Reinsurance (E) Task Force

A new model

The NAIC solicits comments on this draft. The working draft of the Non-Universal Life and Universal Life with Secondary Guarantees is available at http://naic.org/committees_e_reinsurance.htm.

Non-Universal Life and Universal Life With Secondary Guarantees Credit for Reinsurance Model Regulation

Section 1. Authority.

This regulation is adopted and promulgated by [title of supervisory authority] pursuant to Section [applicable section] of the [name of state] Insurance Code.

Section 2. Purpose and Intent.

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

Section 3. Applicability.

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

Section 4. Exemptions from this Regulation.

This regulation does not apply to:

A. Risks ceded to an assuming insurer for policies eligible for exemption under [insert provision of state law equivalent to Section 6F or Section 6G. of the Valuation of Life Insurance Policies Model Regulation] or the portion of the reserve ceded under Yearly Renewable Term (“YRT”) Reinsurance under [insert provision of state law equivalent to Section 6.E. of the Valuation of Life Insurance Policies Model Regulation]; or
B. Risks ceded to an assuming insurer that meets the applicable requirements of (1) [insert provision of state law equivalent to Section 2E of the Credit for Reinsurance Model Act, if the state has adopted such a provision and has been certified in this state or, if this state has not adopted a provision equivalent to Section 2E, in a minimum of five states.] or (2) [insert provision of state law equivalent to Section 2D of the Credit for Reinsurance Model Act]; or

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

1. prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, without any departures from NAIC statutory accounting practices and procedures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer’s reported surplus and are material enough that they need to be 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. Risks ceded to an assuming insurer if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply: (1) the risks are clearly outside of the intent and purpose of this regulation (as described in Section 2 above); (2) the risks are included within the scope of this regulation only as a technicality; and (3) the application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made pursuant to this Section 4D to exempt a reinsurance arrangement from this regulation, as well as the general basis therefor (including a summary description of the arrangement).

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

Section 5. Definitions.

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

B. Covered Policies: Subject to the exemptions described in Section 4, Covered Policies are those policies that are required to be valued under [insert provisions of state law equivalent to Sections 6 or 7 of the Valuation of Life Insurance Policies Model Regulation] and that have
risk ceded to an assuming insurer; provided, however, that Covered Policies shall not include policies that were both (1) issued prior to January 1, 2015 and (2) ceded so that they were part of a reinsurance arrangement, as of December 31, 2014, that would not qualify for exemption as described in Section 4 if that section would have been applicable.

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

D. Primary Security: The following forms of security:

1. Cash meeting the requirements of [insert provision of state law equivalent to Section 3A of the Credit for Reinsurance Model Act];

2. SVO-listed securities meeting the requirements of [insert provision of state law equivalent to Section 3B of the Credit for Reinsurance Model Act], but excluding any synthetic letter of credit, contingent note, credit-linked note or other similar security that operates in a manner similar to a letter of credit, and excluding any securities issued by the ceding insurer or any of its affiliates; and

3. For security held in connection with funds-withheld and modified coinsurance reinsurance arrangements:
   a. Commercial loans in good standing of CM3 quality and higher;
   b. Policy Loans; and
   c. Derivatives acquired in the normal course and used to support and hedge liabilities pertaining to the actual risks in the policies ceded pursuant to the reinsurance arrangement.

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

F. Valuation Manual: The valuation manual adopted by the NAIC as described in Section 11B(1) of the Standard Valuation Law, with all amendments through the effective date of this regulation and as subsequently amended by the NAIC.

[Drafting Note: Section 5F 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 5F as appropriate to do so].

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

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

[Drafting Note: States that have not yet adopted the Standard Valuation Law, as amended by the NAIC in 2009, at the time they are adopting this regulation, should substitute the following definition: “January 1 of the first calendar year following the first July 1 as of which all of the following have occurred:
1. The Valuation Manual has been adopted by the NAIC by an affirmative vote of at least forty-two (42) members, or three-fourths of the members voting, whichever is greater;

2. The Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions, has been enacted by States representing greater than 75% of the direct premiums written as reported in the following annual statements submitted for 2008: life, accident and health annual statements; health annual statements; or fraternal annual statements.

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

[Drafting Note: Sections 5E, G and H 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 – Before the Operative Date of the Valuation Manual

Before the Operative Date of the Valuation Manual, the Actuarial Method to establish the Required Level of Primary Security shall be VM-20, with the modifications as provided below:

1. For Covered Policies required to be valued under Section 6 of the Valuation of Life Insurance Policies Model Regulation, the Actuarial Method is the greater of the Deterministic Reserve or the Net Premium Reserve (NPR), subject to any additional modifications below. No exemption testing is allowed.

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

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

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

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

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

(i) For a quota share retained by the ceding insurer for its own account, the Required Level of Primary Security will be reduced by at most a percentage equal to the excess of one hundred percent (100%) over the quota share ceded in the non-exempt reinsurance arrangement;

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

(a) The Required Level of Primary Security will be calculated as the excess of (1) over (2), where (1) is the Required Level of Primary Security using the Actuarial Method applied to all risks under the Covered Policies including the ceded secondary guarantee rider (reduced by the amount specified pursuant to Subsection (iv) below in the event any risk is ceded on a yearly renewable term basis in an exempt arrangement) and (2) is the statutory reserve retained by the ceding insurer on the Covered Policies (reduced by the amount specified pursuant to Subsection (iv) below in the event any risk is ceded on a yearly renewable term basis in an exempt arrangement);

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

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

(iv) For risks ceded on a yearly renewable term basis in an exempt arrangement, the Required Level of Primary Security will be reduced by at most \( \left( \frac{1}{2 \times \text{number of reinsurance premiums per year}} \right) \times cx \), calculated using the mortality defined in the NPR; and

(v) For all other exempt arrangements, including but not limited to stop loss, excess of loss and other non-proportional reinsurance arrangements, there will be no reduction in the Required Level of Primary Security.

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

The adjustments outlined in Subsections (ii), (iii) and (iv) above will be made only with respect to exempt arrangements entered into directly by the ceding insurer. The ceding insurer will make no adjustments as a result of retrocession arrangements entered into by any of its assuming insurers.
b. Section 8 of VM-20 (Reinsurance) in the Valuation Manual shall not be used in applying the Actuarial Method, except that Section 8C11 shall apply when some of the assets supporting the gross reserve are held by the counterparty or by another party. In no event will the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.

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

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

C. Valuation used for Purposes of Calculations

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

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

A. Requirements

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

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

2. The ceding insurer determines the Required Level of Primary Security with respect to such reserves and provides support for its calculation as determined to be acceptable to the commissioner;
3. Funds consisting of Primary Security, in an amount at least equal to the Required Level of Primary Security, are held by or on behalf of the ceding insurer, as security under the reinsurance contract within the meaning of [insert provision of state law equivalent to Section 3 of the Model Credit for Reinsurance Act], on a funds withheld, trust, or modified coinsurance basis;

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

5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of [insert provision of state law equivalent to Section 11 of the Credit for Reinsurance Model Regulation], except that:
   a. funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6C, be valued according to the valuation rules set forth in Section 6C, as applicable; and
   b. there are no affiliate investment limitations with respect to any security held in such trust if such security is not needed to satisfy the requirements of Section 7A3; and
   c. The reinsurance agreement must prohibit withdrawals or substitutions of trust assets that would leave the fair market value of the Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer in the manner required by Section 7A3) below 102% of the level required by Section 7A3 at the time of the withdrawal or substitution; and

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

B. Requirements at Inception Date; Annual Review and Remediation

The requirements of Section 7A shall be satisfied as of the date that risks are ceded under Covered Policies (if such date is on or after the effective date of this regulation) and on an ongoing basis thereafter. Beginning on or before [February 15th in the calendar year immediately following the calendar year in which this regulation becomes effective], and on or before each February 15th thereafter, each life insurance company within the scope of Section 3 shall perform an analysis, on a treaty by treaty basis, to determine, as to each reinsurance contract under which Covered Policies have been ceded, whether as of the immediately preceding December 31st (the valuation date), the requirements of Sections 7A3 and 4 remain satisfied. If the company determines as a result of such analysis that the requirements of Section 7A3 and 4 were not fully satisfied as of the valuation date and if such company seeks to receive credit for reinsurance as of the valuation date, it shall, on or before the March 1st immediately following the valuation date, add additional Primary Security and/or Other Security, as the case may be, in such amount and held in such form as would have caused the requirements of Section 7A3 and 4 to be fully satisfied as of the valuation date.
Section 8. Severability.

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

Section 9. Prohibition against Avoidance.

No insurer shall take any action or series of actions, or enter into any transaction or arrangement or series of transactions or arrangements, involving Covered Policies, if the purpose of such action, transaction or arrangement or series thereof is to avoid the requirements of this regulation.

Section 10. Effective Date

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