

DEPARTMENT OF REGULATORY AGENCIES

Division of Insurance

3 CCR 702-4

LIFE, ACCIDENT AND HEALTH

Amended Regulation 4-1-16

TERM AND UNIVERSAL LIFE INSURANCE RESERVE FINANCING

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Section 1 Authority

This regulation is promulgated and adopted by the Commissioner of Insurance under the authority of §§ 10-7-101; 10-7-309 - 10-7-316; 10-7-114, C.R.S.

Section 2 Scope and Purpose

The purpose and intent of this regulation 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 4, 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; or (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 regulation shall apply to reinsurance treaties that cede liabilities pertaining to Covered Policies, as that term is defined in Section 4.B., issued by any life insurance company domiciled in this state. This regulation and Colorado Regulation 3-3-3 shall both apply to such reinsurance treaties; provided, that in the event of a direct conflict between the provisions of this regulation and Colorado Regulation 3-3-3, the provisions of this regulation shall apply, but only to the extent of the conflict.

Section 4 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 5, 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 B1 and B2 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 5 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 Section 10-3-703(1)(a), C.R.S.;
 - 2. Securities listed by the Securities Valuation Office meeting the requirements of Section 10-3-703(1)(b), C.R.S., 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" shall have the same meaning as found at Section 10-7-301.5(12), C.R.S.

- I. “VM-20” means “Requirements for Principle-Based Reserves for Life Products,” including all relevant definitions, from the Valuation Manual.

Section 5 Exemptions from this Regulation

This regulation does not apply to the situations described in Subsections A through E.

A. Reinsurance of:

1. Policies that satisfy the criteria set forth in Optional Exemption for Attained-Age-Based Yearly Renewable Term Life Insurance Policies or Exemption from Unitary Reserves for Certain n-Year Renewable Term Life Insurance Policies in Colorado Regulation 4-1-9; and which are issued before the later of:
 - a. The effective date of this regulation, 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;
2. Portions of policies that satisfy the criteria for exemption set forth in Optional Exemption for Yearly Renewable Term (YRT) Reinsurance in Colorado Regulation 4-1-9 and which are issued before the later of:
 - a. The effective date of this regulation, 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 (CSO) 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 Section 10-3-702(5), C.R.S.; or

C. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Section 10-3-702(2) or 10-3-702(3) or 10-3-702(4), C.R.S., 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 ("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 Colorado Regulation 3-1-11 when its RBC is calculated in accordance with the life risk-based capital report including overview and instructions for companies, without deviation; or

D. Reinsurance ceded to an assuming insurer that meets the applicable requirements of Section 10-3-702(2) or 10-3-702(3) or 10-3-702(4), C.R.S., and that, in addition:

1. Is not an affiliate, as that term is defined in Section 10-3-801(1), C.R.S., 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 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 500% of the Authorized Control Level RBC as that term is defined in Colorado Regulation 3-1-11 when its Risk-Based Capital (RBC) is calculated in accordance with the life risk-based capital report including overview and instructions for companies, 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 not otherwise exempt under Subsections A through D if the commissioner, after consulting with the NAIC Financial Analysis Working Group (FAWG) 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 regulation (as described in Section 2 above);
2. The risks are included within the scope of this regulation only as a technicality; and
3. The application of this regulation to those risks is not necessary to provide appropriate protection to policyholders. The commissioner shall publicly disclose any decision made

pursuant to this Section 5.E. to exempt a reinsurance treaty from this regulation, as well as the general basis therefor (including a summary description of the treaty).

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 regulation 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 4.B.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 4.B.2 above, the ceding insurer may elect to instead use Section 6.A.2. as the Actuarial Method for the entire reinsurance agreement. Whether Section 6.A.1 or Section 6.A.2. are 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 4.B.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 Section 6.A.4 , 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 Section 6.A.4.c, 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 Net Premium Reserve; 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 Section 6.A.4 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 regulation, 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 regulation;
7. If a reinsurance treaty subject to this regulation 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 Sections 10-3-702 — 10-3-703, C.R.S. 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. 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.

**Section 7 Requirements Applicable to Covered Policies to Obtain Credit for Reinsurance;
Opportunity for Remediation**

A. Requirements

Subject to the exemptions described in Section 5 and the provisions of Section 7.B., credit for reinsurance shall be allowed with respect to ceded liabilities pertaining to Covered Policies pursuant to Section 10-3-702 or 10-3-703, C.R.S. 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 Sections 10-7-101; 10-7-309 - 10-7-316; 10-7-114, C.R.S., and related regulations and actuarial guidelines, and credit claimed for any reinsurance treaty subject to this regulation 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 regulation 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 Section 10-3-703, C.R.S., 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 Section 7.A.3., are held by or on behalf of the ceding insurer as security under the reinsurance treaty within the meaning of Section 10-3-703, C.R.S.; and
5. Any trust used to satisfy the requirements of this Section 7 shall comply with all of the conditions and qualifications of Colorado Regulation 3-3-3, except that:
 - a. Funds consisting of Primary Security or Other Security held in trust, shall for the purposes identified in Section 6.B., be valued according to the valuation rules set forth in Section 6.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 Section 7.A.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 7.A.3. below 102%

of the level required by Section 7.A.3. at the time of the withdrawal or substitution; and

- d. The determination of reserve credit under Colorado Regulation 3-3-3 shall be determined according to the valuation rules set forth in Section 6.B., 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 7.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 regulation) 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 7.A.3 or 7.A.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 7.A.3 and Section 7.A.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 7.A.3., unless either:
 - a. The requirements of Section 7.A.3. and Section 7.A.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 7.A.3. and 7.A.4. to be fully satisfied as of the valuation date.
3. Nothing in Section 7.B.2. shall be construed to allow a ceding company to maintain any deficiency under Section 7.A.3. or Section 7.A.4. for any period of time longer than is reasonably necessary to eliminate it.

Section 8 Severability

If any provision of this regulation or the application of it to any person or circumstance is for any reason held to be invalid, the remainder of this regulation shall not be affected.

Section 9 Incorporated Materials

Valuations Manual shall mean the January 1, 2022, Edition as published by the National Association of Insurance Commissioners and does not include later amendments or editions of the Valuations Manual. A copy of the Valuations Manual may be examined during regular business hours at the Colorado Division of Insurance, 1560 Broadway, Suite 850, Denver, Colorado, 80202. A certified copy of the Valuations Manual may be requested from the Colorado Division of Insurance, 1560 Broadway, Suite 850, Denver, CO 80202. A charge for certification or copies may apply. A copy may also be obtained online from_

<https://content.naic.org/>. A copy may also be obtained from the NAIC Central Office, 1100 Walnut Street, Suite 1500, Kansas City, Missouri 64106.

NAIC Accounting Practices and Procedures Manual, including the Statement of Statutory Accounting Principles No 1., as published by the National Association of Insurance Commissioners on the effective date of this regulation and does not include later amendments or editions of the NAIC Accounting Practices and Procedures Manual. A copy of the NAIC Accounting Practices and Procedures Manual may be examined during regular business hours at the Colorado Division of Insurance, 1560 Broadway, Suite 850, Denver, Colorado, 80202. A certified copy of the NAIC Accounting Practices and Procedures Manual may be requested from the Colorado Division of Insurance, 1560 Broadway, Suite 850, Denver, CO 80202. A charge for certification or copies may apply. A copy may also be obtained online from <https://content.naic.org/>. A copy may also be obtained from the NAIC Central Office, 1100 Walnut Street, Suite 1500, Kansas City, Missouri 64106.

Section 10 Enforcement

Noncompliance with this regulation may result in the imposition of any of the sanctions made available in the Colorado statutes pertaining to the business of insurance, or other laws, which include the imposition of civil penalties, issuance of cease and desist orders, and/or suspensions or revocation of license, subject to the requirements of due process.

No insurer that has Covered Policies as to which this regulation 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 regulation, or to circumvent its purpose and intent, as set forth in Section 2.

Section 11 Effective Date

This regulation shall be effective January 1, 2024

Section 12 History

New regulation effective March 2, 2023.

Amended regulation effective January 1, 2024.