

CLIENT UPDATE

NAIC 2014 SUMMER NATIONAL MEETING

NEW YORK

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The National Association of Insurance Commissioners (NAIC) held its 2014 Summer National Meeting from August 14 to 19, 2014 in Louisville, Kentucky. This Client Update highlights some of the developments from the Summer National Meeting that are of particular interest to many of our insurance industry clients, including developments relating to:

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For purposes of this report:

- “ACLI” means the American Council of Life Insurers.
- “EU” means the European Union.
- “FIO” means the Federal Insurance Office of the U.S. Department of the Treasury.
- “FSB” means the Financial Stability Board.
- “FSOC” means the Financial Stability Oversight Committee.
- “G-SII” means a global systemically important insurer.
- “IAIG” means an internationally active insurance group.
- “IAIS” means the International Association of Insurance Supervisors.
- “RBC” means NAIC risk-based capital.
- “SIFI” means a systemically important financial institution.
- “SVO” means the NAIC Securities Valuation Office.

(1) REINSURANCE MATTERS

Implementation of the 2011 Amendments to the Credit for Reinsurance Model Law and Regulation

The **Reinsurance (E) Task Force** received a status report on state implementation of the 2011 amendments to the Credit for Reinsurance Model Law and Regulation which included the addition of reduced collateral for unauthorized reinsurers that are “certified reinsurers” that, in the case of non-U.S. reinsurers, are domiciled and licensed to transact insurance or reinsurance in a “qualified jurisdiction.” Twenty-three states have enacted legislation to adopt the revised Model Law and Regulation, with the insurers domiciled in these 23 states writing more than 60% of the primary insurance premiums in the U.S. Five additional states are expected to introduce legislation to enact the revised Model Law and Regulation in 2014 or 2015, which would raise the market share to 80%.

NAIC Qualified Jurisdictions List/Process

The Task Force received the report of the **Qualified Jurisdiction (E) Working Group** that the number of jurisdictions being evaluated for the list of qualified jurisdictions is up to seven, with five initial reviews complete. The Working Group intends to have the reviews completed by the 2014 Fall National Meeting in November 2014.

The Task Force received a memorandum from the Working Group and the Reinsurance Financial Analysis (E) Working Group on issues regarding information sharing and confidentiality agreements with qualified jurisdictions. The Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions (Qualified Jurisdiction Process) requires qualified jurisdictions to enter into a memorandum of understanding with U.S. state insurance regulators, and further directs that “NAIC staff will create a template MOU to be used with each Qualified Jurisdiction.” The memorandum explained that both Working Groups believe that the IAIS Multilateral Memorandum of Understanding (MMoU) is the preferred method of sharing information and cooperation with qualified jurisdictions, but as an interim solution until all states that are certifying reinsurers for reinsurance collateral reduction have been approved under the IAIS MMoU application process, it should only be required that a “Lead State” designated by the NAIC has an MOU with the qualified jurisdiction. The Lead State will act as a conduit for information between the qualified jurisdiction and other states that have certified a reinsurer domiciled and licensed in that jurisdiction, and will share information with these states under the NAIC Master Information Sharing and Confidentiality Agreement. The Task Force discussed the memorandum on July 25, 2014 and exposed it for public comment until August 11, 2014. Six letters were received and only non-substantive changes were made since then. The Task Force adopted the memorandum, which included amendments to the Qualified Jurisdiction Process.

U.S. Certified Reinsurers – NAIC Peer Review (Passporting)

The **Reinsurance Financial Analysis (E) Working Group** updated the Task Force that it is recommending passporting for 25 reinsurers and one is pending for re-review. It did not give passporting to six of the certified reinsurers for confidential reasons. “Passporting” is intended to speed the process by which reinsurers certified in one state are certified in another state by encouraging the latter state’s insurance regulator to rely on the certification completed by the former state’s insurance regulator. The Task Force passed a motion for the Working Group to continue discussions about the Uniform Application Checklist for Certified Reinsurers and come back to the Task Force with possible changes to the draft application.

(2) CORPORATE GOVERNANCE

Duplication Report

The **Corporate Governance (E) Working Group** discussed comments that it had received on proposed responses to the duplication report submitted by interested parties. The

duplication report identified redundancies that may be created with the adoption of an annual corporate governance disclosure. The Working Group referred several possible redundancies to the Blanks (E) Working Group and the Financial Examiners Handbook (E) Technical Group. In addition, the Working Group referred a letter outlining broader redundancy concerns to the Financial Condition (E) Committee.

Corporate Governance Annual Disclosure Model Act and the Corporate Governance Annual Disclosure Model Regulation Adopted

The Working Group adopted the Corporate Governance Annual Disclosure Model Act and the Corporate Governance Annual Disclosure Model Regulation. The Model Act and Model Regulation provide a framework under which an insurer annually will provide information on its corporate governance practices to state insurance regulators. Comments focused on the importance on including confidentiality language when the Model Act and Regulation are enacted and promulgated by the states. Working Group members expressed the view that it will be important for the insurance industry to work with legislators to explain the importance of the confidentiality provisions of the Model Act.

(3) GROUP-WIDE SUPERVISION

The **Group Solvency Issues (E) Working Group** received a report on NAIC-conducted legal research that compared various systems of insurance holding company regulation in the U.S. and abroad. The research on the U.S. systems focused on the Insurance Holding Company Systems Regulatory Act and legislation enacted in Pennsylvania, California, and Nebraska. The research on the foreign systems focused on Solvency II and legislation adopted in Bermuda and Switzerland.

Pursuant to the Working Group's charge to identify amendments to the Model Act to address issues that have arisen since the Model Act was adopted, the Working Group considered whether to amend the Model Act regarding state authority to act as a group-wide supervisor. Several Working Group members emphasized the importance of creating the legal authority for such supervision in light of international attention to group-wide supervision.

The Working Group directed NAIC staff to develop a first draft of proposed changes to the Model Act with an expectation that new language will be adopted by the end of 2014.

The Working Group has since released draft amendments to the Model Act on August 22, 2014. The draft amendments add a new Section 7A to the Model Act titled "Group-wide

Supervision of International Insurance Groups” which is drawn from Pennsylvania law, 40 P.S. § 991.1406b. Comments on the proposal are due on September 22, 2014.

(4) RECEIVERSHIP AND INSOLVENCY

Reinsurance Recoverables

The **Receivership Reinsurance Recoverables (E) Working Group** adopted a response to a referral from the Receivership Technology and Administration (E) Working Group for recommended benchmarks for reinsurance recoverables in the Global Receivership Information Database. The response recommended that the Receivership Technology and Administration Working Group “[r]eport reinsurance recoverables in the Global Receivership Information Database if 10% or more of an estate’s total reinsurance recoverables is greater than 90 days past due from a cumulative perspective regardless of justification (i.e., dispute, arbitration, slow pay, etc.).]”

The Working Group and later the **Receivership and Insolvency (E) Task Force** also adopted the Guideline for Payment of Interest to Receiver on Overdue Reinsurance Recoverables. The Guideline was created because most states felt they did not have the authority to charge interest when a reinsurer unreasonably withholds payment. In keeping with the proposed changes circulated in advance of the meeting, the Guideline does not specify the type of interest (e.g., simple or compound) that should accrue on past-due reinsurance claims as the Working Group members generally agreed that such a decision should be made by each state. The Task Force cautioned that the imposition of interest should not be used punitively. The Task Force also clarified that the Guideline language was purposely simple in order to give it the flexibility to fit into a variety of state laws.

Contingent Deferred Annuity Definition and Guaranty Association Coverage

NOLHGA gave a presentation to the **Receivership and Insolvency (E) Task Force** on its work on contingent deferred annuities (CDAs), which analyzed whether an individual certificate holder under a CDA would be covered by a guaranty fund. While it did not look at every state guaranty fund, it concluded that CDAs would be covered under the Life and Health Insurance Guaranty Association Model Act as “annuities”. As most states have adopted guaranty fund laws similar to the Model Act, it is likely that CDAs would be covered under most state guaranty funds, with the exception of New York due to General Counsel Opinion No. 09-06-11 (June 25, 2009) that opines that a contingent deferred annuity is an impermissible form of financial guaranty insurance in New York. The Task

Force exposed for a two-week comment period a draft response summarizing these findings.

Resolution Planning

Patrick Hughes and Paul Cantwell from Alvarez & Marsal gave a presentation to the **Receivership and Insolvency (E) Task Force** on the lessons they have learned from their resolution planning experience. The presenters explained that the goal of resolution planning is to protect the system as a whole. They mentioned the recent finding by the FDIC that all of the 2013 plans filed by first-round filers were “not credible” and discussed the consequences of such a finding. The presenters identified best practices for resolution planning and emphasized the questions critical to the inquiry, including the purpose of the plan.

Resolution Plans for Large Insurance Groups

The **Receivership and Insolvency (E) Task Force** adopted a report to the Financial Condition (E) Committee that recommended that the charge to evaluate the benefits and costs associated with requiring resolution plans of large insurance groups be tabled. The report suggests the merit in developing a template checklist of information that a state insurance regulator could request from a troubled insurer. The report suggests referring this suggestion to the Financial Analysis (E) Working Group to develop a checklist for the Troubled Insurance Company Handbook.

(5) INTERNATIONAL INSURANCE RELATIONS

ComFrame Field Testing

The **ComFrame Development and Analysis (G) Working Group** and the **International Insurance Relations (G) Committee** received an update on the IAIS ComFrame field testing process, which involves three modules that are expected to last for three years. The first module was completed earlier this year. The second module is currently in progress, and it involves 33 volunteers engaged in quantitative testing. The qualitative questionnaire will be released in October 2014. The third module will begin field testing in 2015.

IAIS Capital Developments

The Working Group and the Committee discussed the IAIS capital developments, including basic capital requirements (BCR), higher loss absorbency (HLA), and a global

insurance capital standard (ICS). BCR is the current IAIS priority, and a proposal for a global BCR calculation for G-SIIs was released in July 2014 for a comment period that ended in August 2014. After review of the comments, the proposal will go to the FSB in the fall with the potential for future refinement. HLA is the second priority for the IAIS, and the IAIS expects to release a first draft in December 2014, although a number of BCR-related issues are still open. The final proposal is due to be released in December 2015. The development of a global insurance capital standard is expected to be complete by the end of 2016 with an implementation date for IAIGs in 2019.

The Working Group also heard a summary of the well-attended NAIC International Capital Standards Forum, which had been held the previous day. Comments raised at the forum included uncertainty about the objectives of global ICS.

IAIS Transparency and U.S. Coordination

Discomfort with the IAIS's trend toward a lack of transparency was a theme in the Working Group and Committee meetings due to the IAIS's recent proposal to eliminate observer status. Instead of permitting observers to participate in meetings, the IAIS would occasionally invite participation and increase the number of conference calls and publications. Interested parties expressed concern that they would have limited opportunities to provide input on significant capital and other regulations, and they noted the difficulty in effecting change once a proposal has been drafted. There were several calls for the U.S. to act with a more coherent voice at the IAIS, including developing a consensus viewpoint before attending IAIS meetings. Several Working Group and Committee members stated that the NAIC would vigorously oppose the IAIS's trend away from transparency. The Committee plans to schedule a conference call at the end of August 2014 to discuss the NAIC's comments on the proposal. The IAIS proposal is also posted on its web site, and the Committee encouraged people and organizations to submit individual comments.

International Regulatory Cooperation Activities

The Committee heard a report on the U.S./EU Insurance Dialogue Project. In July 2014, the U.S./EU steering committee agreed to a revised "Way Forward" document, which represents a continuing dialogue to close or reduce gaps between the U.S. and the EU. The mechanisms for exchanging confidential information are still under discussion, and the steering committee expects to identify by the end of 2014 whether there should be a formal agreement on confidentiality between the U.S. and the EU. The document does not commit the NAIC to a stance on group supervision but generally affirms the NAIC

structure. Similarly, the document does not commit the NAIC to a particular stance on reinsurance collateral requirements, although it is based on the Credit for Reinsurance Model Law.

Joint Forum

The Committee heard an update on the Joint Forum. The Joint Forum was established in 1996 under the aegis of the Basel Committee on Banking Supervision, the International Organization of Securities Commissions and the IAIS to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates. The future of the Joint Forum is in question given the role of the FSB. If the Joint Forum is not re-endorsed, it will wind down in 2015.

IMF Financial Sector Assessment Program

The Committee heard an update on the IMF Financial Sector Assessment Program, which is currently underway and expected to be completed by 2015. The program assesses IAIS core principles against the existing U.S. insurance regulatory system.

(6) FINANCIAL STABILITY (EX) TASK FORCE

The **Financial Stability (EX) Task Force** heard updates on the IAIS's financial stability-related initiatives, including the non-bank-non-insurer designation process, the development of basic capital requirements (BCR) for G-SII's and the development of the global insurance capital standard for inclusion in the ComFrame, the Common Framework for the Supervision of IAIGs.

Missouri Director John Huff updated the Task Force on developments at FSOC, reiterating the concerns expressed in FSOC's May 2014 Annual Report, including the potential for captive reinsurance to create systemic risk, the difficulties to the insurance industry posed by the low interest rate environment and the transfer of pension plan risks to insurers.

The Task Force also heard remarks from Thomas Sullivan, who was recently appointed adviser to the Federal Reserve Board on insurance matters. Mr. Sullivan emphasized the need for cooperation and coordination between the Federal Reserve Board and state insurance regulators, in particular, in order to present a unified position internationally when developing international standards. He also emphasized the need for the U.S. to take the lead in international standard setting in order to preempt "regulatory arbitrage". State insurance regulators expressed concerns that they have been marginalized at the

IAIS, but that they were hopeful that a unified federal-state position could provide U.S. insurance regulators a greater voice in international forums.

(7) REINSURANCE CAPTIVES

Adoption of Reinsurance Framework and Referrals

The **Executive (EX) Committee** received a report from the **Principle-Based Reserving Implementation (EX) Task Force** about the adoption of the XXX/AXXX Reinsurance Framework in concept, the related charges for other NAIC groups and three model law development requests.

The Task Force made referrals to the Life Actuarial (A) Task Force, Blanks (E) Working Group, Financial Analysis Handbook (E) Working Group, Capital Adequacy (E) Task Force, Reinsurance (E) Task Force, Statutory Accounting Principles (E) Working Group, Financial Condition (E) Committee and the Financial Regulation Standards and Accreditation (F) Committee. Two of these charges are for implementation by the end of 2014, including the charge to the Blanks (E) Working Group to adopt an XXX/AXXX reinsurance supplement to be filed by insurers ceding XXX/AXXX business in the 2014 financial statement blank and the charge to the Financial Analysis Handbook (E) Working Group for the development of a new section in the Financial Analysis Handbook regarding XXX/AXXX reinsurance transactions.

Among the major actions to be taken to implement the Framework are the following:

- The Framework is expected to be codified through the Credit for Reinsurance Model Law and through the adoption of a new model regulation.
- The Actuarial Opinion and Memorandum Regulation is expected to be amended to require the opining actuary for the ceding insurer to issue a qualified opinion if the Framework is not followed.
- An actuarial guideline is expected to be drafted and adopted. See the report below about exposure of a new draft AG 48.
- The ceding insurer and its independent auditor are expected to have to indicate in a Note to the insurer's audited financial statement whether the Framework is being followed.

North Carolina Commissioner Wayne Goodwin expressed concern that the target dates for certain charges relating to implementation of the Framework do not provide enough time for discussion and implementation. He also stated that he would like to spend more time

discussing confidentiality and he would have preferred to delay the vote because he thought the Framework had many loose ends to tie up. Rhode Island Commissioner Joseph Torti and Tennessee Commissioner Julie McPeak, Co-chairs of the Task Force, responded that the issues have been discussed at length and it is time to take action. New York Deputy Superintendent & General Counsel Robert Easton stated that New York did not support the February 17, 2014 Rector Report, but supports even less the June 4, 2014 Rector Modified Recommendations. Deputy Superintendent Easton cited a few examples, including the fact that the timelines for implementation are now longer. Also, the February 17, 2014 report contemplated that if a ceding insurer did not satisfy the Framework standards, there would be a presumption that it was operating in a hazardous financial condition. New York does not support the replacement of this hazardous financial condition presumption in the February 17, 2014 with an actuarial report in the June 4, 2014 Modified Recommendations. Commissioner Torti responded that there is still a very tight time schedule and a ceding insurer's actuary cannot issue an unqualified actuarial opinion unless it is justified in doing so.

RBC Referrals

The **Capital Adequacy (E) Task Force** discussed the Reinsurance Framework proposed charges that were sent to the Task Force from the Principle-Based Reserving Implementation (EX) Task Force and observed that no comments had been received. The Task Force referred all three charges to the Life Risk-Based Capital (E) Working Group.

Actuarial Guideline 48 Exposure

The **Life Insurance and Annuities (A) Committee** heard an update from the Life Actuarial (A) Task Force and voted to expose a proposed actuarial guideline (AG 48) to address the Reinsurance Framework for 30 days.

New Proposed Supplemental XXX/AXXX Reinsurance Exhibit

Subsequent to the Summer National Meeting, the **PBR Review (EX) Working Group** released a revised exposure draft Supplemental XXX/AXXX Reinsurance Exhibit. Comments on the draft are due on September 29, 2014.

Reinsurance Captives and NAIC Accreditation Standards

The **Financial Regulation Standards and Accreditation (F) Committee** briefly discussed proposed changes to the preamble to the NAIC accreditation standards that were released by the NAIC at the 2014 Spring National Meeting for a 45-day comment period. In total,

the Committee received 34 comment letters. Although the Committee did not discuss the comment letters in detail, it did observe that many of them raised the concern that the proposal would negatively impact captive insurers that do not reinsure XXX/AXXX risk. The Committee also stated that the proposal was a straw man and therefore meant to draw comments. The Committee ultimately left the issue open to further consideration and stated that the Committee might take action at the upcoming 2014 Fall National Meeting, but any action would likely be on a revised proposal.

The proposal would have required that, in order to maintain its NAIC accreditation, a state would have to apply the NAIC accreditation standards applicable to traditional insurers to “multi-state reinsurers”, which would have been defined as “an insurer assuming business that is directly written in more than one state and/or in any state other than its state of domicile”. The definition of “multi-state reinsurer” covers captive insurers, special purpose vehicles and other entities assuming business even if only licensed in one state, as the definition is based on where underlying policies are written. The definition includes captives assuming XXX/AXXX risk, but includes any captive that assumes risk written in a state other than the captive’s domestic state. Some of the standards that captives are generally not subject to currently, but would need to be applied to multi-state reinsurers under the proposal are (1) the Risk-Based Capital (RBC) Model Act, (2) valuation of investments in accordance with standards promulgated by the Valuation of Securities (E) Task Force and the Financial Condition (E) Committee, (3) the Insurance Holding Company System Regulatory Act and the related regulation (including the new Enterprise Risk Management report), (4) investment law, (5) Standard Valuation Law and Actuarial Opinion and Memorandum, (6) Credit for Reinsurance Model Law and Regulation and Life and Health Reinsurance Agreement Model Regulation (risk transfer rules), and (7) filing of annual and quarterly statutory financial statements with the NAIC.

Under the proposal, if a state did not subject multi-state reinsurers to the same NAIC accreditation standards as traditional insurers, the state could potentially lose its NAIC accreditation status, and not be recognized as an adequate state insurance regulator by the other states. The application of accreditation standards to newly defined “multi-state reinsurers” under the proposal would have only applied prospectively to reinsurance agreements entered into after July 1, 2014 on direct business written on or after July 1, 2015.

Although new or amended NAIC accreditation standards are subject to a multiple year phase-in period to allow for states to enact related legislation, the proposed changes to the preamble to the accreditation standards would have been implemented without such a phase-in period. A representative from the Delaware Department of Insurance not in the

Working Group stated during a comment period that any revised proposal should have a 365-day comment period, which would be in line with other accreditation standards, rather than the 45-day period the Committee exposed the proposal for following the 2014 Spring National Meeting.

The Committee left open the possibility of revising the NAIC accreditation standards for XXX/AXXX reinsurers, but no definitive action was taken.

(8) PRIVATE EQUITY OWNERSHIP OF INSURERS

The **Private Equity Issues (E) Working Group** heard a presentation from A.M. Best regarding an analysis of the role of private equity funds related to their ownership of insurers. The presentation included a comparison of the types of assets held by the insurers owned by private equity funds and other insurers and the related returns.

The Working Group also discussed that they have been made aware of transactions between insurers owned by private equity funds and large investors in those funds. The Working Group stated that, since these transactions are not reviewed by state insurance regulators, this may represent a current gap in the regulatory framework. The Working Group proposed discussing this issue on a conference call to be held prior to the 2014 Fall National Meeting.

The Working Group also proposed discussing the proposed changes to the Financial Analysis Handbook. The changes, which were not discussed at the meeting, set forth qualitative factors for state insurance regulators to consider when reviewing Form A (acquisition of control of a domestic insurer) applications to ensure that the broader risks associated with a proposed acquisition transaction are taken into account. The proposed changes include stipulations that can be required of an acquiring entity to alleviate such concerns.

The Working Group stated that it would like to have a representative from the SEC give a presentation at the 2014 Fall National Meeting and directed the NAIC staff to try to set up that presentation. The Working Group stated that they would not like to adopt any final changes to the Financial Analysis Handbook until they heard a presentation from the SEC. Andrew J. Bowden, Director of the Office of Compliance Inspections and Examinations of the SEC, spoke at the Private Equity International Private Fund Compliance Forum on May 6, 2014 on trends in the private equity industry from a compliance perspective, and his speech was referenced by members of the Working Group.

(9) LIFE INSURER DEVELOPMENTS

Principles-Based Reserving – State of PBR Adoption

The **Principle-Based Reserving Implementation (EX) Task Force** heard an update on state implementation of principle-based reserving legislation. Eighteen states have enacted principle-based reserving legislation or are awaiting governor signature, representing 28% of the primary insurance premiums in the U.S. Texas has partially enacted legislation, and twelve more states have or are expected to introduce legislation in 2014 and 2015. If all those states enact legislation, thirty states representing a 60.3% market share will be represented. The Task Force discussed that it is likely that the Valuation Manual will not be operative until January 1, 2017.

Principles-Based Reserving – VM-20 Small Company Exception

The **Life Insurance and Annuities (A) Committee** heard an update from the Life Actuarial (A) Task Force. The Task Force voted to expose certain ACLI proposals, including a proposal for exempting small companies from VM-20, which was exposed for a 21-day comment period.

Unclaimed Life Insurance Benefits

The **Unclaimed Life Insurance Benefits (A) Working Group** heard a presentation from the ACLI on its study related to unclaimed life insurance benefits and the death master file. The ACLI pointed out a number of judicial decisions that question the authority of state insurance regulators to require search of the death master file. Working Group members disagreed with this characterization, stating that regulatory action on the issue has been predicated on unfair trade practice laws and not on unclaimed property laws, which was the focus of the ACLI's report.

The Working Group then turned to discussing next steps in the development of a model law relating to unclaimed life insurance benefits, including the interaction of any such law with existing regulatory settlements with life insurers and the applicability of such a law to smaller life insurers that have never conducted so-called "asymmetrical matching." The Working Group will hold a public conference call within the next month to consider next steps.

Contingent Deferred Annuities

The **Contingent Deferred Annuity (A) Working Group** discussed the development of the draft “Guidelines for the Financial Solvency and Market Conduct Regulation of Insurers Who Offer Contingent Deferred Annuities,” model law amendments related to contingent deferred annuities (CDAs), the progress of other NAIC committees working on CDA-related matters and the applicability of nonforfeiture benefit requirements to CDAs. CDAs have been defined as “an annuity contract that establishes a life insurer’s obligation to make periodic payments for the annuitant’s lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually defined amount due to contractually-permitted withdrawals, market performance, fees and/or other charges.” The Guidelines, which are directed towards states considering modifying their annuity laws to clarify the applicability of such laws to CDAs, have been exposed for comment through September 5, 2014.

The Working Group also considered whether it should propose the adoption of amendments to certain model laws, drafting notes to certain model laws or only the Guidelines. Working Group members expressed support for the adoption of amendments to model laws rather than for the adoption of drafting notes.

The Working Group also discussed the applicability of nonforfeiture benefit laws to CDAs and generally agreed that such laws could not in their current form be applied to CDAs. The Working Group requested comments by September 30, 2014 on (1) whether a nonforfeiture or similar benefit should apply to CDAs, (2) what any such benefit should look like and how it should be calculated, and (3) the appropriate role of the Working Group with respect to the issue.

The Working Group also heard remarks from the Center of Economic Justice, which summarized a report expressing concerns about CDAs. The Center’s stated concerns focused chiefly on potentially unfair or deceptive policy provisions, the relationship of benefits to premiums charged and the absence of nonforfeiture benefits.

Please refer to “Contingent Deferred Annuity Definition and Guaranty Association Coverage” on Page 5 for a discussion of guaranty fund coverage for CDAs.

(10) RISK-BASED CAPITAL DEVELOPMENTS

Reporting Proposal Deadline

The **Capital Adequacy (E) Task Force** heard numerous comments from interested parties regarding the final adoption date of current year reporting proposals that are modified due to non-RBC working group adoptions. Interested parties expressed concern that reducing the amount of time available to iterate with vendors would lead to quality control problems. Several Task Force members stated that the modifications would only impact RBC specifications that had already been adopted and expressed the hope that this would only be an occasional issue. The Task Force decided to consider a revision to the proposal based on the concerns voiced. Potential edits include specifying that a modification must be minor for the change to be implemented on the earlier date or a requirement for a super-majority of states to agree on adoptions later than the current date. The Task Force suggested that interested parties submit comments as to how to put the proposal into effect. The comments will be used to put together a document that will be exposed for another round of comments.

RBC Factors

The Task Force adopted language in the Management Discussion and Analysis RBC Instructions, which clarifies that the RBC Requirement, Total Adjusted Capital and RBC factors cannot be modified for the calculation of authorized control level RBC, even at the request of an insurer's domestic state. The guidance is effective starting with the 2014 reporting year, and it will be posted to the Task Force web page and as additional guidance on the NAIC web pages for all RBC business types.

Investment Risk-Based Capital

The **Investment Risk-Based Capital (E) Working Group** heard an update from the American Academy of Actuaries on the development of revised base asset risk factors for corporate bonds held by life insurers. The Academy continues to advocate for increased granularity, but has changed its recommendation from a matrix of asset risk factors to a simple expansion of the number of rating classes from the current five to 13.

The Working Group also discussed the possibility of increased granularity in RBC for real estate investments beyond what was previously discussed. While preliminary analysis suggested that increased granularity was not necessary with respect to most real estate investments, discussion is expected to continue.

(11) VALUATION OF SECURITIES

Statutory Accounting

The **Valuation of Securities (E) Task Force** heard reports on Bottom-Tier Residual Interests and the Joint Project on Investment SSAPs. The Joint Project has released an exposure document for comments, which are due in October 2014. It is starting with the definition of “security” in SSAP No. 26, and will subsequently address specific topics in a way that creates a logical conversation about the overall project. There is no set timeline as to when specific topics will be addressed or decisions made due to the project’s flow.

Global Financial Presentation Issues

The Task Force heard a report on a study of Canada’s Accounting Standards for Private Enterprises (ASPE) and French GAAP. Canadian GAAP has been approved by the Task Force. Recently, however, Canada enacted ASPE, which differs from Canadian GAAP. The SVO continues to learn about these accounting systems related to a possible amendment of the definition of National Standards in the definition of Audited Financial Statement in the SVO Purposes and Procedures Manual.

Amendments to Instructions in the SVO Purposes and Procedures Manual

The Task Force heard proposals related to catastrophe-linked bonds, eligible Credit Rating Provider (CRP) credit ratings eligible for filing exemption, and the definition of NAIC designation. The Task Force released the proposed amendments for a 30-day comment period, which will end September 26, 2014. As to catastrophe-linked bonds, the proposed amendment would subject unrated catastrophe bonds to the 5*/6* Special Reporting Instruction set forth in Part Two, Section 5, of the SVO Purposes and Procedures Manual. As to eligible CRP credit ratings, the proposed amendment would limit descriptions of required CRP credit ratings characteristics under the filing exempt rule and the process of translating CRP credit ratings into NAIC designations to certain sections. As to the definition, the proposed amendment would seek to resolve an ambiguity that currently exists by clarifying that designations reflect the position of a security in an issuer’s capital structure. The Task Force observed that it is likely it will consider more of these clarifications in the future.

The Task Force also adopted an amendment to the SVO Purposes and Procedures Manual that reduced the time period during which an insurer may correct missing information for a security filed with the SVO from 90 days to 45 days.

The Task Force declined to act on a proposed change to the definition of “Structured Notes”. The Task Force may resume its review of this issue in 2015.

Miscellaneous

The Task Force received a proposal from the SVO that insurers file copies of private letter ratings with the SVO when the security is not in the NAIC system. Interested parties had numerous questions about this proposal, and the Task Force directed the SVO to discuss this issue with interested parties.

The Task Force also heard a report that the SEC adopted changes to the money market fund rules, including a rule prohibiting institutional prime funds from using Stable Net Asset Value of \$1 per share. The SVO held the view that government money market funds would not be affected, but Class I funds would be impacted. The rule will not go into effect for two years, so the Task Force need not take immediate action.

Finally, the Task Force received a request from the Financial Conditions (E) Committee to review the Derivative Instruments Model Regulation against the NAIC model law criteria. The SVO will study the issue and report to the Task Force at the 2014 Fall National Meeting.

(12) OTHER MATTERS

Reauthorization of the Terrorism Risk Insurance Act of 2002

The **Terrorism Insurance Implementation (C) Working Group** heard an update on the progress of U.S. House and Senate bills that would reauthorize the federal Terrorism Risk Insurance Act of 2002 (TRIA), which is set to expire at the end of 2014. The Senate bill, S. 2244, passed the full chamber on July 7, 2014, while the House bill, H.R. 4871, was reported by the Committee on Financial Services on June 20, 2014. Both bills would reduce federal support of insurers under TRIA, the Senate bill modestly and the House bill more substantially. The Working Group also discussed amendments to certain NAIC model documents that would be required upon TRIA reauthorization.

Mortgage Guaranty Insurers

The **Mortgage Guaranty Insurance (E) Working Group** discussed comments received on a revised draft of the Mortgage Guaranty Insurance Model Act that was circulated to the Working Group before its August 5, 2014 conference call. A few of the topics addressed on

the call included capital standards, geographic risk limitations and the role of the non-domiciliary commissioner.

Birny Birnbaum from the Center for Economic Justice raised a procedural comment as to transparency relating to the development of the capital model that will be the foundation of the revised Model Act. He suggested that the deliberations be in public forums, to which Wisconsin Commissioner Ted Nickel, the Working Group Chair, responded that there are concerns about the confidentiality of public company data. Mr. Birnbaum suggested using generic/anonymized data and Commissioner Nickel said they would consider the request but do not want to jeopardize publicly traded companies.

The Task Force also discussed geographic concentration as it relates to risk limitations. Mr. Birnbaum pointed out that property in California and New York is much more expensive than other states, and Commissioner Nickel said they would take that into account. There was also discussion about how much detail on underwriting standards should be included in the revised Model Act. Some thought the detail would be better in a procedure manual as that would be easier to amend. Others thought the detailed underwriting standards should be kept in the revised Model Act as a public relations statement.

The Working Group also received an update on federal legislative matters from Tony Cotto of the NAIC. The proposed housing finance reform legislation, entitled the Housing Finance Reform and Taxpayer Protection Act of 2014, is no longer being considered for this Congress but will continue to be an issue in the next Congress. The bill received a 13-9 vote in the U.S. Senate, but Senate leadership did not consider it worth pursuing with only 13 votes. Mr. Cotto thanked members of the Working Group for helping get the bill to a place that the group could live with. For example, the final draft contained certain provisions restricting the role of the Federal Mortgage Insurance Corporation (FMIC), including: (1) if the FMIC wants to change capital standards, it would need to go through a public comment process, (2) state insurance regulators would be able to participate in any examination of a private mortgage insurer, and (3) the FMIC's backup authority regarding private mortgage insurer insolvency is limited to where the FMIC has recommended that the state take action but the state has not done so within 60 days, among others.

The Working Group also heard a presentation from representatives from MGIC and Genworth on the Oliver Wyman study on capital modeling. An interested party asked whether the sessions could be open to insurers that had previously withdrawn from the study, and it was indicated that this would be considered.

(13) NAIC CORPORATE GOVERNANCE

On its June 27, 2014 conference call, the **Governance Review (EX) Task Force** recommended to the Executive (EX) Committee that an outside consultant be retained to review NAIC governance and best practices. The Task Force also adopted a draft “Scope of Work” for the consultant, including four main categories: review of organizational structure, review of Standing Committee, Task Force, and Working Group processes, review of NAIC external engagements and conduct benchmarking of the NAIC’s organizational and governance model against best practices of other associations, as well as additional sub-categories.

Missouri Director John Huff, the Task Force Chair, reported that the Executive (EX) Committee accepted the recommendation and put out a “Request for Proposal” (RFP) process to solicit bids and ultimately select a consultant. The Committee intends to make a decision by September 2014, and a subcommittee will be reviewing the bids.

Connecticut Commissioner Thomas Leonardi praised Director Huff for his good work leading the Task Force, pointing out that the Task Force has made enormous progress since December 2014. However, Commissioner Leonardi voiced his concern that it was poor governance for the Executive (EX) Committee after creating this Task Force to then create a subcommittee of the Executive (EX) Committee to review RFP bids without any notice to the Task Force. Illinois Director Andrew Boron echoed Commissioner Leonardi’s sentiments and demanded that the selection process be returned to the Task Force. An interested party stated that the NAIC needs to define what it is as an organization, and until that is done, it won’t know how to behave.

The Task Force considered a motion to request that the Executive (EX) Committee rescind the creation of a new subcommittee and turn the RFP process back to the Task Force. A Task Force member pointed out that four out of five members of the subcommittee are also on the Task Force. Director Huff opposed the motion, stating that it would cause delay. The motion received some votes in favor, but failed to pass.

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Please do not hesitate to contact us with any questions.

August 25, 2014