

CLIENT MEMORANDUM

NAIC Executive Committee Adopts XXX/AXXX Reinsurance Framework

August 20, 2014

AUTHORS

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On August 17, 2014, during the 2014 Summer National Meeting of the National Association of Insurance Commissioners (the “NAIC”), the Executive (EX) Committee of the NAIC (the “Executive Committee”) adopted the XXX/AXXX Reinsurance Framework (the “Framework”).

The Framework is part of the NAIC action plan to develop further regulatory requirements specific to surplus relief transactions involving level premium term policies (XXX) and universal life policies with secondary guarantees (AXXX), which the NAIC has now studied for a significant period of time. During the meeting of the Executive Committee, Rhode Island Superintendent of Insurance Joseph Torti III indicated that the NAIC had concerns with XXX and AXXX transactions during its review and that the Framework aims to set standards applicable to XXX and AXXX transactions without restricting them outright. The Framework is also intended to provide an interim solution with respect to XXX and AXXX transactions, since—as Superintendent Torti also noted during the meeting of the Executive Committee—the NAIC expects that there will no longer be a need for XXX and AXXX transactions after the full implementation of the NAIC’s Principles-Based Reserving (“PBR”) initiative.

The Framework would apply only prospectively, and only to XXX transactions and AXXX transactions. The Framework would not change statutory reserve requirements applicable to a ceding insurer. Instead, the Framework would change the types of assets necessary to back those reserve liabilities as follows: (a) a portion of the total statutory reserve

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approximately equal to the PBR level would be required to be collateralized with “hard assets” (e.g., cash and securities listed with the NAIC’s Securities Valuations Office (“SVO”)); and (b) the remainder of the reserve could be collateralized with other assets identified as acceptable by regulators. The Framework would also require the opining actuary of the ceding insurer to issue a qualified opinion if the Framework is not followed. The NAIC plans to issue an actuarial guideline before the end of this year to implement this requirement. In addition, as another enforcement tool, a note to the annual audited financial statement would require the cedent and its independent auditor to indicate whether the Framework is being followed.

The Framework would also require the cedent to disclose the assets used to support the reserves and hold an RBC cushion if the captive does not file RBC reports.

The Framework would be codified through the *Credit for Reinsurance Model Law (#785)* with the creation of a new model regulation to establish requirements regarding the reinsurance of XXX and AXXX policies. The Executive Committee adopted a number of charges to various NAIC groups to implement the above requirements, in addition to adopting model law development requests for a new XXX/AXXX Reinsurance Model Regulation and amendments to the *Credit for Reinsurance Model Law (#785)* and the *Actuarial Opinion and Memorandum Regulation (#822)*.

The Executive Committee’s vote to adopt the above items was by no means unanimous. During the meeting, New York and North Carolina regulators both expressed opposition to the Framework and were among the vocal minority of Executive Committee members who voted against the Framework’s adoption. In addition, the California Department of Insurance presumably continues its previously stated opposition to the Framework. The California Department of Insurance is not currently a member of the Executive Committee, but voted against the adoption of the Framework by the PBR Implementation (EX) Task Force earlier this summer.

It is important to note that the adoption of the Framework by the Executive Committee is but one of many steps in its implementation and much work is still required. Various NAIC groups have been charged with developing the details to create the framework for subsequent consideration by the entire NAIC membership. In this regard, the NAIC has set an ambitious year-end timetable for many of the tasks associated with implementation of the Framework.

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