

April 22, 2010

NAIC Will Study Separate Account Risk Charges

The **Separate Account Risk Charge (E) Working Group** (Risk Charge Working Group) of the National Association of Insurance Commissioners (NAIC) recently held its first meeting by conference call (chaired by Blaine Shepherd of Minnesota). The charge of the Working Group is to consider the need to develop express regulatory requirements that insurers establish adequate risk charges to compensate the general account for the risks that it assumes in guaranteeing individual separate account products. At the end of its study, the Working Group is charged with providing recommendations to the NAIC's Financial Condition (E) Committee on whether to request that a model law be developed.

While insurers are required to hold reserves within their general accounts for guarantees of individual separate account products, there are currently no express model laws or regulations that the general account be compensated for such guarantees by means of separate account risk charges or that a qualified actuary opine on the adequacy of such charges. The lack of such risk charge regulation has been identified by the Statutory Accounting Principles (E) Working Group (SAP Working Group) as a very concerning matter for solvency regulation. Further the SAP Working Group believes that the recent economic downturn has demonstrated the significance that these guarantees can have on the general account. As a result, the SAP Working Group has requested that the (E) Committee consider establishing guidelines requiring risk charges for individual separate account products that would:

- Adequately compensate the general account for the risks it takes through the guarantee of separate account products;
- Be appropriate in accordance with the nature of the guaranteed contract liabilities, losses experienced in connection with separate account contracts and other pricing factors; and
- Be reviewed and opined upon by an appropriate actuary.

As part of its charge, the Risk Charge Working Group will review the Model Variable Contract Law (Model Law 260) ([Click Here](#)) and the Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts Model Regulation (Model Reg 200) ([Click here](#)).

Model Reg 200 currently applies only to "group" contracts. The Risk Charge Working Group will consider whether a similar model rule should be developed for individual products, and whether the Model Law 260 should be updated.

In addition, the Risk Charge Working Group will review the regulatory framework supporting general account guarantees of insulated separate accounts, particularly when assets needed to cover reserves are held in an insulated account. Regulators are particularly concerned that the risk charges be sufficient, so that there can be no self-dealing. In the view of several regulators, the separate account is buying a service from the general account for its guarantees, and the separate account must adequately compensate the general account for such service.

The Risk Charge Working Group agreed to move forward with its work through a series of conference calls. No schedule of calls has yet been announced, and no target date has been set for completion of the study. We will keep you informed of future developments.

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If you have any questions about this Legal Alert, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.

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