

## 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)**

#### **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 the NAIC *Valuation of Life Insurance Policies Model Regulation* (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 ###)**

Subsequently, on January 8, 2016 the NAIC adopted revisions to the *Credit for Reinsurance Model Law* (Model 785). Among other things, the revisions to the NAIC *Credit for Reinsurance Model Law* (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 MM/DD/YYYY the NAIC adopted the *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) as the regulation permitted by the NAIC *Credit for Reinsurance Model Law* (Model 785). LATF subsequently received a charge to redraft AG 48 to make it as consistent as possible with the provisions of the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###). The current version of this Actuarial Guideline is the result.

The following is an overview of the interrelationship between this Actuarial Guideline and the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###), 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 ###)) 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 the NAIC *Credit for Reinsurance Model Law* (Model 785) and adopt the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) to replace it.
4. Notwithstanding, it is anticipated that in a small number of states, the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) 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 the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###), 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 the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) and to avoid confusion, this Actuarial Guideline is being updated, effective as of January 1, 2017, to make it as substantively identical to the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) 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 are to establish uniform, national standards governing XXX or AXXX reserve financing arrangements<sup>1</sup> 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 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**

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<sup>1</sup> 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).

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 the NAIC *Valuation of Life Insurance Policies Model Regulation* (Model 830); and which are issued before the later of:
  - (a) The effective date of the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) 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 Jan 1, 2020;
- (2) Portions of policies that satisfy the criteria for exemption set forth in Section 6E of the NAIC *Valuation of Life Insurance Policies Model Regulation* (Model 830) and which are issued before the later of:
  - (a) The effective date of the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) 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 Jan. 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

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- (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 the NAIC *Credit for Reinsurance Model Law* (Model 785); or
  
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Sections 2A, 2B or 2C, of the NAIC *Credit for Reinsurance Model Law* (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 ("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 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 the NAIC *Credit for Reinsurance Model Law* (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 the NAIC *Risk-Based Capital (RBC) for Insurers Model Act* (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 the NAIC *Credit for Reinsurance Model Law* (Model 785), pertaining to certain certified reinsurers or Section 5B(4)(b) of the NAIC *Credit for Reinsurance Model Law* (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 the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model ###) 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 the NAIC *Credit for Reinsurance Model Law* (Model 785);
  - (2) Securities listed by the Securities Valuation Office meeting the requirements of Section 3B of the NAIC *Credit for Reinsurance Model Law* (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
    - (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.
- I. “VM-20” means “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.

## 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.

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- (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.
- (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  $[c_x / (2 * \text{number of reinsurance premiums per year})]$  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 Dec. 31<sup>st</sup> 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<sup>st</sup> (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 the NAIC *Credit for Reinsurance Model Law* (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 the NAIC *Credit for Reinsurance Model Law* (Model 785); and

***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 opinion 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

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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 the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model ###). 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 the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###), and (2) Covered Policies subject to the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###) 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 the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###); 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 the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###); 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 the NAIC *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model ###).

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<sup>t</sup> of the calendar year immediately preceding the year in which the actuarial opinion is to be filed, a regulation substantially similar to the NAIC *Term and Universal Life Insurance Reserve*

**Pending Adoption by the A Committee**

**LATF Adoption 12/1/2016**

*Financing Model Regulation (Model ###) adopted by the NAIC on XXX, 2016; and (b) subject to the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model ###) 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 the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model ###) applies prospectively only, i.e., applies only to Covered Policies issued on or after the effective date of their version of the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model ###). It is anticipated, however, that most states will be able to adopt a version of the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model ###) 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 the NAIC Term and Universal Life Insurance Reserve Financing Model Regulation (Model ###).*