

## **SYNTHETIC GUARANTEED INVESTMENT CONTRACTS MODEL REGULATION**

### **Table of Contents**

Section 1.	Authority
Section 2.	Purpose
Section 3.	Scope and Application
Section 4.	Definitions
Section 5.	Financial Requirements and Plan of Operation
Section 6.	Required Contract Provisions and Filing Requirements
Section 7.	Investment Management of the Segregated Portfolio
Section 8.	Purchase of Annuities
Section 9.	Unilateral Contract Terminations
Section 10.	Reserves
Section 11.	Severability
Section 12.	Effective Date

### **Section 1. Authority**

This rule is issued pursuant to the authority vested in the commissioner of the State of [insert state] under [insert citation for authority].

### **Section 2. Purpose**

- A. The purpose of this regulation is to prescribe:
- (1) The terms and conditions under which life insurance companies may issue group annuity contracts and other agreements that in whole or in part establish the insurer's obligation by reference to a segregated portfolio of assets that is not owned by the insurer;
  - (2) The essential operational features of the segregated portfolio of assets; and
  - (3) The reserve requirements for these group annuity contracts and agreements.
- B. This regulation is intended to aid in the timely approval of such products by the commissioner, and recognizes that timely approval is essential given the competitive nature of the market for these products.

### **Section 3. Scope and Application**

This regulation applies to that portion of a group annuity contract or other agreement described in Section 4W and issued by a life insurer that functions as an accounting record for an accumulation fund and has benefit guarantees relating to a principal amount and levels of interest at a fixed rate of return specified in advance. The fixed rates of return will be constant over the applicable rate periods, and may reflect prior and current market conditions with respect to the segregated portfolio but may not reference future changes in market conditions. It applies to all contracts issued after the effective date of this regulation. Contracts that have been negotiated prior to the effective date need not be refiled with the commissioner.

**Drafting Note:** This explanation of the fixed rate of return is intended to clarify the fact that the regulation excludes products such as those that guarantee the future performance of a stated index. It is recognized that versions of synthetics other than those described in the scope section may evolve over time; the intent of the regulation is not to preclude the issuance of such products, but rather to describe how a specific set of synthetics (those described in the scope) should be regulated.

**Drafting Note:** It is expected that individual regulators, where applicable, will retain the right to withdraw approval of previously filed contract forms for new issuance if they do not conform to the regulation. Therefore, no language explicitly withdrawing approval of previously filed forms was included.

#### **Section 4. Definitions**

As used in this regulation, the following terms shall have these meanings:

- A. "Account assets" means the assets in the segregated portfolio plus any assets held in the general account or a separate account to meet the asset maintenance requirements.
- B. "Actuarial opinion and memorandum" means the opinion and memorandum of the valuation actuary required to be submitted to the commissioner pursuant to Section 10B of this regulation.
- C. "Affirmatively approved" means approval of an insurer's plan of operation for a class of contracts containing the form of contract under review, after the plan of operation associated with the class of contracts has been reviewed by the insurer's domiciliary insurance department, and the plan of operation has been found to be in compliance with the NAIC Synthetic Guaranteed Investment Contracts Model Regulation by the domiciliary insurance department. Affirmatively approved does not mean approval as a result of the deemer provision.
- D. "Appointed actuary" means the qualified actuary appointed or retained either directly by or by the authority of the board of directors through an executive officer of the company to prepare the annual statement of actuarial opinion for the company as a whole pursuant to Section [insert reference to standard valuation law].
- E. "Asset maintenance requirement" means the requirement to maintain assets to fund contract benefits in accordance with Section 10 of this regulation.
- F. "Class of contracts" means the set of all contracts to which a given plan of operation pertains.
- G. "Contract value record" means an accounting record, provided by the contract in relation to a segregated portfolio of assets, that is credited with a fixed rate of return over regular periods, and that is used to measure the extent of the insurer's obligation to the contractholder. The fixed rate of return credited to the contract value record is determined by means of a crediting rate formula or declared at the inception of the contract and valid for the entire term of the contract.
- H. "Crediting rate formula" means a mathematical formula used to calculate the fixed rate of return credited to the contract value record during any rate period and based in part upon the difference between the contract value record and the market value record amortized over an appropriate period. The fixed rate of return calculated by means of this formula may reflect prior and current market conditions with respect to the segregated portfolio, but may not reference future changes in market conditions.

- I. “Date of filing,” with respect to a filing for approval of a contract form under this regulation, means the date as defined by the applicable statutes or regulations of the state of issue with regard to contract filings.

**Drafting Note:** Individual states may wish to insert a specific reference to the applicable statute or regulation.

- J. “Duration” means, with respect to the segregated portfolio assets or guaranteed contract liabilities, a measure of price sensitivity to changes in interest rates, such as the Macaulay duration or option-adjusted duration.
- K. “Fair market value” means a reasonable estimate of the amount that a knowledgeable buyer of an asset would be willing to pay, and a knowledgeable seller of an asset would be willing to accept, for the asset without duress in an arm’s length transaction. In the case of a publicly traded security, the fair market value is the price at which the security is traded or, if no price is available, a price that appropriately reflects the latest bid and asked prices for the security. In the case of a debt instrument that is not publicly traded, the fair market value is the discounted present value of the asset calculated at a reasonable discount rate. For all other non-publicly traded assets, fair market value will be determined in accordance with valuation practices customarily used within the financial industry.
- L. “Guaranteed minimum benefits” means contract benefits on a specified date that may be either:
- (1) A principal guarantee, with or without a fixed minimum interest rate guarantee, related to the segregated portfolio;
  - (2) An assurance as to the future investment return or performance of the segregated portfolio; or
  - (3) The fair market value of the segregated portfolio, to the extent that the fair market value of the assets determines the contractholder’s benefits.
- M. (1) “Hedging instrument” means:
- (a) An interest rate futures agreement or foreign currency futures agreement, an option to purchase or sell an interest rate futures agreement or foreign currency futures agreement, or any option to purchase or sell a security or foreign currency, used in a bona fide hedging transaction; or
  - (b) A financial agreement or arrangement entered into with a broker, dealer or bank, qualified under applicable federal and state securities or banking law and regulation, in connection with investment in one or more securities in order to reduce the risk of changes in market valuation or to create a synthetic investment that, when added to the portfolio, reduces the risk of changes in market valuation.
- (2) An instrument shall not be considered a hedging instrument or a part of a bona fide hedging transaction if it is purchased in conjunction with another instrument where the effect of the combined transaction is an increase in the portfolio's exposure to market risk.

- N. "Investment guidelines" means a set of written guidelines, established in advance by the person with investment authority over the segregated portfolio, to be followed by the investment manager. The guidelines shall include a description of:
- (1) The segregated portfolio's investment objectives and limitations;
  - (2) The investment manager's degree of discretion;
  - (3) The duration, asset class, quality, diversification, and other requirements of the segregated portfolio; and
  - (4) The manner in which derivative instruments may be used, if at all, in the segregated portfolio.
- O. "Investment manager" means the person (including the contractholder) responsible for managing the assets in the segregated portfolio in accordance with the investment guidelines in a fiduciary capacity to the owner of the assets.
- P. "Market value record" means an accounting record provided by the contract to reflect the fair market value of the segregated portfolio.
- Q. "Permitted custodial institution" means a bank, trust company or other licensed fiduciary services provider.

**Drafting Note:** When adopting this regulation, individual regulators may wish to review their applicable state laws to ensure that this definition hasn't inadvertently authorized an entity to act as a custodial institution that it would not wish to do so.

- R. "Plan of operation" means a written plan meeting the requirements of Section 5B(1) of this regulation.
- S. "Qualified actuary" means an individual who meets the qualification standards set forth in [insert reference to section of the regulations related to actuarial opinions and memoranda].
- T. "Rate period" means the period of time during which the fixed rate of return credited to the contract value record is applicable between crediting rate formula adjustments.
- U. "Segregated portfolio" means:
- (1) A portfolio or sub-portfolio of assets to which the contract pertains that is held in a custody or trust account by the permitted custodial institution and identified on the records of the permitted custodial institution as special custody assets held for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract; and
  - (2) Any related cash or currency received by the permitted custodial institution for the account of the contractholder and held in a deposit account for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract.
- V. "Spot rate"

- (1) “Treasury-based spot rate” corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable United States government obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing, non-callable and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operation.
- (2) “Index spot rate” corresponding to a given time of benefit payment means the zero-coupon yield implied by (x) the Barclays Short Term Corporate Index (for a given time of benefit payment under one year) or (y) the zero-coupon yield implied by the Barclays U.S. Corporate Investment Grade Bond Index (for a given time of benefit payment greater than or equal to one year).
- (3) “Blended spot rate” corresponding to a given time of benefit payment means a blend of 50% each of (i) the treasury-based spot rate, and (ii) the index spot rate. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rated in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner and are supported by investments denominated in the currency of the foreign country, the treasury-based spot rate component of the blended spot rate may be determined by reference to substantially similar obligations of the government of the foreign country. For liabilities other than those described above, the blended spot rate shall be determined on a basis mutually agreed upon by the insurer and the commissioner.  
~~corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable United States government obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing, non-callable and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operation. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rated in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner and are supported by investments denominated in the currency of the foreign country, the spot rate may be determined by reference to substantially similar obligations of the government of the foreign country. For liabilities other than those described above, the spot rate shall be determined on a basis mutually agreed upon by the insurer and the commissioner.~~
- W. “Synthetic guaranteed investment contract” or “contract” means a group annuity contract or other agreement that in whole or in part establishes the insurer’s obligations by reference to a segregated portfolio of assets that is not owned by the insurer.
- X. “Unilateral contract termination event” means an event allowing the insurer to unilaterally and immediately terminate the contract, without future liability or obligation to the contractholder.
- Y. “United States government obligation” means a direct obligation issued, assumed, guaranteed or insured by the United States of America or by an agency or instrumentality of the United States government.

- Z. "Valuation actuary" means the appointed actuary or, alternatively, a qualified actuary designated by the appointed actuary to render the actuarial opinion pursuant to Section 10. Written documentation of any such designation shall be on file at the company and available for review by the commissioner upon request.

## **Section 5. Financial Requirements and Plan of Operation**

A contract may not be delivered or issued for delivery in this state unless the issuing insurer is licensed as a life insurance company in this state and is financially qualified under the provisions of Subsection A of this section. In addition, a domestic insurer may not deliver or issue for delivery, either in this state or outside this state, a contract belonging to a specific class of contracts unless the insurer has satisfied the requirements of Subsection B of this section with respect to that class.

- A. An insurer will be financially qualified under this section if its most recent statutory financial statements reflect at least \$1 billion in admitted assets or \$100 million in capital and surplus, and its risk-based capital results do not place it at a regulatory level of action. In lieu of the requirements in the preceding sentence, the insurer may be required to satisfy such other financial qualification requirements set forth by the commissioner as having been deemed necessary or appropriate in a particular case to protect the insurer's policyholders and the public.
- B. A domestic insurer will satisfy the requirements of this section with respect to a class of contracts if the insurer has filed a plan of operation pertaining to the class of contracts, together with copies of the forms of contract in the class, with the commissioner and the filing of the plan of operation has been approved or has not been disapproved within the sixty-day period following the date of filing, in which event the plan of operation shall be deemed approved.
- (1) The plan of operation for a class of contracts shall describe the financial implications for the insurer of the issuance of contracts in the class, and shall include at least the following:
- (a) A statement that the plan of operation will be administered in accordance with the requirements prescribed by the commissioner pursuant to this regulation, along with a statement that the insurer will comply with the plan of operation in its administration of the contract;
  - (b) A statement describing the methods and procedures used to value statutory liabilities for purposes of Section 10;
  - (c) A description of the criteria used by the insurer in approving the investment manager for the segregated portfolio of assets associated with a contract in the class, if the investment manager is an entity other than the insurer or its wholly owned subsidiary;
  - (d) A description of the insurer's requirement for reports concerning the assets in each segregated portfolio and transactions involving the assets, and a description of how the insurer can use the information in a report to determine that the segregated portfolio is being managed in accordance with its investment guidelines. The insurer shall require that the report be prepared no less frequently than quarterly,

and include a complete statement of segregated portfolio holdings and their fair market value;

- (e) A demonstration of financial results for one or more sample contracts from the class of contracts, showing at a minimum the projected contract value records, the applicable fixed rate or rates of return, and the projected market value records, describing how the investments in the segregated portfolio reflect provision for benefits insured by the contract and how the contract value and market values and the rates of return may be affected by changes in the investment returns of the segregated portfolio and reasonably anticipated deposits to and withdrawals from the segregated portfolio by the contractholder, as well as any advances made by the insurer to the contractholder. The sample contracts shall be chosen to reasonably represent the range of results that could be expected from possible combinations of contract provisions of all contracts within the class. The demonstration shall include at least three (3) hypothetical return scenarios (level, increasing and decreasing) and for each of these scenarios, at least three (3) withdrawal scenarios (zero, moderate and high) shall be modeled. The commissioner may require additional scenarios if deemed necessary to fully understand the risks under the class of contracts. The demonstration period shall be the greater of five (5) years or the minimum period the insurer must underwrite the risk;
- (f) A statement that all contracts in the class of contract satisfy the requirement of Section 9 regarding unilateral contract terminations, together with a description of all termination events, discontinuation triggers and options, notice requirements, corrective action procedures, all other contract safeguards, and the procedures to be followed when a unilateral contract termination event occurs;
- (g) A description of the allowable investment parameters (such as objectives, derivative strategies, asset classes, quality, duration and diversification requirements applied to the assets held within the segregated portfolio) to be reflected in the investment guidelines applicable to each contract issued in the class to which the submitted plan of operation applies; and a description of the procedures that will be followed by the insurer in evaluating the appropriateness of any specific investment guidelines submitted by the contractholder. If the insurer chooses to operate a contract in accordance with investment guidelines not meeting the criteria established pursuant to this subparagraph, the non-conforming set of investment guidelines shall be filed with the commissioner in accordance with the filing requirements of this subsection;
- (h) A description of the criteria used by the insurer in approving for contract issuance a pooled fund representing multiple employer-sponsored plans and in approving the investment manager for the segregated portfolio of assets associated with such pooled fund contract;

**Guidance Note:** A pooled fund is an arrangement in which multiple, unaffiliated employer sponsored plans invest in a shared trust. Pooled funds generally allow plan sponsors the right to exit the fund at book value subject to advance

notification requirements. In describing the criteria used by the insurer in evaluating the potential issuance of a contract, discuss the insurer's advance notification requirements and how any actual advance notifications will be monitored and reflected in the risk management of the contract.

- (i) A description of risk-mitigation techniques used by the insurer in connection with contracts issued to pooled funds representing multiple employer-sponsored plans;
  - (j) An unqualified opinion by a qualified actuary with expertise in these matters as to the adequacy of the consideration charged by the insurer for the risks it has assumed with respect to the contracts in the class to which the plan of operation applies;
  - (k) A statement that the actuarial opinion and memorandum required by Section 10 shall include, with respect to the class of contracts to which the plan of operation applies:
    - (i) If a payment has been made by the insurer in the prior reporting period under a contract in the class, the amount of aggregate risk charges (net of administrative expenses) for contracts in the class, and the aggregate amount of any losses incurred; and
    - (ii) An inventory of all material unilateral contract termination events in the class that have not been cured within the time period specified and that have occurred during the prior reporting period but where the company decided not to terminate the contract.
- (2) Review of the plan of operation by the commissioner may necessitate requests for information to supplement that furnished pursuant to Paragraph (1). Replies made in compliance with this paragraph should be made in sufficient detail that any follow-up correspondence can be held to a minimum.

## **Section 6. Required Contract Provisions and Filing Requirements**

**Drafting Note:** This section may be omitted in its entirety if a state does not require contracts to be filed for approval, and the state wishes to eliminate required contract provisions. Subsection B of this section may be omitted if a state does not require contracts to be filed for approval, but wishes to maintain required contract provisions.

A contract may not be delivered or issued for delivery in this state unless the contract satisfies the requirements of Subsection A of this section and the issuing insurer has satisfied the requirements of Subsection B of this section with respect to the contract.

### **A. The contract shall:**

- (1) Provide that the assets to which the contract pertains and for which a contract value record is established will be maintained in a segregated portfolio of a permitted custodial institution;
- (2) Grant the insurer the right to perform audits and inspections of assets held in the segregated portfolio from time to time upon reasonable notice to the permitted custodial institution;

- (3) Provide that the insurer will receive prior notice of and the right to approve any appointment or change of investment managers;
- (4) Give a description of how the contract value record will be determined, and, where applicable, adjusted by a crediting rate formula;
- (5) State the maximum rate period between crediting rate formula recalculations that will be permitted, if any;
- (6) Provide the insurer with the right to refuse to recognize any new deposits to the segregated portfolio unless there is a written agreement between the insurer and the contractholder as to the permissible levels and timing of new deposits;
- (7) Clearly identify all circumstances under which insurer payments or advances to the contractholder are to be made;
- (8) Clearly identify the types of withdrawals made on a market value basis;
- (9) Provide either a fixed maturity schedule or a settlement option permitting the contractholder to receive the contract value record over time, provided that no unilateral contract termination event has occurred; and
- (10) Include a provision stating, or substantially similar to, the following:

“No waiver of remedies by the insurer that is a party to this agreement, following the breach of any contractual provision of the agreement or of the investment guidelines applicable to it, or failure to enforce the provisions or guidelines, which constitutes grounds for termination of this agreement for cause by the insurer, and is not cured within thirty (30) days following the insurer's discovery of it, shall be effective against an insurance commissioner in any future rehabilitation or insolvency proceedings against the insurer unless approved in advance in writing by the commissioner.”

**Drafting Note:** An adopting state may wish to add an “entire contract” provision in this section if such a provision is not required elsewhere in the adopting state's insurance code.

- B. An insurer will satisfy the filing and approval requirements of this section with respect to a contract if the insurer has filed the form of the contract with the commissioner and it is accompanied by the items specified in Paragraphs (1), (2), and (3) of this subsection, and the form has been approved or has not been disapproved within the thirty-day period following the date of filing, in which event the form of contract shall be deemed approved. Notwithstanding the foregoing, the requirement for filing and approval of the form of contract may be waived at the discretion of the commissioner.

- (1) The form of contract filed for approval shall be accompanied by a statement that the contract meets the conditions of Subsection A of this section.
- (2) The form of contract filed for approval shall be accompanied by a statement:
  - (a) Specifying the range of variation of variable contract provisions, if any, that could have a material effect on the risk assumed by the

insurer under the contract, including withdrawal methodology, crediting rate formula and termination events;

**Drafting Note:** Contract forms covered by this regulation frequently incorporate variable provisions. The statement required by this subparagraph is intended to provide the information regulators need to evaluate the risks associated with such variability.

- (b) Describing how the fair market value will be determined, including a description of the rules for valuing securities and other assets that are not publicly traded;
  - (c) Describing the crediting rate formula, if any, and how it will operate to take into account the difference between the market value record and the contract value record over time; and
  - (d) Listing events that give the insurer the right to terminate the contract immediately.
- (3)
- (a) In the case that the plan of operation pertaining to the class of contracts to which the contract belongs has been affirmatively approved by the commissioner of the state in which the issuing insurer is domiciled, the form of contract filed for approval shall be accompanied by a statement indicating the receipt of approval, and that the approval was an affirmative approval.
  - (b) In the case that the plan of operation pertaining to the class of contracts to which the contract belongs has been deemed approved in the state in which the issuing insurer is domiciled, the form of contract filed for approval shall be accompanied by a statement indicating that the issuing insurer has met the requirements for deemed approval.
  - (c) In the case that the plan of operation pertaining to the class of contracts to which the contract belongs has not been approved, either affirmatively or by deemer, in the state in which the issuing insurer is domiciled, the form of contract filed for approval shall be accompanied by a statement of this fact, together with a plan of operation pertaining to the contract.

**Drafting Note:** The state of filing may request the plan of operation for informational purposes and may take it into account in deciding whether to approve the form. It is not anticipated that the state of filing would review and approve the plan of operation, but may use it in connection with the review of the form of contract.

**Drafting Note:** In the case that the plan of operation has not been approved, either affirmatively or by deemer, in the state of domicile of the issuing insurer, the state of issue, in issuing contract approvals, may wish to establish requirements to be met by the issuing insurer (e.g., notice requirement if the plan of operation subsequently changes, or requirement that the contract be operated in compliance with the plan of operation) in order to maintain its approval.

## **Section 7. Investment Management of the Segregated Portfolio**

- A. The investment manager must have full responsibility for, and control over, the management of all segregated portfolio assets within the constraints specified in the investment guidelines.

**Drafting Note:** In the event that the segregated portfolio has multiple managers, all of these managers will be covered by the investment guidelines.

- B. The investment guidelines shall be submitted to the insurer for underwriting review before the contract becomes effective.
- C. If the insurer accepts a proposed change to the investment guidelines or allows the contract to operate in accordance with investment guidelines not meeting the criteria established in Section 5B(1)(g), approval of the non-conforming investment guidelines must be obtained pursuant to Section 5B.

#### **Section 8. Purchase of Annuities**

For contracts that are group annuity contracts, and that make available to the contractholder the purchase of immediate or deferred annuities for the benefit of individual members of the group, an annuity may not be purchased without the delivery of the contractually agreed upon consideration in cash to the insurer from the segregated portfolio for allocation to the insurer's general account or a separate account. The insurer shall collect adequate consideration for the cost of annuities purchased under contract option by transfer from the segregated portfolio.

#### **Section 9. Unilateral Contract Terminations**

A contract subject to this regulation shall allow the insurer to unilaterally and immediately terminate, without future liability of the insurer or obligation to provide further benefits, upon the occurrence of any one of the following events that is material and that is not cured within thirty (30) days following the insurer's discovery of it:

- A. The investment guidelines are changed without the advance consent of the insurer and the investment manager is not controlling, controlled by or under common control with the insurer;
- B. The segregated portfolio, if managed by an entity that is not controlling, controlled by or under common control with the insurer, is invested in a manner that does not comply with the investment guidelines; or
- C. Investment discretion over the segregated portfolio is exercised by or granted to anyone other than the investment manager.

#### **Section 10. Reserves**

- A. Asset maintenance requirements for segregated portfolios governed by this regulation.
  - (1) At all times an insurer shall hold minimum reserves in the general account or one or more separate accounts, as appropriate, equal to the excess, if any, of the value of the guaranteed contract liabilities, determined in accordance with Paragraphs (6) and (7) of this subsection, over the market value of the assets in the segregated portfolio less the deductions provided for in Paragraph (2) of this subsection. The reserve requirements of this subsection shall be applied on a contract-by-contract basis.
  - (2) In determining compliance with the asset maintenance requirement and the reserve for guaranteed contract liabilities specified in Paragraph (1) of this subsection, the insurer shall deduct a percentage of the market value of an asset as follows:

- (a) For debt instruments, the percentage shall be the NAIC asset valuation reserve "reserve objective factor," but the factor shall be increased by fifty percent (50%) for the purpose of this calculation if the difference in durations of the assets and liabilities is more than one-half year. The above notwithstanding, in the event that, under the terms of the synthetic guaranteed investment contract, the asset default risk for debt instruments is borne solely by the contractholder, there shall be no asset valuation reserve percentage deduction from the market value of an asset, for purposes of complying with the asset maintenance requirement and the reserve for guaranteed contract liabilities specified in Paragraph (1) of this subsection.
- (b) For assets that are not debt instruments, the percentage shall be the NAIC asset valuation reserve "maximum reserve factor."
- (3) To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by segregated portfolio assets denominated in the currency of the foreign country, the percentage deduction for these assets under Paragraph (2) of this subsection shall be that for a substantially similar investment denominated in the currency of the United States.
- (4) To the extent that guaranteed contract liabilities are denominated in the currency of the United States and are supported by segregated portfolio assets denominated in the currency of a foreign country, and to the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by segregated portfolio assets denominated in the currency of the United States, the deduction for debt instruments under Paragraph (2) of this subsection shall be increased by fifteen percent (15%) of the market value of the assets unless the currency exchange risk on the assets has been adequately hedged, in which case the percentage deduction under Paragraph (2) of this subsection shall be increased by one-half percent (.5%). No guaranteed contract liabilities denominated in the currency of a foreign country shall be supported by segregated portfolio assets denominated in the currency of another foreign country without the approval of the commissioner. For purposes of this paragraph, the currency exchange risk on an asset is deemed to be adequately hedged if:
- (a) It is an obligation of
- (i) A jurisdiction that is rated in one of the two (2) highest rating categories by an independent nationally recognized United States rating agency acceptable to the commissioner;
- (ii) Any political subdivision or other governmental unit of such a jurisdiction, or any agency or instrumentality of jurisdiction, political subdivision or other governmental unit; or
- (iii) An institution that is organized under the laws of any such jurisdiction; and

- (b) At all times the principal amount of the obligation and scheduled interest payments on the obligation are hedged against the United States dollar pursuant to contracts or agreements that are:
  - (i) Issued by or traded on a securities exchange or board of trade regulated under the laws of the United States or Canada or a province of Canada;
  - (ii) Entered into with a United States banking institution that has assets in excess of \$5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an independent, nationally recognized, United States rating agency, or with a broker-dealer registered with the Securities and Exchange Commission that has net capital in excess of \$250 million; or
  - (iii) Entered into with any other banking institution that has assets in excess of \$5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an independent, nationally recognized, United States rating agency and that is organized under the laws of a jurisdiction that is rated in one of the two (2) highest rating categories by an independent, nationally recognized United States rating agency.
- (5) These contracts may provide for the allocation to one or more separate accounts of all or any portion of the amount needed to meet the asset maintenance requirement. If the contract provides that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurer, the insurer shall maintain in a distinct separate account that is so chargeable:
  - (a) That portion of the amount needed to meet the asset maintenance requirement that has been allocated to separate accounts; less
  - (b) The amounts contributed to separate accounts by the contractholder in accordance with the contract and the earnings on the contract.
- (6) For purposes of this section, the minimum value of guaranteed contract liabilities is defined to be the sum of the expected guaranteed contract benefits, each discounted at a rate corresponding to the expected time of payment of the contract benefit that is not greater than ~~the maximum multiple of the spot rate supportable by the expected return from the segregated portfolio assets, and in no event greater than 405 percent of the~~ blended spot rate as described in the plan of operation (pursuant to Section 5) or the actuary's opinion and memorandum, (pursuant to Section 10B), except that if the expected time of payment of a contract benefit is more than thirty (30) years, it shall be discounted from the expected date of payment to year thirty (30) at a rate of no more than eighty percent (80%) of the thirty-year blended spot rate and from year thirty (30) to the date of valuation at a rate not greater than ~~405 percent of the thirty-year~~ blended spot rate.

- (7) In calculating the minimum value of guaranteed contract benefits:
- (a) All guaranteed benefits potentially available to the contractholder on an ongoing basis shall be considered in the valuation process and analysis, and the reserve held must be sufficient to fund the greatest present value of each independent guaranteed contract benefit. For purposes of this subparagraph, the right granted to the contractholder to exit the contract by discharging the insurer of its guarantee obligation under the contract and taking control of the assets in the segregated portfolio shall not be considered a guaranteed benefit.
  - (b) To the extent that future guaranteed cash flows are dependent upon the benefit responsiveness of an employer-sponsored plan, a best estimate based on company experience, or other reasonable criteria if company experience is not available, shall be used in the projections of future cash flows.
  - (c) The minimum value of guaranteed contract benefits under a contract issued to a pooled fund representing multiple employer-sponsored plans shall be determined so as to reflect projected plan sponsor contract value withdrawals available to the member plans in the pooled fund.

Projections of such future cash flows shall take into account (i) known plan sponsor withdrawals, and (ii) a prudent estimate of future plan sponsor withdrawals. The prudent estimate shall be based on company experience and other relevant criteria.

**Guidance Note:** Other relevant criteria include, but are not limited to, the pooled fund's profile (e.g., number of employer-sponsored plans, and the minimum, maximum and average size of such plans), the minimum notice that plan sponsors are required to give in order to effectuate a plan sponsor withdrawal, the percentage of the pooled fund that is investment-only and that is full service, and economic conditions.

A single valuation rate shall be determined, consistent with Paragraph (6) of this subsection, equal to the lesser of:

- (i) The expected return from the segregated portfolio of assets, or
- (ii) The blended spot rate based on the duration of the segregated portfolio of assets.

This single valuation rate shall be used to model future market values of the segregated portfolio of assets. Future credited interest rates shall be modeled according to the contractually defined crediting rate formula. Modeled future contract values shall reflect modeled future market values, modeled future credited interest rates, known future plan sponsor withdrawals, the prudent estimate of future plan sponsor withdrawals, future withdrawals consistent with Paragraph (7)(b) of this subsection and any remaining final payment at the modeled contract termination date.

All such modeled withdrawals and termination payments shall be discounted using the single valuation rate and the modeled times of those withdrawals and payments. The sum of these present values

shall be deemed the minimum value of the guaranteed contract liabilities for a pooled fund contract.

B. Actuarial opinion and memorandum for segregated portfolios governed by this regulation.

- (1) An insurer that issues a synthetic guaranteed investment contract subject to this regulation shall submit an actuarial opinion and, upon request, a memorandum to the commissioner annually by March 1 following the December 31 valuation date showing the status of the accounts as of the prior December 31. The actuarial opinion and memorandum shall be in form and substance satisfactory to the commissioner.

**Drafting Note:** The state may wish to include the information contained in the actuarial opinion and memorandum as a part of its overall filing requirements, rather than mandating a separate filing for synthetic guaranteed investment contracts.

- (2) The actuarial memorandum required by this regulation is deemed to be confidential to the same extent, and under the same conditions, as the actuarial memorandum required by [insert reference to state law equivalent to Section 3 of the NAIC Model Standard Valuation Law].

**Drafting Note:** A thorough review should be performed of the specific laws and regulations in a state which may affect the confidential status of the memorandum.

- (3) Except in cases of fraud or willful misconduct, the valuation actuary shall not be liable for damages to any person (other than the insurance company and the commissioner) for any act, error, omission, decision, or conduct with respect to the actuary's opinion.
- (4) The statement of actuarial opinion submitted in accordance with Section 10B(1) shall consist of:
  - (a) A paragraph identifying the valuation actuary and his or her qualification;
  - (b) A scope paragraph identifying the subjects on which the opinion is to be expressed and describing the scope of the valuation actuary's work;
  - (c) A reliance paragraph describing those areas, if any, where the valuation actuary has deferred to other experts in developing data, procedures or assumptions;
  - (d) An opinion paragraph expressing the valuation actuary's opinion with respect to the matters described in Subparagraphs 5A and 5B below; and;
  - (e) One or more additional paragraphs may be needed in individual company cases as follows:
    - (i) If the valuation actuary considers it necessary to state a qualification of his or her opinion;

- (ii) If the valuation actuary must disclose an inconsistency in the method of analysis used at the prior opinion date with that used for this opinion;
  - (iii) If the valuation actuary chooses to add a paragraph briefly describing the assumptions which form the basis of the actuarial opinion.
- (5) Contents of the opinion paragraph of the actuarial opinion.
  - (a) The actuarial opinion shall state that, after taking into account any risk charge payable, the segregated portfolio assets, and the amount of any reserve liability with respect to the asset maintenance requirement, the account assets make adequate provision for contract liabilities.
  - (b) The opinion shall also state that:
    - (i) Reserves for contract liabilities are calculated pursuant to the requirements of Section 10A(1);
    - (ii) After taking into account any reserve liability with respect to the asset maintenance requirement, the amount of the account assets satisfied the asset maintenance requirement;
    - (iii) The fixed-income segregated portfolio conformed to and justified the rates used to discount contract liabilities for valuation pursuant to Section 10A(6);
    - (iv) Whether any rates used pursuant to Section 10A(6) to discount guaranteed contract liabilities and other items applicable to the segregated portfolio were modified from the rate or rates described in the plan of operation filed pursuant to Section 5; and;
    - (v) The level of risk charges, if any, retained in the general account was appropriate in view of such factors as the nature of the guaranteed contract liabilities and losses experienced in connection with account contracts and other pricing factors.
- (6) The opinion shall be accompanied by a certificate of an officer of the insurance company responsible for monitoring compliance with the asset maintenance requirements for synthetic guaranteed investment contracts describing the extent to and manner in which, during the preceding year:
  - (a) Actual benefit payments conformed to the benefit payment estimated to be made as described in the plan of operation;
  - (b) The determination of the fair market value of the segregated portfolio conformed to the valuation procedures described in the plan of operation, including a statement of the procedures and sources used during the year; and;

- (c) Any assets were transferred to or from the insurer's general account, or any amounts were paid to the insurer by any contractholder to support the insurer's guarantee.
- (7) The actuarial memorandum shall:
- (a) Substantially conform with those portions of Section [insert reference to section of the regulations related to actuarial memoranda] of these regulations that are applicable to asset adequacy testing and either:
    - (i) Demonstrate the adequacy of account assets based upon cash flow analysis, or
    - (ii) Explain why cash flow testing analysis is not appropriate, describe the alternative methodology of asset adequacy testing used, and demonstrate the adequacy of account assets under that methodology;
  - (b) Clearly describe the assumptions the valuation actuary used in support of the actuarial opinion, including any assumptions made in projecting cash flows under each class of assets, and any dynamic portfolio hedging techniques utilized and the tests performed on the utilization of the techniques;
  - (c) Clearly describe how the valuation actuary has reflected the cost of capital;
  - (d) Clearly describe how the valuation actuary has reflected the risk of default on obligations and mortgage loans, including obligations and mortgage loans that are not investment grade;
  - (e) Clearly describe how the valuation actuary has reflected withdrawal risks, if applicable, including a discussion of the positioning of the contracts within the benefit withdrawal priority order pertaining to the contracts, the impact of any dynamic lapse assumption and the results of sensitivity testing the prudent estimate of future plan sponsor withdrawals pursuant to Section 10A(7)(c);
  - (f) If the plan of operation provides for investments in segregated portfolio assets other than United States government obligations, demonstrate that the rates used to discount contract liabilities pursuant to Section 10A(6) conservatively reflect expected investment returns, taken into account any foreign exchange risks;
  - (g) If the contracts provide that in certain circumstances they would cease to be funded by a segregated portfolio and, instead would become contracts funded by the general account, clearly describe how any increased reserves would be provided for if and to the extent these circumstances occurred;
  - (h) State the amount of account assets maintained in a separate account that are not chargeable with liabilities arising out of any other business of the insurance company;

- (i) State the amount of reserves and supporting assets as of December 31 and where the reserves are shown in the annual statement; ~~and~~
  - (j) State the amount of any contingency reserve carried as part of surplus;
  - (k) State the market value of the segregated asset portfolio; and
  - (l) Where separate account assets are not chargeable with liabilities arising out of any other business of the insurance company, describe how the level of risk charges payable to the general account provides an appropriate compensation for the risk taken by the general account.
- C. When the insurer issues a synthetic guaranteed investment contract and complies with the asset maintenance requirements of Section 10A, it need not maintain an asset valuation reserve with respect to those account assets.
- D. This section describes the reserve valuation requirements for contracts subject to this regulation.
- (1) Reserves for synthetic investment contracts subject to this regulation shall be an amount equal to the sum of the following:
    - (a) The amounts determined as the minimum reserve as required under Section 10A(l);
    - (b) Any additional amount determined by the insurer's valuation actuary as necessary to make adequate provision for all contract liabilities; and
    - (c) Any additional amount determined as necessary by the commissioner due to the nature of the benefits.
  - (2) The amount of any reserves required by Paragraph (1) of this subsection may be established by either:
    - (a) Allocating sufficient assets to one or more separate accounts; or
    - (b) Setting up the additional reserves in the general account.

### **Section 11. Severability**

If any provision of this regulation or its application to any person or circumstances is judged invalid by a court of competent jurisdiction, the judgment shall not affect or impair the validity of the other provisions of this regulation.

### **Section 12. Effective Date**

This regulation shall take effect [insert date].

*Chronological Summary of Actions (all references are to the Proceedings of the NAIC).*

*1998 Proc. 4<sup>th</sup> Quarter 16, 17, 609, 638-647 (adopted).*

This page is intentionally left blank