

# ARKANSAS REGISTER

## Proposed Rule Cover Sheet



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**PROPOSED RULE 124****TERM AND UNIVERSAL LIFE INSURANCE RESERVE FINANCING****TABLE OF CONTENTS:**

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**Section 1. Authority**

This Rule is adopted and promulgated by the Arkansas Insurance Commissioner (“Commissioner”) pursuant to Ark. Code Ann. §§ 23-61-108, 23-62-308, 25-15-201, *et seq.*, and other applicable laws.

**Section 2. Purpose and Intent**

The purpose and intent of this Rule is 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 Section 5, 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 (1) are issued by the ceding insurer or its affiliates; (2) are not unconditionally available to satisfy the general account obligations of the ceding insurer; or (3) 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 3. Applicability**

This Rule shall apply to reinsurance treaties that cede liabilities pertaining to Covered Policies, as that term is defined in Section 5B, issued by any life insurance company domiciled in this state. This Rule and Rule 65 shall both apply to such reinsurance treaties; provided, that in the event of a direct conflict between the provisions of this Rule and Rule 65, the provisions of this Rule shall apply, but only to the extent of the conflict.

**Section 4. Exemptions from this Rule**

This Rule does not apply to the situations described in Subsections A through F, as follows:

- A. Reinsurance of:
- (1) Policies that satisfy the criteria for exemption set forth in Rule 47, § 6(F) or § 6(G); and which are issued before the later of:
    - (a) The effective date of this Rule, 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 January 1, 2020;
  - (2) Portions of policies that satisfy the criteria for exemption set forth in Rule 47, § 6(E) and which are issued before the later of:
    - (a) The effective date of this Rule, 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 Commissioners Standard Ordinary 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
  - (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.
- B. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Ark. Code Ann. § 23-62-305(c)(1); or
- C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Ark. Code Ann. § 23-62-305(a)(4), (a)(5), or (b), and that, in addition:

- (1) Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual, 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 financial statement of the assuming insurer pursuant to Statement of Statutory Accounting Principles No. 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 Ark. Code Ann. §§ 23-63-1301, *et seq.*, when its Risk-Based Capital ("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; or
- D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Ark. Code Ann. § 23-62-305(a)(4), (a)(5), or (b), and that, in addition:
- (1) Is not an affiliate, as that term is defined in Ark. Code Ann. § 23-63-503(1), of:
    - (a) The insurer ceding the business to the assuming insurer; or
    - (b) Any insurer that directly or indirectly ceded the business to that ceding insurer;
  - (2) Prepares statutory financial statements in compliance with the NAIC Accounting Practices and Procedures Manual;
  - (3) Is both:
    - (a) Licensed or accredited in at least ten (10) states (including its state of domicile), and
    - (b) 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
  - (4) Is not, or would not be, below five hundred percent (500%) of the Authorized Control Level RBC as that term is defined in Ark. Code Ann. §§ 23-63-1301, *et seq.*, 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
- E. Reinsurance ceded to an assuming insurer that meets the requirements of Ark. Code Ann. § 23-62-308(c); or
- F. Reinsurance not otherwise exempt under Subsections A through E if the Commissioner, 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:

- (1) The risks are clearly outside of the intent and purpose of this Rule (as described in Section 2 above);
- (2) The risks are included within the scope of this Rule only as a technicality; and
- (3) The application of this Rule to those risks is not necessary to provide appropriate protection to policyholders. The Commissioner shall publicly disclose any decision made pursuant to this Section 4F to exempt a reinsurance treaty from this Rule, as well as the general basis therefor (including a summary description of the treaty).

## **Section 5. Definitions**

- A. “Actuarial Method” means the methodology used to determine the Required Level of Primary Security, as described in Section 6.
- B. “Covered Policies” means the following: Subject to the exemptions described in Section 4, 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.
- C. “Grandfathered Policies” means policies of the types described in Subsections B(1) and B(2) 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 4 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 Ark. Code Ann. § 23-62-306(c)(1);

- (2) Securities listed by the Securities Valuation Office meeting the requirements of Ark. Code Ann. § 23-62-306(c)(2), 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.
- G. “Other Security” means any security acceptable to the Commissioner other than security meeting the definition of Primary Security.
- H. “Valuation Manual” means the valuation manual adopted by the NAIC as described in Ark. Code Ann. § 23-84-101(b)(13), with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed.
- I. “VM-20” means “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.

**Section 6. The Actuarial Method**

A. 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:

- (1) For Covered Policies described in Section 5B(1) above, 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 described in Section 5B(2) above, the ceding insurer may elect to instead use paragraph 2 below as the Actuarial Method for the entire reinsurance agreement. Whether Paragraph 1 or 2 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 described in Section 5B(2) above, 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 Paragraph (4) 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.
- (4) If the reinsurance treaty cedes less than one hundred percent (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 Subparagraph (c) below, 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 Jan 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 Subparagraphs (a), (b), (c), and (d) above 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 one hundred percent (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 Rule, 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 Rule;
- (7) 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:
  - (a) The Actuarial Method shall be used to determine the Required Level of Primary Security for the Covered Policies, and Section 7 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 Subparagraph (a), is held by or on behalf of the ceding insurer in accordance with Ark. Code Ann. §§ 23-62-305 and 23-62-306. Any Primary Security used to meet the requirements of this Subparagraph may not be used to satisfy the Required Level of Primary Security for the Covered Policies.

B. Valuation used for Purposes of Calculations

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 Dec. 31<sup>st</sup> 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 7. Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation**

A. Requirements

Subject to the exemptions described in Section 4 and the provisions of Section 7B, credit for reinsurance shall be allowed with respect to ceded liabilities pertaining to Covered Policies pursuant to with Ark. Code Ann. §§ 23-62-305 or 23-62-306 if, and only if, in addition to all other requirements imposed by law or Rule, 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 Ark. Code Ann. §§ 23-84-101, *et seq.*, 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
- (2) The ceding insurer determines the Required Level of Primary Security with respect to each reinsurance treaty subject to this Rule and provides support for its calculation as determined to be acceptable to the Commissioner; 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 Ark. Code Ann. § 23-62-306, 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 Paragraph (3) above, are held by or on behalf of the ceding insurer as security under the reinsurance treaty within the meaning of Ark. Code Ann. § 23-62-306; and
- (5) Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of Rule 65, § 12, except that:
  - (a) Funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6B, be valued according to the valuation rules set forth in Section 6B, 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 Section 7A(3); 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 Section 7A(3)) below one hundred two percent (102%) of the level required by Section 7A(3) at the time of the withdrawal or substitution; and
- (d) The determination of reserve credit under Rule 65, §12(E) shall be determined according to the valuation rules set forth in Section 6B, as applicable; and
- (6) The reinsurance treaty has been approved by the Commissioner.

B. Requirements at Inception Date and on an On-going Basis; Remediation

- (1) The requirements of Section 7A 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 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 Section 7A(3) or 7A(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 Section 3 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 Sections 7A(3) and 7A(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 Section 7A(3), unless either:
  - (a) The requirements of Sections 7A(3) and 7A(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 and/or Other Security, as the case may be, in such amount and in such form as would have caused the requirements of Section 7A(3) and 7A(4) to be fully satisfied as of the valuation date.
- (3) Nothing in Section 7B(2) shall be construed to allow a ceding company to maintain any deficiency under Section 7A(3) or 7A(4) for any period of time longer than is reasonably necessary to eliminate it.

**Section 8. Severability**

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

**Section 9. Prohibition against Avoidance**

No insurer that has Covered Policies as to which this Rule applies (as set forth in Section 3) 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 Rule, or to circumvent its purpose and intent, as set forth in Section 2.

**Section 10. Effective Date**

This Rule shall become effective ten (10) days following the filing of the final Rule with the Secretary of State and shall pertain to all Covered Policies in force as of and after that date.

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ALAN McCLAIN  
INSURANCE COMMISSIONER  
STATE OF ARKANSAS

\_\_\_\_\_  
DATE



Michael Preston  
SECRETARY OF COMMERCE

Alan McClain  
COMMISSIONER,  
ARKANSAS INSURANCE  
DEPARTMENT

DATE: NOVEMBER 15, 2022

TO: ALL LIFE INSURERS AND REINSURER, TRADE ORGANIZATIONS, NAIC, AND OTHER INTERESTED PARTIES

FROM: ARKANSAS INSURANCE DEPARTMENT

SUBJECT: PROPOSED NEW RULE 124  
"TERM AND UNIVERSAL LIFE INSURANCE RESERVE FINANCING"

### **NOTICE OF RULEMAKING AND PUBLIC HEARING**

Pursuant to Ark. Code Ann. §§ 23-61-108, 25-15-201, *et seq.*, and other applicable Arkansas laws or rules, NOTICE is hereby given that a PUBLIC HEARING will be held on January 10, 2023 at 2:00 p.m. in the Diamond Mine Room of the Department of Commerce, One Commerce Way, Little Rock, Arkansas 72202.

The purpose of the public hearing is to determine whether the Insurance Commissioner should adopt Proposed Rule 124, "TERM AND UNIVERSAL LIFE INSURANCE RESERVE FINANCING," as a new Rule.

All interested persons are encouraged to attend the Public Hearing and may appear and present, orally or in writing, statements, arguments, or opinions on the proposed amended Rule. Any written or oral comments regarding Proposed New Rule 124 will be accepted until the close January 9, 2023. All licensees and other interested persons are responsible for notifying their personnel, agents, and employees of this Public Hearing. Persons wishing to testify should notify the Legal Division as soon as possible and are asked to submit intended statements in writing in advance of the hearing.

Please direct your inquiries to the Legal Division at (501) 371-2820 or via electronic mail to [insurance.legal@arkansas.gov](mailto:insurance.legal@arkansas.gov).

Proposed Rule 124 can be viewed on the Legal Division's website at <https://insurance.arkansas.gov/pages/industry-regulation/legal/proposed-rules/>.

Sincerely yours,

A handwritten signature in blue ink, appearing to read "A.C. Rose", is written over a white background.

Amanda Capps Rose  
Associate Counsel  
(501) 370-2820