Date: 3/2/20

Conference Call

REINSURANCE (E) TASK FORCE
Wednesday, March 11, 2020
1:30 p.m. Eastern/12:30 p.m. Central/11:30 a.m. Mountain/10:30 a.m. Pacific

ROLL CALL

Chlora Lindley-Myers, Chair Missouri James J. Donelon Louisiana
Raymond G. Farmer, Vice Chair South Carolina Eric A. Cioppa Maine
Jim L. Ridling Alabama Gary Anderson Massachusetts
Lori K. Wing-Heier Alaska Matthew Rosendale Montana
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Doug Ommen Iowa Michael S. Pieciak Vermont
Vicki Schmidt Kansas Scott A. White Virginia
Sharon P. Clark Kentucky Mark Afable Wisconsin

NAIC Support Staff: Jake Stultz/Dan Schelp

AGENDA

1. Discuss whether the 2019 revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) should be an Accreditation Standard for Risk Retention Groups—John Rehagen (MO)
   a. Memorandum Regarding Applicability to Risk Retention Groups Attachment A

2. Discuss whether compliance with Actuarial Guideline XLVIII (AG 48) should be considered “substantially similar” to the Term and Universal Life Insurance Reserve Financing Model Regulation (#787) for accreditation purposes—John Rehagen (MO)
   a. Feb. 5 exposure documents Attachment B
   b. Comment letters Attachment C

3. Discuss Any Other Matters Brought Before the Task Force—John Rehagen (MO)

4. Adjournment

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MEMORANDUM

To: Financial Regulation Standards and Accreditation (F) Committee

From: NAIC Staff

Date: February 12, 2020

Re: 2011 & 2019 Revisions to Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786)—Applicability to Risk Retention Groups (RRGs)

Executive Summary

On June 25, 2019, the NAIC Executive (EX) Committee and Plenary unanimously adopted revisions to the NAIC Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786). These revisions were intended to incorporate the relevant provisions of the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” (Covered Agreement), which was signed on Sept. 22, 2017. At the 2019 Fall National Meeting, the Financial Regulation Standards and Accreditation (F) Committee adopted these revisions to the Reinsurance Ceded accreditation standard effective Sept. 1, 2022, for consideration by the Executive (EX) Committee and Plenary for final adoption at the Spring National Meeting.

The purpose of this memorandum is to clarify the applicability of these revisions to risk retention groups (RRGs) organized as captives. The recommendation to this Committee is that the 2019 revisions to Model #785 and Model #786, as well as the 2011 revisions establishing certified reinsurers and qualified jurisdictions (which became applicable as an accreditation standard Jan. 1, 2019), also should be made applicable to RRGs.

Risk Retention Groups Organized as Captives

Article 3 (Reinsurance) of the Covered Agreement is applicable to ceding insurers, which Article 2(j) defines as “an undertaking which is authorized or licensed to take up or engage in the business of direct or primary insurance.” This would arguably include RRGs that are organized or incorporated by states as captive insurers. Reinsurance Ceded is part of the Part A accreditation requirements for RRGs, and requires that state law should contain Model #785 and Model #786, or substantially similar laws. The primary difference between the current reinsurance accreditation standard for RRGs is that “a state’s laws and regulations may allow RRGs to take credit for reinsurance without posting collateral in circumstances not contemplated by the Credit for Reinsurance Model Law and Regulation. For such cases, the Accreditation Interlineations include ‘Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers’ and a state’s laws and regulations must comply with the guidelines in order to be considered substantially similar with this standard.”

NAIC staff has reviewed the laws and regulations with respect to the fifteen (15) NAIC jurisdictions which currently license multi-state RRGs as captive insurers (AL, AZ, CO, DE, DC, HI, KY, ME, MT, NV, NC, OK, SC, TN and VT), and each meets the current Reinsurance Ceded accreditation standard in a very similar manner. First, each
states’ laws require that an RRG must be licensed as a captive insurer (and in some instances, a specific type of captive insurer) subject to its captive insurance laws. Second, the captive insurance laws generally exempt captive insurers from the general laws with respect to traditional insurers, except as is otherwise specified in statute. Finally, the statutes make RRGs that are licensed as captive insurers subject to the state’s credit for reinsurance laws, either generally (e.g., an RRG licensed as a captive insurer must comply with all of the laws, rules, regulations and requirements applicable to insurers chartered and licensed in the state) or specifically (e.g., an RRG licensed as a captive insurer must comply with the laws specified in this chapter, including specifically the credit for reinsurance laws). We also reviewed the proposed legislation of the five states currently considering adoption of the 2019 revisions to the models (ME, OK, SC, TN & VT), and the proposed legislation would not change this outcome.

Recommendation

NAIC staff recommends that the Committee consider making the 2019 revisions to Model #785 and Model #786 an accreditation standard for RRGs effective Sept. 1, 2022, with enforcement of the standard to commence Jan. 1, 2023. Staff further recommends that the 2011 revisions to the models relating to certified reinsurers and qualified jurisdictions also be made a part of the accreditation standard, because the 2019 revisions are in large part based on these earlier revisions. Finally, we recommend that the changes in the attached redlined accreditation standard be adopted as the new accreditation standard for reinsurance ceded to RRGs. [The Risk Retention Group (E) Task Force met on March 2, and approved these recommendations.]
TO: Reinsurance (E) Task Force

FROM: NAIC Staff

RE: Comparison of Term and Universal Life Insurance Reserve Financing Model Regulation (#787) and Actuarial Guideline XLVIII

DATE: February 5, 2020

Executive Summary

At the 2019 Fall National Meeting, the Financial Regulation Standards and Accreditation (F) Committee adopted the Term and Universal Life Insurance Reserve Financing Model Regulation (#787) as an accreditation standard. The NAIC Executive (EX) Committee and Plenary are expected to consider it for final adoption at the Spring National Meeting, to be effective Sept. 1, 2022. On its conference call on Jan. 29, the Reinsurance (E) Task Force discussed whether compliance with Actuarial Guideline XLVIII (AG 48) should be considered “substantially similar” to Model #787 for accreditation purposes. Acting Chair John Rehagen (MO) directed NAIC staff to distribute a memorandum comparing the significant differences between AG 48 and Model #787 for a 21-day public comment period requesting comments on whether compliance with AG 48 should be considered substantially similar to Model #787.

2017 Recommendation on Accreditation

In its memorandum dated August 24, 2017, the Reinsurance Task Force recommended that “a state’s adoption of AG 48 will serve to satisfy this accreditation standard until such time that the state adopts the significant elements of Model #787.” (Attachment A). This recommendation was based on an expedited effective date for the accreditation standard of January 1, 2020. The Task Force recognized that “meeting the expedited date may not be feasible for some states in instances due, in whole or part, to other legislative priorities of the states. It is the recommendation of the Task Force that, in such cases, a state’s compliance with AG 48 should be considered as satisfactory to the Financial Regulation Standards and Accreditation (F) Committee as substantial compliance with Model #787.”

At that time the Committee deferred its consideration of Model #787 as an accreditation standard due to concerns expressed with respect to the impending Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement), which was signed on September 22, 2017. In 2017 AG 48 was amended “to draft AG 48 to make it as consistent as possible with the provisions of Model #787.”

Comparison of Model #787 and AG 48

The primary difference between AG 48 and Model #787 are the consequences to an insurer if the requirements of either are not met. Paragraph 6B(1) of AG 48 (Attachment B) provides, as follows:
B. Qualified Actuarial Opinion; Remediation

(1) The appointed actuary of the ceding insurer performing the analysis required by Section 6A above must issue a qualified actuarial opinion as described in Section 6.D. of the AOMR or Section 3A(10) of VM-30 of the Valuation Manual, as applicable, unless:

(a) The requirements of Section 6A(1) and 6A(2) were fully satisfied as of the valuation date as to such reinsurance treaty; or

(b) Any deficiency has been eliminated before the due date of the Annual Statement to which the valuation date relates through the addition of Primary Security and/or Other Security, as the case may be, in such amount and in such form as would have caused the requirements of Section 6A(1) and 6A(2) to be fully satisfied as of the valuation date; or

(c) The ceding insurer has established a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held pursuant to Section 6A(1).

[Emphasis Added]. A Drafting Note to this paragraph provides that the “remediation option set forth in Section 6B(1)(c) mirrors that set forth in Model #787.” In addition, the following proposals related to the XXX/AXXX Reinsurance Framework were adopted by the Capital Adequacy (E) Task Force on its June 30, 2015, conference call:

1. 2014-33-L-Mod Qualified Actuarial Opinion – This proposal modifies the interrogatory on LR027 Interest Rate Risk and Market Risk. This interrogatory allows companies submitting an unqualified opinion to receive a one-third reduction in the factors. It was modified to prevent an opinion qualified solely due to the direction in AG 48, which is line of business specific, from impacting all lines of business.

2. 2014-35b-L-Mod Primary Securities Shortfall – This proposal adds a new schedule showing the primary security shortfall by individual cession. The cumulative amount of primary security shortfall, with no offset for any surpluses, is then taken as a dollar-for-dollar addition to the reporting company’s Authorized Control Level.

3. 2014-42-L-Mod RBC Shortfall – This proposal adds a new schedule which shows the RBC calculation by individual captive. The cumulative amount of RBC shortfalls, with no offset for any surpluses, is then taken as a dollar-for-dollar reduction to the reporting company’s Total Adjusted Capital.

In summary, the Qualified Actuarial Opinion under paragraph 1-above does not constitute an RBC penalty in and of itself, but is a required element to trigger the RBC penalty under paragraph 2 and is applicable only with respect to AG 48. The RBC penalty under paragraph 3 is applicable to both noncompliance with AG 48 and Model #787. Section 7B of Model #787 then provides the following additional consequences for failure to follow its requirements:
B. Requirements at Inception Date and on an On-going Basis; Remediation

(1) The requirements of Section 7A must be satisfied as of the date that risks under Covered Policies are ceded (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Under no circumstances shall a ceding insurer take or consent to any action or series of actions that would result in a deficiency under Section 7A(3) or 7A(4) with respect to any reinsurance treaty under which Covered Policies have been ceded, and in the event that a ceding insurer becomes aware at any time that such a deficiency exists, it shall use its best efforts to arrange for the deficiency to be eliminated as expeditiously as possible.

(2) Prior to the due date of each Quarterly or Annual Statement, each life insurance company that has ceded reinsurance within the scope of Section 3 shall perform an analysis, on a treaty-by-treaty basis, to determine, as to each reinsurance treaty under which Covered Policies have been ceded, whether as of the end of the immediately preceding calendar quarter (the valuation date) the requirements of Sections 7A(3) and 7A(4) were satisfied. The ceding insurer shall establish a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held pursuant to Section 7A(3), unless either:

(a) The requirements of Section 7A(3) and 7A(4) were fully satisfied as of the valuation date as to such reinsurance treaty; or

(b) Any deficiency has been eliminated before the due date of the Quarterly or Annual Statement to which the valuation date relates through the addition of Primary Security and/or Other Security, as the case may be, in such amount and in such form as would have caused the requirements of Section 7A(3) and 7A(4) to be fully satisfied as of the valuation date.

[Emphasis added]. Finally, Paragraph 8 of AG 48 provides that it will sunset when a state adopts a regulation substantially similar to Model #787, but will continue to apply only with respect to the limited number of states in which their version of Model #787 applies prospectively only.

Substantially Similar

The NAIC Financial Standards and Accreditation Program provides the following definition of “substantially similar”:

For those standards included in the Part A: Laws and Regulations Standards where the term “substantially similar” is included, a state must have a law, regulation, administrative practice or a combination of the above which addresses the significant elements included in the NAIC model laws or regulations… It is NOT required that states adopt every “significant” element in the interim annual review form by law or regulation. Instead, it is required that the state demonstrate that the law, regulation, administrative practice or a combination of the above enforced by a state insurance department results in solvency regulation that is similar in force and no less effective than the NAIC model law or regulation for that standard.
MEMORANDUM

TO: Financial Regulation Standards and Accreditation (F) Committee

FROM: Reinsurance (E) Task Force

DATE: August 24, 2017

RE: Term and Universal Life Insurance Reserve Financing Model Regulation (#787)

Executive Summary

The NAIC membership adopted the Term and Universal Life Insurance Reserve Financing Model Regulation (#787) at the 2016 Fall National Meeting on Dec. 13, 2016. At that same time, the NAIC membership also adopted revisions to 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) to conform with the provisions of Model #787, effective Jan. 1, 2017. Model #787 establishes uniform, national standards governing reserve financing arrangements pertaining to term life and universal life insurance policies with secondary guarantees, and ensures that funds consisting of primary security and other security are held in the forms and amounts required.

At its meeting on Aug. 7, 2017, the Reinsurance (E) Task Force agreed to submit the following recommendations to the Financial Regulation Standards and Accreditation (F) Committee:

1. Model #787 should be adopted as a new accreditation standard by the NAIC, with significant elements as outlined in Attachment A.

2. The Financial Regulation Standards and Accreditation (F) Committee should consider a waiver in its normal timeline for adoption of an accreditation standard, and expeditiously consider adoption of this standard. The Task Force recommends that the accreditation standard become effective Jan. 1, 2020. The Task Force further recommends that a state’s adoption of AG 48 will serve to satisfy this accreditation standard until such time that the state adopts the significant elements of Model #787.

3. The 2016 revisions to the Credit for Reinsurance Model Law (#785) should be considered acceptable but not required by the states.

In addition to the preceding recommendations, the Task Force is offering the following additional information in order to assist the Financial Regulation Standards and Accreditation (F) Committee in reviewing the proposed accreditation standard for Model #787.
Substantially Similar

The Task Force has recommended in the draft accreditation standard that the “substantially similar” standard be utilized to meet the minimum requirements of the standard. However, the Task Force did note that Drafting Notes to Section 2, Section 3 and Section 5 of Model #785 might suggest a stronger standard of review than “substantially similar.” The Drafting Notes provide, as follows: “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.” [Emphasis added]. In recognition of this, and to assist in review of the actuarial method used to determine the required level of primary security as described in Section 6 of Model #787, the Task Force recommends that the NAIC Legal Division specifically note any material changes in a state’s regulation during an accreditation review for consideration by the Financial Regulation Standards and Accreditation (F) Committee.

State Adoption of AG 48

The Task Force recommends that the accreditation standard become effective on an expedited basis beginning Jan. 1, 2020. However, the Task Force further recognizes that meeting the expedited date may not be feasible for some states in instances due, in whole or part, to other legislative priorities of the states. It is the recommendation of the Task Force that, in such cases, a state’s compliance with AG 48 should be considered as satisfactory to the Financial Regulation Standards and Accreditation (F) Committee as substantial compliance with Model #787. AG 48 became effective Jan. 1, 2015, and became part of the Accounting Practices and Procedures Manual through its inclusion in Appendix C, and has been amended to conform with Model #787 effective Jan. 1, 2017.

2016 Revisions to Model #785

The Task Force does not recommend that the 2016 revisions to Model #785 be included in the proposed accreditation standard. These revisions provide that the commissioner may 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. The revisions to Model #785 also contain a “professional reinsurer exemption” for reinsurers that maintain at least $250 million in capital and surplus when determined in accordance with the Accounting Practices and Procedures Manual, including all amendments thereto adopted by the NAIC, excluding the impact of any permitted or prescribed practices, and is: 1) licensed in at least 26 states; or 2) licensed in at least 10 states, and licensed or accredited in a total of at least 35 states.

The reasoning of the Task Force is that Model #787 only applies to term life and universal life with secondary guarantees (XXX/AXXX) captive reinsurance transactions, and that variable annuities, long-term care insurance and other life and health insurance and annuity products are not currently addressed. Therefore, it would be considered to be premature to require the states to adopt these provisions. In addition, the professional reinsurer exemption of Section 5B(4) of Model #785 is specifically referenced in the draft accreditation standard. Therefore, it is the recommendation of the Task Force that the 2016 revisions to Model #785 are optional, and should be considered as acceptable but not required by the states.
State statute and/or regulation should be substantially similar to uniform, national standards that govern reserve financing arrangements pertaining to life insurance policies containing guaranteed nonlevel gross premiums, guaranteed nonlevel benefits and universal life insurance policies with secondary guarantees, to ensure that both the total security and the primary security are provided in forms and amounts that are in compliance with the requirements set forth in the Term and Universal Life Insurance Reserve Financing Model Regulation (#787).

a. Provides that the Credit for Reinsurance Model Regulation (#786) and Model #787 shall both apply to reinsurance treaties that cede liabilities pertaining to Covered Policies; provided, that in the event of a direct conflict between the provisions of Model #787 and the provisions of Model #786, the provisions of Model #787 shall apply, but only to the extent of the conflict, substantially similar to Section 3 of Model #787?

b. Provides that Model #787 does not apply to reinsurance exempt by the provisions of Section 4 of Model #787, including reinsurance ceded to an assuming insurer that meets the requirements of either Section 5B(4)(a) of the Credit for Reinsurance Model Law (#785), which pertains to certain certified reinsurers, or Section 5B(4)(b) of Model #785, which pertains to reinsurers meeting certain threshold size and licensing requirements?

c. Provides definitions of “Covered Policies,” “Grandfathered Policies,” “Required Level of Primary Security,” “Actuarial Method,” “Primary Security,” “Other Security” and “Valuation Manual” that are substantially similar to such terms as defined in Section 5 of Model #787?

d. Provides for an Actuarial Method to establish the Required Level of Primary Security for each reinsurance treaty subject to this regulation that is substantially similar to the methodology as set forth in Section 6A of Model #787?

e. Provides for valuations to be used 1) in calculating the Required Level of Primary Security pursuant to the Actuarial Method; and 2) in determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, that are substantially similar to the valuations set out in Section 6B of Model #787?

f. Provides for requirements to obtain credit for reinsurance with respect to ceded liabilities pertaining to Covered Policies that are substantially similar to the requirements set out in Section 7A of Model #787?

g. Provides for requirements at inception date and on an ongoing basis substantially similar to Section 7B(1) of Model #787?

h. Provides that if the requirements to hold Primary Security and total security are not both satisfied, the ceding insurer shall establish a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held, unless any deficiency has been eliminated pursuant to remediation provisions substantially similar to Section 7B(2) of Model #787?

i. Includes a prohibition against avoidance provision similar to Section 9 of Model #787?
Actuarial Guideline XLVIII  
(Appplies to 2017 and Subsequent Year Valuations)

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)

Background

The NAIC Principle-Based Reserving Implementation (EX) Task Force (“PBRI 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. The PBRI 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. Some of these reinsurance arrangements have been referred to as “XXX/AXXX Captive arrangements,” although not all such arrangements actually involve reinsurers organized as captives. In this connotation, XXX denotes the reserves prescribed by Section 6 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model #830) while AXXX denotes the reserves prescribed by Section 7 of Model #830, and by Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation (AG 38). On June 30, 2014, the PBRI Task Force adopted a framework as found in Exhibits 1 and 2 of the June 4, 2014 report from Rector & Associates, Inc. (the “June 2014 Rector Report”). Exhibit 2 of the report included a charge to the Life Actuarial (A) Task Force (LATF) to develop a level of reserves (the “Required Level of Primary Security”) that must be supported by certain defined assets (“Primary Security”). The level of reserves is to be calculated by a method referred to as the “Actuarial Method.” Another charge to LATF was to promulgate an actuarial guideline specifying that, in order to comply with the NAIC Actuarial Opinion and Memorandum Regulation Model 822 (“AOMR”) as it relates to XXX/AXXX reinsurance arrangements, the opining actuary must issue a qualified opinion as to the ceding insurer’s reserves if the ceding insurer or any insurer in its holding company system has engaged in a XXX/AXXX reserve financing arrangement that does not adhere to the Actuarial Method and Primary Security forms adopted by the NAIC. The initial version of 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) was developed in response to that charge, with an effective date of January 1, 2015.

Coordination between this Actuarial Guideline and the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model #787)

Subsequently, on January 8, 2016, the NAIC adopted revisions to the Credit for Reinsurance Model Law (Model #785). Among other things, the revisions to Model #785 provide commissioners with the authority to enact, by regulation, additional requirements for ceding insurers to claim credit for reinsurance with respect to certain XXX/AXXX financing arrangements. On December 13, 2016, the NAIC adopted the Term and Universal Life Insurance Reserve Financing Model Regulation (Model #787) as the regulation permitted by Model #785. LATF subsequently received a charge to redraft AG 48 to make it as consistent as possible with the provisions of Model #787. The current version of this actuarial guideline is the result.

The following is an overview of the interrelationship between this actuarial guideline and Model #787, and the regulatory strategy that led to the adoption of each:

1. The initial version of this actuarial guideline immediately established national standards for the use of XXX/AXXX financing arrangements in an attempt to quickly set minimum standards based on the framework adopted by the PBRI Task Force on June 30, 2014. This initial version applied to such reinsurance arrangements entered into on or after 1/1/2015.
2. The revised statute (the NAIC Credit for Reinsurance Model Law (Model #785)) and a new regulation (the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model #787)) were then developed and adopted by the NAIC.

3. Except as noted in #4 below, this actuarial guideline will cease to be effective, on a state by state basis, as individual states enact Model #785 and adopt Model #787 to replace it.

4. Notwithstanding, it is anticipated that in a small number of states, Model #787 will need to be adopted on a “prospective” basis only (that is, it will only apply to ceded policies issued on or after the effective date thereof). In those cases, this actuarial guideline will remain as the authority for ceded policies subject to this actuarial guideline but to which Model #787, as adopted in a given state, does not apply. So although its role might diminish, this actuarial guideline will remain an essential part of the regulatory framework for a small number of states for many years to come.

5. To ensure uniformity of treatment between states, companies, and ceded policies (whether governed by this actuarial guideline or by Model #787) and to avoid confusion, this actuarial guideline is being updated, effective as of January 1, 2017, to make it as substantively identical to Model #787 as possible.

Authority, Avoidance, and Purpose

The requirements in this actuarial guideline derive authority from Section 3 of the AOMR, or, after the Operative Date of the Valuation Manual, from Section 1 of VM-30 of the Valuation Manual. Both Section 3 of the AOMR and Section 1 of VM-30 provide that the commissioner has the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner's judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items. As contained in the framework adopted by the PBRI Task Force on June 30, 2014, this actuarial guideline defines new terms, such as Primary Security and Required Level of Primary Security, specifies the Actuarial Method used to calculate the Required Level of Primary Security, and specifies other requirements that must be followed when reinsurance is involved in order for the appointed actuary to render an actuarial opinion that is not qualified.

No statute, regulation or guideline can anticipate every potential XXX/AXXX captive arrangement. Common sense and professional responsibility are needed to assure not only that the text of this actuarial guideline is strictly observed, but also that its purpose and intent are honored scrupulously. To that end, and to provide documentation to the appointed actuary as to the arrangements that are subject to review under this actuarial guideline, the appointed actuary may request from each ceding insurer, and may rely upon, the certification by the Chief Financial Officer or other responsible officer of each ceding insurer filed with the insurer’s domiciliary regulator that the insurer has not engaged in any arrangement or series of arrangements involving XXX or AXXX reserves that are designed to exploit a perceived ambiguity in, or to violate the purpose and intent of, this actuarial guideline.

The purpose and intent of this actuarial guideline is to establish uniform, national standards governing XXX or AXXX reserve financing arrangements in conformity with the PBRI Task Force framework and, in connection with such arrangements, to ensure that Primary Security, in an amount at least equal to the Required Level of Primary Security, is held by or on behalf of the ceding insurer. As described further in

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1 In general, reserve financing arrangements are those where the security/assets backing part or all of the reserves have one or more of the following characteristics: such security/assets (1) are issued by the ceding insurer or its affiliates; and/or (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; and/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).
Section 4.B., the provisions of this actuarial guideline are not intended to apply to policies that were issued prior to 1/1/2015 if those policies were included in a captive reserve financing arrangement as of 12/31/2014. Further, the requirements of this actuarial guideline should be viewed as minimum standards and are not a substitute for the diligent analysis of reserve financing arrangements by regulators. A regulator should impose requirements in addition to those set out in this actuarial guideline if the facts and circumstances warrant such action.

Text

1. Authority

Pursuant to Section 3 of the AOMR or, after the Operative Date of the Valuation Manual, to Section 1 of VM-30 of the Valuation Manual, the commissioner shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the commissioner’s judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items.

2. Scope

This actuarial guideline applies to reinsurance contracts that cede liabilities pertaining to Covered Policies as that term is defined in Section 4.

3. Exemptions

This actuarial guideline does not apply to the situations described in Subsections A through F.

A. Reinsurance of:

(1) Policies that satisfy the criteria for exemption set forth in Section 6F or Section 6G of Model #830; and which are issued before the later of:

(a) The effective date of Model #787 in the state of domicile of the ceding insurer, and

(b) The date on which the ceding insurer begins to apply the provisions of VM-20 to establish the ceded policies’ statutory reserves, but in no event later than January 1, 2020;

(2) Portions of policies that satisfy the criteria for exemption set forth in Section 6E of Model #830 and which are issued before the later of:

(a) The effective date of Model #787 in the state of domicile of the ceding insurer, and

(b) The date on which the ceding insurer begins to apply the provisions of VM-20 to establish the ceded policies’ statutory reserves, but in no event later than January 1, 2020;

(3) Any universal life policy that meets all of the following requirements:

(a) Secondary guarantee period, if any, is five (5) years or less;
(b) Specified premium for the secondary guarantee period is not less than the net level reserve 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

(c) The initial surrender charge is not less than one hundred percent (100%) of the first year annualized specified premium for the secondary guarantee period;

(4) Credit life insurance;

(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; or

(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; or

B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Section 2D of Model #785; or

C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Sections 2A, 2B or 2C, of Model #785, 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—Accounting Policies, Risks & Uncertainties and Other Disclosures (“SSAP No. 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 the NAIC Risk-Based Capital (RBC) for Insurers Model Act (Model #312) 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 Sections 2A, 2B or 2C, of Model #785, and that, in addition:

(1) Is not an affiliate, as that term is defined in Section 1A of the NAIC Insurance Holding Company System Regulatory Model Act (Model #440), of:

(a) The insurer ceding the business to the assuming insurer; or

(b) Any insurer that directly or indirectly ceded the business to that ceding insurer;

(2) Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual;
(3) Is both:

(a) Licensed or accredited in at least 10 states (including its state of domicile), and

(b) Not licensed in any state as a captive, special purpose vehicle, special purpose financial captive, special purpose life reinsurance company, limited purpose subsidiary, or any other similar licensing regime; and

(4) Is not, or would not be, below 500% of the Authorized Control Level RBC as that term is defined in Model #312 when its risk-based capital (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 admission or valuation of assets or liabilities that increase the assuming insurer’s reported surplus; or

E. Reinsurance ceded to an assuming insurer that meets the requirements of either Section 5B(4)(a) of Model #785, pertaining to certain certified reinsurers or Section 5B(4)(b) of Model #785, pertaining to reinsurers meeting certain threshold size and licensing requirements; or

F. Reinsurance not otherwise exempt under Subsections A through E 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 actuarial guideline (as described in the Authority, Avoidance and Purpose section above);

(2) The risks are included within the scope of this actuarial guideline only as a technicality; and

(3) The application of this actuarial guideline to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 3F to exempt a reinsurance treaty from this actuarial guideline, as well as the general basis therefor (including a summary description of the treaty).

Drafting Note: The exemption set forth in Section 3F 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 actuarial guideline 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 treaties 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 3A, B, C, D, or E or meet the substantive requirements of this actuarial guideline.

4. Definitions
A. “Actuarial Method” means the methodology used to determine the Required Level of Primary Security, as described in Section 5.

B. “Covered Policies” means the following: Subject to the exemptions described in Section 3, Covered Policies are those policies, other than Grandfathered Policies, 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.

*Note: Although “Covered Policies” is defined to include all the policies described in Subsections B1 and B2 above, it is noted that whether a given “Covered Policy” is subject to this actuarial guideline or, instead, to Model #787 should be determined under Section 8 (Sunset).*

C. “Grandfathered Policies” means policies of the types described in Subsections B1 and B2 above that were:

(1) Issued prior to January 1, 2015; and

(2) Ceded, as of December 31, 2014, as part of a reinsurance treaty that would not have met one of the exemptions set forth in Section 3 had that section then been in effect.

D. “Non-Covered Policies” means any policy that does not meet the definition of Covered Policies, including Grandfathered Policies.

E. “Required Level of Primary Security” means 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” means the following forms of security:

(1) Cash meeting the requirements of Section 3A of Model #785;

(2) Securities listed by the Securities Valuation Office meeting the requirements of Section 3B of Model #785, 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 treaties:

(a) Commercial loans in good standing of CM3 quality and higher;

(b) Policy Loans; and
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(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 treaty.

G. “Other Security” means any security acceptable to the commissioner other than security meeting the definition of Primary Security.

H. “Valuation Manual” means 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.


5. The Actuarial Method

A. Description of Actuarial Method

The Actuarial Method to establish the Required Level of Primary Security for each reinsurance treaty subject to this actuarial guideline shall be VM-20, applied on a treaty-by-treaty basis, including all relevant definitions, from the Valuation Manual as then in effect, applied as follows:

(1) For Covered Policies described in Section 4B(1) above, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR) regardless of whether the criteria for exemption testing can be met. However, if the Covered Policies do not meet the requirements of the Stochastic Reserve exclusion test in the Valuation Manual, then the Actuarial Method is the greatest of the Deterministic Reserve, the Stochastic Reserve, or the NPR. In addition, if such Covered Policies are reinsured in a reinsurance treaty that also contains Covered Policies described in Section 4B(2) above, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement. Whether Paragraph 1 or 2 are used, the Actuarial Method must comply with any requirements or restrictions that the Valuation Manual imposes when aggregating these policy types for purposes of principle-based reserve calculations. The mortality basis for the NPR shall be the 2017 CSO Mortality Table.

(2) For Covered Policies described in Section 4B(2) above, the Actuarial Method is the greatest of the Deterministic Reserve, the Stochastic Reserve, or the NPR regardless of whether the criteria for exemption testing can be met. The mortality basis for the NPR shall be the 2017 CSO Mortality Table.

(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, as well as any adjustment under Subparagraph (c) below, may be
reduced to a pro rata portion in accordance with the percentage of the risk ceded;

(b) If the reinsurance treaty in a non-exempt arrangement cedes only the risks pertaining to a secondary guarantee, the Required Level of Primary Security may be reduced by an amount determined by applying the Actuarial Method on a gross basis to all risks, other than risks related to the secondary guarantee, pertaining to the Covered Policies, except that for Covered Policies for which the ceding insurer did not elect to apply the provisions of VM-20 to establish statutory reserves, the Required Level of Primary Security may be reduced by the statutory reserve retained by the ceding insurer on those Covered Policies, where the retained reserve of those Covered Policies 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 in an exempt arrangement, the Required Level of Primary Security may be reduced by the amount resulting by applying the Actuarial Method including the reinsurance section of VM-20 to the portion of the Covered Policy risks ceded in the exempt arrangement, except that for Covered Policies issued prior to Jan 1, 2017, this adjustment is not to exceed \[c_x/(2 \times \text{number of reinsurance premiums per year})\] where \(c_x\) is calculated using the same mortality table used in calculating the Net Premium Reserve; and

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

It is possible for any combination of Subparagraphs (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) 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) If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance treaty subject to this actuarial guideline, in no event will the aggregate Required Level of Primary Security for those reinsurance treaties be less than the Required Level of Primary Security calculated using the Actuarial Method as if all risks ceded in those treaties were ceded in a single treaty subject to this actuarial guideline.
(7) If a reinsurance treaty subject to this actuarial guideline cedes risk on both Covered and Non-Covered Policies:

(a) The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies; and

(b) Any Primary Security and/or Other Security used to meet any requirements pertaining to the Non-Covered Policies may not be used to satisfy any requirements related to the Required Level of Primary Security and/or Other Security for the Covered Policies.

B. Valuation Used for Purposes of Calculations

For the purposes of both calculating the Required Level of Primary Security pursuant to the Actuarial Method and determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply:

(1) 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

(2) 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 31 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.

6. Required Actuarial Analysis and Actuarial Opinion and Memorandum Requirements

A. Required Actuarial Analysis

Before the due date of each actuarial opinion, as to each reinsurance treaty in which Covered Policies have been ceded, the appointed actuary of each ceding insurer must perform an analysis on a treaty by treaty basis, of such Covered Policies to determine whether, as of the immediately preceding December 31 (the valuation date):

(1) 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 treaty within the meaning of Section 3 of Model #785, on a funds withheld, trust, or modified coinsurance basis; and

(2) 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 Paragraph (1) above, are held by or on behalf of the ceding insurer as security under the reinsurance treaty within the meaning of Section 3 of Model #785; and
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Note: For the sake of clarity, funds consisting of Primary Security pursuant to Paragraphs (1) may exceed the Required Level of Primary Security, and Other Security is only required under Paragraph (2) to the extent that there is any portion of the statutory reserves as to which Primary Security is not so held. For example, if a ceding insurer’s statutory reserves equal $1 Billion, its Required Level of Primary Security is $600 Million, and it holds $1 Billion in Primary Security pursuant to Paragraph (1), no Other Security is required under Paragraph (2).

(3) Any trust used to satisfy the requirements of this Section 6 complies with all of the conditions and qualifications of Section 11 of the NAIC Credit for Reinsurance Model Regulation (Model #786), except that:

(a) Funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 5B, be valued according to the valuation rules set forth in Section 5B, 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 6A(1); and

(c) The reinsurance treaty 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 6A(1)) below 102% of the level required by Section 6A(1) at the time of the withdrawal or substitution.

B. Qualified Actuarial Opinion; Remediation

(1) The appointed actuary of the ceding insurer performing the analysis required by Section 6A above must issue a qualified actuarial opinion as described in Section 6.D. of the AOMR or Section 3A(10) of VM-30 of the Valuation Manual, as applicable, unless:

(a) The requirements of Section 6A(1) and 6A(2) were fully satisfied as of the valuation date as to such reinsurance treaty; or

(b) Any deficiency has been eliminated before the due date of the Annual Statement to which the valuation date relates through the addition of Primary Security and/or Other Security, as the case may be, in such amount and in such form as would have caused the requirements of Section 6A(1) and 6A(2) to be fully satisfied as of the valuation date; or

(c) The ceding insurer has established a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held pursuant to Section 6A(1).

(2) In addition to the requirement set forth in Section 6B(1) above, the appointed actuary of the ceding insurer performing the analysis required by Section 6A above must issue a qualified actuarial option as described in Section 6.D. of the AOMR or Section 3A(10) of VM-30 of the Valuation Manual, as applicable, if the appointed actuary for any affiliated reinsurer of the ceding insurer issues a qualified actuarial opinion with respect to such affiliated reinsurer where (a) the affiliate reinsures Covered Policies of the ceding insurer and (b) the qualified
actuarial opinion pertaining to the affiliated reinsurer results, in whole or in part, from the analysis required by this actuarial guideline.

**Note:** The remediation option set forth in Section 6B(1)(c) mirrors that set forth in Model #787. Under this option, a ceding company may choose to avoid the consequence (a qualified opinion under this actuarial guideline) by establishing a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held. For example, suppose a ceding insurer has established statutory reserves of $1 Billion and has Primary Security of $550 Million and Other Security of $450 Million. Suppose further that the actuary determines that the insurer’s Required Level of Primary Security is $600 Million. Under Section 6B(1)(c), the insurer may avoid a qualified opinion by establishing a liability equal to $450 Million (the difference between the statutory reserve of $1 Billion and the $550 Million amount of Primary Security actually held).

C. Additional Requirements for the Actuarial Opinion and Memorandum for Companies that have Covered Policies Requiring the Analysis Pursuant to this actuarial guideline

1. In the statement of actuarial opinion, the appointed actuary of the ceding insurer must state whether (i) he has performed an analysis, as to each reinsurance arrangement under which Covered Policies have been ceded, of the security supporting the Covered Policies and whether 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 and (ii) funds consisting of Primary Security or Other Security in an amount equal to the statutory reserves are held by or on behalf of the ceding insurer as security under the reinsurance arrangement.

2. In the actuarial memorandum as described by Section 7 of the AOMR or Section 3B of VM-30 of the *Valuation Manual*, as applicable, the appointed actuary of the ceding insurer must document the analysis and requirements applied by this actuarial guideline as to each reinsurance arrangement under which Covered Policies are ceded.

3. In the event that a reinsurance treaty contains both (1) Covered Policies subject to this actuarial guideline rather than to Model #787, and (2) Covered Policies subject to Model #787 rather than to this actuarial guideline, the treaty shall be tested as a whole for purposes of a ceding insurer’s compliance with both (a) the requirements of Section 6A(1) and Section 6A(2) of this actuarial guideline and (b) the requirements of Section 7A(3) and Section 7A(4) of Model #787; provided further, that:

   (a) If funds consisting of Primary Security are held in amounts less than the Required Level of Primary Security, such funds consisting of Primary Security shall be allocated first to fulfill the Required Level of Primary Security for the Covered Policies subject to this actuarial guideline, with any remainder allocated to those Covered Policies subject to Model #787; and

   (b) If funds consisting of Other Security are held in amounts less than the requirements of Section 6A(2), such funds consisting of Other Security shall be allocated first to fulfill the Other Security requirements for the Covered Policies subject to this actuarial guideline, and any remainder shall be allocated to those Covered Policies subject to Model #787.
7. Effective Date

This actuarial guideline shall become effective as of January 1, 2017 with respect to all Covered Policies. This actuarial guideline supersedes and replaces all previous versions thereof with respect to actuarial opinions rendered as to valuation periods ending on or after January 1, 2017.

Note: For the avoidance of doubt, actuarial opinions issued with respect to the year ended December 31, 2016, shall be governed by the version of AG 48 in effect on December 31, 2016, as included in the Accounting Practices and Procedures Manual.

8. Sunset Provision

This actuarial guideline shall cease to apply as to Covered Policies that are both (a) issued by ceding insurers domiciled in a jurisdiction that has in effect, as of December 31st of the calendar year immediately preceding the year in which the actuarial opinion is to be filed, a regulation substantially similar to Model #787 adopted by the NAIC on December 13, 2016; and (b) subject to Model #787 as so adopted by the ceding insurer’s jurisdiction of domicile. This Actuarial Guideline shall continue to apply, without interruption, to any and all Covered Policies not included in both (a) and (b) of the immediate preceding sentence.

Note: It is anticipated that, for most states, this actuarial guideline will sunset pursuant to (a) and (b) of Section 8 and will continue only with respect to the limited number of states in which their version of Model #787 applies prospectively only, i.e., applies only to Covered Policies issued on or after the effective date of their version of Model #787. It is anticipated, however, that most states will be able to adopt a version of Model #787 that, like the Model itself, applies to all Covered Policies (subject to the applicable exemptions and grandfathering provisions) that are “in force” on or after the effective date, even if the policies were originally issued prior to that effective date. The goal of Section 8 is to ensure that all Covered Policies ceded in reinsurance transactions within the scope of this actuarial guideline continue to be subject to this actuarial guideline unless and until they become subject to Model #787.
February 26, 2020

Director Chlora Lindley-Myers
Chair, Reinsurance (E) Task Force
Attn: John Rehagen
National Association of Insurance Commissioners (NAIC)

Dear Director Lindley-Myers,

The Life Reinsurance Work Group (“the Work Group”) of the American Academy of Actuaries appreciates the opportunity to comment on the NAIC’s Model #787 Exposure Memorandum, requesting comments on whether compliance with Actuarial Guideline XLVIII (AG 48) should be considered to be “substantially similar” to Model #787 under the NAIC Financial Standards and Accreditation Program.

In the Work Group’s view, Model #787 and AG 48 differ in significant ways, and a sunset of AG 48 and its replacement by Model #787, wherever possible, is important to achieve, for reasons described below.

Model #787 and AG 48 differ principally in the means by which they require or incentivize companies to conform their captive reinsurer arrangements (if they have them) to certain standards. For business within its scope, Model #787 defines the standards in order for the cedent to receive full reserve credit for reinsurance. Further, Model #787 directly requires the ceding insurer to establish an additional liability if there is an uncorrected shortfall in amounts of Primary Security or Other Security, as defined in the model. AG 48 sets out similar standards and definitions of required amounts of Primary Security and Other Security for a captive arrangement and requires the cedent’s Appointed Actuary to issue a “Qualified Actuarial Opinion” on the cedent reserves in cases where the AG 48 standards are not met. The Qualified Actuarial Opinion, along with adverse risk-based capital (RBC) consequences for any shortfall in amount of Primary Security, together constitute the enforcement means for AG 48.

Throughout the development of AG 48 in 2014, the Academy’s Life Practice Council expressed concerns several times with the NAIC’s proposed forced use of a Qualified Actuarial Opinion to achieve the goals of the new captive regulatory framework. We stated these concerns in our June 25, 2014, letter to the PBR Implementation (EX) Task Force; our Sept. 17, 2014, letter to the Life Actuarial Task Force (LATF); and our Oct. 30, 2014, letter to the PBR Implementation (EX) Task Force.

In the Work Group’s view, a forced Qualified Actuarial Opinion is inconsistent with the purpose and intent of the Actuarial Opinion and Memorandum Requirements (AOMR) in VM-30, which places responsibility on the appointed actuary to issue an opinion as to the overall adequacy of reserves.

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1 The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
Codifying circumstances when an appointed actuary must qualify his/her opinion reduces the independence given to the appointed actuary in the AOMR in forming his/her opinion.

The AOMR is designed to ensure the overall adequacy of an insurer’s reserves based on asset adequacy analysis and is not designed or intended to implement new transaction-specific calculation requirements. Section 1(A)(3) of the VM-30 provides (emphasis added):

The AOM requirements shall be applied in a manner that allows the appointed actuary to use his or her professional judgment in performing the actuarial analysis and developing the actuarial opinion and supporting actuarial memoranda, conforming to relevant ASOPs. However, a state commissioner has the authority to specify methods of analysis and assumptions when, in the commissioner’s judgment, these specifications are necessary for the actuary to render an acceptable opinion relative to the adequacy of reserves and related actuarial items. For purposes of VM-30, the requirements of 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), of the AP&P Manual, shall be applicable.

The reference to actuarial methods and assumptions in Section 1(A)(3) supports our view that the AOMR is focused on reserve adequacy with an independent, professional actuarial opinion as its cornerstone.

Although the Work Group acknowledges that the NAIC took steps in 2015 to distinguish the RBC consequences of an actuarial opinion deemed as qualified solely on account of AG 48, we still have strong concerns with the approach taken in AG 48 requiring that the Appointed Actuary issue a qualified opinion in a specific circumstance. We continue to believe it is anomalous for regulators to mandate a Qualified Actuarial Opinion via AG 48, the AOMR, or otherwise. In our view, the Appointed Actuary’s Opinion should be preserved as just that—a professional opinion rendered by the Appointed Actuary.

In 2014, the NAIC implemented its new captive regulatory framework via actuarial guideline (namely, AG 48) principally to expedite implementation of the new framework, recognizing that implementation through model law, model regulation, and NAIC adoption as an accreditation standard would take years. The expressed plan, explicit in AG 48 itself, was to sunset AG 48 once the equivalent model law and regulation was adopted at NAIC and by the states. The Work Group believes that if AG 48 is deemed substantially similar to Model #787, then its replacement by Model #787 could be deferred indefinitely by some states, and deferral would maintain the use of a forced Qualified Actuarial Opinion, which we believe is undesirable.

Should you have questions regarding these suggestions, please contact Ian Trepanier, the Academy’s life policy analyst, at trepanier@actuary.org.

Sincerely,

Richard Daillak, MAAA, FSA
Chairperson, Life Reinsurance Work Group
American Academy of Actuaries
Mr. John Rehagen  
Acting Chair, Reinsurance (E) Task Force  
National Association of Insurance Commissioners  
Via email: Dan Schelp (dschelp@naic.org)

Dear John:

Connecticut appreciates the opportunity to comment on the February 5, 2020 staff memo to the Reinsurance Task Force comparing the significant differences between AG48 and NAIC Model Regulation #787. We would also like to acknowledge the thoroughness of the staff review of the subject matter.

We concur that the primary difference between AG48 and Model #787 is the consequences to an insurer if the requirements of either are not met. AG48 merely calls for the filing of a qualified actuarial opinion, whereas Model #787 calls for the ceding insurer to establish a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held.

Normally a qualified actuarial opinion generates a substantial (50%) increase in the Interest Rate Risk and Market Rate Risk factors used in determining minimum RBC requirements. However, the normal RBC penalty normally associated with a qualified actuarial opinion is not being applied in this instance. Instead, a dollar-for-dollar addition to the reporting company’s ACL RBC amount equal to the shortfall in Primary Security is mandated.

The staff memo notes the existence of a second potential RBC “penalty” related to cessions to captives. Since any such penalty is applicable to noncompliance with both AG48 and Model #787, we do not feel that penalty is germane to the discussion at hand.

The staff memo also notes that the Financial Regulation Standards and Accreditation (F) Committee chose to defer consideration of Model #787 as an accreditation standard in recognition of the impending adoption of the Covered Agreement. We would like to point out that the functional word is “defer”, as the Committee’s main consideration was to avoid asking states to revise their regulations and statutes multiple times in a short time span. Hence the wording of the August 24, 2017 recommendation of the Reinsurance Task Force that “a state’s adoption of AG48 will serve to satisfy this accreditation standard until such time that the state adopts the significant elements of Model #787”.

Connecticut does not consider the consequences of a modest change to the cedant’s RBC ratio to be substantially similar to reducing surplus by the entire excess of the credit for reinsurance taken over the amount of Primary Security actually held. Simply put, AG48 does not
contemplate or effect a balance sheet adjustment. Further, we are aware that the drafters of Model #787 considered and ultimately rejected incorporating a more modest consequence of non-compliance that would have limited the balance sheet adjustment to the shortfall from full coverage of the Required Level of Primary Security.

Regards,

Kathy Belfi
Kathy Belfi, CPA
Director, Financial Regulation
February 26, 2019

Via Electronic Delivery

Director Chlora Lindley-Myers
Missouri Department of Commerce & Insurance
P.O. Box 690
Jefferson City, MO 65102

Attention: John Rehagen, Jake Stultz and Dan Schelp

Re: Reinsurance (E) Task Force Exposure Comparing Model # 787 and AG 48

New York Life Insurance Company and The Northwestern Mutual Insurance Company offer the following comments on the February 5, 2020 memorandum (the “Memo”) from NAIC Staff to the Reinsurance Task Force (the “Task Force”) entitled “Comparison of Term and Universal Life Insurance Reserve Financing Model Regulation (#787) and Actuarial Guideline XLVIII”. Our companies have engaged extensively with the NAIC and the Task Force over the years as it considered the recommendations made in the Rector Report and subsequently developed both AG 48 and Model 787.

Background of Accreditation Discussions

In 2017, we submitted several joint comment letters supporting the NAIC’s efforts to make Model 787 an accreditation standard. We continue to believe that taking this step will strengthen the state-based system of insurance regulation, ensuring the consistent adoption of the NAIC’s framework for regulating the solvency of XXX and AXXX life insurer captives.

At that time, the NAIC was contemplating making Model 787 an accreditation standard on an expedited basis so that it would become effective concurrently with the nation-wide transition to principles-based reserving. However, at the 2017 Fall National Meeting, the Financial Regulation Standards and Accreditation (F) Committee (“F Committee”), while strongly supporting moving forward, agreed to defer this recommendation in light of the then-pending changes to the Credit for Reinsurance Model Law and Regulation (respectively, “Models 785 and 786”) to reflect the US-EU Covered Agreement. This step as articulated by F Committee members was intended to prevent state legislatures from needing to reopen the reinsurance-related provisions of the insurance code multiple times in a short period. It was the F Committee’s clear intention that accreditation standards for Models 785, 786 and 787 would ultimately proceed alongside one another.

In the years since this decision, the NAIC has completed its revisions to Models 785 and 786 and a few states have moved forward with adopting Model 787, notwithstanding the absence of an accreditation standard. At the 2019 Fall National Meeting, the F Committee adopted a recommendation to make Model 787 an accreditation standard on an expedited basis, which would move in parallel with the accreditation standards for Models 785 and 786. This adoption
was consistent with the discussions in 2017, which focused not on whether Model 787 should be an accreditation standard, but rather the timing for the standard’s effective date.

Reliance on AG 48 for Accreditation Purposes

The Memo explores whether states could, for accreditation purposes, rely on ongoing enforcement of AG 48 as a “substantially similar” provision to Model 787. While the definition of “substantially similar” is seemingly broad enough to encompass this position, there are meaningful differences between Model 787 and AG 48, including both the penalty provisions and the reliance upon the actuarial opinion.

*The Penalty Provisions in AG 48 and Model 787 Differ Significantly*

As noted in the Memo, the primary difference between Model 787 and AG 48 is the consequences to an insurer if an insurer fails to hold a sufficient level of Primary Security. Model 787 contains a penalty provision specifically aimed at deterring behavior that contravenes its positions: the loss of reinsurance credit for improperly reserved transactions.

AG 48’s penalty provision, in contrast, is indirect. In the event of a deficiency in Primary Security, insurers are subject to an RBC penalty commensurate with the amount of the shortfall. As you know, RBC was designed as an early warning system for the identification of weakly capitalized companies. It was never intended to evaluate well-capitalized companies. Ultimately, while AG 48’s penalty could have a meaningful effect on RBC ratios, reliance on such ratios to bring regulatory attention to Primary Security shortfalls or otherwise deter non-compliance with AG 48’s requirements is inconsistent with the purposes for which RBC was developed.

The inclusion of an RBC penalty in AG 48 reflects several factors arising from the intensive negotiations regarding the implementation of the Rector Framework, including an acknowledgment that additional penalties could not be included in an Actuarial Guideline, and that AG 48 itself would ultimately sunset once Model 787 was adopted. A similar logic undergirds AG 48’s reliance on the issuance of a qualified actuarial opinion as a trigger for these penalty provisions. Generally speaking, an actuarial opinion is designed to be an independent actuarial assessment of overall reserve adequacy, and is not intended as a compliance mechanism for a particular regulatory requirement. Indeed, the Academy of Actuaries, among others, expressed serious concerns with AG 48 being the permanent, or even the temporary, solution. However, all parties agreed to stand down on the issue when it became clear that AG 48 would be used in limited, short-term circumstances.

*Regulators Intended AG 48 to be Temporary Solution*

At the time that the NAIC first considered making Model 787 an accreditation standard, it was acknowledged that the expedited time frame could present challenges for some states. The solution to this was not to keep AG 48 in place forever and for all XXX and AXXX business, but rather to develop some exceptions for specific circumstances.
In states that were unable to comply with the expedited time frame, the Task Force acknowledged that compliance with AG 48 would be satisfactory for accreditation purposes. The Task Force’s acknowledgment did not envision, however, that AG 48 would remain in place in those states indefinitely.

This is consistent with the introductory language of AG 48 itself, which notes that AG 48 was adopted to “quickly set minimum standards” for XXX/AXXX reinsurance transactions. The introductory language also contemplates that AG 48 would eventually sunset in most states as Model 787 was adopted to replace it. The only caveat to that expectation is a recognition that “in a small number of states,” Model 787 would be adopted on a prospective basis (meaning it would only apply to policies issued after the date that the state adopted the model). In that minority of cases, AG 48 would remain in effect (along with Model 787) for the subset of policies issued after January 1, 2015 but before a state adopted the Model.

Conclusion

Finally, we would note that when the F Committee agreed in 2017 to delay the adoption of an accreditation standard for Model 787, they were responding to regulators’ legitimate concerns that they would need to approach their legislatures several times in quick succession regarding revisions to Model 785. There was no discussion at that time about never approaching legislatures to obtain the requisite authority to issue Model 787. If regulators remain concerned with making repeated requests on similar topics then we would urge them to include both the changes responsive to the US-EU Covered Agreement and the authorizing language in their legislative packages. If regulators remain concerned with completing the revisions to Model 785, 786 and 787 on an expedited basis then we would suggest that a preferable solution is to extend the time frame for making Model 787 an accreditation standard rather than to allow states to rely on AG 48 in perpetuity for all XXX/AXXX business.

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We are grateful for your time and attention to our comments. If you would like to discuss this letter with us, please let us know.

Sincerely,

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