

Capital Adequacy (E) Task Force

RBC Proposal Form

- | | | |
|---|--|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input checked="" type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>4/11/23</u></p> <p>CONTACT PERSON: <u>Andrew Holland</u></p> <p>TELEPHONE: <u>212-839-5882</u></p> <p>EMAIL ADDRESS: <u>aholland@sidley.com</u></p> <p>ON BEHALF OF: <u>J.P. Morgan Securities LLC</u></p> <p>NAME: <u>Philip Prince</u></p> <p>TITLE: <u>Managing Director</u></p> <p>AFFILIATION: <u>Interested Party</u></p> <p>ADDRESS: <u>383 Madison Ave., 7th Floor</u> <u>New York, NY 10017</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <hr/> <p>Agenda Item # <u>2023-08-L</u> Year <u>2023</u></p> <hr/> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
---	---

IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input checked="" type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

See attached.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

RBC Proposal Form – Custody Control Accounts

Background

- Life reinsurance transactions with Reinsurers which are licensed, accredited or approved as reciprocal jurisdiction reinsurers in a Cedant's state of domicile generally do not require a collateral mechanism to provide credit for reinsurance (CFR).
- In many life reinsurance transactions, however, the parties nonetheless negotiate and agree to collateral arrangements for commercial reasons.
 - Such collateral arrangements are common in a variety of life reinsurance transactions, including block acquisitions, embedded value and reserve financings, and pension risk transfers.
- The Life RBC Manual instructions currently allow a Cedant to avoid an overstatement of RBC charges that would otherwise be applied for credit exposure to reinsurance counterparties if such collateral is held by the Cedant as funds withheld or a "comfort" reinsurance trust is established by the Reinsurer.
- Other collateral mechanisms can provide the same level of security to Cedants with lower costs and greater flexibility.
 - The Finance industry widely supports and leverages custodial control accounts ("Custody Control Accounts") where segregated collateralization under third-party control is required (e.g., pledges of assets to Federal Home Loan Banks, posting of initial margin and variation margin on derivatives transactions).
- A Custody Control Account can similarly hold assets pledged by a Reinsurer for the benefit of a Cedant in connection with a reinsurance transaction.
- A Custody Control Account can provide the same protections to the Cedant as would be provided by a trust arrangement. However, a Custody Control Account operates at a reduced cost due to increased scale and automation.
- This proposal would amend the Life RBC formula to similarly avoid overstatement of credit risk on a reinsurance transaction when collateral is held by the Cedant in a Custody Control Account.
 - No changes to the Credit for Reinsurance Model Law or Credit for Reinsurance Model Regulation are being proposed.

Proposed Changes to Life RBC Instructions

From Risk-Based Capital Forecasting & Instructions – Life and Fraternal, 2019

REINSURANCE

LR016 (p. 53 of the 2019 Edition)

There is a risk associated with recoverability of amounts from reinsurers. The risk is deemed comparable to that represented by bonds between risk classes 1 and 2 and is assigned a pre-tax factor of 0.78 percent. To avoid an overstatement of risk-based capital, the formula gives a 0.78 percent pre-tax credit for reinsurance with non-authorized and certified companies, for reinsurance among affiliated companies, for reinsurance with funds withheld or reinsurance with authorized reinsurers that is supported by equivalent trusted **or custodied** collateral ~~that meets the requirements of the types~~ stipulated in **paragraph 18 of** Appendix A-785 (Credit for Reinsurance), where there have been regular bona fide withdrawals from such trusted **or custodied** collateral to pay claims or recover payments of claims during the calendar year covered by the RBC report, and for reinsurance involving policy loans. Withdrawals from trusted **or custodied** collateral that are less than the amounts due the ceding company shall be deemed to not be bona fide withdrawals. **For purposes of these instructions, “custodied collateral” shall mean assets held pursuant to a custodial arrangement with a qualified U.S. financial institution (as defined in Appendix A-785 (Credit for Reinsurance)) pursuant to which the underlying assets are segregated from other assets of the reinsurer and are subject to the exclusive control of, and available to, the ceding company in the event of the reinsurer’s failure to pay under, and otherwise pursuant to the terms of, the subject reinsurance agreement.**

Additional Resource Materials

- Presentation dated October 2022 containing Summary of Contractual Terms for Custody Control Arrangement and Schematic Diagram
- Form of Custody Control Agreement Wording
- Comparison Chart – CFR Trust, Comfort Reinsurance Trust and Custody Control Account