

CAPTIVES

Superintendent
Joe Torti

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DEVELOPMENT OF CAPTIVE STRUCTURE

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

CONCERNS WITH DISPARATE REGULATION

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

XXX / AXXX BUSINESS

- ▶ Section 6, NAIC Model 830 (aka “XXX”)
 - In general, XXX was developed to address a reserving issue with level term (and similar) products
 - Reserves based on a specified interest rate and specified mortality table
- ▶ Section 7, NAIC Model 830 (aka AXXX)
 - Addressed reserving issues for Universal Life Insurance policies that Contain a Secondary Guarantee

XXX / AXXX BUSINESS (cont.)

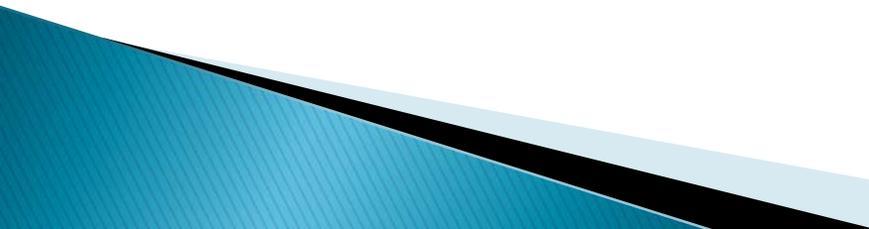
- ▶ Industry's Issue with XXX / AXXX
 - Products are priced using expected assumptions
 - Premiums collected are not sufficient to fund the required statutory reserves
 - Companies are faced with a decision to fund this difference with surplus or look for other sources of capital
- ▶ XXX / AXXX Reserves were established too high, sometimes 3–4 times the “economic” reserve.
- ▶ Insurers began reserve financing transactions by ceding reserve values to captives and SPVs.

XXX/AXXX Reinsurance Framework

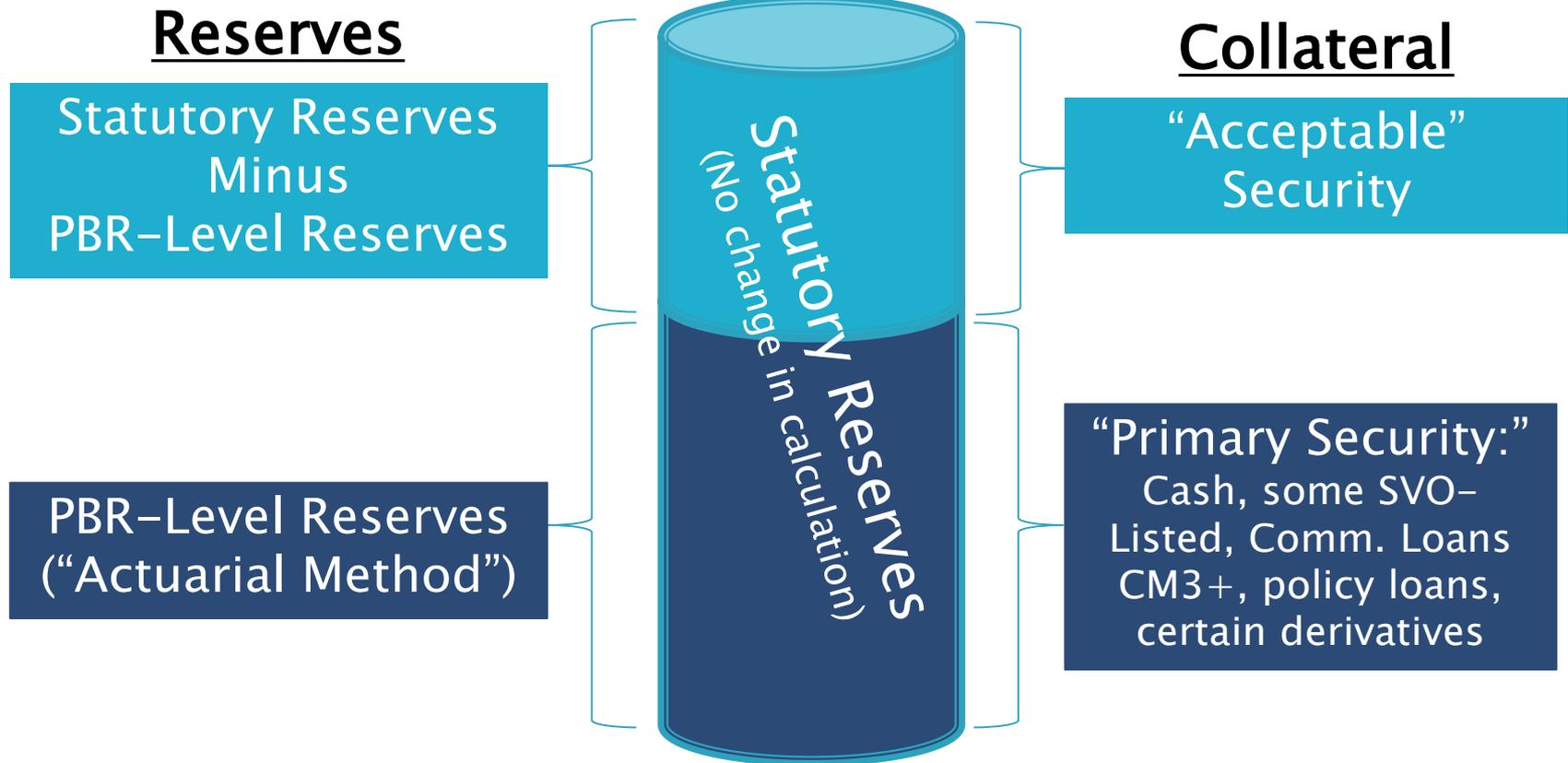
Require the direct ceding company for reinsurance financing transactions, in most instances, to:

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

Rector & Associates, Inc.



XXX / AXXX Reinsurance Framework



Means to Implement Framework

- ▶ **Credit for Reinsurance Model Law**
 - Will reference a new model regulation related to XXX/AXXX reinsurance transactions
 - This is the longer-term solution requiring state-by-state adoption.
- ▶ **New Actuarial Guideline 48**
 - AG 48 was created for quick implementation.
 - AG 48 will sunset once Credit for Reinsurance Model Law & new Regulation are implemented.
- ▶ **Permanent Solution is PBR!!!!**

Actuarial Guideline 48 (AG48)

▶ Background Section Summary

- Purpose and intent of AG48 is to establish uniform, national standards governing XXX or AXXX reserve financing
 - AG48 defines the “Actuarial Method” used to determine the reserve level
 - AG48 defines “Primary Security”
 - AG48 may require a qualified actuarial opinion
 - AG48 states that the requirements of the actuarial guideline are minimum standards and are not a substitute for the diligent analysis of reserve financing arrangements by regulators and that a regulator should impose requirements in addition to those set out in this actuarial guideline if the facts and circumstances warrant such action.
- Effective Date
 - January 1, 2015 to all Covered Policies
- Sunset Provision
 - This Actuarial Guideline shall cease to apply as to ceding insurers domiciled in a jurisdiction that has in effect, as of January 1st of the calendar year immediately preceding the year in which the actuarial opinion is to be filed, a law and regulation substantially similar to the amendment to the Credit for Reinsurance Model Law and new Model Regulation adopted by the NAIC.

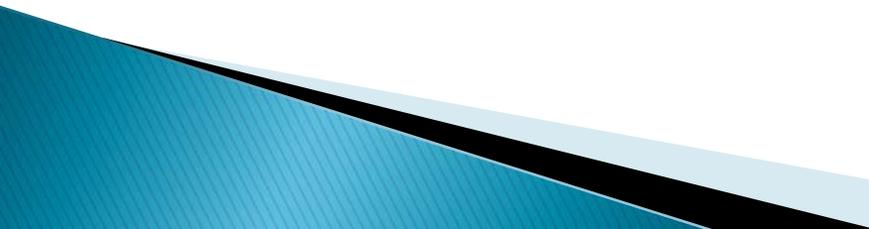
TRANSPARENCY & ANALYSIS FOR XXX/AXXX CAPTIVE TRANSACTIONS

- ▶ Increased Transparency:
 - 2014 Blanks Change
 - XXX/AXXX Reinsurance Supplement – Due by April 1
- ▶ Improved Regulatory Review, Including 2014 Financial Analysis Handbook Changes
 - Sets forth procedures and other considerations when:
 - reviewing a new proposed XXX/AXXX transaction
 - when analyzing an existing XXX/AXXX transaction
 - Sets forth requirements related to holding company analysis
- ▶ Part B accreditation requirements related to the above

VARIABLE ANNUITIES

- ▶ Our next priorities: Variable Annuities and Long-term Care (LTC).
 - Remember, FSOC's 2014 Annual Report identified variable annuity and LTC captive reinsurance transactions as priorities for state regulators to address, and some have suggested these and potentially other captive transactions are a systemic issue.
- ▶ NAIC established the Variable Annuities Issues (E) Working Group, led by Commissioner Gerhart of Iowa, to “study and address, as appropriate, regulatory issues resulting in variable annuity captive reinsurance transactions.”
 - Consultant hired to identify issues and possible solutions
 - “Preliminary Findings and Conclusions” presented to the Working Group and Industry on September 10th
 - Quantitative Impact Study (“QIS”) approved and funded
 - Additional Disclosure being added to provide immediate transparency

AND LONG-TERM CARE

- ▶ Perception that captives are being used to reduce required reserves on a line of business that has had under reserving and underpricing issues.
 - ▶ NAIC staff and the primary regulators of insurers utilizing LTC Captives did an initial review of these transactions.
 - ▶ Reserving and/or assets to support reserves do not appear to be an issue at all
 - ▶ Still on the E Committee Agenda
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ACCREDITATION

- ▶ The Financial Regulation Standards and Accreditation (F) Committee is also considering language to scope in captive reinsurance transactions involving XXX/AXXX, variable annuity, and long-term care business.
- ▶ Accreditation program is there to ensure that all states are regulating the companies writing multi-state coverages in a uniform and consistent manner.

Wrap Up

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

QUESTIONS OR COMMENTS

