

Title 210 – Nebraska Department of Insurance

Chapter 80 – SYNTHETIC GUARANTEED INVESTMENT CONTRACTS

001. Authority.

This regulation is promulgated under the authority vested in the Director of Insurance by *Neb.Rev.Stat.* §44-708.01(3).

002. Purpose.

The purpose of this regulation is to implement *Neb.Rev.Stat.* §44-708.01 by setting forth the terms and conditions under which life insurance companies may issue synthetic guaranteed investment contracts.

003. Definitions.

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

003.01 “Contract” or “synthetic guaranteed investment contract” means a policy, contract or agreement, which establishes the insurance company’s obligations to the contractholder with regard to a segregated portfolio that is neither owned by nor in the possession of the insurance company. It shall be structured as an indemnity contract for payment of money upon the occurrence of specified contingencies relating to fluctuations in the market value of the segregated portfolio, except with assets in external custody. As used herein, the term

“contract” refers to any document whereby obligations are memorialized, regardless of its caption or form.

003.02 “Contract value record” means an accounting record established by the contract in relation to the segregated portfolio that is credited with a fixed rate of return over regular periods. The contract value record is experience rated relative to the market value record and is used to measure the extent of the insurance company’s obligations to the contractholder with regard to the segregated portfolio.

003.03 “Department” means the Nebraska Department of Insurance and any employee of the Department authorized to act on behalf of the Department.

003.04 “Director” means the Director of the Nebraska Department of Insurance.

003.05 “Experience crediting formula” means a mathematical formula used to calculate the fixed rate of return to be credited to the contract value record during any rate period. The formula is based upon the differences between the contract value record and the market value record, over a period of time not to exceed the average duration of assets held in the segregated portfolio, and any other appropriate actuarial factors or methods.

003.06 “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.

003.07 “Investment guidelines” means the set of written guidelines established by the contractholder, and agreed to by the insurer, setting forth the quality, sector and duration corridors within which the investment manager may invest and reinvest assets within the segregated portfolio.

003.08 “Investment manager” means the insurer, if it is registered as an investment advisor under the Investment Advisors Act of 1940 and is managing the assets in the segregated portfolio, or any third party so registered as an

investment advisor and approved by the insurer to manage the segregated portfolio in accordance with the investment guidelines.

003.09 “Market value record” means an accounting record established by the contract in relation to the market value of the segregated portfolio and expressed as the sum of: (1) the fair market value of the assets, plus (2) any related cash or currency held in the segregated portfolio.

003.10 “Permitted custodial institution” means a bank, savings and loan association, or trust company.

003.11 “Plan of operation” means a written plan meeting the requirements of Section 004.03A of this regulation.

003.12 “Rate period” means the period of time during which the fixed rate of return credited to the contract value record is applicable between experience crediting formula adjustments.

003.13 “Segregated portfolio” means: (1) shares of a regulated investment company, or (2) 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, plus (3) 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.

004. Financial Requirements and Plan of Operation.

004.01 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 004.02 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 unless the insurer has satisfied the requirements of Subsection 004.03 of this section with respect to that contract.

004.02 An insurer will be financially qualified under this section if its most recent statutory financial statements on file with the Director of Insurance reflect that it meets the financial requirements of *Neb.Rev.Stat.* §44-708.01.

004.03 A domestic insurer will satisfy the requirements of this section with respect to a contract if the insurer has filed a plan of operation pertaining to the contract, together with the form of the contract, with the director, and the plan of operation has been approved.

004.03A The plan of operation for the contract shall describe the financial implications for the insurer of the issuance of the contract, and shall include at least the following:

004.03A(1) A profile of the market the insurer expects to service with this contract form that includes: (a) an overview of the synthetic guaranteed investment contract market and how this contract form works within that market; (b) definitions specific to that market and contract not included in Section 003 of this regulation; (c) target markets and buyers; (d) marketing and distribution processes and description of arrangements to ensure adequate marketing supervision; (e) for the current and next three calendar years: (i) the number of contract forms to be sold, (ii) the minimum initial asset amount per contract, (iii) the maximum initial asset amount per contract, (iv) the average initial asset amount per contract, (v) the maximum insurer exposure per investment manager and contractholder, (vi) the insurer's total exposure to synthetic guaranteed investment contracts, (vii) the insurer's percentage of the segregated portfolio to which the contract pertains if the contract does not cover the entire segregated portfolio (if applicable) and (viii) the sales impact on insurer's business and liabilities; and (f) states in which this contract form is to be filed;

004.03A(2) A statement describing the reserve methodology used to value statutory liabilities for purposes of Section 009;

004.03A(3) A description of the criteria used by the insurer in approving the investment manager for the segregated portfolio of assets associated with the contract, if the investment manager is an entity other than the insurer or its wholly owned subsidiary;

004.03A(4) 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 will 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;

004.03A(5) A demonstration of how the interest rate credited to the contract value record will be affected by changes in interest rates and withdrawal experience. The demonstration shall include at least seven (7) hypothetical interest rate scenarios (level, increasing, decreasing, pop up, pop down, increasing then decreasing, and decreasing then increasing) and for each of those interest rate scenarios, at least three (3) withdrawal scenarios (zero, moderate and high) shall be modeled. Additional scenarios may be required if the Department determines it to be necessary to fully understand the risks of the contract or agreement. The demonstration period shall be for the lesser of 15 years or the maximum potential life of the contract;

004.03A(6) A description of all termination features of the contract, including any causes, events, and situations where the insurer has the discretion to terminate the contract. The description should include the timing of the termination and the method of payment determination;

004.03A(7) A description of the allowable investment parameters (such as objectives, asset classes, quality, duration and diversification requirements applied to the assets held within the segregated portfolio) and any allowed hedging techniques to be employed, along with a discussion of the creation, design and management of investment strategy to mitigate deviation in the market value/contract value ratio, to be reflected in the investment guidelines applicable to the contract issued to which the submitted plan of operation applies; and a discussion of the underwriting criteria applied by the insurer in evaluating the appropriateness of any specific investment guidelines submitted by the contractholder;

004.03A(8) A demonstration that the consideration charged by the insurer for the contract is appropriate in view of the risks to the insurer with respect to the contract;

004.03A(9) A description of all guarantees and associated risks under which the contract might require the insurer to make payments or perform other obligations to the contractholder in support of the contract value record;

004.03A(10) A description of the insurer's ability to change fees and/or stop issuing contracts;

004.03A(11) A description of how contract fees, and investment management fees, if any, are to be reported on the annual financial statement;

004.03A(12) A statement that the segregated portfolio will be accounted for by the insurer with an accounting prepared no less frequently than quarterly, and which must include the following items: (a) a complete statement of segregated portfolio holdings and values (market or book/amortized value, as appropriate); and (b) the cash balance within the segregated portfolio;

004.03A(13) A statement that the insurer shall maintain a market value record at all times for each contract subject to this regulation, and that no less frequently than monthly, the insurer shall update the market value record to reflect the market value of the segregated portfolio. In performing the market value calculation, the method of valuation selected must be designed to reflect the fair market value of the segregated portfolio and may include the use of a vendor market value valuation service. The statement should be accompanied by a description as to how the market value record will be calculated, including a summary description of the procedures to be followed by the insurer in verifying any market value reporting performed by the contractholder or the permitted custodial institution which the insurer may use as the basis for calculating the market value record; and

004.03A(14) A statement that the insurer shall maintain a contract value record at all times for each contract subject to this regulation. The statement should be accompanied by a description of the method by which the experience crediting formula reconciles the differences between the market value record and the contract value record.

004.03B The director may request, and the company shall provide, information to supplement that required by Paragraph 004.03A.

004.04 If an insurer chooses to operate a contract with a material change from the approved plan of operation, the changed provision(s) shall be filed with and

approved by the director in accordance with the requirements of Subsection 004.03.

005. Required Contract Provisions and Filing Requirements.

005.01 A contract may not be delivered or issued for delivery in this state unless the contract satisfies the requirements of Subsection 005.02 of this section and the issuing insurer has satisfied the requirements of Subsection 005.03 of this section with respect to the contract.

005.02 The contract shall:

005.02A 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;

005.02B 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;

005.02C Provide the insurer with the rights to receive prior notice of, and to approve, any change of investment managers and any change to the investment guidelines;

005.02D Give a description of how the contract value record will be determined, including the method by which the fixed rate of return credited to the contract value record will be determined;

005.02E State the maximum rate period between experience crediting formula recalculations that will be permitted;

005.02F 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;

005.02G Clearly specify the insurer's obligations under the contract and identify the circumstances under which insurer payments to the contractholder are to be made;

005.02H State the market value adjustment formula used in calculating the effect on the contract value record of certain withdrawals from the

segregated portfolio, and clearly identify the types of withdrawals subject to market value adjustment;

005.02I Provide the methodology for paying the contract value record at the stated maturity of the contract, or if no stated maturity, the methodology permitting the contractholder to receive the contract value record over time; and

005.02J Provide that forbearance by the insurer in a particular case shall not be a waiver as to actions that may be taken with regard to future non-compliance.

005.03 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 (including application) with the director and it is accompanied by the items specified in Paragraphs 005.03A, B, C, D and E of this subsection, and the form has been approved. The contract form may not be used unless approved by the director.

005.03A The form of contract filed for approval shall be accompanied by a statement that the contract meets the conditions of Subsection 005.02 of this section.

005.03B The form of contract filed for approval shall be accompanied by a statement:

005.03B(1) 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, experience crediting formula and termination events;

005.03B(2) Describing how fair market value will be determined, including a description of the procedures for valuing securities and other assets that are not publicly traded;

005.03B(3) Describing the experience crediting 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

005.03B(4) Listing events that give the insurer the right to terminate the contract immediately.

005.03C The form of contract filed for approval shall be accompanied by a signed actuarial certification stating that the pricing of the contract fees are reasonable and sufficient for the risks assumed by the insurer with respect to the contract. The signing actuary must be familiar with the pricing and valuation requirements for the contract and must be a member in good standing of the American Academy of Actuaries.

005.03D The form of contract filed for approval shall be accompanied by a signed certification from an officer of the insurer that the issuance of the contract is not hazardous to the public, or to its present or future policyholders, and any such additional statements as may be required by the director.

005.03E In the case that the plan of operation pertaining to the contract:

005.03E(1) Has been affirmatively approved by the state in which the issuing insurer is domiciled, the form of contract filed for approval shall be accompanied by a statement indicating receipt of affirmative approval. Upon request of the director, the insurer shall furnish the plan of operation pertaining to the contract.

005.03E(2) Has not been affirmatively approved 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 the plan of operation pertaining to the contract.

005.04 The director may disapprove a contract form filing upon a finding that the form of contract contemplates practices that are unfair or unreasonable or otherwise inconsistent with the provisions of Chapter 44 of the Revised Statutes of Nebraska, including the requirements of this regulation, specifying in what regard the contract form is unfair or unreasonable or otherwise inconsistent with the provisions of Chapter 44 of the Revised Statutes of Nebraska.

005.05 The director may withdraw an approval of a contract form on any basis that would have justified initial disapproval. The director shall notify the insurer in writing of the reason for the withdrawal of the contract form approval. The insurer may, within 15 days of the withdrawal of approval, make a written request for a hearing before the director to determine the reasonableness of the director's action. The hearing shall be held within 30 days of the request.

006. Investment Management of the Segregated Portfolio.

006.01 The investment manager must have responsibility for, and control of the investment management of the funds in the segregated portfolio.

006.02 The investment guidelines, and changes thereto, must be approved by the insurer.

007. Purchase of Annuities.

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For contracts which make available to the contractholder the purchase of immediate or deferred annuities for the benefit of individual members of the group, no annuity may be purchased without the prior delivery of the contractually-agreed annuity consideration in cash to the insurer from the segregated portfolio for allocation to the insurer's general account or separate account where the annuity's reserve assets will be held.

008. Unilateral Contract Terminations.

008.01 A contract subject to this regulation shall allow the insurer to unilaterally and immediately terminate with refund of any unearned contract fees or investment management fees, without future liability of the insurer or obligation to provide further benefits, upon the occurrence of any one of the following events:

008.01A The investment guidelines are changed without the advance consent of the insurer;

008.01B The segregated portfolio is invested in a manner that does not comply with the investment guidelines;

008.01C Investment discretion over the segregated portfolio is exercised by or granted to anyone other than the investment manager without the approval of the insurer; or

008.01D Any act of fraud, misrepresentation of material facts, deceit or any other unauthorized action of the contractholder that has a material adverse affect on the insurer.

009. Reserves.

Risk reserves shall be equal to 009.01 plus 009.02:

009.01 Gross unearned contract fees.

009.02 Each year, the reserve shall be increased by at least 30% of any excess of contract fees received over claims paid during the year. This amount shall be accumulated without interest. The maximum required reserve shall be 150% of the current annualized contract fees. The reserve may be reduced, with the result never less than zero, by any excess of claims paid over the contract fees received during the year.

010. Severability.

If any provision of this regulation or its application to any person or circumstance is for any reason held to be invalid by a court, the remainder of the regulation and the application of the provision to other persons or circumstances shall not be affected.