MEMO

Date: December 28, 2018

From: Jonathan D. Weir, JD*

To: ICOLI Clients & Colleagues

Subject: NAIC Adopted Revisions to ICOLI as an Admitted Asset
NAIC Fall 2018 Update – Blanks Working Group Resolution

Insurance company clients and colleagues with corporate owned cash value life insurance should take note of recent revisions by the National Association of Insurance Commissioners (NAIC) to the statutory accounting guidance on such life insurance policies under Statements of Standard Accounting Practice (SSAP) No. 21.

Background

In the Spring National Meeting the NAIC tasked the Statutory Accounting Policy Working Group (SAPWG) to study the accounting treatment of company owned cash value life insurance and annuities under SSAP No. 21. This came in response to a marketed proposal by an advisor representing a private equity owned life insurance and annuity carrier seeking SSAP No. 21 treatment on a Private Placement Variable Annuity (PPVA) product they had designed. This investment banker conceived scheme served to open review on all assets that may qualify for SSAP No. 21 treatment, including insurance company owned life insurance (ICOLI), and in particular, private placement contracts.

Traditional Universal Life (UL), Indexed Universal Life (IUL) and Whole Life (WL) represent the lion's share of the corporate owned life insurance (COLI) market, including the ~$25B in insurer ICOLI holdings as of YE 2017. SEC registered VUL, as well as Private Placement Variable UL (PPVUL) have stood the test of time, largely held by banks (BOLI), and now represents the other ~20% of ICOLI. Further, ICOLI has been a growing segment as, like banks have for 30+ years, insurers come to understand the function and value this alternative asset. These products have a clear purpose and history as informal funding for corporate benefits and have undergone strict scrutiny by the heavily regulated banking industry, as well as the IRS. COLI Best Practices 101(j) applies to all COLI, traditional, SEC registered and PPVUL alike.

NAIC Modification

Adopted Revisions to SSAP No. 21, Paragraph 6:

The Amount That Could Be Realized on Life Insurance Where the Reporting Entity is Owner and Beneficiary or Has Otherwise Obtained Rights to Control the Policy

6. The provisions in this paragraph are for life insurance policies, which are in compliance with Internal Revenue Code (IRC) §7702[1], in which the reporting entity is the owner and beneficiary[2]. For these owned products, the amount that could be realized on life insurance policies where the reporting entity is the owner and beneficiary or has otherwise obtained the rights to control the policy, is similar to a cash deposit that is realizable on demand. As such, the amount that could be realized on a life insurance policy as of the date to which premiums have been paid shall be reported as an admitted asset.

   In determining the amount that could be realized, reporting entities shall consider the cash surrender value as well as other contractual terms which limit or provide for additional realizable amounts. If any of these contractual terms which limit or provide for additional realizable amounts allow the owner to pay variable premium (reducing or increasing the premium based on the increase or decrease of a variable investment vehicle of the policy), the life insurance policies must always remain compliant with IRC §7702 to be an admitted asset under this paragraph.

Amounts recoverable by the reporting entity at the discretion of the issuing company shall not be included. Amounts realizable beyond one year from the surrender date shall be discounted. For group policies or a group of individual life policies, reporting entities shall assume surrender on a policy by policy or certificate by certificate basis, unless contractual terms only allow for surrender of all policies or certificates as a group, in which case the amount that could be realized shall be determined on a group basis.

Disclosure is required of the amount of the cash surrender value that is within an investment vehicle by investment category (e.g., bonds, common stock, joint ventures, derivatives, etc.)

New Footnote 1*:* In order to be in compliance with IRC §7702:

1. The contract must be considered "life insurance" under applicable state insurance law. This is a contractual definition that includes:
   - The contract must be filed and approved as life insurance
   - It must be regulated as life insurance under applicable laws and regulations (such as variable life insurance regulation and non-forfeiture laws)
   - There must be an insurable interest in the continued life of the insured (federal and state law also require the consent of the insured to the coverage)
   - There must be a significant transfer of mortality risk between the policyholder and the insurance company.
2. The contract must meet one of two actuarial tests of the policy's cash value relation to its death benefit to assure that, prior to death / maturity, the policy cash value does not exceed the net single premium required to fund the death benefit.

New Footnote 2*:* These life insurance products shall be acquired with the primary consideration of the costs related to employee benefit obligations or the loss of a key person.

Summary

This past week I sought out clarifications direct from the NAIC, notably:

- The disclosures regarding underlying investments will initially be sought in narrative form
- The language regarding insurable interest in New Footnote 1 was intended simply to support the existing insurable interest requirement in IRC Sec. 101(j)
- and, most importantly, in the words of a NAIC manager involved with the working group: ***"as of now, there are no changes (including to RBC) expected". ****

We are pleased with these clarifications, which, with the additional disclosure requirements, bring regulatory guidance on ICOLI even more in line with BOLI. Further, it clearly restates, in New Footnote 2, that acquisition of ICOLI must be done in consideration of company benefits and key person coverage.

We will continue to monitor and report any continued developments that stem from these revisions. And certainly, we will work with our clients and colleagues to best understand the disclosure requirements which I am told will be provided during the **NAIC Fall 2018 national meeting**.

NAIC Fall 2018 Update

Blanks (E) Working Group

BWG received a memo from SAPWG about the reporting and disclosure requirements for certain revisions to statutory accounting guidance that are effective for year-end 2018 reporting. **No structural changes were made to the annual statement blanks to data capture these requirements for year-end 2018, but the instructions provide a template for narrative disclosures. Reporting entities can reference the example disclosures included in the memo *(see below)* to meet these requirements.** BWG accepted the memo and will make its content available as an update to the 2018 annual statement instructions.

NAIC Example Disclosure:

This disclosure is proposed to be captured in Note 21 – Other as follows:

> *The Company is the owner and beneficiary of life insurance policies included in [name of Assets line] at their cash surrender values pursuant to SSAP No. 21, paragraph 6. At December 31, 2018, the cash surrender value in an investment vehicle is $_____, and is allocated into the following categories based on primary underlying investment characteristics: x% bonds, x% stocks, x% mortgage loans, x% real estate, x% cash and short-investments, x% derivatives and x% other invested assets. (Investments in private funds / hedge funds shall be reported as other invested assets.)*

Please contact me at jweir@weirresources.com or 716.863.0085 if you need a copy of the November 15, 2018 SAPWG Memo.

* Please note, statements by NAIC staff have no authority and are based on the information provided and existing NAIC guidance. The state of domicile should be contacted with any specific questions as to the appropriate accounting or reporting, as the insurance departments decisions are the final authority for statutory accounting and reporting when guidance is not specific. **Please contact me if you have any questions.**