).

**Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees**

**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. Purpose and Intent.**

The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing nonlevel gross premiums, nonlevel gross benefits and universal life insurance with secondary guarantees required to be valued under [insert provisions of state law equivalent to Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation]; and to ensure that, with respect to each such financing arrangement, funds consisting of Primary Security and Other Security, as defined in Section 5, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance contract or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any of its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).

*Drafting Note: No statute or regulation can anticipate every potential nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance reserve financing arrangement. Common sense and professional responsibility are needed to assure not only that the text of this regulation is strictly observed, but also that its spirit and intent are honored scrupulously. It is expected that those who are subject to this regulation will not engage in any arrangement or series of arrangements involving reserves for nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this regulation.*

**Section 3. Applicability.**

This regulation shall apply to reinsurance contracts that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation]

**Comment [A1]:** NAI C style seems to capitalize "States" but make "this state" lowercase. Seems backwards. (In Maine, "State" is only capitalized if it refers specifically and exclusively to Maine.)

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shall both apply to such reinsurance contracts; provided, that in the event of a direct conflict between the provisions of this regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation], the provisions of this regulation shall apply, but only to the extent of the conflict.

**Section 4. Exemptions from this Regulation.**

This regulation does not apply to:

- A. Reinsurance ceded to an assuming insurer:
  - 1. for Yearly Renewable Term Insurance; or
  - 2. for ~~n-Year Renewable Term Insurance with the following characteristics:~~
    - i. The policy consists of a series of  $n$ -year periods, where  $n$  is the same for each period except for the final renewal period, which may be no greater than the ~~lesser~~ lesser of 2 times  $n$  or 10 years; and,
    - ii. For each period, the premium rates on both the initial current premium scale and the guaranteed maximum premium scale are level for the entire period; and,
    - iii. The guaranteed gross premiums in all  $n$ -year periods are not less than the corresponding net premiums calculated using the 1980 CSO Table with or without the ten-year select mortality factors; and,
    - iv. There are no cash surrender values in any policy year; or,
- B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of  [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act ]; or
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:
  - 1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"); and
  - 2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the 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; or
- D. Reinsurance ceded to an assuming insurer that meets the requirements of [insert provision of state law equivalent to Section 5B(4)(a) or Section 5B(4)(b)]; or

**Comment [A2]:** This is a mouthful. I can't see any way to simplify it to more than a marginal degree, but it's a shame we need so much space for what seems to be an esoteric product.



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- E. Reinsurance ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4E to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

*[Drafting Note: The exemption set forth in Section 4E was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance arrangements where the ceding insurer was exiting the type of business ceded. The exemption should not be used with respect to so-called "normal course" reinsurance transactions; rather, such transactions should either fit within one of the standard exemptions set forth in Sections 4A, B, C, or D or meet the substantive requirements of this regulation.]*

**Section 5. Definitions.**

- A. Actuarial Method: The methodology used to determine the Required Level of Primary Security, as described in Section 6.
- B. **Covered Policies:** Subject to the exemptions described in Section 4, Covered Policies are those policies, other than Grandfathered Policies, that have risk ceded to an assuming insurer of the following policy types:
1. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium (universal life) policies; or,
  2. Flexible premium (universal) life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period; provided, however, that Covered Policies shall not include Grandfathered Policies.
- C. **Grandfathered Policies:** Grandfathered Policies are those policies that were (1) issued prior to January 1, 2015 and (2) ceded, as of December 31, 2014, as part of a reinsurance arrangement that does not meet one of the exemption criteria in Section 4.
- D. Required Level of Primary Security: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.
- E. Primary Security: The following forms of security:
1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];

**Comment [A3]:** The condition that Covered Policies must be reinsured is a distraction. It's unnecessary to build into the definition because the regulation is automatically inapplicable to those Covered Policies that are not (or are not yet) reinsured. Likewise, the condition that any reinsurance must be ceded to an assuming insurer is an unnecessary tautology.

**Comment [A4]:** Actually, the exemptions in Section 4 don't really affect whether the policies ought to be regarded as Covered Policies. (Consider a block of business with a 50% quota share ceded to a professional reinsurer or joint venture, and then the retained 50% ... [1])

**Comment [A5]:** This term is only used in the definition of Covered Policies, so the term could be eliminated entirely and its definition turned into an additional exemption in Section 4.

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2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and
3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
  - a. Commercial loans in good standing of CM3 quality and higher;
  - b. Policy Loans; and
  - c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.

F. Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security.

G. Valuation Manual: ~~The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed. Before the Operative Date of the Valuation Manual, use the version of the Valuation Manual most recently adopted by the NAIC.~~

*[Drafting Note: Section 5G presumes that each State is permitted under its State laws to directly reference the valuation manual adopted by the NAIC. If a State is required by its State laws to reference a State law or regulation, it should modify Section 5G as appropriate to do so].*

H. VM-20: ~~“Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.~~

I. Operative Date of the Valuation Manual: ~~The “Operative Date of the Valuation Manual” has the meaning that the term is given in [insert provision of state law equivalent to statutory definition of the term in the Standard Valuation Law, as amended by the NAIC in 2009]~~

*[Drafting Note: States that have not yet- adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:*

1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;
2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual

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statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.

3. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the following fifty-five (55) jurisdictions: The fifty States of the United States, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.”

*[Drafting Note: Sections 5E, H and I presume that each State is permitted under its State laws to “adopt” the valuation manual in a manner similar to how the Accounting Practices and Procedures Manual becomes effective in many States, without a separate regulatory process such as adoption by regulation. It is desirable that all States adopt the valuation manual requirements and that such adoption be achieved without a separate State regulatory process in order to achieve uniformity of reserve standards in all States. However, to the extent that a State may need to adopt the valuation manual through a formal State regulatory process, these sections may be amended to reflect any State’s need to adopt the valuation manual through regulation or otherwise.]*

**Section 6. The Actuarial Method.**

**[[NOTE: The proposed edits to the Actuarial Method are subject to review and comment by LATF. One possibility under consideration is that some of the new provisions appearing below will instead be set forth in a new Actuarial Guideline. It is anticipated that, to ensure uniformity, any material changes to the Actuarial Method set forth in this Model Regulation will also be incorporated into AG48. The Maine Bureau of Insurance and the ACLI have proposed that, once all substantive changes to Section 6 have been made, Section 6 should be reorganized nonsubstantively to improve its readability. The proposed reorganization is set forth in Appendix 1]]**

A. Actuarial Method – Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, applied on a treaty-by-treaty basis, with the modifications as provided below:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

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*[Drafting Note: Sections 6A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6A1& 2 above may need to be modified.]*

3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.
4. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsections (ii) or (iii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies (reduced by the amount specified pursuant to Subsection (iii) below in the event that any risk is ceded to a different reinsurer on a yearly renewable term basis in an exempt arrangement);
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;
    - (iii) If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $cx / (2 * \text{number of reinsurance premiums per year})$  where  $cx$  is calculated using the same mortality table used in calculating the Net Premium Reserve; ; and
    - (iv) For any other arrangement ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional

**Comment [A6]:** Consider reformatting to provide more space without digging into the paragraph.

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reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i), (ii), (iii), and (iv) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

The Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurers.

- b. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.
5. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
    - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
    - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies

**B. Actuarial Method – At and After the Operative Date of the Valuation Manual**

At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant definitions, from the Valuation Manual as then in effect, without modification. In lieu of the methodologies set forth in Subsections A4a(iii), Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, including risks written prior to the Operative Date of the Valuation Manual. The methodologies set forth in Subsections A4a(i), (ii) and (iv), as well as Subsection A5, will continue to apply.

**C. Valuation used for Purposes of Calculations**

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the

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valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

**Section 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

A. Requirements

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to risks ceded under Covered Policies pursuant to [insert provisions of state law equivalent to Sections 2 or 3 of the Credit for Reinsurance Model Law] if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer's statutory policy reserves with respect to the Covered Policies are established in full in accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law and related regulations and actuarial guidelines], and credit claimed for any reinsurance contract subject to this Regulation does not exceed the proportionate share of those reserves ceded under the contract;
2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance contract subject to this Regulation and provides support for its calculation as determined to be acceptable to the commissioner;
3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;
4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Subsection 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of Model Credit for Reinsurance Act];
5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
  - a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and

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- b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and
- c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the value (according to the valuation rules set forth in Section 6C) of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section 7A3) below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and
- d. The determination of reserve credit under [insert provision of state law equivalent to Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation] shall be determined ~~according to the valuation rules set forth in Section 6C, as applicable; and~~

6. The reinsurance arrangement has been approved by the commissioner.

**B. Requirements at Inception Date; Annual Review and Remediation**

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15<sup>th</sup> in the calendar year immediately following the calendar year in which this regulation becomes effective], and on or before each February 15<sup>th</sup> thereafter, each life insurance company within the scope of Section 3 ~~shall~~ perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. ~~If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive credit for reinsurance as of the valuation date, it shall, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.~~

**Section 8. Severability.**

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

**Section 9. 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 Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.

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**Section 10. Effective Date**

This regulation shall become effective [insert date] and shall pertain to all Covered Policies in force as of and after that date.

**APPENDIX 1**

**Proposed reorganization of Section 6 (assumes revisions included in the main body of the regulation above have been adopted).**

**Section 6. The Actuarial Method.**

A. Actuarial Method

The Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant, from the Valuation Manual as then in effect, without modification except for the following:

1. Except as provided in Paragraph 2 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies ceded under the treaty as originally issued or assumed by the ceding insurer. However, the Required Level of Primary Security resulting from application of the Actuarial Method shall not exceed the amount of statutory reserves ceded.
2. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsection (ii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies;
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation,, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation; and



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(iii) For any other arrangement ceding a portion of the risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i) through (iii) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.

3. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

**B. Actuarial Method – Temporary Adjustments Before the Operative Date of the Valuation Manual**

Before the Operative Date of the Valuation Manual, in addition to the adjustments provided by Section 6A above, the Actuarial Method will include the following adjustments:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

**Comment [A7]:** Is "allowed" really the right word? We're not prohibiting the testing itself.

*[Drafting Note: Sections 6B1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to*

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*“recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6B1& 2 above may need to be modified.]*

3. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $c_x / (2 * \text{number of reinsurance premiums per year})$ , where  $c_x$  is calculated using the same mortality table used in calculating the NPR. This adjustment is to be made in lieu of the adjustment in Section 6A2(iii) above.
4. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

C.

Valuation used for Purposes of Calculations

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer’s general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC’s Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

Page 3: [1] Comment [A4]

Author

Actually, the exemptions in Section 4 don't really affect whether the policies ought to be regarded as Covered Policies. (Consider a block of business with a 50% quota share ceded to a professional reinsurer or joint venture, and then the retained 50% is ceded to a captive.) The place to reference these exemptions is at the beginning of Subsection 6(A), and it's already been done there, through the limiting language: "for each reinsurance contract subject to this regulation"



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March 25, 2016

Mr. John Finston  
Deputy Commissioner, Corporate & Regulatory Affairs  
California Department of Insurance  
Chair, NAIC Reinsurance (E) Task Force

Via email [jarpin@naic.org](mailto:jarpin@naic.org)

RE: Exposure Draft of XXX/AXXX Model Regulation

Dear Mr. Finston:

There is a gentlemen in the Vermont state senate who has been in office since shortly after the Spanish-American War. He has, on occasion, cast uncharacteristic votes and then requested to change his vote when awakened from his nap.

I was fully awake when I voted for a complete reduction in credit for reinsurance when a shortfall in other security occurs, but after further consideration, I believe that a proportional reduction in credit for reinsurance is more appropriate than the “all or nothing” approach.

My thought at the time of the initial committee vote was that if the company can’t structure the captive reinsurance correctly, no credit is warranted. However, if the Primary Security is the target amount needed to fulfill policyholder obligations, a minor shortfall in the Other Security backing up the reserves in excess of those indicated by the Actuarial Method need not unwind the entire transaction and create unnecessary strain for the ceding company.

Sincerely,

A handwritten signature in black ink that reads "David F. Provost" with a stylized flourish at the end.

David F. Provost  
Deputy Commissioner  
Captive Insurance Division



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802-828-3307

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# STATE OF CONNECTICUT

## INSURANCE DEPARTMENT

March 28, 2016

To: Mr. John Finston- Chair  
NAIC Reinsurance (E) Task Force

Connecticut offers the following comments and observations with respect to the 2/26/16 revised draft of the proposed XXX/AXXX Credit for Reinsurance Model Regulation. We have not critically reviewed the merits of Appendix 1, and hence do not offer any comments. We are also providing a track-changed document that highlights the location of our suggested changes and a clean copy that better illustrates how those changes look in print. All Section citations that follow refer to the currently exposed draft.

### Substantive Changes:

1. Section 2 – We have modified the citation of Section 6 and 7 of Model 830 to remove the instruction to cite the applicable state law, as many states have not adopted Model 830. The new wording is consistent with Sections 6A1 and 6A2.
2. Section 4D – We have added a clarification that all citations apply to the Credit for Reinsurance Model Act.
3. Section 6A – We propose changing the lead-in wording to be consistent with Section 6B by adding “including all relevant definitions”. That change will also strengthen the implication that the undefined terms Deterministic Reserve, Stochastic Reserve and Net Premium Reserve are synonymous with the terms as defined in VM-20.
4. Section 6A2 – We have modified the drafting note to make it clearer that the Valuation Manual must be amended by the date a given state is considering adopting this Model Regulation, not by the date as of which the Model Regulation is finalized and adopted by the NAIC.
5. Section 6A4a(i) – We have added the clause “some or all” to be consistent with the final clause of “as will any adjustment under Subsections (ii) or(iii) below”.
6. Section 6A5b – We propose changing the first sentence to read “Credit for the Non-Covered Policy reserves shall be granted only to the extent that security, in addition to the security held to satisfy the

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requirements of Subparagraph (a), is held by or on behalf of the ceding insurer in accordance with Section 3 of the Credit for Reinsurance Model Act.”. Even though we include this in the substantive change section due to the replacement of Section 5B with Section 3, in practice we regard this change as merely clarifying our understanding of the intent of the current wording.

7. Section 6B – We propose changes to the first two sentences that will make this section read nearly identically to the lead-in to Section 6A. The most important change is the addition of the sentence stipulating treaty-by-treaty application of the Actuarial Method, as the absence of this guidance could be interpreted to mean that the treaty-specific mandate set forth in Section 6A does not apply after the Operative Date of the Valuation Manual.
8. Section 7A5c – We prefer retention of the fair value standard incorporated into the original wording of this subsection. While we understand the ACLI’s arguments for changing the accounting basis, we feel this regulation should remain consistent with the language of Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation.

#### Editorial Changes:

1. Title and Section 2 – In addition to the change to Section 2 cited above, we offer further modifications to better implement the stated intent of having the language of the Model Regulation mirror, as much as possible, the Model Act.
2. Section 4A – We modified Sections 4A1 and 4A2 to better mirror the language of Sections 6F and 6G of Model 830
3. Sections 5B1 and 5B2 – We changed “flexible premium (universal life)policies to “flexible premium universal life insurance policies” to achieve consistency between these two subsections.
4. Section 6A4a(i) – We changed “Covered Policy” to “Covered Policies”.
5. Section 6A4a(ii) – We inserted additional clauses in two places for added clarity of intent.
6. Section 6A4a(iii) – We changed “Net Premium Reserve” to “NPR” to make it more clearly cross reference back to the implied definition embedded in Section 6A(1).
7. Section 6A4b and 6B – We once again suggest replacing “Section 8 of VM-20 (Reinsurance)” with “the reinsurance section of VM-20” and “Section 8C11” with “the guidance found therein” as insurance against the possibility that the format of the VM-20 changes at some future date.
8. Section 6A4b – We propose converting the last sentence into a new subsection 6A4c, in that the guidance in the second sentence is a separate and distinct topic from the guidance provided in the first sentence.
9. Throughout we have changed “reinsurance treaty” (and in some instances “reinsurance arrangement”) to “reinsurance contract”, capitalized all references to the Valuation Manual and uncapitalized the word “Regulation”. Our intent is to create better consistency between the drafting styles of the various contributors that have built up the current draft through many iterations and modifications of previous

drafts, so we would also support a consistent use of “reinsurance treaty” as opposed to “reinsurance contract”.

Regards,

A handwritten signature in black ink that reads "Kathy Belfi". The signature is written in a cursive, flowing style.

Kathy Belfi, CPA  
Director Financial Regulation  
860-297-3968

CT Draft of 03/25/2016

**Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Guaranteed Nonlevel Gross Premiums, Guaranteed Nonlevel Benefits and Universal Life Insurance Policies With Secondary Guarantees**

**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. Purpose and Intent.**

The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing guaranteed nonlevel gross premiums, guaranteed nonlevel benefits and universal life insurance policies with secondary guarantees required to be valued under Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation; and to ensure that, with respect to each such financing arrangement, funds consisting of Primary Security and Other Security, as defined in Section 5, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance contract or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any of its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).

*Drafting Note: No statute or regulation can anticipate every potential nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance reserve financing arrangement. Common sense and professional responsibility are needed to assure not only that the text of this regulation is strictly observed, but also that its spirit and intent are honored scrupulously. It is expected that those who are subject to this regulation will not engage in any arrangement or series of arrangements involving reserves for nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this regulation.*

**Section 3. Applicability.**

This regulation shall apply to reinsurance contracts that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation] shall both apply to such reinsurance contracts; provided, that in the event of a direct conflict between the provisions of this regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation], the provisions of this regulation shall apply, but only to the extent of the conflict.



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**Section 4. Exemptions from this Regulation.**

This regulation does not apply to:

- A. Reinsurance ceded to an assuming insurer:
  - 1. with respect to Attained-Age-Based Yearly Renewable Term Life Insurance Policies; or
  - 2. with respect to n-Year Renewable Term Life Insurance Policies with the following characteristics:
    - i. The policy consists of a series of  $n$ -year periods, where  $n$  is the same for each period except for the final renewal period, which may be no greater than the lessor of 2 times  $n$  or 10 years; and,
    - ii. For each period, the premium rates on both the initial current premium scale and the guaranteed maximum premium scale are level for the entire period; and,
    - iii. The guaranteed gross premiums in all n-year periods are not less than the corresponding net premiums calculated using the 1980 CSO Table with or without the ten-year select mortality factors; and,
    - iv. There are no cash surrender values in any policy year; or,
- B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act ]; or
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:
  - 1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"); and
  - 2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the 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; or
- D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 5B(4)(a) or Section 5B(4)(b) of the Credit for Reinsurance Model Act]; or
- E. Reinsurance ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following

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apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4E to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

*[Drafting Note: The exemption set forth in Section 4E was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance arrangements where the ceding insurer was exiting the type of business ceded. The exemption should not be used with respect to so-called "normal course" reinsurance transactions; rather, such transactions should either fit within one of the standard exemptions set forth in Sections 4A, B, C, or D or meet the substantive requirements of this regulation.]*

**Section 5. Definitions.**

- A. Actuarial Method: The methodology used to determine the Required Level of Primary Security, as described in Section 6.
- B. Covered Policies: Subject to the exemptions described in Section 4, Covered Policies are those policies that have risk ceded to an assuming insurer of the following policy types:
  - 1. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium universal life insurance policies; or,
  - 2. Flexible premium universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period, provided, however, that Covered Policies shall not include Grandfathered Policies..
- C. Grandfathered Policies: Grandfathered Policies are those policies that were (1) issued prior to January 1, 2015 and (2) ceded, as of December 31, 2014, as part of a reinsurance arrangement that does not meet one of the exemption criteria in Section 4.
- D. Required Level of Primary Security: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.
- E. Primary Security: The following forms of security:
  - 1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];
  - 2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that

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operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and

3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
  - a. Commercial loans in good standing of CM3 quality and higher;
  - b. Policy Loans; and
  - c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.
- F. Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security.
- G. Valuation Manual: The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed. Before the Operative Date of the Valuation Manual, use the version of the Valuation Manual most recently adopted by the NAIC.

*[Drafting Note: Section 5G presumes that each State is permitted under its State laws to directly reference the Valuation Manual adopted by the NAIC. If a State is required by its State laws to reference a State law or regulation, it should modify Section 5G as appropriate to do so].*

- H. VM-20: “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.
- I. Operative Date of the Valuation Manual: The “Operative Date of the Valuation Manual” has the meaning that the term is given in [insert provision of state law equivalent to statutory definition of the term in the Standard Valuation Law, as amended by the NAIC in 2009]

*[Drafting Note: States that have not yet adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:*

1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;
2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.

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3. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the following fifty-five (55) jurisdictions: The fifty States of the United States, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.”

*[Drafting Note: Sections 5E, H and I presume that each State is permitted under its State laws to “adopt” the Valuation Manual in a manner similar to how the Accounting Practices and Procedures Manual becomes effective in many States, without a separate regulatory process such as adoption by regulation. It is desirable that all States adopt the Valuation Manual requirements and that such adoption be achieved without a separate State regulatory process in order to achieve uniformity of reserve standards in all States. However, to the extent that a State may need to adopt the Valuation Manual through a formal State regulatory process, these sections may be amended to reflect any State’s need to adopt the Valuation Manual through regulation or otherwise.]*

**Section 6. The Actuarial Method.**

**[[NOTE: The proposed edits to the Actuarial Method are subject to review and comment by LATF. One possibility under consideration is that some of the new provisions appearing below will instead be set forth in a new Actuarial Guideline. It is anticipated that, to ensure uniformity, any material changes to the Actuarial Method set forth in this Model Regulation will also be incorporated into AG48. The Maine Bureau of Insurance and the ACLI have proposed that, once all substantive changes to Section 6 have been made, Section 6 should be reorganized nonsubstantively to improve its readability. The proposed reorganization is set forth in Appendix 1]]**

A. Actuarial Method – Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, including all relevant definitions, applied on a treaty-by-treaty basis, with the modifications as provided below:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model*

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*Regulation is being considered for adoption, the references to NPR in Sections 6A1& 2 above will need to be modified.]*

3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.
4. If the reinsurance contract cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance contract cedes only a quota share of some or all of the risks pertaining to the Covered Policies, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsections (ii) or (iii) below;
    - (ii) If the reinsurance contract cedes only the risk pertaining to a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies (reduced by the amount specified pursuant to Subsection (iii) below in the event that any of the retained risk is ceded to a different reinsurer on a yearly renewable term basis in an exempt arrangement);
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;
    - (iii) If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $cx / (2 * \text{number of reinsurance premiums per year})$  where  $cx$  is calculated using the same mortality table used in calculating the NPR; and
    - (iv) For any other arrangement ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

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It is possible for any combination of Subsections (i), (ii), (iii), and (iv) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

The adjustments for other reinsurance will be made only with respect to reinsurance contracts entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocessional contracts entered into by the assuming insurers.

- b. The reinsurance section 8 of VM-20 in the Valuation Manual shall not be used in applying the Actuarial Method, except that the guidance found therein shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.
  - c. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.
5. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
- a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only to the extent that security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer in accordance with Section 3 of the Credit for Reinsurance Model Act. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies

**B. Actuarial Method – At and After the Operative Date of the Valuation Manual**

At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, including all relevant definitions, from the Valuation Manual as then in effect, without modification. The Actuarial Method shall be applied on a treaty-by-treaty basis. In lieu of the adjustment methodology set forth in Subsection A4a(iii), the reinsurance section of VM-20 in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, including risks written prior to the Operative Date of the Valuation Manual. The methodologies set forth in Subsections A4a(i), (ii) and (iv), as well as Subsection A5, will continue to apply.

**C. Valuation used for Purposes of Calculations**

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into

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consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

**Section 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

A. Requirements

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to ceded liabilities pertaining to Covered Policies pursuant to [insert provisions of state law equivalent to Sections 2 or 3 of the Credit for Reinsurance Model Law] if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer's statutory policy reserves with respect to the Covered Policies are established in full accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law and related regulations and actuarial guidelines], and credit claimed for any reinsurance contract subject to this regulation does not exceed the proportionate share of those reserves ceded under the contract;
2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance contract subject to this regulation and provides support for its calculation as determined to be acceptable to the commissioner;
3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;
4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Subsection 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of Model Credit for Reinsurance Act];
5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
  - a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and

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- b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and
  - c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the fair market value of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section 7A3) below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and
  - d. The determination of reserve credit under [insert provision of state law equivalent to Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation] shall be determined according to the valuation rules set forth in Section 6C, as applicable;
6. The reinsurance arrangement has been approved by the commissioner.
- B. Requirements at Inception Date; Annual Review and Remediation**

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15<sup>th</sup> in the calendar year immediately following the calendar year in which this regulation becomes effective], and on or before each February 15<sup>th</sup> thereafter, each life insurance company within the scope of Section 3 shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive credit for reinsurance as of the valuation date, it shall, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.

**Section 8. Severability.**

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

**Section 9. 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 Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.



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**Section 10. Effective Date**

This regulation shall become effective [insert date] and shall pertain to all Covered Policies in force as of and after that date.

**APPENDIX 1**

**Proposed reorganization of Section 6 (assumes revisions included in the main body of the regulation above have been adopted).**

**Section 6. The Actuarial Method.**

A. Actuarial Method

The Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant, from the Valuation Manual as then in effect, without modification except for the following:

1. Except as provided in Paragraph 2 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies ceded under the treaty as originally issued or assumed by the ceding insurer. However, the Required Level of Primary Security resulting from application of the Actuarial Method shall not exceed the amount of statutory reserves ceded.
2. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsection (ii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies;
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation,, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation; and

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(iii) For any other arrangement ceding a portion of the risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i) through (iii) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.

3. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

**B. Actuarial Method – Temporary Adjustments Before the Operative Date of the Valuation Manual**

Before the Operative Date of the Valuation Manual, in addition to the adjustments provided by Section 6A above, the Actuarial Method will include the following adjustments:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6B1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to*

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*“recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6B1 & 2 above may need to be modified.]*

3. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $c_x / (2 * \text{number of reinsurance premiums per year})$ , where  $c_x$  is calculated using the same mortality table used in calculating the NPR. This adjustment is to be made in lieu of the adjustment in Section 6A2(iii) above.
4. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

C.

Valuation used for Purposes of Calculations

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer’s general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC’s Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

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Reinsurance (E) Task Force  
*A new model*

The NAIC solicits comments on this draft. The working draft of the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees is available on the Reinsurance (E) Task Force Web page at [http://naic.org/committees\\_e\\_reinsurance.htm](http://naic.org/committees_e_reinsurance.htm).

**Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Guaranteed Nonlevel Gross Premiums, Guaranteed Nonlevel Gross Benefits and Universal Life Insurance Policies With Secondary Guarantees**

**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. Purpose and Intent.**

The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing guaranteed nonlevel gross premiums, guaranteed nonlevel gross benefits and universal life insurance policies with secondary guarantees required to be valued under ~~[insert provisions of state law equivalent to Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation]~~; and to ensure that, with respect to each such financing arrangement, funds consisting of Primary Security and Other Security, as defined in Section 5, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance contract or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any of its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).

*Drafting Note: No statute or regulation can anticipate every potential nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance reserve financing arrangement. Common sense and professional responsibility are needed to assure not only that the text of this regulation is strictly observed, but also that its spirit and intent are honored scrupulously. It is expected that those who are subject to this regulation will not engage in any arrangement or series of arrangements involving reserves for nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this regulation.*

**Section 3. Applicability.**

This regulation shall apply to reinsurance contracts that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation]

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shall both apply to such reinsurance contracts; provided, that in the event of a direct conflict between the provisions of this regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation], the provisions of this regulation shall apply, but only to the extent of the conflict.

**Section 4. Exemptions from this Regulation.**

This regulation does not apply to:

- A. Reinsurance ceded to an assuming insurer:
  - 1. ~~For~~with respect to Attained-Age-Based Yearly Renewable Term Life Insurance Policies; or
  - 2. ~~for~~with respect to n-Year Renewable Term Life Insurance Policies with the following characteristics:
    - i. The policy consists of a series of  $n$ -year periods, where  $n$  is the same for each period except for the final renewal period, which may be no greater than the lessor of 2 times  $n$  or 10 years; and,
    - ii. For each period, the premium rates on both the initial current premium scale and the guaranteed maximum premium scale are level for the entire period; and,
    - iii. The guaranteed gross premiums in all  $n$ -year periods are not less than the corresponding net premiums calculated using the 1980 CSO Table with or without the ten-year select mortality factors; and,
    - iv. There are no cash surrender values in any policy year; or,
- B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act ]; or
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:
  - 1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"); and
  - 2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the 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; or
- D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 5B(4)(a) or Section 5B(4)(b) of the Credit for Reinsurance Model Act]; or

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- E. Reinsurance ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4E to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

*[Drafting Note: The exemption set forth in Section 4E was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance arrangements where the ceding insurer was exiting the type of business ceded. The exemption should not be used with respect to so-called "normal course" reinsurance transactions; rather, such transactions should either fit within one of the standard exemptions set forth in Sections 4A, B, C, or D or meet the substantive requirements of this regulation.]*

**Section 5. Definitions.**

- A. Actuarial Method: The methodology used to determine the Required Level of Primary Security, as described in Section 6.
- B. Covered Policies: Subject to the exemptions described in Section 4, Covered Policies are those policies that have risk ceded to an assuming insurer of the following policy types:
1. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium (universal life) insurance policies; or,
  2. Flexible premium (universal) life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period, provided, however, that Covered Policies shall not include Grandfathered Policies..
- C. Grandfathered Policies: Grandfathered Policies are those policies that were (1) issued prior to January 1, 2015 and (2) ceded, as of December 31, 2014, as part of a reinsurance arrangement that does not meet one of the exemption criteria in Section 4.
- D. Required Level of Primary Security: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.
- E. Primary Security: The following forms of security:
1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];

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2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and
  3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
    - a. Commercial loans in good standing of CM3 quality and higher;
    - b. Policy Loans; and
    - c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.
- F. Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security.
- G. Valuation Manual: The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed. Before the Operative Date of the Valuation Manual, use the version of the Valuation Manual most recently adopted by the NAIC.

*[Drafting Note: Section 5G presumes that each State is permitted under its State laws to directly reference the Valuation Manual adopted by the NAIC. If a State is required by its State laws to reference a State law or regulation, it should modify Section 5G as appropriate to do so].*

- H. VM-20: “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.
- I. Operative Date of the Valuation Manual: The “Operative Date of the Valuation Manual” has the meaning that the term is given in [insert provision of state law equivalent to statutory definition of the term in the Standard Valuation Law, as amended by the NAIC in 2009]

*[Drafting Note: States that have not yet adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:*

1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;
2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.

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3. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the following fifty-five (55) jurisdictions: The fifty States of the United States, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.”

*[Drafting Note: Sections 5E, H and I presume that each State is permitted under its State laws to “adopt” the ~~v~~Valuation ~~m~~Manual in a manner similar to how the Accounting Practices and Procedures Manual becomes effective in many States, without a separate regulatory process such as adoption by regulation. It is desirable that all States adopt the ~~v~~Valuation ~~m~~Manual requirements and that such adoption be achieved without a separate State regulatory process in order to achieve uniformity of reserve standards in all States. However, to the extent that a State may need to adopt the ~~v~~Valuation ~~m~~Manual through a formal State regulatory process, these sections may be amended to reflect any State’s need to adopt the ~~v~~Valuation ~~m~~Manual through regulation or otherwise.]*

**Section 6. The Actuarial Method.**

**[[NOTE: The proposed edits to the Actuarial Method are subject to review and comment by LATF. One possibility under consideration is that some of the new provisions appearing below will instead be set forth in a new Actuarial Guideline. It is anticipated that, to ensure uniformity, any material changes to the Actuarial Method set forth in this Model Regulation will also be incorporated into AG48. The Maine Bureau of Insurance and the ACLI have proposed that, once all substantive changes to Section 6 have been made, Section 6 should be reorganized nonsubstantively to improve its readability. The proposed reorganization is set forth in Appendix 1]]**

A. Actuarial Method – Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, including all relevant definitions, applied on a treaty-by-treaty basis, with the modifications as provided below:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. –If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model*



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*Regulation is being considered for adoption, the references to NPR in Sections 6A1& 2 above ~~may~~will need to be modified.]*

3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.
4. If the reinsurance ~~treaty~~contract cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance ~~treaty~~contract cedes only a quota share of some or all of the risks pertaining to the Covered Policies, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsections (ii) or (iii) below;
    - (ii) If the reinsurance ~~treaty~~contract cedes only the risk pertaining to a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies (reduced by the amount specified pursuant to Subsection (iii) below in the event that any of the retained risk is ceded to a different reinsurer on a yearly renewable term basis in an exempt arrangement);
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;
    - (iii) If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $cx / (2 * \text{number of reinsurance premiums per year})$  where  $cx$  is calculated using the same mortality table used in calculating the ~~Net Premium Reserve~~; NPR; and
    - (iv) –For any other arrangement ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i), (ii), (iii), and (iv) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

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The ~~Adjustments~~ for other reinsurance will be made only with respect to reinsurance ~~arrangements~~contracts entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocessional ~~arrangements~~contracts entered into by the assuming insurers.

b. ~~The reinsurance Section 8 of VM-20 (Reinsurance)~~ in the Valuation Manual shall not be used in applying the Actuarial Method, except that ~~Section 8C11~~the guidance found therein shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

~~b.c.~~ In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.

5. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only ~~if to the extent that~~ security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer ~~to the extent required by Section 5B~~in accordance with Section 3 of the Credit for Reinsurance Model Act. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies

**B. Actuarial Method – At and After the Operative Date of the Valuation Manual**

At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, including all relevant definitions, from the Valuation Manual as then in effect, without modification. The Actuarial Method shall be applied on a treaty-by-treaty basis. In lieu of the ~~adjustment methodologies~~ set forth in Subsections A4a(iii), ~~Section 8 of the reinsurance section of VM-20 (Reinsurance)~~ in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, including risks written prior to the Operative Date of the Valuation Manual. The methodologies set forth in Subsections A4a(i), (ii) and (iv), as well as Subsection A5, will continue to apply.

**C. Valuation used for Purposes of Calculations**

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20

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shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

**Section 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

A. Requirements

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to ~~risks~~ ceded liabilities pertaining to ~~under~~ Covered Policies pursuant to [insert provisions of state law equivalent to Sections 2 or 3 of the Credit for Reinsurance Model Law] if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer's statutory policy reserves with respect to the Covered Policies are established in full ~~in~~ accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law and related regulations and actuarial guidelines], and credit claimed for any reinsurance contract subject to this ~~R~~regulation does not exceed the proportionate share of those reserves ceded under the contract;
2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance contract subject to this ~~R~~regulation and provides support for its calculation as determined to be acceptable to the commissioner;
3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;
4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Subsection 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of Model Credit for Reinsurance Act];
5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
  - a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and
  - b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and

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- c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the fair market value ~~(according to the valuation rules set forth in Section 6C)~~ of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section 7A3) below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and
  - d. The determination of reserve credit under [insert provision of state law equivalent to Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation] shall be determined according to the valuation rules set forth in Section 6C, as applicable; ~~and~~
6. The reinsurance arrangement has been approved by the commissioner.

**B. Requirements at Inception Date; Annual Review and Remediation**

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15<sup>th</sup> in the calendar year immediately following the calendar year in which this regulation becomes effective], and on or before each February 15<sup>th</sup> thereafter, each life insurance company within the scope of Section 3 shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive credit for reinsurance as of the valuation date, it shall, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.

**Section 8. Severability.**

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

**Section 9. 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 Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.

**Section 10. Effective Date**

This regulation shall become effective [insert date] and shall pertain to all Covered Policies in force as of and after that date.

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**APPENDIX 1**

**Proposed reorganization of Section 6 (assumes revisions included in the main body of the regulation above have been adopted).**

**Section 6. The Actuarial Method.**

A. Actuarial Method

The Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant, from the Valuation Manual as then in effect, without modification except for the following:

1. Except as provided in Paragraph 2 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies ceded under the treaty as originally issued or assumed by the ceding insurer. However, the Required Level of Primary Security resulting from application of the Actuarial Method shall not exceed the amount of statutory reserves ceded.
2. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsection (ii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies;
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation,, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation; and
    - (iii) For any other arrangement ceding a portion of the risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

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It is possible for any combination of Subsections (i) through (iii) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.

3. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

**B. Actuarial Method – Temporary Adjustments Before the Operative Date of the Valuation Manual**

Before the Operative Date of the Valuation Manual, in addition to the adjustments provided by Section 6A above, the Actuarial Method will include the following adjustments:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6B1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6B1 & 2 above may need to be modified.]*

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3. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $c_x / (2 * \text{number of reinsurance premiums per year})$ , where  $c_x$  is calculated using the same mortality table used in calculating the NPR. This adjustment is to be made in lieu of the adjustment in Section 6A2(iii) above.
  
4. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

C.

Valuation used for Purposes of Calculations

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.



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March 24, 2016

John Finston  
Chair  
NAIC Reinsurance (E) Task Force

**RE: Exposure Draft of Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees**

Dear Mr. Finston:

The ACLI<sup>1</sup> appreciates the opportunity to comment on the Exposure Draft of *Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees* (“Exposure Draft”) exposed by the Reinsurance (E) Task Force on February 26, 2016.

**Substantive Comments**

ACLI has four substantive concerns with the Exposure Draft, the first two of which are paramount to our support of this Model Regulation.

1. Consequences of Shortfalls in Primary or Other Security

ACLI continues to have significant concerns over the “all-or-nothing” consequence. We think that it significantly increases the amount of systemic risk of the insurance sector for no apparent reason. As a matter of fact, this provision is contrary to the objectives of the NAIC’s Financial Stability (EX) Task Force, as during a credit market crisis when many operating companies (and captives) are stressed, should a holding company be in default and thus prohibited from contributing funds to a captive, the “all-or-nothing” provision might push a ceding company into an RBC event or insolvency. In this Exposure Draft, high quality admitted assets are available to defease liabilities, yet are not being properly recognized as valid security. While we can appreciate that regulators may not agree with the “dollar-for-dollar” approach, other consequence options can be considered that meet the regulatory goal of incentivizing compliance, while at the same time minimizing the drastic (and potentially misleading or artificially negative) impact that an inadvertent shortfall in Primary Security or Other Security could have, especially during times of elevated market volatility or dislocation related to macroeconomic conditions (e.g., in 2008 when liquidity was frozen for a period of time).

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<sup>1</sup> The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. Learn more at [www.acli.com](http://www.acli.com).



As we noted in a prior comment letter, a security shortfall may be more complicated to remediate than simply having the ceding company top off a trust or funds withheld account. The rules on risk transfer may preclude a ceding company from directly remediating a shortfall of security (either Primary or Other). If the risk transfer rules come into play, it may not be possible to remediate a shortfall using a funds withheld account, since that could be comparable to a ceding company reimbursing a reinsurer for excessive claims (although an increase in VM-20 reserves is not necessarily due to excessive claims experience). Hence, in these instances, a shortfall in Primary or Other Security will need to be remediated either by the captive reinsurer or a third party (presumably an affiliate of the ceding company or financing provider) through a reinsurance trust. In some cases, the reinsurance trust may not yet be established. And, depending upon the corporate structure, the need for a third-party to provide additional financing increases the probability that a security shortfall might not be remediated before the 15 day deadline contained in the draft Model Regulation. For these reasons, it is extremely important to ACLI that the Consequence Option chosen is appropriately scaled to the actual financial and solvency impact of a security shortfall.

With these concerns in mind, ACLI respectfully asks the Task Force to reconsider its decision to use the “all-or-nothing” option. ACLI suggests that a reasonable compromise would be to use the “pro rata” option for a shortfall in Primary Security, as that outcome would be the equivalent to reducing the coinsurance percentage of the treaty, and then passing the test for Required Level of Primary Security. This option still has considerable “teeth” to incentivize companies to comply, but avoids the significantly harsh penalty for inadvertent inability to comply within the 15 day remediation window allowed by the draft regulation. We think it is fair to say that companies are not going to willingly circumvent compliance when the penalty (loss of a pro rata portion of the credit) exceeds the cost of compliance (funding the Required Level of Primary Security). We also request that the Task Force consider using the “dollar-for-dollar” option for shortfalls in Other Security. That option most closely matches the XXX/AXXX *Reinsurance Framework* that has been adopted by the NAIC, whereby little, if any, solvency value is placed on the Other Security. Furthermore, a shortfall in Other Security should not result in the complete disallowance of all Primary Security. While a shortfall in Other Security is highly unlikely to occur (only in a period of severe financial stress and liquidity freezes), the reduction in reserve credit for shortfalls in Other Security should be treated similar to other “normal course” reinsurance transactions with unauthorized reinsurers.

## 2. Exclusion for Reinsurance with Small Professional Reinsurers

The ACLI greatly appreciates the effort that the Task Force went through to determine a way to exempt a considerable number of traditional reinsurance transactions from regulations designed for captives during the adoption process of the recent amendments to the *Credit for Reinsurance Model Law*. That exemption excludes reinsurance treaties with companies with \$250 million in surplus (ignoring impacts of permitted practice) as long as the reinsurer has a significant number of licenses. Because this particular Exposure Draft is designed for captive reinsurance transactions, it was not drafted to handle several issues associated with traditional reinsurance that do not occur with captive reinsurance.

Therefore, we believe it is imperative to properly define the scope of the regulation and to limit unintended consequences. For instance, under this draft regulation, if a small, traditional reinsurer were to receive a permitted practice, the regulation does not contemplate which treaties of that reinsurer would have a collateral requirement associated with them. The following questions are raised: Is it only treaties entered into after the permitted practice is received?; Is it all treaties?; Since the grandfathering is limited to policies that were in a non-exempt treaty as of 12/31/14, does the grandfathering even apply (the treaty was exempt at the end of 2014, but would change to non-

exempt when the permitted practice was granted)?; What happens once the permitted practice is no longer requested?

Once these questions are answered, we end up with the rather nonsensical outcome: the establishing of collateral requirements for traditional reinsurance transactions on only term insurance and universal life with secondary guarantees, even though the purpose of this draft Model Regulation is to focus on captive transactions. This is in contradiction to the stated purpose and intent of Section 2 of the Exposure Draft.

With all of that in mind, ACLI requests an additional exemption be designed for the Model Regulation that would screen out treaties with smaller, licensed, professional reinsurers that meet a minimum RBC threshold (ignoring impacts of any permitted accounting practices). Without such an exemption, these small licensed reinsurers are competitively disadvantaged compared to larger reinsurers by, practically speaking, disallowing any permitted accounting practices and potentially impacting their sales of traditional reinsurance. The collateral requirements associated with this Exposure Draft are even stricter than those for unauthorized companies (letters of credit cannot be used to meet the Required Level of Primary Security). Failure to provide collateral leaves these reinsurers' clients with a loss of reserve credit. Knowing this, ceding companies may avoid the smaller reinsurers due to the uncertainty associated with doing business with them, no matter how well-capitalized they may be. This unintended consequence and potential non-level playing field for small professional reinsurers should be corrected in this captive regulation.

ACLI believes that it is very simple to craft an exemption for these smaller reinsurers that would not be able to be met by a XXX/AXXX captive reinsurer (or, if they were, there would be no regulatory concerns with the captive). We suggest an exemption for any reinsurer, licensed in at least 5 states, with an RBC ratio above 400% of Authorized Control Level, ignoring the impacts of any permitted accounting practices. The wording of the exclusion would look as follows:

*Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:*

- 1. Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual; and*
- 2. Is not, or would not be, below 400% of the Authorized Control Level RBC as that term is defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the 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, and without recognition of any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus; and,*
- 3. Is licensed in at least 5 states.*

### 3. Drafting note in Section 2

ACLI requests that the drafting note at the end of Section 2 be deleted. The purpose of developing this regulation is to eliminate any regulatory ambiguity and ensure regulatory certainty across jurisdictions. Instead, this drafting note leaves open to interpretation the phrases "purpose and intent of the regulation" and "perceived ambiguity", which only serves to increase regulatory uncertainty. Regulators and companies alike should know exactly what the rules are, and ACLI sees no ambiguity of the rules within the Model Regulation as drafted.

#### 4. Addition of Real Estate as a Primary Security

ACLI requests that Real Estate be added to the list of assets allowed as Primary Security if it is held in connection with a funds-withheld coinsurance or modified coinsurance arrangement, as this is a common asset used to back long-tailed life insurance reserves. While the liquidity of these investments is less than most securities rated by the SVO, the NAIC Investments RBC Working Group is in the process of reducing RBC charges on Real Estate based on studies that show significantly better default risk than was previously incorporated into the RBC factors. Given the low level of liquidity needs for term insurance and universal life insurance with secondary guarantees (little to no cash values), ACLI does not see a reason to exclude this asset class from the definition of Primary Security.

#### Technical Comments and Changes for Clarity

The following comments are suggested either for clarity of language or technical corrections.

1. Name - The name of the Regulation is more precise than it needs to be. For instance, NAIC Model #830 is named "Valuation of Life Insurance Policies Model Regulation" rather than listing out all of the product designs to which it might apply. We suggest something simple, like "Life Insurance Reserve Financing Model Regulation" or "Captive Reinsurance for Life Insurance Policies Model Regulation". The Scope section accurately defines the actual policy types to which the regulation applies.
2. Section 2. (lines 4 and 5) - Remove the wording regarding "required to be valued under ...]". The regulation no longer refers back to valuation requirements, but rather policy descriptions.
3. Section 4.A. - This section should exclude both YRT insurance (Section 6.F. of Model 830) and YRT reinsurance (Section 6.E. of Model 830) to be consistent with the exemptions from Actuarial Guideline 48.
4. Section 4.A. - Since there is no longer a reference to the *Valuation of Life Insurance Policies Model Regulation*, this section needs to have the same exclusions as are contained in Section 3.A. of that Model Regulation.
5. Section 4.A.2.iii. - The reference to the 1980 CSO mortality table needs to be generalized to include policies valued on later CSO mortality tables. The 1980 CSO table was in effect when Model 830 was adopted, but the 2001 CSO table is applicable for policies issued currently, and the 2017 CSO table will be applicable beginning next year.
6. Section 4.D. - It should be clarified that the sections referred to within this paragraph are sections of the *Credit for Reinsurance Model Law*.
7. Section 5.B. - It should be clarified that the exclusion of Grandfathered Policies are for policies described in both subsections 1 and 2. As written, it appears that the exclusion is only for subsection 2.
8. Section 5.C. - The definition of Grandfathered Policies should be clarified to restrict the types of policies that may be considered grandfathered to only those that are in the scope of the regulation (i.e., those listed in Section 5.B. subsections 1 and 2).
9. Section E.2. - We note that an additional exclusion has been added (without explanation) that excludes from the definition of Primary Security any security issued by the ceding insurer or any of its affiliates. We note that these assets would qualify for deposit in a reserve credit trust as well as would qualify as admitted assets if they were on the balance sheet of the ceding company. We would suggest that instead of outright excluding these securities, that a limit on affiliated debt, consistent with what is currently in the Credit for Reinsurance Model Regulation (not to exceed 5% of total investments) or under state investments law of the ceding insurer as to what counts as an admitted asset.

10. Section 6.A.1. – The regulation no longer should reference back to valuation requirements, but rather policy descriptions.
11. Section 6.A.2. – The regulation no longer should reference back to valuation requirements, but rather policy descriptions.
12. Section 6.A.4.b. – Cross-references to the Valuation Manual could be problematic, since the Valuation Manual is expected to change over time. While using a cross-reference to Section 8 is probably fine, reference to subsection C.11. is problematic. We are already aware of changes being proposed to the Valuation Manual that will change this subsection to C.14. We suggest using words to describe what is being done in the subsection rather than direct reference to the subsection.
13. Section 6.A.5.b. - Non-Covered Policies should be defined. While it might be intuitive that those are any policies not meeting the definition of Covered Policies, it is important to understand that it may not simply be Grandfathered Policies. For instance, some captives reinsure both term insurance and variable annuities. We suggest adding this definition right after the definition of Grandfathered Policies. Also, the Non-Covered Policies are not regulated by Section 5B of this Model Regulation, but rather Sections 2 and 3 of the *Credit for Reinsurance Model Law*.
14. Section 6.C. – The description of which asset spreads and asset default costs to use incorrectly uses the phrase “the December 31st immediately preceding the valuation date”. That would indicate that a valuation performed on 12/31/16 would use the 12/31/15 tables. The phrase should read “the December 31st of the valuation year”.
15. Section 7.B. – It should be clarified that, due to risk transfer rules, that the obligation of the ceding company for remediating a shortfall is not to add security, but rather to arrange for the addition of the security. The addition would have to be made by the captive reinsurer.
16. Section 6. - Once all the changes are made to the Model Regulation, we support rearranging Section 6, as shown in Appendix 1. By listing the lasting requirements of the regulation first, and the additional temporary requirements (prior to the operative date of the Valuation Manual), a state may choose to simply omit the temporary requirements if the state is adopting the Model Regulation after the operative date of the Valuation Manual. Since this is currently expected to be 1/1/17, and most states will not adopt the 2016 amendments to the *Credit for Reinsurance Model Law* this year, the temporary requirements will not be necessary for a majority of states.

#### Appendix I, Alternative Section 6 Comments

17. Alternative Section 6.A. (second line) – There is a word missing. The word “definitions” should be inserted directly after the word “relevant”.
18. Alternative Section 6.A.2.a. – The adjustment for YRT Reinsurance was inadvertently omitted. A new subsection 2.a.iii should be inserted that states that adjustments for YRT reinsurance are to be made in accordance with Section 8 of VM-20. The numbering needs to be iii. because there is a cross reference in Section B.3 to this YRT adjustment.
19. Alternative Section 6.A.3.b. - Non-Covered Policies are not regulated by Section 5B of this Model Regulation, but rather Sections 2 and 3 of the *Credit for Reinsurance Model Law*. See # 5 above.
20. Alternative Section 6.B.1. – The regulation no longer should reference back to valuation requirements, but rather policy descriptions.
21. Alternative Section 6.B.2. – The regulation no longer should reference back to valuation requirements, but rather policy descriptions.
22. Alternative Section 6.B.4. – Cross-references to the Valuation Manual could be problematic, since the Valuation Manual is expected to change over time. We suggest using words to describe what is being done in the subsection rather than direct reference to the subsection.

A marked up version of the Model Regulation that shows all of the changes recommended by ACLI is attached as Appendix A.

The ACLI thanks the Task Force for considering our comments on this Exposure Draft. We look forward to further explaining our thoughts and discussing our concerns at the upcoming meeting of the Task Force.

Sincerely,

A handwritten signature in cursive script that reads "Paul S. Graham, III". The signature is written in black ink and includes a stylized flourish at the end.

Paul S. Graham, III, FSA, MAAA

cc: Members, NAIC Reinsurance (E) Task Force  
Dan Schelp, Josh Arpin, NAIC

## Appendix A

Reinsurance (E) Task Force  
*A new model*

The NAIC solicits comments on this draft. The working draft of the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees is available on the Reinsurance (E) Task Force Web page at [http://naic.org/committees\\_e\\_reinsurance.htm](http://naic.org/committees_e_reinsurance.htm).

### **Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees**

#### **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. Purpose and Intent.**

The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing nonlevel gross premiums, nonlevel gross benefits and universal life insurance with secondary guarantees ~~required to be valued under [insert provisions of state law equivalent to Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation];~~ and to ensure that, with respect to each such financing arrangement, funds consisting of Primary Security and Other Security, as defined in Section 5, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance contract or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any of its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).

*Drafting Note: No statute or regulation can anticipate every potential nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance reserve financing arrangement. Common sense and professional responsibility are needed to assure not only that the text of this regulation is strictly observed, but also that its spirit and intent are honored scrupulously. It is expected that those who are subject to this regulation will not engage in any arrangement or series of arrangements involving reserves for nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this regulation.*

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

This regulation shall apply to reinsurance contracts that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation] shall both apply to such reinsurance contracts; provided, that in the event of a direct conflict between the provisions of this regulation and

[insert provision of state law equivalent to the Credit for Reinsurance Model Regulation], the provisions of this regulation shall apply, but only to the extent of the conflict.

#### **Section 4. Exemptions from this Regulation.**

This regulation does not apply to:

- A. Reinsurance ceded to an assuming insurer:
1. for Yearly Renewable Term Insurance or Yearly Renewable Term Reinsurance; or
  2. for n-Year Renewable Term Insurance with the following characteristics:
    - i. The policy consists of a series of  $n$ -year periods, where  $n$  is the same for each period except for the final renewal period, which may be no greater than the lessor of 2 times  $n$  or 10 years; and,
    - ii. For each period, the premium rates on both the initial current premium scale and the guaranteed maximum premium scale are level for the entire period; and,
    - iii. The guaranteed gross premiums in all  $n$ -year periods are not less than the corresponding net premiums calculated using the ~~1980~~applicable CSO Table with or without the ten-year select mortality factors (if applicable); and,
    - iv. There are no cash surrender values in any policy year; or,
  3. Credit Life Insurance; or,
  4. Any universal life policy that meets all of the following requirements:
    - i. Secondary guarantee period, if any, is five (5) years or less;
    - ii. Specified premium for the secondary guarantee period based on the CSO valuation tables and valuation interest rate applicable to the issue year of the policy; and
    - iii. The initial surrender charge is not less than 100 percent of the first annualized specified premium for the secondary guarantee period.
  5. Any variable life insurance policy that provides for life insurance, the amount or duration of which varies according to the investment experience of any separate account or accounts.
  6. Any group life insurance certificate unless the certificate provides for a stated or implied schedule of maximum gross premiums required in order to continue coverage in force for a period in excess of one year.
- B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act ]; or
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:
1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"); and
  2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in

accordance with the 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; or

- D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:
1. Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual; and
  2. Is not, or would not be, below 400% of the Authorized Control Level RBC as that term is defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the 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, and without recognition of any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus; and,
  3. Is licensed in at least 5 states.
- E. Reinsurance ceded to an assuming insurer that meets the requirements of [insert provision of state law equivalent to Section 5B(4)(a) or Section 5B(4)(b)] of the Credit for Reinsurance Model Law; or
- F. Reinsurance ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section ~~4EE~~ to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

*[Drafting Note: The exemption set forth in Section ~~4EE~~ was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance arrangements where the ceding insurer was exiting the type of business ceded. The exemption should not be used with respect to so-called "normal course" reinsurance transactions; rather, such transactions should either fit within one of the standard exemptions set forth in Sections 4A, B, C, D or ~~D~~E or meet the substantive requirements of this regulation.]*

## **Section 5. Definitions.**

- A. Actuarial Method: The methodology used to determine the Required Level of Primary Security, as described in Section 6.
- B. Covered Policies: Subject to the exemptions described in Section 4, Covered Policies are those policies that have risk ceded to an assuming insurer of the following policy types:
1. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium (universal life) policies; or,



2. Flexible premium (universal) life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period, ~~provided, however, that Covered Policies shall not include Grandfathered Policies.~~  
provided, however, that Covered Policies shall not include Grandfathered Policies.
- C. Grandfathered Policies: Grandfathered Policies are those policies of the types described in Sections 5.B.1 and 5.B.2 above that were (1) issued prior to January 1, 2015 and (2) ceded, as of December 31, 2014, as part of a reinsurance arrangement that does not meet one of the exemption criteria in Section 4.
- D. Non-Covered Policies: Any policy reinsured in the treaty that does not meet the definition of Covered Policies, including Grandfathered Policies.
- E. Required Level of Primary Security: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.
- F. Primary Security: The following forms of security:
  1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];
  2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit. For securities issued by the ceding insurer or any of its affiliates, the amount qualifying as Primary Security shall not exceed five percent (5%) of the total security required; ~~and excluding any securities issued by the ceding insurer or any of its affiliates;~~ and
  3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
    - a. Commercial loans in good standing of CM3 quality and higher;
    - b. Real Estate;
    - c. Policy Loans; and
    - d. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.
- G. Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security.
- H. Valuation Manual: The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed. Before the Operative Date of the Valuation Manual, use the version of the Valuation Manual most recently adopted by the NAIC.

*[Drafting Note: Section 5G presumes that each State is permitted under its State laws to directly reference the valuation manual adopted by the NAIC. If a State is required by its State laws to reference a State law or regulation, it should modify Section 5G as appropriate to do so].*

- I. VM-20: “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.
- J. Operative Date of the Valuation Manual: The “Operative Date of the Valuation Manual” has the meaning that the term is given in [insert provision of state law equivalent to statutory definition of the term in the Standard Valuation Law, as amended by the NAIC in 2009]

*[Drafting Note: States that have not yet adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:*

1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;
2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.
3. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the following fifty-five (55) jurisdictions: The fifty States of the United States, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.”

*[Drafting Note: Sections 5E, H and I presume that each State is permitted under its State laws to “adopt” the valuation manual in a manner similar to how the Accounting Practices and Procedures Manual becomes effective in many States, without a separate regulatory process such as adoption by regulation. It is desirable that all States adopt the valuation manual requirements and that such adoption be achieved without a separate State regulatory process in order to achieve uniformity of reserve standards in all States. However, to the extent that a State may need to adopt the valuation manual through a formal State regulatory process, these sections may be amended to reflect any State’s need to adopt the valuation manual through regulation or otherwise.]*

## **Section 6. The Actuarial Method.**

**[[NOTE: The proposed edits to the Actuarial Method are subject to review and comment by LATF. One possibility under consideration is that some of the new provisions appearing below will instead be set forth in a new Actuarial Guideline. It is anticipated that, to ensure uniformity, any material changes to the Actuarial Method set forth in this Model Regulation will also be incorporated into AG48. The Maine Bureau of Insurance and the ACLI have proposed that, once all substantive changes to Section 6 have been made, Section 6 should be reorganized nonsubstantively to improve its readability. The proposed reorganization is set forth in Appendix 1]]**

### **A. Actuarial Method – Before the Operative Date of the Valuation Manual**

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, applied on a treaty-by-treaty basis, with the modifications as provided below:

1. For Covered Policies ~~required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation described in Section 5.B.1 above,~~ the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional

modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies ~~required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation~~ described in Section 5.B.2 above, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.

2. For Covered Policies ~~required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation~~ described in Section 5.B.2. above, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6A1 & 2 above may need to be modified.]*

3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.
4. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsections (ii) or (iii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies (reduced by the amount specified pursuant to Subsection (iii) below in the event that any risk is ceded to a different reinsurer on a yearly renewable term basis in an exempt arrangement);
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;
    - (iii) If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $cx / (2 * \text{number of reinsurance premiums per year})$  where  $cx$  is calculated using the same mortality table used in calculating the Net Premium Reserve; and

- (iv) For any other arrangement ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i), (ii), (iii), and (iv) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

The Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurers.

- b. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, ~~except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party~~ except for guidance in Section 8 pertaining to the case when assets supporting the reserve are held by the counterparty or by another party. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.
5. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
- a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer ~~to the extent required by Section 5B~~ in accordance with [insert existing provision of state law equivalent to Sections 2 and 3 of the Credit for Reinsurance Model Regulation]. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies

#### B. Actuarial Method – At and After the Operative Date of the Valuation Manual

At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant definitions, from the Valuation Manual as then in effect, without modification. In lieu of the methodologies set forth in Subsections A4a(iii), Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, including risks written prior to the Operative Date of the Valuation Manual. The methodologies set forth in Subsections A4a(i), (ii) and (iv), as well as Subsection A5, will continue to apply.

#### C. Valuation used for Purposes of Calculations

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose

of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st ~~immediately preceding the valuation date~~ of the valuation year for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

## **Section 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

### **A. Requirements**

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to risks ceded under Covered Policies pursuant to [insert provisions of state law equivalent to Sections 2 or 3 of the Credit for Reinsurance Model Law] if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer's statutory policy reserves with respect to the Covered Policies are established in full in accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law and related regulations and actuarial guidelines], and credit claimed for any reinsurance contract subject to this Regulation does not exceed the proportionate share of those reserves ceded under the contract;
2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance contract subject to this Regulation and provides support for its calculation as determined to be acceptable to the commissioner;
3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;
4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Subsection 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of Model Credit for Reinsurance Act];
5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
  - a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and
  - b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and
  - c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the value (according to the valuation rules set forth in Section 6C) of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section

7A3) below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and

- d. The determination of reserve credit under [insert provision of state law equivalent to Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation] shall be determined according to the valuation rules set forth in Section 6C, as applicable; and

6. The reinsurance arrangement has been approved by the commissioner.

**B. Requirements at Inception Date; Annual Review and Remediation**

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15<sup>th</sup> in the calendar year immediately following the calendar year in which this regulation becomes effective], and on or before each February 15<sup>th</sup> thereafter, each life insurance company within the scope of Section 3 shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive full credit for reinsurance as of the valuation date, it shall arrange for the addition of, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date. Credit for reinsurance shall be reduced from full credit in the event that such remediation is not made. In the event that there is a shortfall in Primary Security as required by Section 7A3, reserve credit shall be reduced in proportion to such shortfall as compared to the Required Level of Primary Security. In the event that there is a shortfall in Other Security as required by 7A4, reserve credit shall be reduced by the amount of the shortfall.

**Section 8. Severability.**

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

**Section 9. 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 Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.

**Section 10. Effective Date**

This regulation shall become effective [insert date] and shall pertain to all Covered Policies in force as of and after that date.

## APPENDIX 1

**Proposed reorganization of Section 6 (assumes revisions included in the main body of the regulation above have been adopted).**

### **Section 6. The Actuarial Method.**

#### A. Actuarial Method

The Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant definitions, from the Valuation Manual as then in effect, without modification except for the following:

1. Except as provided in Paragraph 2 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies ceded under the treaty as originally issued or assumed by the ceding insurer. However, the Required Level of Primary Security resulting from application of the Actuarial Method shall not exceed the amount of statutory reserves ceded.
2. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsection (ii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies;
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation,, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation; ~~and~~
    - (iii) If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security shall be adjusted according to the instructions contained in Section 8 of VM-20 (Reinsurance) in the Valuation Manual for determining reinsurance reserve credit; and
    - (iv) For any other arrangement ceding a portion of the risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i) through (~~iii~~iv) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.

3. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer ~~to the extent required by Section 5B~~ in accordance with [insert existing provision of state law equivalent to Sections 2 and 3 of the Credit for Reinsurance Model Regulation]. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

#### B. Actuarial Method - Temporary Adjustments Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, in addition to the adjustments provided by Section 6A above, the Actuarial Method will include the following adjustments:

1. For Covered Policies ~~required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation described in Section 5.B.1 above~~, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies ~~required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation described in Section 5.B.2 above~~, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies ~~required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation described in Section 5.B.2 above~~, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6B1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to "recalibrate" the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to "recalibrate" the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6B1 & 2 above may need to be modified.]*

3. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $c_x / (2 * \text{number of reinsurance premiums per year})$ , where  $c_x$  is calculated using the same mortality table used in calculating the NPR. This adjustment is to be made in lieu of the adjustment in Section 6A2(iii) above.
4. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except ~~that Section 8C11 shall apply for guidance in Section 8 pertaining to~~



the case when ~~some of~~ the assets supporting the ~~gross~~ reserve are held by the counterparty or by another party.

#### C. Valuation used for Purposes of Calculations

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.



**David R. Remstad, FSA**  
Senior Vice President & Chief Actuary

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March 24, 2016

Mr. John Finston  
General Counsel, California Department of Insurance  
Chair, NAIC Reinsurance (E) Task Force

Via email: [jarpin@naic.org](mailto:jarpin@naic.org); [dschelp@naic.org](mailto:dschelp@naic.org)

Re: Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Non-level Gross Premiums, Non-level Gross Benefits and Universal Life With Secondary Guarantees

Dear Mr. Finston:

Northwestern Mutual supports the exposed draft Model Regulation. We encourage the NAIC to adopt the Model Regulation and to make it an accreditation standard.

As we wrote last September:

Life insurer captive transactions should be the exception, not the rule. When regulators approve a life insurer captive transaction they are approving a deviation from the NAIC's uniform valuation and capital standards, outside of the permitted practices mechanism of statutory accounting. Each such deviation has consequences for all other life insurers, for consumers and for the system itself. Accordingly, the NAIC should take care that in improving the regulation of captive transactions it does not inadvertently broaden their use.

The exposed Model Regulation does a good job of implementing the Rector Framework while at the same time not creating incentives to broaden life insurer use of captives. Once the Model Regulation has been implemented and principles-based reserving is available for companies to use, we encourage the NAIC to review whether life insurers continue to use captives for business subject to PBR. If captives use continues on business subject to PBR, the NAIC should make adjustments to end that use. These are critical steps to strengthen and preserve the state-based system of insurance regulation.

Sincerely,

A handwritten signature in black ink that reads "David Remstad".

David R. Remstad  
Senior Vice President & Chief Actuar

***Claire Thinking, Inc.***  
*Actuarial Consulting*

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March 21, 2016

John Finston, Esq.  
Chair of the NAIC Reinsurance (E) Task Force

*Re: Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life With Secondary Guarantees*

Dear Mr. Finston:

Thank you for the opportunity to comment on the proposed new model regulation. I want to acknowledge the work of the NAIC Reinsurance Task Force and the time invested in producing a model regulation that balances prudent insurance regulation with fairness for the insurance industry. One of the key provisions of the model regulation is the role that Primary Security and Other Security play in providing support for statutory reserves. It is my opinion that one important missing piece in the model regulation is the requirement that Other Security be available as a means of obtaining funds that meet the Primary Security criteria, when there is a shortfall in the level of Primary Security. In other words, if Other Security consists of a note from a third party, the reinsurer needs to have the ability to redeem the note for enough cash to make up the Primary Security deficiency.

What would happen if a reinsurance agreement specified that Primary Security would have to be exhausted before Other Security could be utilized? In such case Other Security could not be redeemed to obtain cash or other Primary Security assets to make up any shortfall in Primary Security. As a result, Other Security would have limited, if any, real value. For example, assume that statutory reserves for a block of reinsured universal life policies at year-end 2017 are \$100 million, and are supported by \$60 million of Primary Security and \$40 million of Other

Security. During 2018 interest rates drop and mortality experience is more adverse than expected, causing a change in assumptions used to determine the modified VM20 reserves which in turn results in an increase in the required level of Primary Security to \$70 million at year-end 2018. For simplicity assume statutory reserves remain unchanged, so the required level of Other Security drops to \$30 million. If the reinsurer has no other source of funds to make up the shortfall, and as a result the ceding company is obligated to make up the \$10 million increase, then the Other Security will seldom be used for the payment of claims no matter how adverse the experience of the reinsured business turns out to be. This is because the ceding company would keep on adding more Primary Security to prefund projected claims whenever necessary.

A reinsurance agreement will require the reinsurer, not the ceding company, to be responsible for funding any increase in assets required to be deposited in a trust account or maintained as funds withheld by the ceding company. Otherwise, the reinsurance agreement would be out of compliance with the Life and Health Reinsurance Agreements Model Regulation (on risk transfer) - including its Section 4 Accounting Requirements A(2), A(3) and A(5) regarding deprivation of surplus, reimbursement for negative experience, and possible payment of amounts other than from income realized from the reinsured policies. A requirement that a shortfall in Primary Security be funded by the ceding company rather than the reinsurer, particularly when the reinsurer holds Other Security in support of a portion of the statutory reserves, would be inconsistent with the risk transfer model regulation. The risk transfer model regulation does not generally allow reinsurance credit if any surplus enhancement realized by the ceding company as a result of a reinsurance agreement is subject to possible future reduction due to reasons related to the reinsured business (with the exception of voluntary acts on the part of the ceding company, such as recapture). Also, if the ceding company is responsible for a shortfall in Primary Security, then the ceding company has not passed on the risk that the experience of the reinsured business turns out to be more adverse than assumed in the establishment of the modified VM20 reserves – and the reinsurance agreement would therefore also be out of compliance with Accounting Requirement A(6) of the risk transfer model regulation. I realize that the proposed new model regulation does not intend to reduce the responsibility of the reinsurer to provide proper security and only intends for the ceding company to step in when the reinsurer is unable to fully meet its obligation, but the ability of the reinsurer to meet the Primary Security requirements could be hindered if there are limitations on its ability to draw on Other Security to obtain additional Primary Security in the event of a shortfall.

My specific recommendation is that the following revisions be made to the 02/26/2016 draft of the proposed new model regulation:

Section 5.F. Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security, which can be converted to Primary Security to meet any shortage in the level of Primary Security.

Modify the last sentence of Section 7.B. as follows:

If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive credit for reinsurance as of the valuation date, ~~it shall, Primary Security and/or Other Security, as the case may be, must be increased~~ on or before the March 1<sup>st</sup> immediately following the valuation date, ~~add additional Primary Security and/or Other Security, as the case may be,~~ in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.

Thank you for considering my comments.

Sincerely,

A handwritten signature in black ink, appearing to read 'Sheldon Summers', with a long horizontal flourish extending to the right.

Sheldon Summers, FSA, MAAA  
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(661) 367-7392  
[ctwest@socal.rr.com](mailto:ctwest@socal.rr.com)



BY E-MAIL

March 27, 2016

John Finston  
Chair, NAIC Reinsurance (E) Task Force

Attention: Josh Arpin (jarpin@naic.org)  
Dan Schelp (dschelp@naic.org)

Re: XXX/AXXX Credit for Reinsurance Model Regulation

Dear Mr. Finston,

New York Life appreciates the opportunity to comment on the recently exposed revised draft XXX/AXXX Credit for Reinsurance Model Regulation.

We appreciate the thoughtful, thorough and deliberate approach that the task force has taken in the preparation of the revised draft. The latest exposure is a strong, well drafted work product. In particular, we are pleased that the task force has decided to include a meaningful enforcement mechanism in order to ensure consistent national implementation of new captive reinsurance requirements. We therefore strongly support adoption of the revised draft.

There are several aspects of the revised draft that are especially important. Although other interested parties may request changes to these parts of the draft, we believe they should remain unchanged. Specifically:

- Consequences of a Shortfall. We strongly support the decision to deny all reinsurance credit to life insurers that do not remediate shortfalls in “primary security” by setting aside additional qualifying assets. This provision will promote full compliance with the new regulatory framework.

This provision will be particularly important after principle-based reserving (PBR) takes effect in 2017. To maintain the integrity of PBR, life insurers should not be permitted to use captives to finance the required level of “primary security” with assets that do not meet traditional standards of quality and safety, or that are not properly matched to the duration of an insurer’s liabilities. Denying all credit for non-compliant structures will serve as a deterrent against attempts to circumvent the “primary security” requirement within the model regulation.

The task force considered other options last year, including denying credit for all of the “other security” or denying credit for “primary security” and “other security” on a pro rata basis. These options will lose much of their meaning once companies begin to implement PBR, as there will no longer be any “other security.” After PBR, the statutory reserve, the reserve required under PBR and the required level of “primary security” should be one and the same. The task force also considered a “dollar for dollar” option,

TO: John Finston  
Chair, Reinsurance (E) Task Force

FROM: Mike Boerner  
Chair, Life Actuarial (A) Task Force

Copy: Dan Schelp, NAIC  
Josh Arpin, NAIC

The Life Actuarial (A) Task Force (LATF) offers the following comments on the exposure draft of the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees (exposure). LATF did not review Appendix 1 of the exposure given the reorganization below. A red line version and a clean edits accepted version is attached. An excel file is attached as FYI which provides 14 examples of how the Actuarial Method adjustments are interpreted to work. Note LATF plans to coordinate AG-48 as appropriate with the final model rule. A summary of the proposed changes are as follows:

**Proposed Substantive Change to Section 6B:**

For policies issued prior to the Valuation Manual Operative Date (Operative Date) the exposure provides an adjustment to the Required Level of Primary Security for an exempt YRT reinsurance arrangement to an assuming reinsurer. The exposure's adjustment is different for such policies after the Operative Date. LATF recommends the adjustment used before the Operative Date should continue after the Operative Date for such policies issued before the Operative Date.

Basis to continue the same adjustment is because the adjustment to the Required Level of Primary Security should not be greater than what an assuming reinsurer for an exempt YRT reinsurance arrangement can currently set up, which will not change after the Operative Date for such prior policies.

**Simplification & Reorganization of Section 6A4 & New 6A6, 7, & 8:**

Redundant verbiage was eliminated (especially the lead in paragraph to the exposure's 6A4a) which helped to eliminate lower levels that resulted in levels no lower than 6A4a thru d. Also, some of the requirements in 6A4 were moved to new higher levels of 6A5, 6, & 7 (the exposure's 6A5 was moved to 6A8). The following is a summary of these changes:

6A4a: Was 6A4a(i) in the exposure. Non-substantive edits were added for clarity.

6A4b: Was 6A4a(ii) in the exposure. Non-substantive clarifications were applied.

6A4c: Was 6A4a(iii) in the exposure. Minor typo edits were made.

6A4d: Was 6A4a(iv) in the exposure.

6A5: Was 6A4b, first sentence, of the exposure that specified not applying the reinsurance section of VM-20 but applying guidance from that reinsurance section relating to assets in certain cases.

6A6: Was 6A4b, second sentence, of the exposure. This is the sentence that says "In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded."

6A7: Was 6A4a(ii)(b) in the exposure. This was moved higher in the multi-level list to the new position 6A7 as it is felt that it applies more broadly than just to secondary guarantee policies

6A8: Was 6A5 in the exposure.

**Summary of Other Changes Believed To Be Non-Substantive:**

1. Non-substantive changes were made to the title of the Model Reg. and to the first sentence of Section 2 to more closely mirror the authorizing language in the recently adopted Credit for Reinsurance Model Law.
2. In Section 4A1 and 4A2, changes were made to incorporate more precise wording to better mirror the descriptive language of Sections 6F and 6G of Model 830. Model 830 was not specifically cited as Model 830 has not been adopted in all states.
3. Section 4D – A clarification was provided that all citations there apply to the Credit for Reinsurance Model Act.
4. Section 5B – A slight rearrangement was made of the list to move the comment regarding Grandfathered Policies to a position outside the list. Minor changes to the descriptive name of “flexible premium universal life” are also suggested to add consistency and clarity.
5. Section 5C – an editorial change was made in the formal definition of Grandfathered Policies.
6. In addition to the substantive change to 6B mentioned at the beginning of this memo, some wordsmithing has been done for clarity and consistency. For example the cites to the reinsurance section of VM-20 have been generalized in case the reinsurance instructions in the Valuation Manual move, and the treaty-by-treaty concept has been reiterated for consistency with 6A.
7. In 6C the phrase which now appears as “...December 31<sup>st</sup> immediately preceding the valuation date...” might be interpreted to represent a full year earlier than a valuation date of December 31<sup>st</sup> (which is the most likely valuation date). This is not believed to be the intent of this sentence. Wording to clarify the intent was provided to say “...the December 31<sup>st</sup> **on or** immediately preceding the valuation date...”
8. In Section 7A1 a typo is corrected.
9. In Section 7A5d this final item in the list is ended with a comma and the final “and” deleted.
10. We suggest that throughout the regulation the references to treaty(ies), contract(s), and arrangement(s) be standardized and capitalizing all references to the Valuation Manual in an attempt to create better consistency between the drafting styles of the various contributors that have built up the current draft through many iterations and modifications.



**Additional Handout – Life Actuarial (A) Task Force Comments – Tracked Revisions**

**LATF Draft of 02/2603/29/2016**

Reinsurance (E) Task Force  
*A new model*

The NAIC solicits comments on this draft. The working draft of the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees is available on the Reinsurance (E) Task Force Web page at [http://naic.org/committees\\_e\\_reinsurance.htm](http://naic.org/committees_e_reinsurance.htm).

**Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Guaranteed Nonlevel Gross Premiums, Guaranteed Nonlevel Gross Benefits and Universal Life Insurance With Secondary Guarantees**

**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. Purpose and Intent.**

The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing guaranteed nonlevel gross premiums, guaranteed nonlevel gross benefits and universal life insurance policies with secondary guarantees required to be valued under [Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation]; and to ensure that, with respect to each such financing arrangement, funds consisting of Primary Security and Other Security, as defined in Section 5, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance contract or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any of its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).

*Drafting Note: No statute or regulation can anticipate every potential nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance reserve financing arrangement. Common sense and professional responsibility are needed to assure not only that the text of this regulation is strictly observed, but also that its spirit and intent are honored scrupulously. It is expected that those who are subject to this regulation will not engage in any arrangement or series of arrangements involving reserves for nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this regulation.*

**Additional Handout – Life Actuarial (A) Task Force Comments – Tracked Revisions**

**LATF Draft of 02/26/03/29/2016**

**Section 3. Applicability.**

This regulation shall apply to reinsurance contracts that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation] shall both apply to such reinsurance contracts; provided, that in the event of a direct conflict between the provisions of this regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation], the provisions of this regulation shall apply, but only to the extent of the conflict.

**Section 4. Exemptions from this Regulation.**

This regulation does not apply to:

- A. Reinsurance ceded to an assuming insurer consisting of:
  - 1. ~~for~~ Attained-Age-Based Yearly Renewable Term Life Insurance Policies; or
  - 2. ~~for~~ n-Year Renewable Term Life Insurance Policies with the following characteristics:
    - i. The policy consists of a series of  $n$ -year periods, where  $n$  is the same for each period except for the final renewal period, which may be no greater than the lessor of 2 times  $n$  or 10 years; and,
    - ii. For each period, the premium rates on both the initial current premium scale and the guaranteed maximum premium scale are level for the entire period; and,
    - iii. The guaranteed gross premiums in all  $n$ -year periods are not less than the corresponding net premiums calculated using the 1980 CSO Table with or without the ten-year select mortality factors; and,
    - iv. There are no cash surrender values in any policy year; or,
- B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act ]; or
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:
  - 1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"); and
  - 2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the life risk-based capital report including

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overview and instructions for companies, as the same may be amended by the NAIC from time to time, without deviation; or

- D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 5B(4)(a) or Section 5B(4)(b) of the Credit for Reinsurance Model Act]; or
- E. Reinsurance ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4E to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

*[Drafting Note: The exemption set forth in Section 4E was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance arrangements where the ceding insurer was exiting the type of business ceded. The exemption should not be used with respect to so-called “normal course” reinsurance transactions; rather, such transactions should either fit within one of the standard exemptions set forth in Sections 4A, B, C, or D or meet the substantive requirements of this regulation.]*

**Section 5. Definitions.**

- A. Actuarial Method: The methodology used to determine the Required Level of Primary Security, as described in Section 6.
- B. Covered Policies: Subject to the exemptions described in Section 4, Covered Policies are those policies that have risk ceded to an assuming insurer of the following policy types:;
  - 1. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium (universal life) insurance policies; or,
  - 2. Flexible premium (universal) life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period,

provided, however, that Covered Policies shall not include Grandfathered Policies..

- C. Grandfathered Policies: Grandfathered Policies are those policies that were (1) issued prior to January 1, 2015 and (2) ceded, as of December 31, 2014, as part of a reinsurance arrangement

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- that ~~would not meet~~have met one of the exemption criteria in Section 4 had that section then been applicable.
- D. Required Level of Primary Security: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.
- E. Primary Security: The following forms of security:
1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];
  2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and
  3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
    - a. Commercial loans in good standing of CM3 quality and higher;
    - b. Policy Loans; and
    - c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.
- F. Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security.
- G. Valuation Manual: The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed. Before the Operative Date of the Valuation Manual, use the version of the Valuation Manual most recently adopted by the NAIC.
- [Drafting Note: Section 5G presumes that each State is permitted under its State laws to directly reference the valuation manual adopted by the NAIC. If a State is required by its State laws to reference a State law or regulation, it should modify Section 5G as appropriate to do so].*
- H. VM-20: “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.
- I. Operative Date of the Valuation Manual: The “Operative Date of the Valuation Manual” has the meaning that the term is given in [insert provision of state law equivalent to statutory definition of the term in the Standard Valuation Law, as amended by the NAIC in 2009]

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*[Drafting Note: States that have not yet adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:*

1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;
2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.
3. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the following fifty-five (55) jurisdictions: The fifty States of the United States, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.”

*[Drafting Note: Sections 5E, H and I presume that each State is permitted under its State laws to “adopt” the valuation manual in a manner similar to how the Accounting Practices and Procedures Manual becomes effective in many States, without a separate regulatory process such as adoption by regulation. It is desirable that all States adopt the valuation manual requirements and that such adoption be achieved without a separate State regulatory process in order to achieve uniformity of reserve standards in all States. However, to the extent that a State may need to adopt the valuation manual through a formal State regulatory process, these sections may be amended to reflect any State’s need to adopt the valuation manual through regulation or otherwise.]*

**Section 6. The Actuarial Method.**

**[[NOTE: The proposed edits to the Actuarial Method are subject to review and comment by LATF. One possibility under consideration is that some of the new provisions appearing below will instead be set forth in a new Actuarial Guideline. It is anticipated that, to ensure uniformity, any material changes to the Actuarial Method set forth in this Model Regulation will also be incorporated into AG48. The Maine Bureau of Insurance and the ACLI have proposed that, once all substantive changes to Section 6 have been made, Section 6 should be reorganized nonsubstantively to improve its readability. The proposed reorganization is set forth in Appendix 1]]**

**A. Actuarial Method – Before the Operative Date of the Valuation Manual**

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, applied on a treaty-by-treaty basis, with the modifications as provided below:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional

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modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.

2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6A1& 2 above may need to be modified.]*

3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.
4. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies then the ~~Actuarial Method will be applied in the following manner~~ Required Level of Primary Security may be reduced as follows:

~~a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:~~

~~a. If a reinsurance treaty cedes only a quota share of some or all of the risks pertaining to the Covered PolicyPolicies, the Required Level of Primary Security will may be reduced to a pro rata portion in accordance with the percentage of the risk ceded, as will any adjustment under Subsections (ii) or (iii)Subsection c below;~~

~~a.b.~~

If the reinsurance treaty cedes in a non-exempt arrangement only the risks pertaining to a secondary guarantee rider;

~~The Required Level of Primary Security is may be reduced by the statutory reserve retained not ceded to the assuming by the ceding insurer on the Covered Policies, where the retained reserve should be reflective of any reduction pursuant to the cession of retained-mortality risk (reduced by the amount specified pursuant to Subsection (iii) below in the event that any risk is ceded to a different reinsurer on a yearly renewable term basis in an exempt arrangement);~~

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~~If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;~~

~~b.c. (iii)~~–If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $[c_x / (2 * \text{number of reinsurance premiums per year})]$  where  $c_x$  is calculated using the same mortality table used in calculating the Net Premium Reserve; and

~~e.d. (iv)~~–For any other arrangement ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections ~~(i), (ii), (iii),~~ a, b, c, and ~~(iv)~~ d above to apply. Such adjustments to the Required Level of Primary Security will be done in the sequence that accurately reflects the portion of the risk ceded via the treaty. The ceding insurer should document the rationale and steps taken to accomplish the ~~division of adjustments to the Required Level of Primary Security among due to the individual treaties~~ cession of less than one hundred percent (100%) of the risk.

The Adjustments for other reinsurance will be made only with respect to reinsurance ~~arrangements~~ treaties entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of a retrocession arrangement ~~treaty~~ entered into by the assuming insurers.

~~5.~~ Section 8 ~~The reinsurance section~~ of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that ~~Section 8C11~~ the guidance found therein regarding asset assumptions shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

~~5.6.~~ In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.

~~6.7.~~ If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;

~~7.8.~~ If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:

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- a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
- b. Credit for the Non-Covered Policy reserves shall be granted only ~~to the extent that~~ security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer ~~to in accordance with [cite the extent required by state's version of Section 5B-3 of the Credit for Reinsurance Act].~~ Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies

**B. Actuarial Method – At and After the Operative Date of the Valuation Manual**

At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20 applied on a treaty-by-treaty basis, including all relevant definitions, from the Valuation Manual as then in effect, without modification, except that the adjustment methodologies set forth in subsections A4a, b, and d, as well as Subsection A8 will continue to apply. In lieu of the methodologies set forth in ~~Subsections A4a(iii), Section 8~~ Subsection A4c, the reinsurance section of VM-20 (Reinsurantee) in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement to an assuming insurer, for risks written after the Operative Date, but A4c will continue to apply to risks written prior to the Operative Date, including risks written prior to the Operative Date of the Valuation Manual. The methodologies set forth in Subsections A4a(i), (ii), b, and (iv), d as well as Subsection A5A8, will continue to apply.

**C. Valuation used for Purposes of Calculations**

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st on or immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.



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**Section 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

A. Requirements

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to risks ceded under Covered Policies pursuant to [insert provisions of state law equivalent to Sections 2 or 3 of the Credit for Reinsurance Model Law] if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer's statutory policy reserves with respect to the Covered Policies are established in full and in accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law and related regulations and actuarial guidelines], and credit claimed for any reinsurance contract subject to this Regulation does not exceed the proportionate share of those reserves ceded under the contract;
2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance contract subject to this Regulation and provides support for its calculation as determined to be acceptable to the commissioner;
3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;
4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Subsection 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of Model Credit for Reinsurance Act];
5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
  - a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and
  - b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and
  - c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the value (according to the valuation rules set forth in

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Section 6C) of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section 7A3) below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and

- d. The determination of reserve credit under [insert provision of state law equivalent to Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation] shall be determined according to the valuation rules set forth in Section 6C, as applicable, ~~and~~

6. The reinsurance arrangement has been approved by the commissioner.

**B. Requirements at Inception Date; Annual Review and Remediation**

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15<sup>th</sup> in the calendar year immediately following the calendar year in which this regulation becomes effective], and on or before each February 15<sup>th</sup> thereafter, each life insurance company within the scope of Section 3 shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive credit for reinsurance as of the valuation date, it shall, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.

**Section 8. Severability.**

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

**Section 9. 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 Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.

**Section 10. Effective Date**

This regulation shall become effective [insert date] and shall pertain to all Covered Policies in force as of and after that date.

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**APPENDIX 1**

**Proposed reorganization of Section 6 (assumes revisions included in the main body of the regulation above have been adopted).**

**Section 6. The Actuarial Method.**

A. Actuarial Method

The Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant, from the Valuation Manual as then in effect, without modification except for the following:

1. Except as provided in Paragraph 2 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies ceded under the treaty as originally issued or assumed by the ceding insurer. However, the Required Level of Primary Security resulting from application of the Actuarial Method shall not exceed the amount of statutory reserves ceded.
2. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsection (ii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:
      - (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies;
      - (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation,, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation; and
    - (iii) For any other arrangement ceding a portion of the risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

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It is possible for any combination of Subsections (i) through (iii) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.

3. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

**B. Actuarial Method – Temporary Adjustments Before the Operative Date of the Valuation Manual**

Before the Operative Date of the Valuation Manual, in addition to the adjustments provided by Section 6A above, the Actuarial Method will include the following adjustments:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6B1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the*

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*NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6B1 & 2 above may need to be modified.]*

3. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $c_x / (2 * \text{number of reinsurance premiums per year})$ , where  $c_x$  is calculated using the same mortality table used in calculating the NPR. This adjustment is to be made in lieu of the adjustment in Section 6A2(iii) above.
4. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

C.

Valuation used for Purposes of Calculations

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC's Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

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Reinsurance (E) Task Force  
*A new model*

The NAIC solicits comments on this draft. The working draft of the Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees is available on the Reinsurance (E) Task Force Web page at [http://naic.org/committees\\_e\\_reinsurance.htm](http://naic.org/committees_e_reinsurance.htm).

**Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Guaranteed Nonlevel Gross Premiums, Guaranteed Nonlevel Gross Benefits and Universal Life Insurance With Secondary Guarantees**

**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. Purpose and Intent.**

The purpose and intent of this regulation is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing guaranteed nonlevel gross premiums, guaranteed nonlevel benefits and universal life insurance policies with secondary guarantees required to be valued under [Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation]; and to ensure that, with respect to each such financing arrangement, funds consisting of Primary Security and Other Security, as defined in Section 5, are held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes has one or more of the following characteristics: some or all of the assets used to secure the reinsurance contract or to capitalize the reinsurer (1) are issued by the ceding insurer or its affiliates; or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) create a reimbursement, indemnification or other similar obligation on the part of the ceding insurer or any of its affiliates (other than a payment obligation under a derivative contract acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement).

*Drafting Note: No statute or regulation can anticipate every potential nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance reserve financing arrangement. Common sense and professional responsibility are needed to assure not only that the text of this regulation is strictly observed, but also that its spirit and intent are honored scrupulously. It is expected that those who are subject to this regulation will not engage in any arrangement or series of arrangements involving reserves for nonlevel gross premium, nonlevel gross benefit, or universal life insurance with secondary guarantees life insurance that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this regulation.*

**Section 3. Applicability.**

This regulation shall apply to reinsurance contracts that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation] shall both apply to such

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reinsurance contracts; provided, that in the event of a direct conflict between the provisions of this regulation and [insert provision of state law equivalent to the Credit for Reinsurance Model Regulation], the provisions of this regulation shall apply, but only to the extent of the conflict.

**Section 4. Exemptions from this Regulation.**

This regulation does not apply to:

- A. Reinsurance ceded to an assuming insurer consisting of:
  - 1. Attained-Age-Based Yearly Renewable Term Life Insurance Policies; or
  - 2. n-Year Renewable Term Life Insurance Policies with the following characteristics:
    - i. The policy consists of a series of  $n$ -year periods, where  $n$  is the same for each period except for the final renewal period, which may be no greater than the lesser of 2 times  $n$  or 10 years; and,
    - ii. For each period, the premium rates on both the initial current premium scale and the guaranteed maximum premium scale are level for the entire period; and,
    - iii. The guaranteed gross premiums in all  $n$ -year periods are not less than the corresponding net premiums calculated using the 1980 CSO Table with or without the ten-year select mortality factors; and,
    - iv. There are no cash surrender values in any policy year; or,
- B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act ]; or
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Act], and that, in addition:
  - 1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 ("SSAP 1"); and
  - 2. is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the 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; or
- D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 5B(4)(a) or Section 5B(4)(b) of the Credit for Reinsurance Model Act]; or
- E. Reinsurance ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are

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included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4E to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

*[Drafting Note: The exemption set forth in Section 4E was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance arrangements where the ceding insurer was exiting the type of business ceded. The exemption should not be used with respect to so-called “normal course” reinsurance transactions; rather, such transactions should either fit within one of the standard exemptions set forth in Sections 4A, B, C, or D or meet the substantive requirements of this regulation.]*

**Section 5. Definitions.**

- A. Actuarial Method: The methodology used to determine the Required Level of Primary Security, as described in Section 6.
- B. Covered Policies: Subject to the exemptions described in Section 4, Covered Policies are those policies that have risk ceded to an assuming insurer of the following policy types:
  - 1. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium universal life insurance policies; or,
  - 2. Flexible premium universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period,provided, however, that Covered Policies shall not include Grandfathered Policies..
- C. Grandfathered Policies: Grandfathered Policies are those policies that were (1) issued prior to January 1, 2015 and (2) ceded, as of December 31, 2014, as part of a reinsurance arrangement that would not have met one of the exemption criteria in Section 4 had that section then been applicable.
- D. Required Level of Primary Security: The dollar amount determined by applying the Actuarial Method to the risks ceded with respect to Covered Policies, but not more than the total reserve ceded.
- E. Primary Security: The following forms of security:
  - 1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];
  - 2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and



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3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
  - a. Commercial loans in good standing of CM3 quality and higher;
  - b. Policy Loans; and
  - c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.
- F. Other Security: Any security acceptable to the commissioner other than security meeting the definition of Primary Security.
- G. Valuation Manual: The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed. Before the Operative Date of the Valuation Manual, use the version of the Valuation Manual most recently adopted by the NAIC.

*[Drafting Note: Section 5G presumes that each State is permitted under its State laws to directly reference the valuation manual adopted by the NAIC. If a State is required by its State laws to reference a State law or regulation, it should modify Section 5G as appropriate to do so].*

- H. VM-20: “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.
- I. Operative Date of the Valuation Manual: The “Operative Date of the Valuation Manual” has the meaning that the term is given in [insert provision of state law equivalent to statutory definition of the term in the Standard Valuation Law, as amended by the NAIC in 2009]

*[Drafting Note: States that have not yet adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:*

1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;
2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.
3. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by at least forty-two (42) of the following fifty-five (55) jurisdictions: The fifty States of the United States, American Samoa, the American Virgin Islands, the District of Columbia, Guam, and Puerto Rico.”

*[Drafting Note: Sections 5E, H and I presume that each State is permitted under its State laws to “adopt” the valuation manual in a manner similar to how the Accounting Practices and Procedures Manual becomes effective in many States, without a separate regulatory process such as adoption by regulation. It is desirable that all*

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*States adopt the valuation manual requirements and that such adoption be achieved without a separate State regulatory process in order to achieve uniformity of reserve standards in all States. However, to the extent that a State may need to adopt the valuation manual through a formal State regulatory process, these sections may be amended to reflect any State's need to adopt the valuation manual through regulation or otherwise.]*

**Section 6. The Actuarial Method.**

**[[NOTE: The proposed edits to the Actuarial Method are subject to review and comment by LATF. One possibility under consideration is that some of the new provisions appearing below will instead be set forth in a new Actuarial Guideline. It is anticipated that, to ensure uniformity, any material changes to the Actuarial Method set forth in this Model Regulation will also be incorporated into AG48. The Maine Bureau of Insurance and the ACLI have proposed that, once all substantive changes to Section 6 have been made, Section 6 should be reorganized nonsubstantively to improve its readability. The proposed reorganization is set forth in Appendix 1]]**

A. Actuarial Method – Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20, applied on a treaty-by-treaty basis, with the modifications as provided below:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.
2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6A1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6A1 & 2 above may need to be modified.]*

3. Except as provided in Paragraph 4 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer.
4. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies then the Required Level of Primary Security may be reduced as follows:
  - a. If a reinsurance treaty cedes only a quota share of some or all of the risks pertaining to the Covered Policies, the Required Level of Primary Security may be reduced to a pro

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rata portion in accordance with the percentage of the risk ceded, as will any adjustment under Subsection c below;

- b. If the reinsurance treaty cedes in a non-exempt arrangement only the risks pertaining to a secondary guarantee, the Required Level of Primary Security may be reduced by the statutory reserve retained by the ceding insurer on the Covered Policies, where the retained reserve should be reflective of any reduction pursuant to the cession of mortality risk on a yearly renewable term basis in an exempt arrangement;
- c. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $[c_x / (2 * \text{number of reinsurance premiums per year})]$  where  $c_x$  is calculated using the same mortality table used in calculating the Net Premium Reserve; and
- d. For any other arrangement ceding a portion of risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections a, b, c, and d above to apply. Such adjustments to the Required Level of Primary Security will be done in the sequence that accurately reflects the portion of the risk ceded via the treaty. The ceding insurer should document the rationale and steps taken to accomplish the adjustments to the Required Level of Primary Security due to the cession of less than one hundred percent (100%) of the risk.

The Adjustments for other reinsurance will be made only with respect to reinsurance treaties entered into directly by the ceding insurer. The ceding insurer will make no adjustment as a result of a retrocession treaty entered into by the assuming insurers.

5. The reinsurance section of VM-20 in the Valuation Manual shall not be used in applying the Actuarial Method, except that the guidance found therein regarding asset assumptions shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.
6. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.
7. If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation;
8. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and

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- b. Credit for the Non-Covered Policy reserves shall be granted only to the extent that security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer in accordance with [cite the state’s version of Section 3 of the Credit for Reinsurance Act]. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies

**B. Actuarial Method – At and After the Operative Date of the Valuation Manual**

At and after the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security for each reinsurance contract subject to this regulation shall be VM-20 applied on a treaty-by-treaty basis, including all relevant definitions, from the Valuation Manual as then in effect, without modification, except that the adjustment methodologies set forth in subsections A4a, b, and d, as well as Subsection A8 will continue to apply. In lieu of the methodologies set forth in Subsection A4c, the reinsurance section of VM-20 in the Valuation Manual shall be used to apply the Actuarial Method to risks ceded in an exempt arrangement, for risks written after the Operative Date, but A4c will continue to apply to risks written prior to the Operative Date.

**C. Valuation used for Purposes of Calculations**

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer’s general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC’s Life Actuarial (A) Task Force no later than the December 31st on or immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.

**Section 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

**A. Requirements**

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to risks ceded under Covered Policies pursuant to [insert provisions of state law equivalent to Sections 2 or 3 of the Credit for Reinsurance Model Law] if, and only if, in addition to all other requirements imposed by law or regulation, the following requirements are met on a treaty by treaty basis:

1. The ceding insurer’s statutory policy reserves with respect to the Covered Policies are established in full and in accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law and related regulations and actuarial guidelines], and credit claimed for any reinsurance contract subject to this Regulation does not exceed the proportionate share of those reserves ceded under the contract;

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2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance contract subject to this Regulation and provides support for its calculation as determined to be acceptable to the commissioner;
  3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;
  4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Subsection 3 above, are held by or on behalf of the ceding insurer as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of Model Credit for Reinsurance Act];
  5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
    - a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and
    - b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and
    - c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the value (according to the valuation rules set forth in Section 6C) of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section 7A3) below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and
    - d. The determination of reserve credit under [insert provision of state law equivalent to Paragraph E of Section 11 of the Credit for Reinsurance Model Regulation] shall be determined according to the valuation rules set forth in Section 6C, as applicable,
  6. The reinsurance arrangement has been approved by the commissioner.
- B. Requirements at Inception Date; Annual Review and Remediation**

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15<sup>th</sup> in the calendar year immediately following the calendar year in which this regulation becomes effective], and on or before each February 15<sup>th</sup> thereafter, each life insurance company within the scope of Section 3 shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date

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and if such company seeks to receive credit for reinsurance as of the valuation date, it shall, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.

**Section 8. Severability.**

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

**Section 9. 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 Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.

**Section 10. Effective Date**

This regulation shall become effective [insert date] and shall pertain to all Covered Policies in force as of and after that date.

**APPENDIX 1**

**Proposed reorganization of Section 6 (assumes revisions included in the main body of the regulation above have been adopted).**

**Section 6. The Actuarial Method.**

A. Actuarial Method

The Actuarial Method to establish the Required Level of Primary Security shall be VM-20, including all relevant, from the Valuation Manual as then in effect, without modification except for the following:

1. Except as provided in Paragraph 2 below, the Actuarial Method is to be applied on a gross basis to all risks with respect to the Covered Policies ceded under the treaty as originally issued or assumed by the ceding insurer. However, the Required Level of Primary Security resulting from application of the Actuarial Method shall not exceed the amount of statutory reserves ceded.
2. If the reinsurance treaty cedes less than one hundred percent (100%) of the risk with respect to the Covered Policies, then the Actuarial Method will be applied in the following manner:
  - a. The Actuarial Method will be applied to all risks with respect to the Covered Policies as originally issued or assumed by the ceding insurer and the resulting Required Level of Primary Security will be adjusted using the following methodology:
    - (i) If a reinsurance treaty cedes only a quota share of the Covered Policy, the Required Level of Primary Security will be reduced pro rata in accordance with the percentage of the risk ceded, as will any adjustment under Subsection (ii) below;
    - (ii) If the reinsurance treaty cedes only a secondary guarantee rider:

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- (a) The Required Level of Primary Security is reduced by the statutory reserve not ceded to the assuming insurer on the Covered Policies;
- (b) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance contract subject to this Regulation,, in no event will the aggregate Required Level of Primary Security for those reinsurance contracts be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those contracts were ceded in a single contract subject to this Regulation; and
- (iii) For any other arrangement ceding a portion of the risk to a different reinsurer, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

It is possible for any combination of Subsections (i) through (iii) above to apply. The ceding insurer should document the rationale and steps taken to accomplish the division of the Required Level of Primary Security among the individual treaties.

Adjustments for other reinsurance will be made only with respect to reinsurance arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by the assuming insurer.

- 3. If a reinsurance contract subject to this Regulation cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
  - a. The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
  - b. Credit for the Non-Covered Policy reserves shall be granted only if security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer to the extent required by Section 5B. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

**B. Actuarial Method – Temporary Adjustments Before the Operative Date of the Valuation Manual**

Before the Operative Date of the Valuation Manual, in addition to the adjustments provided by Section 6A above, the Actuarial Method will include the following adjustments:

- 1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed. However, if such Covered Policies are reinsured in a reinsurance agreement that also contains Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement.

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2. For Covered Policies required to be valued under Section 7 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve, the Stochastic Reserve, or the NPR, subject to any additional modifications below. No exemption testing is allowed.

*[Drafting Note: Sections 6B1 & 2 assume that on or prior to the date this Model Regulation is adopted by the NAIC, amendments to the Valuation Manual to “recalibrate” the NPR will also have been adopted by the NAIC. If amendments to the Valuation Manual to “recalibrate” the NPR have not been adopted by the NAIC on or prior to the date this Model Regulation is adopted, the references to NPR in Sections 6B1 & 2 above may need to be modified.]*

3. If a portion of the Covered Policy risk is ceded to another reinsurer on a yearly renewable term basis, the Required Level of Primary Security will be reduced by the credit granted for the yearly renewable term reinsurance treaty, not to exceed  $c_x / (2 * \text{number of reinsurance premiums per year})$ , where  $c_x$  is calculated using the same mortality table used in calculating the NPR. This adjustment is to be made in lieu of the adjustment in Section 6A2(iii) above.
4. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party.

**C.**

**Valuation used for Purposes of Calculations**

For the purposes of both (a) calculating the Required Level of Primary Security pursuant to the Actuarial Method and (b) determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (i) for assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer’s general account and without taking into consideration the effect of any prescribed or permitted practices; and (ii) for all other assets, the valuations are to be those that were assigned to the assets for the purpose of determining the amount of reserve credit taken. In addition, the asset spread tables and asset default cost tables required by VM-20 shall be included in the Actuarial Method if adopted by the NAIC’s Life Actuarial (A) Task Force no later than the December 31st immediately preceding the valuation date for which the Required Level of Primary Security is being calculated. The tables of asset spreads and asset default costs shall be incorporated into the Actuarial Method in the manner specified in VM-20.



**Additional Handout - Life Actuarial (A) Task Force Comment Letter**

**Examples of adjustments to the RLPS for various combinations of reinsurance arrangements.**

("Subject Treaty" means a treaty subject to the XXX/AXXX Credit For Reinsurance Model Regulation)

**Note: RLPS = Required Level of Primary Security**

**Tab Description of Examples .....**

- EX 1** Entire block is ceded to a single captive via a Subject Treaty.
- EX 2** Entire block is ceded to two captives via Subject Treaty #1 (70%) and Subject Treaty #2 (30%); both non-exempt.
- EX 3** 70% of block is ceded to a single captive via Subject Treaty, 30% is retained.
- EX 4** 70% of block is ceded to two captives via Subject Treaty #1: 40% and Subject Treaty #2: 30%. The remaining 30% is retained.
- EX 5** Entire block is ceded to three captives via three subject treaties; #1: 60%; #2: 30%; and #3: 10%. All three are non-exempt.
- EX 6** A block of policies is written 70/30 with a joint venture partner. Partner's share (30%) is ceded via Treaty A. All of risk remaining (70%) is ceded to single captive via a Subject Treaty.
- EX 7** A block of policies is written 70/30 with a joint venture partner. Partner's share (30%) is ceded via Treaty A. All of risk remaining (70%) is ceded to two captives via a Subject Treaty #1 (50%) and Subject Treaty #2 (20%).
- EX 8** The excess over the retention level is ceded to a YRT pool via Treaty A and the remainder is ceded to a single captive via a Subject Treaty.
- EX 9** The excess over the retention level is ceded to a YRT pool via Treaty A and 80% of the remainder is ceded to a single captive via a Subject Treaty.
- EX 10** A block of policies is written 70/30 with a joint venture partner. Partner's share (30%) is ceded via Treaty A. For the remaining risk (70%), the excess over the company's retention level is ceded to a YRT pool via Treaty B, and the remainder is all ceded to single captive via a Subject Treaty.
- EX 11** A block of policies is written 70/30 with a joint venture partner. First the excess over the company's retention level is ceded to a YRT pool via Treaty A. Then the Partner's share (30% after the YRT cession) is ceded via Treaty B. The remaining risk (70% after the YRT cession) is all ceded to single captive via a Subject Treaty.
- EX 12** For a block of ULSG policies, the Secondary Guarantee only is ceded to a single captive via Subject Treaty.
- EX 13** For a block of ULSG policies, the excess over the retention is ceded to a YRT pool via Treaty A and the Secondary Guarantee only is then ceded to a single captive via Subject Treaty.
- Ex14** For a block of ULSG policies, the excess over the retention is ceded to a YRT pool via Treaty A and the Secondary Guarantee only is then ceded to two captives via Subject Treaty #1 (60%) and via Subject Treaty #2 (40%).

**Example 1:**

Entire block is ceded to a single captive via a Subject Treaty.

Block is 100% of the risks on all policies covered by Subject Treaty:  
 Statutory Reserve on Entire Block: 100  
 RLPS for Entire Block (via Actuarial Method): 50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
<b>Subject Treaty:</b>	CO	Non-Exempt	100% of risk.	100.00	

Total Statutory Reserve Ceded: 100.00

**RLPS for Subject Treaty: 50.00 = 50 \* 100%**

**Explanation:** 100% of risks ceded in Subject Treaty so RLPS for Subject Treaty is 100% of RLPS calculated by Actuarial Method without adjustment.

**Example 2:**

Entire block is ceded to two captives via Subject Treaty #1 (70%) and Subject Treaty #2 (30%); both non-exempt.

Input value!

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
<b>Subject Treaty #1</b>	CO	Non-Exempt	70% of risk.	70.00	
<b>Subject Treaty #2</b>	CO	Non-Exempt	30% of risk.	30.00	
Total Statutory Reserve Ceded:				100.00	

<b>RLPS for Subject Treaty #1:</b>	<b>35.00</b>	= (50 * 70%)
<b>RLPS for Subject Treaty #2:</b>	<b>15.00</b>	= (50 * 30%)

**Explanation:** For Subject Treaty #1, since 70% of block is ceded to captive, then the RLPS for this treaty is 70% of that for entire block. Similarly, for Subject Treaty #2, since 30% of block is ceded to captive then the related RLPS is 30% of that for the entire

**Example 3:**

70% of block is ceded to a single captive via Subject Treaty, 30% is retained.

Block is 100% of the risks on all policies covered by Subject Treaty:  
 Statutory Reserve on Entire Block: 100  
 RLPS for Entire Block (via Actuarial Method): 50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
<b>Subject Treaty:</b>	CO	Non-Exempt	70% of risk.	70.00	
Total Statutory Reserve Ceded:				70.00	

**RLPS for Subject Treaty: 35.00 = 50 \* 70%**

**Explanation:** 70% of risks are ceded in Subject Treaty so RLPS for Subject Treaty is 70% of RLPS calculated for the entire block by the Actuarial Method.

**Example 4:**

70% of block is ceded to two captives via Subject Treaty #1: 40% and Subject Treaty #2: 30%. The remaining 30% is retained.

Block is 100% of the risks on all policies covered by Subject Treaty:		<b>Input value!</b>	
Statutory Reserve on Entire Block:		100	
RLPS for Entire Block (via Actuarial Method):		50	

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
<b>Subject Treaty #1</b>	CO	Non-Exempt	40% of risk.	40.00	
<b>Subject Treaty #2</b>	CO	Non-Exempt	30% of risk.	30.00	
Total Statutory Reserve Ceded:				70.00	\$30 of Stat Reserve is retained.

<b>RLPS for Subject Treaty #1:</b>	<b>20.00</b>	<b>= 50 * 40%</b>
<b>RLPS for Subject Treaty #2:</b>	<b>15.00</b>	<b>= 50 * 30%</b>

**Explanation:** For Subject Treaty #1 40% of the risks are ceded so the RLPS for this subject treaty is 40% of RLPS calculated for the entire block. Similarly, for Subject Treaty #2 30% of the risk is ceded so the RLPS for this subject treaty is 30% of the RLPS calculated for the entire block.

**Example 5:**

Entire block is ceded to three captives via three subject treaties; #1: 60%; #2: 30%; and #3: 10%. All three are non-exempt.

Input value!

Block is 100% of the risks on all policies covered by Subject Treaty:  
 Statutory Reserve on Entire Block:  
 RLPS for Entire Block (via Actuarial Method):

100  
 50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
<b>Subject Treaty #1</b>	CO	Non-Exempt	60% of risk.	60.00	
<b>Subject Treaty #2</b>	CO	Non-Exempt	30% of risk.	30.00	
<b>Subject Treaty #3</b>	CO	Non-Exempt	10% of risk.	10.00	
Total Statutory Reserve Ceded:				100.00	

<b>RLPS for Subject Treaty #1:</b>	<b>30.00</b>	= (50 * 60%)
<b>RLPS for Subject Treaty #2:</b>	<b>15.00</b>	= (50 * 30%)
<b>RLPS for Subject Treaty #3:</b>	<b>5.00</b>	= (50 * 10%)

**Explanation:** Since 60%/30%/10% of the block is ceded to Captive #1/#2/#3, respectively, via a subject treaty, then the total RLPS of \$50 is divided up 60%/30%/10% among the treaties resulting in \$30/\$15/\$5 for them, respectively.

**Example 6:**

A block of policies is written 70/30 with a joint venture partner. Partner's share (30%) is ceded via Treaty A. All of risk remaining (70%) is ceded to single captive via a Subject Treaty.

Input value!

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
Treaty A:	CO	Exempt	30% of risk to partner.	30.00	
<b>Subject Treaty:</b>	CO	Non-Exempt	70% of risk.	70.00	
Total Statutory Reserve Ceded:				100.00	

**RLPS for Subject Treaty: 35.00 = 50 \* 70%**

**Explanation:** Since both treaties are quota-share, the RLPS for the subject treaty is 70% of the total of the total RLPS.

**Example 7:**

A block of policies is written 70/30 with a joint venture partner. Partner's share (30%) is ceded via Treaty A. All of risk remaining (70%) is ceded to two captives via a Subject Treaty #1 (50%) and Subject Treaty #2 (20%).

Input value!

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
Treaty A:	CO	Exempt	30% of risk to partner.	30.00	
<b>Subject Treaty #1</b>	CO	Non-Exempt	50% of risk.	50.00	
<b>Subject Treaty #2</b>	CO	Non-Exempt	20% of risk.	20.00	
Total Statutory Reserve Ceded:				100.00	

<b>RLPS for Subject Treaty #1:</b>	<b>25.00</b>	= 50 * 50%
<b>RLPS for Subject Treaty #2:</b>	<b>10.00</b>	= 50 * 20%

**Explanation:** Since all treaties are quota-share, the RLPS for the Subject Treaty #1 is 50% of the total RLPS, while the RLPS for the Subject Treaty #2 is 20% of the total RLPS.



**Example 8:**

The excess over the retention level is ceded to a YRT pool via Treaty A and the remainder is ceded to a single captive via a Subject Treaty.

Input value!

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
Treaty A:	YRT	Exempt	Net Amt at Risk over Retention Level.	5.00	$\leq 1/2 c_x$
<b>Subject Treaty:</b>	CO	Non-Exempt	100% of the risk not ceded via A.	95.00	
Total Statutory Reserve Ceded:				100.00	

**RLPS for Subject Treaty: 45.00 = (50 - 5) \* 100%**

**Explanation:** The excess over retention to the pool applies to the entire block, so first this YRT treaty adjustment is applied. This adjustment is a reduction to the total RLPS by \$5 (i.e., the \$5 statutory reserve credit not to exceed  $1/2 c_x$ ). Since 100% of the remainder is ceded to the captive then the RLPS for the subject treaty is 100% of this reduced RLPS amount (i.e., [50-

**Example 9:**

The excess over the retention level is ceded to a YRT pool via Treaty A and 80% of the remainder is ceded to a single captive via a Subject Treaty.

		<b>Input value!</b>			
Block is 100% of the risks on all policies covered by Subject Treaty:					
Statutory Reserve on Entire Block:		100			
RLPS for Entire Block (via Actuarial Method):		50			
	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
Treaty A:	YRT	Exempt	Net Amt at Risk over Retention Level.	5.00	<= 1/2 c <sub>x</sub>
<b>Subject Treaty:</b>	CO	Non-Exempt	80% of the risk not ceded via A.	76.00	\$19 statutory reserve retained.
Total Statutory Reserve Ceded:				81.00	\$19 statutory reserve retained.

**RLPS for Subject Treaty:            36.00    = (50 - 5) \* 80%**

**Explanation:**    Since the YRT pool cession of the excess over retention is for all of the block, then the first adjustment to the RLPS is for this cession (i.e., \$5 credit for Treaty A not to exceed 1/2 c<sub>x</sub>). The second adjustment is for cession to the captive of only 80% of the risks remaining (i.e., adjustment of the remaining RLPS pro rata; [50-5] \* 80%).

**Example 10:**

A block of policies is written 70/30 with a joint venture partner. Partner's share (30%) is ceded via Treaty A. For the remaining risk (70%), the excess over the company's retention level is ceded to a YRT pool via Treaty B, and the remainder is all ceded to single captive via a Subject Treaty.

**Input value!**

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
Treaty A:	CO	Exempt	30% of risk to partner.	30.00	
Treaty B:	YRT	Exempt	Net Amt at Risk over Retention Level.	3.50	<= 1/2 c <sub>x</sub>
<b>Subject Treaty:</b>	CO	Non-Exempt	100% of risk less that ceded by A & B.	66.50	= (70% of \$100) - \$3.5
Total Statutory Reserve Ceded:				100.00	

**RLPS for Subject Treaty: 31.50 = [(50 \* 70%) - 3.5] \* 100%**

**Explanation:** The adjustment for the 30% cession to the partner is first applied (i.e., 50 \* 30%). Second, the adjustment for the excess over retention to the YRT pool is made (i.e., \$3.50 which is the statutory reserve credit for Treaty B, which does not exceed 1/2 c<sub>x</sub>). Since 100% of remainder is ceded to captive, then the RLPS for the subject treaty is 100% of this reduced RLPS.

**Example 11:**

A block of policies is written 70/30 with a joint venture partner. First the excess over the company's retention level is ceded to a YRT pool via Treaty A. Then the Partner's share (30% after the YRT cession) is ceded via Treaty B. The remaining risk (70% after the YRT cession) is all ceded to single captive via a Subject Treaty.

Input value!

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

	Type	EX/Non-EX	Amount Ceded	Statutory Reserve Ceded	Comments
Treaty A:	YRT	Exempt	Net Amt at Risk over Retention Level.	5.00	$\leq 1/2 c_x$
Treaty B:	CO	Exempt	30% of risk to partner after YRT (Treaty A).	28.50	$= (30\% \text{ of } \$100) - \$5$
<b>Subject Treaty:</b>	CO	Non-Exempt	100% of risk less that ceded by A & B.	66.50	$= (70\% \text{ of } \$100) - \$5$
Total Statutory Reserve Ceded:				100.00	

**RLPS for Subject Treaty:** 31.50 =  $(50 - 5) * 70\%$

**Explanation:** Since the YRT pool cession of the excess over retention is for the entire block, then the first adjustment to the RLPS is for this cession (i.e., \$5 credit for Treaty A not to exceed  $1/2 c_x$ ). Then the remaining RLPS (i.e.,  $[50-5]$ ) is adjusted for the 70/30% split between the partner and the captive and since 70% of remainder is ceded to captive, the final RLPS is 70% of

**Example 12:**  
 Treaty.

Input value!

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

Type	EX/Non-EX	Amount Ceded	Statutory Reserve Ceded	Comments	
Subject Treaty:	-	Non-Exempt	Secondary guarantee only.	80.00	\$20.

Total Statutory Reserve Ceded:

80.00

\$20 statutory reserve retained.

**RLPS for Subject Treaty: 30.00 = (50 - 20) \* 100%**

**Explanation:** The RLPS is calculated using the Actuarial Method applied to all risks under the Covered Policies, including the ceded secondary guarantee (i.e. \$50). It may then be reduced by the statutory reserve retained by the ceding insurer on the Covered Policies (i.e. \$20).

**Example 13:**

For a block of ULSG policies, the excess over the retention is ceded to a YRT pool via Treaty A and the Secondary Guarantee only is then ceded to a single captive via Subject Treaty.

		<b>Input value!</b>		
Block is 100% of the risks on all policies covered by Subject Treaty:				
Statutory Reserve on Entire Block:		100		
RLPS for Entire Block (via Actuarial Method):		50		
	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>
				<u>Comments</u>
Treaty A:	YRT	Exempt	Net Amt at Risk over Retention Level.	5.00
				<= 1/2 c <sub>x</sub>
<b>Subject Treaty:</b>	-	Non-Exempt	Secondary guarantee only.	80.00
				\$20.
Total Statutory Reserve Ceded:				85.00
				\$15 statutory reserve retained.

**RLPS for Subject Treaty:**      **30.00**      = (50 - 15 - 5) \* 100%

**Explanation:**      The RLPS is calculated using the Actuarial Method applied to all risks under the Covered Policies, including the ceded secondary guarantee (i.e. \$50). It may then be reduced by the statutory reserve retained by the ceding insurer on the Covered Policies (i.e. \$15) as well as by the reduction pursuant to the cession of retained mortality risk to the YRT pool not to exceed 1/2 c<sub>x</sub> (i.e. \$5). Note, however, that the retained statutory reserve is also reflective of the cession to the YRT pool (i.e. \$20-5). Therefore the retained amount is 15 and RLPS = 30 = 50-15-5.

**Example 14:**

For a block of ULSG policies, the excess over the retention is ceded to a YRT pool via Treaty A and the Secondary Guarantee only is then ceded to two captives via Subject Treaty #1 (60%) and via Subject Treaty #2 (40%).

**Input value!**

Block is 100% of the risks on all policies covered by Subject Treaty:

Statutory Reserve on Entire Block:

100

RLPS for Entire Block (via Actuarial Method):

50

	<u>Type</u>	<u>EX/Non-EX</u>	<u>Amount Ceded</u>	<u>Statutory Reserve Ceded</u>	<u>Comments</u>
Treaty A:	YRT	Exempt	Net Amt at Risk over Retention Level.	5.00	<= 1/2 c <sub>x</sub>
<b>Subject Treaty #1</b>	-	Non-Exempt	Secondary guarantee only (\$80 * 60%).	48.00	\$20.
<b>Subject Treaty #2</b>	-	Non-Exempt	Secondary guarantee only (\$80 * 40%).	32.00	
Total Statutory Reserve Ceded:				85.00	\$15 statutory reserve retained.

**RLPS for Subject Treaty #1:**      **18.00**      = (50 - 15 - 5) \* 60%

**RLPS for Subject Treaty #2:**      **12.00**      = (50 - 15 - 5) \* 40%

**Explanation:**      The RLPS is calculated using the Actuarial Method applied to all risks under the Covered Policies including the ceded secondary guarantee (i.e., \$50) and may be reduced by the statutory reserve retained by the ceding insurer on the Covered Policies, reflective of any reduction pursuant to the cession of any mortality risk on a yearly renewable term basis in an exempt arrangement, (i.e., \$15), and further reduced by the reserve credit for the YRT arrangement not to exceed 1/2 c<sub>x</sub> (i.e., \$5). Thus, the result would be (50-15-5) split 60%/40% between the two subject treaties.

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To: Hon. Dave Jones, Commissioner, California Dept. of Insurance and Chair, Reinsurance (E) Task Force  
Dan Schelp, NAIC Managing Counsel; Josh Arpin, Accounting and Reinsurance Policy Advisor, FRS

From: Kevin Fry, Chair, Valuation of Securities (E) Task Force  
Bob Carcano, Senior Counsel, Investment Analysis Office

Re: Proposal to Expand the NAIC Bank List to Include Eligible Non-Bank Financial Institutions

Date: February 24, 2016

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**1. Introduction** – At the request of the Reinsurance (E) Task Force (RTF) the Valuation of Securities (E) Task Force (VOSTF) directed the SVO to develop criteria to include non-bank financial institutions (NBFIs) on the NAIC Bank List that reflected the influence of regulation on financial strength.<sup>1</sup> The SVO reported its research at the VOSTF’s 2015 Summer National Meeting and presented its final report at the 2015 Fall National Meeting. The final report was received and released for a 60 day comment period - no comments were received. The report was discussed on a Feb. 22, 2016 conference call. The SVO report and proposal were adopted for the purpose of referral to the RTF.

**2. Referral** – The SVO proposal is contained in Attachment One of the report (refer to pages 2-5 of Attachment 7). Attachment Two summarizes the issues considered and conclusions reached by the SVO (refer to Attachment 8). The full research report (which is available upon request) follows the summary and other attachments translate NRSRO methodology to show how regulation is reflected in NRSRO credit analysis. If the RTF approves the SVO proposal the VOSTF requests that it recommend that the VOSTF implement the proposal.

**3. Synopsis of Proposal** - The SVO proposal is built on three core recommendations:

- Today, the credit rating is only used to determine eligibility. The credit rating should be used more fully. This is possible by defining an acceptable credit rating as one: a) issued by an NRSRO; b) derived using a methodology (identified in the P&P Manual) that the SVO confirms evaluates NBFIs and banks against the same analytical framework and standards; c) *comprehensively evaluates the effectiveness of regulation of the specific institution* and d) generates a credit rating for the institution’s letter of credit or senior debt obligation.

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<sup>1</sup> In 08/2014 the VOSTF asked the RTF if NBFIs should be added to the List to conform to the definition of qualified US financial institution in the NAIC Credit for Reinsurance Model Law. The RTF agreed on 10/29/2014, if SVO found NBFIs were as well regulated as banks. SVO research in a report dated 12/22/2014 confirmed that the definition in the Model Law was consistent with the federal - state banking regulatory process. The SVO research report was presented to the RTF and VOSTF on a call held 02/24/2015 and the report was referred to the RTF and discussed at its 2015 Spring National Meeting. Some RTF members were concerned that bank regulation made banks stronger than NBFIs. RTF asked that SVO develop criteria to include NBFIs that considered the role of regulation. The proposal transmitted today responds to this request.

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- NBFIs should be listed because: 1) statistical analysis shows that the historical default rate for banks (1920–2014) and NBFIs (1971–2014) is almost identical; 2) NBFIs applicants would be lenders who typically adopt bank business models and 3) NBFIs could only apply if they have been assigned an acceptable credit rating.
- Today the SVO performs a clerical function: it adds banks if they meet a minimum standard and removes them when they don't. SVO should analytically monitor the credit quality of institutions and provide regulators and insurers notice when credit quality deteriorates toward the minimum. This recommendation reflects analysis *that during the most recent financial crisis banks on the list failed at close to a 20 percent rate*.

**Attachment One**  
**Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office***

**Part Six – List of Qualified U.S. Financial Institutions**  
**(Issuers of Letters of Credit as Collateral in Reinsurance Arrangements)**

**Section 1. Regulatory Purpose and Objectives**

The List of Qualified U.S. Financial Institutions established in this Part Six implements Section 3 C. (1) and Section 4 A. of the NAIC *Credit for Reinsurance Model Law* (#785) (Model Law).

Section 3 C. (1) of the Model Law permits an asset or a reduction from liability for reinsurance ceded by a domestic insurer to an assuming insurer. The asset or reduction may be in an amount held by or on behalf of the ceding insurer, including security in the form of a LOC issued or confirmed by a qualified U.S. financial institution. Section 4A of the Model Law defines the term “qualified U.S. financial institution,” which is hereby incorporated by reference.

The List of Qualified U.S. Financial Institutions is a compilation of the names of banks and nondepository lenders (financial institutions) that have applied to the NAIC to be identified as issuers of LOCs in support of reinsurance arrangements under the Model Law or state law provisions based on the Model Law.

The placement of the name of a financial institution on the List of Qualified U.S. Financial Institutions indicates that the SVO has verified that the applicant meets the financial and other eligibility standards specified in this part and that the financial institution has agreed to provide the SVO with any information necessary to permit the SVO to evaluate whether the financial institution continued to meet the eligibility standards specified in this Part.

The List of Qualified U.S. Financial Institutions is maintained for the use of state insurance regulators administering credit for reinsurance provisions in state law based on the Model Law and may also be used by insurance companies to identify financial institutions willing to support reinsurance arrangements as identified in Section 3 C. (1) and Section 4A of the Model Law.

The List of Qualified U.S. Financial Institutions implemented under this Part is not intended to be used for any other purpose or by any other person or entities. The placement of the name of a financial institution on the List of Qualified U.S. Financial Institutions is not an opinion as to any aspect of the financial institution’s operations, the appropriateness of doing business with the financial institution or the suitability or unsuitability of any financial institution on the list to serve as a provider of credit enhancement for securities transactions.

**Section 2. Directive to Compile the List of Qualified U.S. Financial Institutions**

The SVO shall compile the List of Qualified U.S. Financial Institutions in accordance with the procedures and instructions provided in this Part Six.

**Section 3. List of Nationally Recognized Statistical Rating Organizations**

**a. Establish a List of Nationally Recognized Statistical Rating Organizations** – The SVO shall establish a List of Nationally Recognized Statistical Rating Organizations (NRSROs), as specified in this Section, to be used to administer the List of Qualified U.S. Financial Institutions. The SVO shall place on the List of NRSROs any credit rating organization that:

- 1) Is registered with the U.S. Securities and Exchange Commission (SEC) as an NRSRO, as that term is defined in the applicable federal statute.
- 2) Has criteria and methodology for assigning credit ratings to banks and nondepository lenders—sometimes hereafter referred to as nonbank financial institutions (NBFIs)—that the SVO has confirmed is consistent with the needs of the NAIC for purposes of the Model Law and which at a minimum:

- (i) Utilizes an analytical framework that assesses the incremental risk of banks and NBFIs (i.e., nondepository lenders) relative to each other and incorporates as criteria in its bank and NBFI methodology the nature and robustness of regulation, access to the central bank for contingent liquidity and the stability of funding.
- (ii) Results in the expression of an opinion of the bank's or NBFI's likelihood of default on an LOC obligation and or long-term debt obligation.
- (iii) Results in the assignment of a stable credit rating, defined to mean that the NRSRO considers it unlikely that the assigned credit rating would be downgraded within one year under the moderate stress scenario specified in its credit rating criteria.

**b. Procedure**

- (i) The SVO may place an NRSRO on the List of NRSROs either on its own initiative or upon the application of the NRSRO, after confirming that as an analytical matter and in its sole discretion the NRSRO's criteria and methodology meets the minimum standards specified above and is otherwise consistent with the needs of the NAIC for the purposes of the Model Law. The SVO may delete the name of an NRSRO if, as an analytical matter and in its sole discretion, it determines that changes in the NRSRO criteria and or methodology no longer meet specified minimum standards or are otherwise no longer consistent with the needs of the NAIC for purposes of the Model Law.
- (ii) The SVO shall place on the List of NRSROs the name of the NRSRO, the titles and dates of publication of the criteria, and methodology for banks and NBFIs that the SVO has determined will provide the NAIC a credit rating suitable for the administration of aspects of credit risk pertaining to reinsurance arrangements under the Model Law.

**c. Policy and Legal Disclosure Pertaining to the List of NRSROs** – The NAIC uses publicly available credit ratings, when available, as one component of the services it provides to state insurance regulators concerned with financial solvency monitoring of insurance company investments. In adopting or in implementing the procedure described in this part, the NAIC acts solely as a private consumer of publicly available credit ratings. The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources—for example, the resources of the SVO. The Valuation of Securities (E) Task Force has established the procedure specified in this section solely to ensure that the NAIC can avail itself of publicly available credit rating opinions for the purposes identified in this part.

The NAIC is not selecting, approving or certifying NRSROs or other rating organizations or distinguishing among them for any public or policy purpose whatsoever. Nor is the NAIC endorsing the credit rating or analytical product of any NRSRO or distinguishing between NRSROs for any specific public purpose. The NAIC disclaims any authority to regulate NRSROs.

**Section 4. List of Qualified U.S. Financial Institutions**

**a. Application to be on the List of Qualified U.S. Financial Institutions**

**(i) Process** – A representative of a financial institution may apply to have the name of the financial institution added to the List of Qualified U.S. Financial Institutions by completing and submitting to the SVO the QUSFI application and paying the applicable fee. The QUSFI application can be obtained at this Web address: **NOTE**

The QUSFI application requires that the applicant:

- Describe whether it is a bank or nondepository lender, as well as identify its federal and state regulators and corporate affiliations.
- Represent that it meets the definition of a qualified U.S. financial institution as specified in the Model Law (as printed in the Application).
- Describe its experience in the issuance of letters of credit.

- Provide evidence of a credit rating grade, assigned by an NRSRO on the List of NRSROs developed using the criteria and methodology specified in the List of NRSROs.
- Provide initially and agree to provide on a periodic basis the financial information identified in the application as the financial institution's profile and metrics to enable the SVO to monitor the financial institution's credit rating and financial profile. (The best method of data collection and the most appropriate data sources to be used for this information are still being determined and thus may change based upon availability and system modifications.)

**b. Procedure**

**(i) Initial Application** – An application is submitted to the SVO. (The mechanics of the application process and of required information has not been finalized). Upon receipt, the SVO shall review the application and supporting documentation and communicate in a writing its determination whether the application has been approved and whether the name of the financial institution will be placed on the List of Qualified U.S. Financial Institutions.

**(ii) Annual Updates** – On an annual basis, the SVO shall contact all financial institutions whose names shall then appear on the List of Qualified U.S. Financial Institutions by mail, requesting each financial institution to indicate whether it requests to be maintained on the List of Qualified U.S. Financial Institutions by submitting the annual update portion of the application and renewal fee or drop off the list.

**(iii) Failure to Timely Respond** – The failure to submit a response to this inquiry and or to provide the required annual update application documents and or the renewal fee shall be interpreted as a request that the name of the financial institution be removed from the List of Qualified U.S. Financial Institutions. The SVO shall accordingly remove the name of the financial institution from the List of Qualified U.S. Financial Institutions without further communication or notice.

**Section 5. Eligibility Standards to Be Placed on the List of Qualified U.S. Financial Institutions**

**a. Eligibility Standards** – The SVO shall place on the List of Qualified U.S. Financial Institutions the name of any financial institution that is:

(i) A domestic financial institution authorized to issue or confirm LOCs that have been assigned a credit rating from an NRSRO on the List of NRSROs generated pursuant to the criteria and methodology specified on the List of NRSROs for that NRSRO of “Baa/BBB” or better for its LOC or long-term debt obligation.

(ii) A U.S. branch or agency of a foreign financial institution:

(A) Authorized to issue LOCs for reinsurance.

(B) That is a part of a foreign institution that (a) has attained a credit rating from an NRSRO on the List of NRSROs generated pursuant to the criteria and methodology specified in the List of NRSROs for that NRSRO of “Baa/BBB” or better for its LOC or long-term debt obligation.

(C) Domiciled in a country with a sovereign debt rating of (a) “Aa/AA” for long-term debt and/or “P1/A1” for short-term debt by an NAIC credit rating provider (CRP).

**Section 6. SVO Monitoring of Movements in the Credit Quality of Financial Institution on the List of Qualified U.S. Financial Institutions**

**a. SVO Monitoring** – The SVO shall monitor the credit quality of financial institutions on the List of Qualified U.S. Financial Institutions by:

(i) Monitoring NRSRO activity relative to the financial institution's assigned LOC or long-term debt obligation credit rating, including whether the NRSRO considers the rating to be stable or has indicated that the financial institution may be placed on Negative Outlook.

(ii) Conducting independent analysis of the financial institution's profile and metrics. The objective of the independent analysis is to monitor the potential for and actual deterioration of the credit quality of a financial institution on the List of Qualified U.S. Financial Institutions in order to provide notice to the regulatory community and insurers so they may consider the implications of the noted credit deterioration for reinsurance arrangements with the financial institution, if any.

**b. Outline of Methodology** – On a quarterly (or semi-annual) basis, the SVO shall:

(i) Calculate the following financial ratios or items for each financial institution on the List of Qualified U.S. Financial Institutions:

- Total assets.
- Total equity capital.
- Cash from operations.
- Total debt.
- Earnings before interest, taxes, depreciation and amortization (EBITDA).
- Interest expense.

(ii) Determine and evaluate the following five primary data points and ratios. (Annually, the NAIC SVO will review industry data to determine if these benchmarks should be adjusted to reflect changes in market conditions.)

- Total assets must remain at greater than \$55 billion.
- Total equity capital must remain at greater than \$5 billion.
- Annualized cash from operations must remain at greater than \$2 billion.
- Debt to capital ratio must remain below 55%.
- EBITDA to interest coverage ratio must remain at greater than 8.5 times.

**c. Notice of Credit Deterioration** – The SVO shall provide notice to the NAIC Reinsurance (E) Task Force and state insurance regulators more generally and to insurers about the credit quality of financial institutions on the List of Qualified U.S. Financial Institutions as described below.

(i) If a financial institution is rated by an NRSRO at “A-/A3” or better and the SVO determines that a financial institution no longer meets one or more of the financial standards specified above, the SVO will monitor the institution to determine if the NRSRO takes any rating action against the institution.

(ii) If the SVO determines that a financial institution on the List of Qualified U.S. Financial Institutions rated below “A-/A3” by an NRSRO no longer meets one or more of the financial standards specified above or that it has been placed on Negative Outlook or Negative Watch by an NRSRO, the SVO shall perform a more detailed review of the financial condition of the institution. If the SVO determines that the noted credit deterioration suggests that the financial institution may soon no longer meet the required minimum, the SVO will place the name of the financial institution on the Watch List, signifying that the financial institution will not be allowed to renew participation on the financial institution list.

(iii) If a financial institution on the List of Qualified U.S. Financial Institutions is downgraded below “BBB-/Baa3” by an NRSRO, the SVO shall remove the name of the financial institution from the List of Qualified U.S. Financial Institutions.

## **Section 6. LOC Requirements Under the Model Law**

**a. Not an SVO Activity** – The SVO does not review individual LOCs, trust agreements or reinsurance arrangements. The placement of the name of a financial institution on the List of Qualified U.S. Financial Institutions does NOT imply that the Model Law requirements pertaining to LOCs, trust agreements or reinsurance arrangements have been met.

**b. Information** – For information about LOC requirements, see Sections 10 A. (3) and Section 12 of the NAIC *Credit for Reinsurance Model Regulation* (#786).



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**MEMORANDUM**

TO: Hon. John M. Huff, Chair, Reinsurance (E) Task Force and Director of Insurance for the State of Missouri  
Stewart Guerin, Chair, Valuation of Securities (E) Task Force  
Members of the Reinsurance (E) Task Force and Members of the Valuation of Securities (E) Task Force

FROM: Bob Carcano, Senior Counsel, NAIC Investment Analysis Office; Frank Meyers, Senior Analyst, SVO; Robert Johnson, Analyst I, SVO

CC: Charles Therriault, Director, NAIC Securities Valuation Office; Dan Daveline, Director, NAIC Financial Regulatory Services (FRS); Joshua Arpin, FRS, Accounting and Reinsurance Policy Advisor; Gail Sciacchetano, NAIC Deputy General Counsel

DATE: October 7, 2015

RE: Recommendations for an NAIC List of Qualified U.S. Financial Institutions (List)

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**1. Executive Summary** – The SVO was asked to develop List criteria for nonbank financial institutions (NBFIs) if it determined that NBFIs were regulated at least as well as banks. Legal and credit analysis indicates that prudential regulation is not so integral to a bank’s ability to pay a letter of credit (LOC) that its absence requires exclusion of NBFIs. While it may be possible to create LOC standards that account for different styles of regulation, it would be expensive to do and if successful, creates reliance on new federal regulatory constructs. The continued use of credit ratings is recommended. However, an acceptable credit rating should be redefined as: 1) one issued by a Nationally Recognized Statistical Rating Organization (NRSRO); 2) derived under a specified analytical methodology that evaluates NBFIs and banks in the same framework and against the same standards; 3) includes a comprehensive evaluation of the effectiveness of the regulation of the specific institution as part of the rating process; and 4) generates a credit rating that applies specifically to the institution’s LOC or senior debt obligation. The SVO recommends that current credit rating grade(s) be retained. In a one-year period, investment grade ratings will remain investment grade 93.5% of the time, with investment grade institutions defaulting less than 0.06% within one year. The SVO should monitor the credit quality of institutions on the List. During the most recent financial crisis, approximately 20% of banks fell below investment grade or failed while on the List. We recommend that NBFIs be eligible to be added to the List. While different styles of regulation place different emphasis on an institution’s ability to pay longer-term obligations, we found no evidence that non-prudential systems of regulation were inadequate in this respect. We did find that the historical default rate for banks (1920–2014) and for NBFIs (1971–2014) is almost identical. More importantly, we found evidence of an increasing and accelerating convergence of business models: i.e., NBFIs become lenders by obtaining banking licenses or creating banking subsidiaries. This strongly indicates NBFIs applicants would be lenders whose business models closely resemble that of banks. Attachment One unifies these recommendations and other proposed changes into an amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). The text that follows this Executive Summary is a condensed version of the SVO’s analysis. A full analytical report is included as a separate report. Attachment Two through Attachment Six summarize the NRSRO methodologies’ characteristics we analyzed and that further NAIC objectives.

**2. Analysis and Recommendations**

*a. Bank Regulation* – Banks are widely perceived to be financially stronger than NBFIs due to three operational attributes in the bank business model. Banks take deposits, which are considered a more stable funding source. Most NBFIs obtain funding by borrowing and issuing securities, which are considered to be less stable funding sources. But a bank may have unstable funding, and an NBFIs may have stable funding. Banks are prudentially regulated, and prudential regulation is considered a stronger system of regulation because it sets capital and credit risk standards. NBFIs are not prudentially regulated. Prudential regulation does not mean banks will maintain adequate levels of capital or adequately manage exposure to credit risk. Careful management can permit banks and NBFIs to maintain adequate capital and limit credit risk. Banks have access to the central bank facility, which provides contingent liquidity and mitigates investor runs. Access to the central bank

is considered a necessary feature of the banking business model. NBFIs are unlikely to have access to central bank facilities, but they may have access to corporate group support and may limit the need for contingent liquidity by business and management practices. The credit ratings and credit rating methodologies we recommend be used by the NAIC evaluate many aspects of regulation, including: 1) macroeconomic risk common to all financial institutions in the country; 2) stability of funding; 3) efficiency of capital; 4) management of credit risk; and 5) contingent liquidity available to banks and NBFIs.

*b. Regulation as Performance Criteria* – The sheer bulk of institution-specific rules and regulations, the complexity of how financial institutions actually conduct business and the subjective nature of assessments of the robustness of regulation indicate that regulation is not a useful indicator of the likelihood that a financial institution will be able to pay an LOC obligation. Different systems of regulation are concerned with the risks posed by the institution’s activity. Different regulation systems may differ in the level of assurance that an institution can pay longer-term obligations. But, there is no reasonable basis to conclude that the level of assurance provided by a different system of regulation that the institution can meet longer-term financial obligations is inadequate.

*c. A List Based on Federal Regulation* – It may be possible to create LOC standards based on differences in federal/international regulation styles. This would entail a significant investment of resources, rely on federal regulatory mechanisms and be less efficient than the properly focused use of credit ratings. Credit ratings were introduced into the List to avoid highly technical and inconclusive legal and bank regulatory analysis of foreign banks. Unlike federal regulators, the NAIC continues to use (not blindly rely on) credit ratings.

*d. The List and the Financial Crisis* – In the period Dec. 31, 2006– Dec. 31, 2013, of the 379 banks placed on the List, 70 banks (approximately 17%) failed, merged, were acquired or closed voluntarily, and 59 of the 70 bank (84%) failed, merged, were acquired or closed in the period of the financial crisis, i.e., 2007–2011. This suggests that credit ratings should be monitored on an ongoing basis.

*e. Legal Definitions and Convergence* – Legal definitions of “bank” and “nonbank” are only of limited use as identifiers of the actual activities in which a specific bank or NBFI is engaged. NRSROs align criteria and methodology to an institution’s activities. Increasing convergence between the finance company and bank business models means NRSROs must often apply bank methodology to an institution legally defined as an NBFI and NBFI methodology to an institution legally defined as a bank. “Convergence” refers to finance companies obtaining banking licenses or creating banking subsidiaries, resorting to deposit funding, or transferring assets and operations into bank subsidiaries.

*f. Default Rates of Banks and NBFIs* – The historical default rate for banks and NBFIs is almost identical: 0.51% (1920–2014) for banks and 0.528% for NBFIs (1971–2014). This reflects that banks and NBFIs are in the same industry and quantifies the meaning, in NRSRO literature, of the statement that banks are only *incrementally* less risky than NBFIs.

*g. Rating Migration for Investment Grade Institutions* – For the time period 1920 – 2014, an investment grade of “Baa3 or higher” would remain investment grade 93.5% of the time within a 1-year time period and 71.5% of the time within a 5-year time period. Institutions rated “investment grade” migrate to non-investment grade 0.3% of the time within one year and 1.1% within five years. Investment grade-rated institutions default less than 0.06% within one year and 0.7% within five years, respectively.

*h. Reflecting Differences in Bank and NBFI Risk* – The proposed credit ratings would be derived under specified analytical frameworks. Standard & Poor’s (S&P) first determines a single “anchor” rating that applies to all banks in the country. The bank anchor rating is lowered to reflect the greater (incremental) industry risk (of default) associated with NBFIs to generate a single anchor rating for all NBFIs in the country. The anchor rating for a specific bank and a specific NBFI is adjusted upward to reflect entity-specific strengths and weaknesses. Moody’s Investors Service’s (MIS) approach is similar.

*i. Credit Ratings Account for Differences in Regulation* – In the first step of its methodology, S&P considers: 1) the type, quality and effectiveness of regulation; 2) the regulator’s track record; 3) the role of nonbanks in the country; 4) how banks are funded; 5) the role of the central bank; and 6) revenue stability. In the second step, S&P evaluates the institution’s capital, funding and liquidity against applicable regulatory standards. MIS’ approach is broadly similar.

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