

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

Method and Primary Security forms adopted by the NAIC. The initial version of *Actuarial Guideline XXXVIII, 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 the effective date of January 1, 2015.

Coordination between this Actuarial Guideline and the NAIC Term and Universal Life Insurance

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

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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.

- 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:

- (5) In no event will the Required Level of Primary Security resulting from app

- (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).

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

