2020 Spring National Meeting  
Phoenix, Arizona  

FINANCIAL CONDITION (E) COMMITTEE  
Monday, March 23, 2020  
2:30 – 3:00 p.m.  
Sheraton Grand Phoenix—Valley of the Sun AB—2nd Level  

ROLL CALL  

Scott A. White, Chair Virginia Mike Chaney Mississippi  
Eric A. Cioppa, Vice Chair Maine Marlene Caride New Jersey  
Michael Conway Colorado Russell Toal New Mexico  
David Altmaier Florida Raymond G. Farmer South Carolina  
Colin M. Hayashida Hawaii Kent Sullivan Texas  
Robert H. Muriel Illinois James A. Dodrill West Virginia  
Stephen W. Robertson Indiana Jeff Rude Wyoming  
Steve Kelley Minnesota  

NAIC Support Staff: Dan Daveline/Julie Gann/Bruce Jenson  

AGENDA  

1. Consider Adoption of its Feb. 27, 2020, and 2019 Fall National Meeting Minutes  
   Attachment One  
   —Commissioner Scott A. White (VA)  

2. Consider Adoption of its Task Force and Working Group Reports  
   —Commissioner Scott A. White (VA)  
   a. Accounting Practices and Procedures (E) Task Force Pending  
   b. Capital Adequacy (E) Task Force Pending  
   c. Examination Oversight (E) Task Force Pending  
   d. Receivership and Insolvency (E) Task Force Pending  
   e. Reinsurance (E) Task Force Pending  
   f. Risk Retention Group (E) Task Force Pending  
   g. Valuation of Securities (E) Task Force Pending  
   h. Group Capital Calculation (E) Working Group Pending  
   i. Mortgage Guaranty Insurance (E) Working Group Pending  
   j. National Treatment and Coordination (E) Working Group Pending  
   k. Restructuring Mechanisms (E) Working Group Pending  
   l. Group Solvency Issues (E) Working Group Pending  

3. Consider Adoption of Technical Edits to the Term and Universal Life Insurance Reserve Financing Model Regulation (#787)—Commissioner Scott A. White (VA)  
   Attachment Fourteen  

4. Discuss Any Other Matters Brought Before the Committee—Commissioner Scott A. White (VA)  

5. Adjournment  

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The Financial Condition (E) Committee met via conference call Feb. 27, 2020. The following Committee members participated: Scott White, Chair (VA); Eric A. Cioppa, Vice Chair, and Vanessa Sullivan (ME); Michael Conway represented by Rolf Kaumann (CO); David Altmaier represented by Carolyn Morgan and Robert Ridenour (FL); Robert H. Muriel represented by Kevin Fry and Kevin Baldwin (IL); Stephen W. Robertson and Roy Eft (IN); Steve Kelley represented by Fred Andersen (MN); Marlene Caride (NJ); Russell Toal (NM); Raymond G. Farmer represented by Daniel Morris (SC); Kent Sullivan represented by James Walker (TX); James A. Dodrill represented by Jamie Taylor (WV); and Jeff Rude (WV).

1. Adopted Request for Model Law Development from the Receivership & Insolvency (E) Task Force

Commissioner White made the Committee aware that the Executive (EX) Committee approved a request for model law development from the Group Capital Calculation (E) Working Group with respect to the Insurance Holding Company System Regulatory Act (440) and Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (450) which could have implications for this new request (Attachment?) from the Receivership & Insolvency (E) Task Force related to the same NAIC models. He described that while the two items are unrelated, it is important for the Committee to understand if this new work could slow down the work of the Group Capital Calculation (E) Working Group. More specifically, the goal is for the Group Capital Calculation to be adopted by the working group at the Summer National Meeting so states could begin introducing early 2021. With that as a backdrop, he requested Mr. Baldwin to provide a summary of their request.

Mr. Baldwin stated on Jan. 8th, the Receivership & Insolvency (E) Task Force adopted a request to the Committee. He stated that the background for the Task Force’s request is a common issue that can arise in a receivership of an insurance company where affiliated entities provide essential services through inter-company agreements. The continuation of these services can be critical to the operation of the receivership, particularly when all staffing and information technology functions are outsourced. This issue is specific to agreements with affiliated entities that are formed for the sole purpose of providing services to the insurance company. For example, affiliated entities may handle all the insurance company’s administrative functions (such as claims handling, underwriting, statutory accounting, and premium collection), but provide no services to entities outside of the group.

Mr. Baldwin described how in some cases the insurance company and an affiliate are inextricably intertwined. He described that if the operations and records of the entities are commingled, it is difficult to handle the receivership without the affiliate’s cooperation. Sometimes it is necessary to place an affiliate in receivership, and administer it with the insurance company. However, if the affiliate does not consent, the ensuing litigation will involve further time and expense.

Mr. Baldwin described how one potential solution the Task Force identified is to consider revisions to 440 by modifying the definition of “insurer” under state insurance holding company laws to encompass affiliated entities whose sole purpose is to provide services to an insurer. While the Task Force recognizes that there are significant issues to be worked through, including potential conflicts with other laws, the Task Force would endeavor to address those and any other issues as part of the work in developing a solution within 440 and 450.

Commissioner Caride made a motion, seconded by Mr. Kaumann, to adopt the request to make changes to 440 and 450 to develop revisions to address issues with continuity of essential services. The motion was unanimously carried.
2. **Adopted a Request for Extension from the Mortgage Guaranty Insurance (E) Working Group**

Commissioner White reminded Committee members that the NAIC requires model law requests, such as the one adopted from Receivership & Insolvency Task Force, to be adopted as NAIC model laws or model law changes within one year of the original request to the NAIC Executive (EX) Committee. He stated that to the extent a model change is not completed within one year from the date approved by the NAIC Executive (EX) Committee, an extension must be requested and approved. With respect to the specific request from the Mortgage Guaranty Insurance (E) Working Group, he stated that while this work has been ongoing for a significant period, this was a project he supported being completed and supported the request. He stated the ongoing work has largely been the product of its technical nature and need for the NAIC to hire consultants and then modifications based upon the consultant’s work. He stated he was encouraged to hear that this group does now appear to be close on finalizing this work as they now have exposed a new Loan Level Capital Model for these mortgage insurers, all of the states on this Working Group are supportive of the direction. A motion was made by Commissioner Toal, and seconded by Commissioner Caride, to adopt the request (Attachment?). The motion was unanimously carried.

3. **Adopted a Request for NAIC Model Law Development from the Financial (EX) Stability Task Force**

Commissioner White stated that the Committee had received an additional model law development request (Attachment?) from the Financial Stability Task Force on Feb. 26, and relates to a liquidity stress test that has been in the process of being developed for some time. He stated that while the actual stress test is not yet completed, it is like the group capital calculation in that the primary purpose of any type of legislative change is to provide the necessary confidentiality protections. The stated that similar to the request from the Receivership and Insolvency (E) Task Force, it’s too early to know whether the completion of this work could impact the group capital calculation, but the idea is to make all three of the different legislative changes to models 440 and 450 at the same time, assuming all are ultimately supported and adopted.

Commissioner White stated that during the Feb. 26 conference call of the Financial Stability (EX) Task Force, one comment letter on this item was received from the American Council of Life Insurers (ACLI) and the general response on adopting the request was that while 440 and 450 might not ultimately be chosen as the ideal placement for holding this tool confidential, if it is it makes sense that all three of the items be addressed at the same time. He described how far fewer companies were likely by this liquidity stress test than the group capital calculation with as few as 23 for this test. Commissioner Robertson and Mr. Eft expressed support for the confidentiality aspect of this request, but they expressed concern about one of the provisions that limits and decides what stress test gets used in a liquidation because it seems to reduce the states right to choose the stress. Commissioner Caride stated work is ongoing and that all comments are welcome. Commissioner Robertson asked what was being voted on and whether the issue of what stress test is being used is still open for consideration. Commissioner White responded that the issue before the Committee was not adoption of the actual stress test but rather the request to work on changes to 440 and 450 that would provide the authority and confidentiality protections of the liquidity stress test, but that the stress test itself is still being developed. Commissioner Caride agreed that the item on the table was only to consider if the model is the appropriate venue. She stated she would be happy to reach out to Commissioner Robertson subsequent to the conference call to better understand his concern regarding the actual stress test. Commissioner Robertson stated that he wanted it to be clear in the minutes that the action contemplated was only requesting the authority for the Task Force to work on the changes to the model law and not the actual stress test to be required. Commissioner White stated that was the case and noted Commissioner Robertson’s concern would be noted in the minutes. A motion was made by Commissioner Caride, and seconded by Superintendent Cioppa, to incorporate this request into what was just adopted from the Receivership and Insolvency (E) Task Force.

Having no further business, the Financial Condition (E) Committee adjourned.

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The Financial Condition (E) Committee met in Austin, TX, Dec. 9, 2019. The following Committee members participated: David Altmaier, Chair (FL); Kent Sullivan, Vice Chair; and Jamie Walker (TX); Michael Conway represented by Rolf Kaumann (CO); Robert H. Muriel and Kevin Fry (IL); Eric A. Cioppa and Vanessa Sullivan (ME); Steve Kelley and Kathleen Orth (MN); Chlora Lindley-Myers and John Rehagen (MO); Matthew Rosendale represented by Steve Matthews (MT); Marlene Caride (NJ); Glen Mulready represented by Eli Snowbarger (OK); Raymond G. Farmer represented by Lee Hill (SC); James A. Dodrill represented by Justin Parr (WV); and Jeff Rude (WY).

1. **Adopted its Oct. 31, Aug. 29 and Summer National Meeting Minutes**

The Committee met Oct. 31, Aug. 29 and Aug. 5. During its Oct. 31 meeting, the Committee took the following action: 1) adopted its 2020 proposed charges; 2) adopted a Request for NAIC Model Law Development related to the group capital calculation (GCC); and 3) adopted revisions to the Guideline for Stay on Termination of Netting Agreements and Qualified Financial Contracts (#1556). During its Aug. 29 meeting, the Committee adopted proposed changes to the Annual Statement Instructions – Property/Casualty specifically related to the actuarial opinion, including, among other things, the definition of “qualified actuary.”

Commissioner Sullivan made a motion, seconded by Ms. Orth, to adopt the Committee’s Oct. 31 (Attachment One) Aug. 29 (Attachment Two) and Aug. 5 (see NAIC Proceedings – Summer 2019, Financial Condition (E) Committee) minutes. The motion passed unanimously.

2. **Adopted the Reports of its Task Forces and Working Groups**

Commissioner Altmaier stated that items adopted within the Committee’s task force and working group reports that are considered technical, noncontroversial and not significant by NAIC standards—i.e., they do not include model laws, model regulations, model guidelines or items considered to be controversial—will be considered for adoption by the Executive (EX) Committee and Plenary through the Financial Condition (E) Committee’s technical changes report process. Pursuant to this process, which was adopted by the NAIC in 2009, a listing of the various technical changes will be sent to NAIC members shortly after completion of the Fall National Meeting, and the members will have 10 days to comment with respect to those items. If no objections are received with respect to an item, the technical changes will be considered adopted by the NAIC membership and effective immediately.

Commissioner Lindley-Myers made a motion, seconded by Commissioner Caride, to adopt the following task force and working group reports: Accounting Practices and Procedures (E) Task Force; Capital Adequacy (E) Task Force; Examination Oversight (E) Task Force; Receivership and Insolvency (E) Task Force; Reinsurance (E) Task Force; Risk Retention Group (E) Task Force; Valuation of Securities (E) Task Force; Group Capital Calculation (E) Working Group (Attachment Three); Mortgage Guaranty Insurance (E) Working Group (Attachment Four); National Treatment and Coordination (E) Working Group (Attachment Five); Restructuring Mechanisms (E) Working Group (Attachment Six); and Group Solvency Issues (E) Working Group (Attachment Seven). The motion passed unanimously.

The Financial Analysis (E) Working Group met Oct. 28 and Oct. 7 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings, to discuss letter responses related to second-quarter 2019 financial results. Additionally, the Valuation Analysis (E) Working Group met Nov. 25 and Nov. 15 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings, to discuss valuation items related to specific companies.

3. **Adopted the 2019 Examiners’ Suggested Salary Rate**

Commissioner Altmaier reminded the Committee members that each year, NAIC staff provide an average recommended increase for examiners’ salaries based on the consumer price index (CPI) for the prior year ending July 31. Commissioner Altmaier emphasized that in order to avoid negative impact to any states, the base compensation on the current salary and per diem guidelines, NAIC staff have continued to maintain the existing Financial Condition Examiners Handbook guidance on compensation, which is being updated via this memorandum. NAIC staff also recommend that the Risk-Focused...
Surveillance (E) Working Group assume the responsibility to oversee development of updates to all compensation-related guidance.

Commissioner Caride made a motion, seconded by Commissioner Lindley-Myers, to adopt the 2020 examiners’ suggested salary rate (Attachment Eight). The motion passed unanimously.

4. **Adopted Revisions to the Process for Evaluating Qualified and Reciprocal Jurisdictions**

Mr. Rehagen reminded members of the Committee that the NAIC originally adopted this process now being considered for modification in 2013 as a method of evaluating the reinsurance supervisory systems of non-U.S. jurisdictions. He stated the purpose was for developing and maintaining a list of jurisdictions for recognition by the states as qualified jurisdictions for reinsurance collateral reduction purposes. He described how the process worked well over the years, and noted the NAIC currently has seven qualified jurisdictions: Bermuda; France; Germany; Ireland; Japan; Switzerland; and the United Kingdom (UK). He stated the expectation is that the NAIC Executive (EX) Committee and Plenary will approve the re-evaluations of these seven qualified jurisdictions upon the completion of their initial five-year periods, effective for Jan. 1, 2020, during its Dec. 10 meeting.

Mr. Rehagen noted that given the NAIC membership’s adopted revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) in June, the proposed revisions for the process conform the models to the reinsurance collateral elimination provisions of the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” and the “Bilateral Agreement Between the United States of America and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance” (Covered Agreements). In addition, not only are jurisdictions that are subject to Covered Agreements treated as reciprocal jurisdictions for reinsurance collateral purposes, but other qualified jurisdictions can also qualify for collateral elimination as reciprocal jurisdictions. States that meet the requirements of the NAIC Financial Regulation Standards and Accreditation Program are also considered to be reciprocal jurisdictions.

Mr. Rehagen reported that the Reinsurance (E) Task Force amended the process to reflect the revisions to Model #785 and Model #786 and to add a new section on the review of qualified jurisdictions as reciprocal jurisdictions. In addition, the Task Force added several improvements with respect to the evaluation of qualified jurisdictions, most important being the elimination of the five-year re-evaluation requirement. He stated that, as revised, qualified jurisdictions and reciprocal jurisdictions will remain on the lists until such time that there is a reason identified to remove them from the lists. He stated the evaluations of Bermuda, Japan and Switzerland as reciprocal jurisdictions under this revised process will be considered by the Executive (EX) Committee and Plenary during their Dec. 10 meeting, but this Committee needs to first approve the documented modified process.

Mr. Rehagen made a motion, seconded by Superintendent Cioppa, to adopt the revised process for evaluating qualified and reciprocal jurisdictions (Attachment Nine).

Having no further business, the Financial Condition (E) Committee adjourned.
TERM AND UNIVERSAL LIFE INSURANCE RESERVE FINANCING MODEL REGULATION

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Section 1. Authority

This regulation is adopted and promulgated by [title of supervisory authority] pursuant to [insert provision of state law equivalent to section 5B of the Credit for Reinsurance Model Law] of the [name of state] Insurance Code.

Section 2. Purpose and Intent

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

Section 3. Applicability

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

Section 4. Exemptions from this Regulation

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

   A. Reinsurance of:

      (1) Policies that satisfy the criteria for exemption set forth in [insert provision of state law equivalent to Section 6F of the Valuation of Life Insurance Policies Model Regulation] or [insert provision of state law equivalent to Section 6G of the Valuation of Life Insurance Policies Model Regulation]; and which are issued before the later of:
(a) The effective date of this regulation, 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 [insert provision of state law equivalent to Section 6E of the Valuation of Life Insurance Policies Model Regulation] and which are issued before the later of:

(a) The effective date of this regulation, 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 Commissioners Standard Ordinary (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; nor

(6) Any group life insurance certificate unless the certificate provides for a stated or implied schedule of maximum gross premiums required in order to continue coverage in force for a period in excess of one year.

B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Law]; or

C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Law], and that, in addition:

(1) Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer’s reported surplus and are material enough that they need to be disclosed in the financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 1 (“SSAP 1”); and

(2) Is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event as those terms are defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its RBC is calculated in accordance with the life risk-based capital report including overview and instructions for companies, as the same may be amended by the NAIC from time to time, without deviation; or

D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of [insert provisions of state law equivalent to Sections 2A, 2B or 2C, of the Credit for Reinsurance Model Law], and that, in addition:
Is not an affiliate, as that term is defined in [insert provision of state law equivalent to Section 1A of the Insurance Holding Company System Regulatory Model Act], 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;

Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual;

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

Is not, or would not be, below 500% of the Authorized Control Level RBC as that term is defined in [insert provision of state law equivalent to the Risk-Based Capital (RBC) for Insurers Model Act] when its 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

Reinsurance ceded to an assuming insurer that meets the requirements of either [insert provision of state law equivalent to Section 5B(4)(a) of the Credit for Reinsurance Model Law, pertaining to certain certified reinsurers] or [insert provision of state law equivalent to Section 5B(4)(b) of the Credit for Reinsurance Model Law, pertaining to reinsurers meeting certain threshold size and licensing requirements]; or

Drafting Note: A state may satisfy the requirements of Section 4E above by either adopting Section 5B(4) of the Credit for Reinsurance Model Law (#785), or it may include the specific provisions of Section 5B(4) of the Credit for Reinsurance Model Law (#785) directly into its adoption of this regulation, Term and Universal Life Insurance Reserve Financing Model Regulation (#787).

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 regulation (as described in Section 2 above);

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

(3) The application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4F to exempt a reinsurance treaty from this regulation, as well as the general basis therefor (including a summary description of the treaty).

Drafting Note: The exemption set forth in Section 4F was added to address the possibility of unforeseen or unique transactions. This exemption exists because the NAIC recognizes that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this regulation purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given at the time this exemption was developed pertained to bulk reinsurance 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 4A, B, C, D, or E or meet the substantive requirements of this regulation.
Section 5. Definitions

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

B. “Covered Policies” means the following: Subject to the exemptions described in Section 4, 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.

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 4 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 [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Law];

(2) Securities listed by the Securities Valuation Office meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Law], 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.

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

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

Section 6. The Actuarial Method

A. Actuarial Method

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

(1) For Covered Policies described in Section 5B(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 5B(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.

(2) For Covered Policies described in Section 5B(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
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 Regulation, 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 Regulation;

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

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

(b) Credit for the Non-Covered Policy reserves shall be granted only to the extent that security, in addition to the security held to satisfy the requirements of Subparagraph (a), is held by or on behalf of the ceding insurer in accordance with [cite the state’s version of Sections 2 and 3 of the Credit for Reinsurance Model Law]. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

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

A. Requirements

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

1. The ceding insurer’s statutory policy reserves with respect to the Covered Policies are established in full and in accordance with the applicable requirements of [insert provisions of state law equivalent to the Standard Valuation Law] and related regulations and actuarial guidelines, and credit claimed for any reinsurance treaty subject to this regulation does not exceed the proportionate share of those reserves ceded under the contract; and

2. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance treaty subject to this regulation and provides support for its calculation as determined to be acceptable to the commissioner; and

3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance treaty within the meaning of [insert provision of state law equivalent to Section 3 of the Credit for Reinsurance Model Law], on a funds withheld, trust, or modified coinsurance basis; and

4. Funds consisting of Other Security, in an amount at least equal to any portion of the statutory reserves as to which Primary Security is not held pursuant to Paragraph (3) above, are held by or on behalf of the ceding insurer as security under the reinsurance treaty within the meaning of [insert provision of state law equivalent to Section 3 of the Credit for Reinsurance Model Law]; and

5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 12A of the Credit for Reinsurance Model Regulation], except that:

   a. Funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6B, be valued according to the valuation rules set forth in Section 6B, 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 7A(3); 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 7A(3)) below 102% of the level required by Section 7A(3) at the time of the withdrawal or substitution; and

   d. The determination of reserve credit under [insert provision of state law equivalent to Section 12A of the Credit for Reinsurance Model Regulation] shall be determined according to the valuation rules set forth in Section 6B, as applicable; and
(6) The reinsurance treaty has been approved by the commissioner.

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.

(3) Nothing in Section 7B(2) shall be construed to allow a ceding company to maintain any deficiency under Section 7A(3) or 7A(4) for any period of time longer than is reasonably necessary to eliminate it.

Section 8. Severability

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

Section 9. Prohibition against Avoidance

No insurer that has Covered Policies as to which this regulation applies (as set forth in Section 3) shall take any action or series of actions, or enter into any transaction or arrangement or series of transactions or arrangements if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation, or to circumvent its purpose and intent, as set forth in Section 2.

Section 10. Effective Date

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