

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
AT RICHMOND, SEPTEMBER 5, 2017

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COMMONWEALTH OF VIRGINIA, *ex rel.*

STATE CORPORATION COMMISSION

CASE NO. INS-2017-00186

Ex Parte: In the matter of
Adopting New Rules Governing
Term and Universal Life Insurance
Reserve Financing

ORDER TO TAKE NOTICE

Section 12.1-13 of the Code of Virginia ("Code") provides that the State Corporation Commission ("Commission") shall have the power to promulgate rules and regulations in the enforcement and administration of all laws within its jurisdiction, and § 38.2-223 of the Code provides that the Commission may issue any rules and regulations necessary or appropriate for the administration and enforcement of Title 38.2 of the Code.

The rules and regulations issued by the Commission pursuant to § 38.2-223 of the Code are set forth in Title 14 of the Virginia Administrative Code. A copy also may be found at the Commission's website: <http://www.scc.virginia.gov/case>.

The Bureau of Insurance ("Bureau") has submitted to the Commission a proposal to promulgate new rules at Chapter 318 of Title 14 of the Virginia Administrative Code entitled "Rules Governing Term and Universal Life Insurance Reserve Financing," which are recommended to be set out at 14 VAC 5-318-10 through 14 VAC 5-318-80.

The proposed new rules are necessary to implement the amendments to §§ 38.2-1316.1, 38.2-1316.2, 38.2-1316.4 and 38.2-1316.7 of the Code, which were enacted in Chapter 477 of the 2017 Acts of Assembly (HB 1471). The amendments to the Code authorize the Commission

to adopt regulations specifying additional requirements relating to the valuation of asset or reserve credits, the amount and forms of security supporting certain reinsurance arrangements, and the circumstances pursuant to which credit will be reduced or eliminated. The amendments to the Code became effective on July 1, 2017.

NOW THE COMMISSION is of the opinion that the proposal to adopt new rules recommended to be set out at Chapter 318 in the Virginia Administrative Code as submitted by the Bureau should be considered for adoption with a proposed effective date of January 1, 2018.

Accordingly, IT IS ORDERED THAT:

(1) The proposed new rules entitled "Rules Governing Term and Universal Life Insurance Reserve Financing," recommended to be set out at 14 VAC 5-318-10 through 14 VAC 5-318-80 are attached hereto and made a part hereof.

(2) All interested persons who desire to comment in support of or in opposition to, or request a hearing to consider the adoption of proposed Chapter 318, shall file such comments or hearing request on or before November 3, 2017, with Joel H. Peck, Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Interested persons desiring to submit comments electronically may do so by following the instructions at the Commission's website: <http://www.scc.virginia.gov/case>. All comments shall refer to Case No. INS-2017-00186.

(3) If no written request for a hearing on the adoption of the proposed new rules as outlined in this Order is received on or before November 3, 2017, the Commission, upon consideration of any comments submitted in support of or in opposition to the proposal, may adopt the rules as submitted by the Bureau.

(4) The Bureau forthwith shall give notice of the proposal by mailing a copy of this Order, together with the proposal, to all life insurers domiciled in Virginia, and to all interested persons.

(5) The Commission's Division of Information Resources forthwith shall cause a copy of this Order, together with the proposed rules, to be forwarded to the Virginia Registrar of Regulations for appropriate publication in the *Virginia Register of Regulations*.

(6) The Commission's Division of Information Resources shall make available this Order and the attached proposal on the Commission's website: <http://www.scc.virginia.gov/case>.

(7) The Bureau shall file with the Clerk of the Commission an affidavit of compliance with the notice requirements of Ordering Paragraph (4) above.

(8) This matter is continued.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to: Kiva B. Pierce, Assistant Attorney General, Division of Consumer Counsel, Office of the Attorney General, 202 N. 9th Street, 8th Floor, Richmond, Virginia 23219-3424; and a copy hereof shall be delivered to the Commission's Office of General Counsel and the Bureau of Insurance in care of Deputy Commissioner Donald C. Beatty.

STATE CORPORATION COMMISSION, BUREAU OF INSURANCE

Rules Governing Term and Universal Life Insurance Reserve Financing

CHAPTER 318RULES GOVERNING TERM AND UNIVERSAL LIFE INSURANCE RESERVE FINANCING**14VAC5-318-10. Purpose and scope.**

The purpose of this chapter is to set forth rules and procedural requirements 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 14VAC5-318-30, 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 (i) are issued by the ceding insurer or its affiliates; or (ii) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (iii) 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 treaty).

14VAC5-318-20. Applicability.

This chapter shall apply to reinsurance treaties that cede liabilities pertaining to covered policies, as that term is defined in 14VAC5-318-30, issued by any life insurance company domiciled in this Commonwealth. The requirements of this chapter shall become effective on

January 1, 2018 and shall pertain to all covered policies in force as of and after that date. This chapter and 14VAC5-300 shall both apply to such reinsurance treaties; provided, that in the event of a direct conflict between the provisions of this chapter and 14VAC5-300, the provisions of this chapter shall apply, but only to the extent of the conflict.

14VAC5-318-30. Definitions.

The following words and terms when used in this chapter shall have the following meanings, unless the context clearly indicates otherwise:

"Actuarial method" means the methodology used to determine the required level of primary security, as described in 14VAC5-318-50.

"Commission" means the State Corporation Commission when acting pursuant to or in accordance with Title 38.2 of the Code of Virginia.

"Covered policy" means subject to the exemptions described in 14VAC5-318-40, those policies, other than grandfathered policies, of the following policy types:

1. Life insurance policies with guaranteed nonlevel gross premiums 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.

"Grandfathered policies" means policies of the types described in the "covered policy" definition 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 14VAC5-318-40 had that section then been in effect.

"NAIC" means the National Association of Insurance Commissioners.

"Non-covered policy" means any policy that does not meet the definition of covered policy, including grandfathered policies.

"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.

"Primary security" means the following forms of security:

1. Cash meeting the requirements of subdivision 2 a of § 38.2-1316.4 of the Code of Virginia;

2. Securities listed by the Securities Valuation Office meeting the requirements of subdivision 2 b of § 38.2-1316.4 of the Code of Virginia, 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.

"Other security" means any security acceptable to the commission other than security meeting the definition of primary security.

"Valuation manual" means the valuation manual adopted by the NAIC as described in subdivision B 1 of § 38.2-1379 of the Code of Virginia, with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed.

"VM-20" means "requirements for principle-based reserves for life products," including all relevant definitions, from the valuation manual.

14VAC5-318-40. Exemptions from this chapter.

This chapter does not apply to the situations described in subdivisions 1 through 6 of this section.

1. Reinsurance of:

a. Policies that satisfy the criteria for exemption set forth in 14VAC5-319-50 F or 14VAC5-319-50 G; and which are issued before the later of:

(1) January 1, 2018, and

(2) 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 January 1, 2020;

b. Portions of policies that satisfy the criteria for exemption set forth in 14VAC5-319-50 E and which are issued before the later of:

(1) The effective date of this chapter, and

(2) 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 January 1, 2020;

c. Any universal life policy that meets all of the following requirements:

(1) Secondary guarantee period, if any, is five years or less;

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

4. Reinsurance ceded to an assuming insurer that meets the applicable requirements of subdivision C 1, 2 or 3 of § 38.2-1316.2 of the Code of Virginia, and that, in addition:

a. Is not an affiliate, as that term is defined in § 38.2-1322 of the Code of Virginia, of:

(1) The insurer ceding the business to the assuming insurer; or

(2) Any insurer that directly or indirectly ceded the business to that ceding insurer;

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

c. Is both:

(1) Licensed or accredited in at least 10 states (including its state of domicile), and

(2) 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

d. Is not, or would not be, below 500% of the Authorized Control Level RBC as that term is defined in § 38.2-5501 of the Code of Virginia 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, 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

5. Reinsurance ceded to an assuming insurer that meets the requirements of either subdivision B 4 a or B 4 b of § 38.2-1316.7 of the Code of Virginia; or

6. Reinsurance not otherwise exempt under subdivisions 1 through 5 of this section if the commission, after consulting with the NAIC Financial Analysis Working Group or other group of regulators designated by the NAIC, as applicable, determines under all the facts and circumstances that all of the following apply:

a. The risks are clearly outside of the intent and purpose of this chapter (as described in 14VAC5-318-10);

b. The risks are included within the scope of this chapter only as a technicality; and

c. The application of this chapter to those risks is not necessary to provide appropriate protection to policyholders. The commission shall publicly disclose any decision made pursuant to this subdivision to exempt a reinsurance treaty from this chapter, as well as the general basis therefor (including a summary description of the treaty).

14VAC5-318-50. The actuarial method.

A. The actuarial method to establish the required level of primary security for each reinsurance treaty subject to this chapter 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 as provided in the definition of "covered policy" in 14VAC5-318-30 subdivision 1, 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

as provided in the definition of "covered policy" in 14VAC5-318-30 subdivision 2, the ceding insurer may elect to instead use subdivision 2 of this subsection as the actuarial method for the entire reinsurance agreement. Whether subdivision 1 or 2 of this subsection is 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 as that term is defined in 14VAC5-318-30 subdivision 2, 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 subdivision 4 of this subsection, 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 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 subdivision 4 c of this subsection, 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 January 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 NPR; 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 subdivisions 4 a, b, c, and d of this subsection 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 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 chapter, 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 chapter;

7. If a reinsurance treaty subject to this chapter 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 14VAC5-318-60 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 subdivision 7 a of this subsection, is held by or on behalf of the ceding insurer in accordance with §§ 38.2-1316.2 and 38.2-1316.4 of the Code of Virginia, 14VAC5-300-90 C, 14VAC5-300-100 and 14VAC5-300-150 B and C. Any primary security used to meet the requirements of this subdivision may not be used to satisfy the required level of primary security for the covered policies.

B. 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 December 31st 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.

14VAC5-318-60. Requirements applicable to covered policies to obtain credit for reinsurance; opportunity for remediation.

A. Subject to the exemptions described in 14VAC5-318-40 and the provisions of subsection B of this section, credit for reinsurance shall be allowed with respect to ceded liabilities pertaining to covered policies pursuant to § 38.2-1316.2 of the Code of Virginia, 14VAC5-300-90 C, 14VAC5-300-100 and 14VAC5-300-150 B and C, or § 38.2-1316.4 of the Code of Virginia 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 Article 10 (§ 38.2-1365 et seq.) of Chapter 13 of Title 38.2 of the Code of Virginia and related regulations and actuarial guidelines, and credit claimed for any reinsurance treaty subject to this chapter 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 chapter and provides support for its calculation as determined to be acceptable to the commission; 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 § 38.2-1316.4 of the Code of Virginia, 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 subdivision 3 of this subsection, are held by or on behalf of the ceding insurer as security under the reinsurance treaty within the meaning of § 38.2-1316.4 of the Code of Virginia; and

5. Any trust used to satisfy the requirements of this section shall comply with all of the conditions and qualifications of 14VAC5-300-120, except that:

a. Funds consisting of primary security or other security held in trust, shall for the purposes identified in 14VAC5-318-50 B, be valued according to the valuation rules set forth in 14VAC5-318-50 B, 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 subdivision 3 of this subsection; 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 subdivision 3 of this subsection below 102% of the level required by subdivision 1 c of this subsection at the time of the withdrawal or substitution; and

d. The determination of reserve credit under 14VAC5-300-120 D shall be determined according to the valuation rules set forth in 14VAC5-318-50 B, as applicable; and

6. The reinsurance treaty has been approved by the commission.

B. Requirements at inception date and on an on-going basis; remediation.

1. The requirements of 14VAC5-318-60 A 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 chapter) 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 14VAC5-318-60 A 3 or 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 14VAC5-318-20 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 14VAC5-318-60 A 3 or 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 14VAC5-318-60 A 3, unless either:

a. The requirements of 14VAC5-318-60 A 3 or 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 or other security, as the case may be, in such amount and in such form as would have caused the requirements of 14VAC5-318-60 A 3 or 4 to be fully satisfied as of the valuation date.

3. Nothing in subdivision 2 of this subsection shall be construed to allow a ceding company to maintain any deficiency under 14VAC5-318-60 A 3 or 4 for any period of time longer than is reasonably necessary to eliminate it.

14VAC5-318-70. Prohibition against avoidance.

No insurer that has covered policies as to which this chapter applies (as set forth in 14VAC5-318-20) 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 chapter, or to circumvent its purpose and intent, as set forth in 14VAC5-318-10.

14VAC5-318-80. Severability.

If any provision of this chapter or the application thereof to any person or circumstance is for any reason held to be invalid, the remainder of the chapter and the application of the provision to other persons or circumstances shall not be affected thereby.

§§ 12.1-13, 38.2-223 and 38.2-1316.7 of the Code of Virginia.