CAPTIVES

Superintendent
Joe Torti

DEVELOPMENT OF CAPTIVE STRUCTURE

- Pure captives developed as an official industry in the late 1970's
- U.S. captive regulation/laws developed outside of the NAIC solvency framework
- Similarly, captives were excluded from the NAIC Accreditation Program

CONCERNS WITH DISPARATE REGULATION

- Inconsistent regulation of the transactions is an important concern
- Lack of transparency
- More Difficult to Assess Industry Position and Any Concerns
- Concerns Shared by Federal Gov't – FSOC, FIO, OFR, Federal Reserve
- Significant Portion of Industry Is No Longer Using Consistent, Conservative Accounting

XXX/AXXX BUSINESS

- Section 6, NAIC Model 830 (aka “XXX”)
  - In general, XXX was developed to address a reserving issue with level term (and similar) products
  - Reserves based on a specified interest rate and specified mortality table
- Section 7, NAIC Model 830 (aka AXXX)
  - Addressed reserving issues for Universal Life Insurance policies that Contain a Secondary Guarantee

XXX/AXXX BUSINESS (cont.)

- Industry's Issue with XXX/AXXX
  - Products are priced using expected assumptions
    - Premiums collected are not sufficient to fund the required statutory reserves
    - Companies are faced with a decision to fund this difference with surplus or look for other sources of capital
- XXX/AXXX Reserves were established too high, sometimes 3-4 times the "economic" reserve.
- Insurers began reserve financing transactions by ceding reserve values to captives and SPVs.

XXX/AXXX Reinsurance Framework

Require the direct ceding company for reinsurance financing transactions, in most instances, to:

- Book the full statutory reserve.
- Collateralize based on a tiered reserve.
- Disclose assets/securities supporting reserves.
- Hold appropriate RBC capital charge.

Rector & Associates, Inc.

XXX/AXXX Reinsurance Framework

Reserves

Statutory Reserves
Minus
PBR-Level Reserves

PBR-Level Reserves
("Actuarial Method")

Collateral

"Acceptable"
Security

"Primary Security:"
Cash, some SVO-Listed, Comm. Loans CM3+, policy loans, certain derivatives

Means to Implement Framework

- Credit for Reinsurance Model Law
  - Will reference a new model regulation related to XXX/AXXX reinsurance transactions
  - This is the longer-term solution requiring state-by-state adoption.
- New Actuarial Guideline 48
  - AG 48 was created for quick implementation.
  - AG 48 will sunset once Credit for Reinsurance Model Law & new Regulation are implemented.
- Permanent Solution is PBR!!!!

Actuarial Guideline 48 (AG48)

Background Section Summary

- Purpose and intent of AG48 is to establish uniform, national standards governing XXX or AXXX reserve financing
  - AG48 defines the “Actuarial Method” used to determine the reserve level
  - AG48 defines “Primary Security”
  - AG48 may require a qualified actuarial opinion
  - AG48 states that the requirements of the actuarial guideline are minimum standards and are not a substitute for the diligent analysis of reserve financing arrangements by regulators and that a regulator should impose requirements in addition to those set out in this actuarial guideline if the facts and circumstances warrant such action.
- Effective Date
  - January 1, 2015 to all Covered Policies
- Sunset Provision
  - This Actuarial Guideline shall cease to apply as to ceding insurers domiciled in a jurisdiction that has in effect, as of January 1st of the calendar year immediately preceding the year in which the actuarial opinion is to be filed, a law and regulation substantially similar to the amendment to the Credit for Reinsurance Model Law and new Model Regulation adopted by the NAIC.

TRANSPARENCY & ANALYSIS FOR XXX/AXXX CAPTIVE TRANSACTIONS

- Increased Transparency:
  - 2014 Blanks Change
    - XXX/AXXX Reinsurance Supplement – Due by April 1
- Improved Regulatory Review, Including 2014 Financial Analysis Handbook Changes
  - Sets forth procedures and other considerations when:
    - <u>reviewing a new proposed</u> XXX/AXXX transaction
    - <u>when analyzing an existing</u> XXX/AXXX transaction
  - Sets forth requirements related to <u>holding company analysis</u>
- Part B accreditation requirements related to the above

VARIABLE ANNUITIES

- Our next priorities: Variable Annuities and Long-term Care (LTC).
  - Remember, FSOC's 2014 Annual Report identified variable annuity and LTC captive reinsurance transactions as priorities for state regulators to address, and some have suggested these and potentially other captive transactions are a systemic issue.

- NAIC established the Variable Annuities Issues (E) Working Group, led by Commissioner Gerhart of Iowa, to "study and address, as appropriate, regulatory issues resulting in variable annuity captive reinsurance transactions."
  - Consultant hired to identify issues and possible solutions
  - "Preliminary Findings and Conclusions" presented to the Working Group and Industry on September 10^{th}
  - Quantitative Impact Study ("QIS") approved and funded
  - Additional Disclosure being added to provide immediate transparency

AND LONG-TERM CARE

- Perception that captives are being used to reduce required reserves on a line of business that has had under reserving and underpricing issues.
- NAIC staff and the primary regulators of insurers utilizing LTC Captives did an initial review of these transactions.
- Reserving and/or assets to support reserves do not appear to be an issue at all
- Still on the E Committee Agenda

ACCREDITATION

- The Financial Regulation Standards and Accreditation (F) Committee is also considering language to scope in captive reinsurance transactions involving XXX/AXXX, variable annuity, and long-term care business.
- Accreditation program is there to ensure that all states are regulating the companies writing multi-state coverages in a uniform and consistent manner.

Wrap Up

- Addressing regulatory concerns with Captive/SPV transactions paired with implementation of PBR is a priority issue for the NAIC Membership and Officers
- We have identified and made significant progress in addressing all of the major issues related to captives/SPVs
- Remaining implementation issues will be addressed promptly, including issues related to Accreditation
- The new E Committee process to identify national solvency framework issues should prevent future single state solutions

QUESTIONS OR COMMENTS