

02 DEPARTMENT OF PROFESSIONAL AND FINANCIAL REGULATION

031 BUREAU OF INSURANCE

Chapter 735: TERM AND UNIVERSAL LIFE INSURANCE RESERVE FINANCING

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Section 1. Authority and Purpose

The Superintendent of Insurance adopts this rule pursuant to 24-A M.R.S. §§ 212 and 731-B(2-B) & (7), to implement uniform national standards for reserve financing arrangements pertaining to life insurance policies with guaranteed nonlevel gross premiums, life insurance policies with guaranteed nonlevel benefits, and universal life insurance policies with secondary guarantees; and to ensure that, with respect to each such financing arrangement, adequate security, including adequate Primary Security as defined in Subsection 4(7), is held by or on behalf of ceding insurers in the forms and amounts required herein. In general, reinsurance ceded for reserve financing purposes involves arrangements where some or all of the assets used to secure the reinsurance treaty or to capitalize the reinsurer have one or more of the following characteristics: (1) they are issued by the ceding insurer or its affiliates; (2) they are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) they 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).

Section 2. Applicability

This rule applies to all reinsurance treaties that cede liabilities pertaining to Covered Policies, as defined in Subsection 4(2), issued by any domestic life insurer. In the event of a direct conflict between this rule and the Credit for Reinsurance Rule, 02-031 CMR ch. 740, the provisions of this rule shall control as applied to such treaties, but Rule 740 shall only be superseded to the extent of any conflict.

Section 3. Exemptions

This rule does not apply to:

- 1 Reinsurance of:
 - A. Policies that satisfy the criteria for exemption set forth in 02-031 CMR §§ 830(6)(F) or (G); and which are issued before the effective date of this rule;
 - B. Portions of policies that satisfy the criteria for exemption set forth in 02-031 CMR §830(6)(E) and which are issued before the effective date of this rule;
 - C. Any universal life policy that meets all of the following requirements:
 - (1) The secondary guarantee period, if any, is five years or less;
 - (2) Specified premium for the secondary guarantee period is not less than the net level reserve premium for the secondary guarantee period based on the Commissioners Standard Ordinary (CSO) valuation tables and valuation interest rate applicable to the issue year of the policy; and
 - (3) The initial surrender charge is not less than 100% of the first year annualized specified premium for the secondary guarantee period;
 - D. Credit life insurance;
 - E. 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; nor
 - F. 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.
2. Reinsurance ceded to an assuming insurer that, at the time the risk is ceded:
 - A. Is certified as a reinsurer in this State pursuant to 24-A M.R.S. §731-B(1)(B-2):
 - B. Is eligible for recognition by reciprocity for credit for reinsurance pursuant to 24-A M.R.S. §731-B(1)(B-3);
 - C. Maintains a multi-beneficiary trust fund in compliance with 24-A M.R.S. §731-B(1)(C); or

- D. Maintains at least \$250,000,000 in capital and surplus as determined in accordance with 24-A M.R.S. §901-A, excluding the impact of any permitted or prescribed practices; and is either:
- (1) Licensed in at least 26 states; or
 - (2) Licensed in at least 10 states and licensed or accredited in a total of at least 35 states.
3. Reinsurance ceded to an assuming insurer that is licensed as an insurance carrier or accredited as a reinsurer in this State, or is domiciled and licensed in another state that employs standards regarding credit for reinsurance, and meets the requirements of 02-031 CMR 740, Subsection 4(F) and, as applicable, Section 5, 8, or 9, and that, in addition:
- A.
- (1) Prepares statutory financial statements 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 assuming insurer's financial statement 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 24-A M.R.S. §6451(8), when its risk-based capital (RBC) is calculated without deviation in accordance with the life RBC report, including overview and instructions for companies; or
- B. Is not an affiliate, as defined in 24-A M.R.S. §222(2)(A), of either the ceding insurer or any insurer that directly or indirectly ceded the business to that ceding insurer, and:
- (1) Is licensed or accredited in at least 10 states (including its state of domicile), and is 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
 - (2) Is not below 500% of the Authorized Control Level Risk-Based Capital, as that term is defined in 24-A M.R.S. §6451(8)(C), when its risk-based capital (RBC) is calculated without deviation in accordance with the life RBC report, including overview and instructions for companies, 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.

4. Reinsurance not otherwise exempt under Subsections 1 through 3 if the Superintendent, after consulting with the NAIC Financial Analysis Working Group (FAWG), or other group of regulators designated by the NAIC for this purpose, 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 rule (as described in Section 1 above);
 - B. The risks are included within the scope of this rule only as a technicality; and
 - C. The application of this rule to those risks is not necessary to provide appropriate protection to policyholders. The Superintendent shall publicly disclose any decision made pursuant to this Subsection to exempt a reinsurance treaty from this rule, as well as the general basis therefor (including a summary description of the treaty).

***Drafting Note:** The exemption set forth in Subsection 3(4) was added to address the possibility of unforeseen or unique transactions. The NAIC recommended that states adopt this exemption, and created a guidance process for the states, in recognition that foreseeing every conceivable type of reinsurance transaction is impossible; that in rare instances unanticipated transactions might get caught up in this rule purely as a technicality; and that regulatory relief in those instances may be appropriate. The example that was given when the NAIC developed this exemption 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, those transactions should either fit within one of the standard exemptions set forth in Subsections 4(1) through 4(3) or meet the substantive requirements of this rule.*

Section 4. Definitions

1. “Actuarial Method” means the methodology used to determine the Required Level of Primary Security, as described in Section 5.
2. “Covered Policies” means policies, other than Grandfathered Policies and policies exempt under Section 3, of the following policy types:
 - A. Life insurance policies with guaranteed nonlevel gross premiums and/or guaranteed nonlevel benefits, except for flexible premium universal life insurance policies; or,
 - B. 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.
3. “Grandfathered Policies” means policies of the types described in Paragraphs 2(A) and (B) above that were:
 - A. Issued before January 1, 2015; and

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- B. 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.
4. “NAIC” means the National Association of Insurance Commissioners or its successor organization.
5. “Non-Covered Policies” means all policies, including Grandfathered Policies, that do not meet the definition of Covered Policies.
6. “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.
7. “Primary Security” means the following forms of security:
- A. Cash meeting the requirements of 24-A M.R.S. §731-B(3)(A);
- B. Securities listed by the NAIC Securities Valuation Office meeting the requirements of 24-A M.R.S. §731-B(3)(B), 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
- C. For security held in connection with funds-withheld and modified coinsurance reinsurance treaties:
- (1) Commercial loans in good standing of CM3 quality and higher;
- (2) Policy Loans; and
- (3) 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.
8. “Other Security” means any security acceptable to the Superintendent that does not meet the definition of Primary Security.
9. “Valuation Manual” means the valuation manual recognized by the Superintendent, pursuant to 24-A M.R.S. §959, with all revisions applicable in this State on the financial statement date on which credit for reinsurance is claimed.
10. “VM-20” means “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.

Section 5. The Actuarial Method

1. *Actuarial Method.* The Actuarial Method to establish the Required Level of Primary Security for each reinsurance treaty subject to this rule 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:
 - A. For Covered Policies described in Paragraph 4(2)(A), 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 Covered Policies described in Paragraphs 4(2)(A) and (B) are reinsured in the same reinsurance treaty, the ceding insurer may elect to instead use Paragraph B below as the Actuarial Method for the entire reinsurance agreement. Whether Paragraph A or B 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.
 - B. For Covered Policies described in Paragraph 4(2)(B), 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.
 - C. Except as provided in Paragraph D 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.
 - D. If the reinsurance treaty does not cede all of the risk with respect to the Covered Policies then the Required Level of Primary Security may be reduced as follows:
 - (1) 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 Subparagraph (3) below, may be reduced to a *pro rata* portion in accordance with the percentage of the risk ceded;
 - (2) 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;

- (3) 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 before 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 Net Premium Reserve; and
 - (4) 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 nonproportional reinsurance treaties, the Required Level of Primary Security may not be reduced.
 - (5) It is possible for any combination of Subparagraphs (1) through (4) above to apply. Such adjustments to the Required Level of Primary Security shall be made in the sequence that accurately reflects the portion of the risk ceded under 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.
 - (6) The adjustments for other reinsurance will be made only with respect to reinsurance treaties entered into directly by the ceding insurer. The ceding insurer may make no adjustment as a result of a retrocession treaty entered into by the assuming insurers.
- E. In no event shall the Required Level of Primary Security resulting from application of the Actuarial Method exceed the amount of statutory reserves ceded.
- F. If the ceding insurer cedes risks with respect to Covered Policies, including any riders, in more than one reinsurance treaty subject to this rule, in no event shall 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 rule;

- G. If a reinsurance treaty subject to this rule cedes risk on both Covered and Non-Covered Policies, credit for the ceded reserves shall be determined as follows:
- (1) The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 6 shall be used to determine the reinsurance credit for the Covered Policy reserves; and
 - (2) 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 Subparagraph (1), is held by or on behalf of the ceding insurer in accordance with the requirements of 24-A M.R.S. §§ 731-B(1) or (3) and the applicable provisions of 02-031 CMR ch. 740. No Primary Security used to secure Non-Covered Policy reserves under this Subparagraph may be used to satisfy the Required Level of Primary Security for the Covered Policies.
2. *Valuation Used for Purposes of Calculations.* The following valuation procedures shall be used for calculating the Required Level of Primary Security pursuant to the Actuarial Method, and also for determining the amount of Primary Security and the total amount of security that is held by or on behalf of the ceding insurer:
- A. For assets, including 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 the assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and
 - B. 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 December 31 of the year ending 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.

Section 6. Credit for Reinsurance of Covered Policies; Remediation of Shortfalls

1. *Requirements.* Credit for reinsurance shall be allowed pursuant to 24-A M.R.S. §§ 731-B(2-B) and (3) with respect to ceded liabilities pertaining to Covered Policies, other than ceded liabilities exempt from this rule pursuant to Section 3, if, and only if, in addition to all other applicable legal requirements, including compliance with Subsection 2 of this Section, the following requirements are met on a treaty-by-treaty basis:

- A. 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 24-A M.R.S. §§ 951 through 962 and related rules and actuarial guidelines, and credit claimed for any reinsurance treaty subject to this rule does not exceed the proportionate share of those reserves ceded under the contract; and
- B. The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance treaty subject to this rule and provides support satisfactory to the Superintendent for its calculation; and
- C. 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 in compliance with 24-A M.R.S. §731-B(3) and the applicable provisions of 02-031 CMR §§ 740(12) through (17), on a funds withheld, trust, or modified coinsurance basis; and
- D. 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 C above, are held by or on behalf of the ceding insurer as security under the reinsurance treaty in compliance with 24-A M.R.S. §731-B(3) and the applicable provisions of 02-031 CMR §§ 740(12) through (17); and
- E. Any trust used to satisfy the requirements of this Section shall comply with all of the conditions and qualifications of 02-031 CMR §§ 740(12) and (13), except that:
 - (1) Funds held in trust shall be valued according to the applicable valuation rules set forth in Section 5(2); and
 - (2) Affiliate investment limitations do not apply to any security that is not needed to satisfy the requirements of Paragraph 6(1)(C); and
 - (3) 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 Paragraph 6(1)(C)) below 102% of the level required by Paragraph 6(1)(C) at the time of the withdrawal or substitution; and
 - (4) The determination of reserve credit under 02-031 CMR §740(12) shall be determined according to the applicable valuation rules set forth in Subsection 5(2); and
- F. The reinsurance treaty has been approved by the Superintendent.

2. *Requirements at Inception Date and on an Ongoing Basis; Remediation*

- A. The requirements of Subsection 1 must be satisfied as of the date that risks under Covered Policies are ceded (or, if later, as of the effective date of this rule) 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 Paragraphs 1(C) or (D) with respect to any reinsurance treaty under which Covered Policies have been ceded, and if 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.
- B. Before the due date of each Quarterly or Annual Statement, each life insurance company that has ceded reinsurance within the scope of Section 2 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 Paragraphs 1(C) and (D) 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 Paragraph 1(C), unless either:
- (1) The security for the reinsurance treaty fully satisfied the requirements of Paragraphs 1(C) and (D) as of the valuation date; or
 - (2) Any deficiency in either Primary Security or total security has been eliminated before the due date of that Quarterly or Annual Statement through the addition of security in such amount and in such form as would have been sufficient to satisfy the requirements of Paragraphs 1(C) and (D) in full as of the valuation date.
- C. Nothing in Paragraph B above shall be construed to allow a ceding insurer to maintain any deficiency under Paragraphs 1(C) or (D) for any longer than is reasonably necessary to eliminate it.

Section 7. Severability

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

Section 8. Prohibition against Avoidance

No domestic life insurer that has issued or proposed to issue Covered Policies shall take any action or series of actions, or enter into any transaction or arrangement or series of transactions or arrangements, with the purpose of avoiding the requirements of this rule or circumventing the rule's purpose and intent, as set forth in Section 1.

Section 9. Effective Date

This rule is effective January 1, 2022, and shall apply to all Covered Policies in force on or after that date.