

§ 58-7-22. Term and universal life insurance reserve financing.

(a) Purpose and Intent. – The purpose and intent of this section is to establish uniform, national standards governing reserve financing arrangements pertaining to life insurance policies containing guaranteed nonlevel gross premiums or guaranteed nonlevel benefits and universal life insurance policies with secondary guarantees, and to ensure that, with respect to those financing arrangements, funds consisting of primary security and other security are held by or on behalf of ceding insurers in the forms and amounts required by this section. In general, for reinsurance ceded for reserve financing purposes, some or all of the assets used to secure the reinsurance treaty or to capitalize the reinsurer meet one of the following:

- (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.
- (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.

(b) Definitions. – The following definitions apply in this section:

- (1) Actuarial method. – The methodology used to determine the required level of primary security, as described in subsection (e) of this section.
- (2) Covered policies. – Subject to the exemptions described in subsection (d) of this section and, other than grandfathered policies, policies of the following policy types:
 - a. Life insurance policies with guaranteed nonlevel gross premiums 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. – Policies of the types described in sub-subdivisions a. and b. of subdivision (2) of subsection (b) of this section that were both:
 - a. Issued prior to January 1, 2015.
 - 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 subsection (d) of this section had that subsection then been in effect.
- (4) Noncovered policies. – Any policy that does not meet the definition of covered policies, including grandfathered policies.
- (5) Other security. – Any security other than security meeting the definition of primary security that is acceptable to the Commissioner.
- (6) Primary security. – All of the following forms of security:
 - a. Cash.
 - b. Securities listed by the Securities Valuation Office of the NAIC meeting the requirements of G.S. 58-7-26(a)(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.
 - c. For security held in connection with funds withheld and modified coinsurance reinsurance treaties, any of the following forms of security:

1. Commercial loans in good standing of CM3 quality and higher.
 2. Policy loans.
 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.
- (7) Required level of primary security. – 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.
- (8) Valuation manual. – The valuation manual adopted by the NAIC as described in G.S. 58-58-51 with all amendments adopted by the NAIC that are effective for the financial statement date on which credit for reinsurance is claimed.
- (9) VM-20. – The requirements for principle-based reserves for life products, including all relevant definitions, as outlined in the valuation manual.
- (c) Applicability. – This section shall apply to reinsurance treaties that cede liabilities pertaining to covered policies issued by any life insurance company domiciled in this State. This section, G.S. 58-7-21, and G.S. 58-7-26 shall apply to those reinsurance treaties. If there is a direct conflict between the provisions of this section and G.S. 58-7-21, or G.S. 58-7-26, then the provisions of this section shall apply, but only to the extent of the conflict.
- (d) Exemptions from this Section. – This section does not apply to any of the following situations:
- (1) Reinsurance of any of the following:
 - a. Policies that satisfy the criteria for exemption for attained age-based yearly renewable term life insurance policies set forth in 11 NCAC 11F.0404(f) or for unitary reserves for certain n-year renewable term life insurance policies set forth in 11 NCAC 11F.0404(g) and that are issued before the later of the following dates:
 1. September 1, 2021.
 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 for yearly renewable term reinsurance set forth in 11 NCAC 11F.0404(e) and which are issued before the later of the following dates:
 1. September 1, 2021.
 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. The secondary guarantee period, if any, is five years or less.
 2. The 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.
 3. The initial surrender charge is not less than one hundred percent (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.
 - 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 meets the applicable requirements of G.S. 58-7-21(b)(4).
- (3) Reinsurance ceded to an assuming insurer that meets the applicable requirements of subdivision (1), (2), or (3) of G.S. 58-7-21(b) and that also meets all of the following criteria:
- a. 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 the NAIC's Statement of Statutory Accounting Principles No. 1.
 - b. 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 Article 12 of Chapter 58 of the General Statutes, when its risk-based capital 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, without deviation.
- (4) Reinsurance ceded to an assuming insurer that meets the applicable requirements of subdivision (1), (2), or (3) of G.S. 58-7-21(b) and that also meets all of the following criteria:
- a. Is not an affiliate, as defined in G.S. 58-19-5, of either of the following:
 - 1. The insurer ceding the business to the assuming insurer.
 - 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 licensed or accredited in at least 10 states, including its state of domicile.
 - d. 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.
 - e. Is not, or would not be, below five hundred percent (500%) of the authorized control level risk-based capital, as defined in G.S. 58-12-2, when its risk-based capital 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, 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.

- (5) Reinsurance ceded to an assuming insurer that meets any of the following criteria:
- a. Meets the requirements specified under G.S. 58-7-21(b)(4b) in this State.
 - b. Is certified in this State.
 - c. Maintains at least two hundred fifty million dollars (\$250,000,000) in capital and surplus when determined in accordance with the NAIC Accounting Practices and Procedures Manual, including all amendments adopted by the NAIC and excluding the impact of any permitted or prescribed practices and is either:
 1. Licensed in at least 26 states.
 2. Licensed in at least 10 states, and licensed or accredited in a total of at least 35 states.

- (6) Reinsurance not otherwise exempt under subdivisions (1) through (5) of this subsection if the Commissioner, after consulting with the NAIC Financial Analysis Working Group or other applicable group of regulators designated by the NAIC, 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 section.
 - b. The risks are included within the scope of this section only as a technicality.
 - c. The application of this section to those risks is not necessary to provide appropriate protection to policyholders.

The Commissioner shall publicly disclose any decision made pursuant to this subdivision to exempt a reinsurance treaty from this section and the general basis of that decision, including a summary description of the treaty.

(e) The Actuarial Method and Valuation Used for Purposes of Calculation. – The following applies to this section:

- (1) The actuarial method to establish the required level of primary security for each reinsurance treaty subject to this section shall be VM-20, applied on a treaty-by-treaty basis, including all relevant definitions, from the valuation manual then in effect, applied as follows:
 - a. For covered policies described in sub-subdivision a. of subdivision (2) of subsection (b) of this section, the actuarial method is the greater of the deterministic reserve or the net premium reserve 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 net premium reserve. In addition, if those covered policies are reinsured in a reinsurance treaty that also contains covered policies described in sub-subdivision b. of subdivision (2) of subsection (b) of this section, then the ceding insurer may elect to instead use sub-subdivision b. of this subdivision as the actuarial method for the entire reinsurance agreement. Whether this sub-subdivision or sub-subdivision b. of this subdivision 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 sub-subdivision b. of subdivision (2) of subsection (b) of this section, the actuarial method is the greatest of the deterministic reserve, the stochastic reserve, or the net premium reserve, regardless of whether the criteria for exemption testing can be met.
- c. Except as provided in sub-subdivision d. of this subdivision, 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 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:
 - 1. If a reinsurance treaty cedes only a quota share of some or all of the risks pertaining to the covered policies, then the required level of primary security, as well as any adjustment under sub-subdivision c. of this subdivision, 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, then 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, then 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 the value of cx divided by double the number of reinsurance premiums per year, where cx is calculated using the same mortality table used in calculating the net premium reserve.
 - 4. For any other treaty ceding a portion of risk to a different reinsurer, including stop loss, excess of loss, and other nonproportional reinsurance treaties, there will be no reduction in the required level of primary security.

It is possible for any combination of sub-sub-subdivisions in this sub-subdivision to apply. In this case, the 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 shall 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.

- e. In no event will 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 section, then 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 section.
 - g. If a reinsurance treaty subject to this section cedes risk on both covered and noncovered policies, then 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 subsections (f), (g), and (h) of this section shall be used to determine the reinsurance credit for the covered policy reserves.
 - 2. Credit for the noncovered policy reserves shall be granted only to the extent that, in addition to the security held to satisfy the requirements of sub-subdivision a. of this subdivision, security is held by or on behalf of the ceding insurer, in accordance with G.S. 58-7-21(b) and G.S. 58-7-26(a). Any primary security used to meet the requirements of this sub-subdivision may not be used to satisfy the required level of primary security for the covered policies.
- (2) Valuation used for purposes of calculations. – For the purposes of both calculating the required level of primary security pursuant to the actuarial method under subsection (e) of this section and determining the amount of primary security and other security, as applicable, held by or on behalf of the ceding insurer, both of the following shall apply:
- a. For assets, including any 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 those assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices.
 - 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 the

December 31 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.

(f) Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance; Opportunity for Remediation. – Subject to the exemptions described in subsection (d) of this section and the provisions of subsections (g) and (h) of this section, credit for reinsurance shall be allowed with respect to ceded liabilities pertaining to covered policies pursuant to G.S. 58-7-21(b) or G.S. 58-7-26(a) if, in addition to all other requirements imposed by law or regulation, all 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 G.S. 58-58-50 and related regulations and actuarial guidelines, and credit claimed for any reinsurance treaty subject to this section does not exceed the proportionate share of those reserves ceded under the contract.
- (2) The ceding insurer determines the required level of primary security with respect to each reinsurance treaty subject to this section and provides support for its calculation, as determined to be acceptable to the Commissioner.
- (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 G.S. 58-7-26(a) on a funds withheld, trust, or modified coinsurance basis.
- (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 G.S. 58-7-26(a).
- (5) Any trust used to satisfy the requirements of this subsection shall comply with all of the conditions and qualifications of 11 NCAC 11C.0504, except for the following:
 - a. Funds consisting of primary security or other security held in trust shall, for the purposes identified in subdivision (2) of subsection (e) of this section, be valued according to the valuation rules set forth by that subdivision, as applicable.
 - b. There are no affiliate investment limitations with respect to any security held in such trust if that security is not needed to satisfy the requirements of subdivision (3) of this subsection.
 - 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 one hundred two percent (102%) of the level required by subdivision (3) of this section at the time of the withdrawal or substitution.
 - d. The determination of reserve credit under 11 NCAC 11C.0504(d)(3) shall be determined according to the valuation rules set forth in subdivision (2) of subsection (e) of this section, as applicable.
- (6) The reinsurance treaty has been approved by the Commissioner.

(g) The requirements of subsection (f) of this section must be satisfied as of the date that risks under covered policies are ceded, if that date is on or after the effective date of this section, 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 subdivision (3) or (4) of subsection (f) of this section with respect to any reinsurance treaty under which covered policies have been ceded. If a ceding insurer becomes aware at any time that a deficiency under subdivision (3) or (4) of subsection (f) of this section exists, then it shall use its best efforts to arrange for the deficiency to be eliminated as expeditiously as possible.

(h) Prior to the due date of each quarterly or annual statement, each life insurance company that has ceded reinsurance within the scope of subsection (c) of this section 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 subdivisions (3) and (4) of subsection (f) of this section 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 subdivision (3) of subsection (f) of this section, unless either of the following applies:

- (1) The requirements of subdivisions (3) and (4) of subsection (f) of this section were fully satisfied as of the valuation date as to such reinsurance treaty.
- (2) 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 applicable, in an amount and in a form as would have caused the requirements of subdivisions (3) and (4) of subsection (f) of this section to be fully satisfied as of the valuation date.

Nothing in this subsection shall be construed to allow a ceding company to maintain any deficiency under subdivisions (3) and (4) of subsection (f) of this section for any period of time longer than is reasonably necessary to eliminate it.

(i) Severability. – If any provision of this section is held invalid, the remainder shall not be affected.

(j) Prohibition Against Avoidance. – No insurer that has covered policies to which this section applies, as set forth in subsection (c) of this section, 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 section, or to circumvent its purpose and intent.

(k) Effective Date. – This section shall become effective September 1, 2021, and apply to all covered policies in force on or after that date. (2021-114, s. 2.)