

NAIC 2009 SPRING NATIONAL MEETING

March 20, 2009

To Our Clients and Friends:

The National Association of Insurance Commissioners (the “NAIC”) held its 2009 Spring National Meeting (the “Spring Meeting”) from March 15 to 18, 2009 in San Diego, California. This Client Update highlights some of the developments from the Spring Meeting that are of particular interest to many of our insurance industry clients, including developments related to: (1) the creation of a Rating Agency Working Group; (2) proposed reserve and capital relief for life insurers and certain life insurance policies and variable annuity contracts; (3) the regulation of annuity sales; (4) principles-based reserving for life insurers; (5) the modernization of reinsurance regulation; and (6) the use of credit scores in the underwriting process for certain types of property and casualty insurance policies.

NEW RATING AGENCY WORKING GROUP

Shortly before the Spring Meeting, the Financial Condition (E) Committee (the “E Committee”) formed a Rating Agency (E) Working Group (the “Rating Agency Working Group”) to evaluate reliance by the NAIC, the insurance industry and the insurance marketplace on ratings of securities published by Nationally Recognized Statistical Rating Organizations (“NRSROs”).

In conducting its review of NRSRO ratings, the Rating Agency Working Group intends to assess and gather information on:

- the problems inherent in reliance on ratings and the role of NRSRO ratings in determining risk-based capital requirements for insurers;
- the reasons for recent NRSRO rating shortcomings, including perceived shortcomings in ratings assigned by NRSROs to structured securities and municipal bonds;
- the current and potential future impact of NRSRO ratings on state insurance financial solvency regulation; and
- the effect of the use of NRSRO ratings on public confidence and public perception of the regulatory oversight of insurance.

The Rating Agency Working Group expects to prepare a written report documenting its findings and any recommendations for corrective action available to state insurance regulators. The report may also include regulatory recommendations to the federal government.

Although the Rating Agency Working Group met for the first time during the Spring Meeting, the group has already completed significant preliminary work. This work includes a report from the staff of the NAIC Securities Valuation Office (the “SVO”) describing the NAIC’s reliance on NRSRO ratings and identifying actions that the NAIC could take to reduce this reliance. Among other things, the SVO’s report outlines the following potential areas of focus for reform for the Rating Agency Working Group:

- consider replacing NRSRO ratings with alternate NAIC SVO analytical processes;
- where alternatives do not exist, create NAIC, SVO or company-level devices to monitor the risk of rating shortcomings and enable possible regulatory intervention;
- focus on discrete market segments where rating shortcomings have occurred; and
- emphasize the discretion of the NAIC and individual state insurance commissioners to override NRSRO opinions.

As a next step, the Rating Agency Working Group has asked the SVO staff to develop a questionnaire highlighting “concerns and issues in areas of importance to the NAIC and state insurance regulation” for distribution to the NRSROs.

CAPITAL AND SURPLUS RELIEF

As reported in previous client updates, in November 2008 the American Council of Life Insurers submitted a nine-part proposal to the NAIC (the “Proposal”), suggesting certain actions the NAIC could take in 2008 to provide relief from conservative reserve and risk-based capital standards applicable to life insurers, life insurance policies and annuity contracts. The Executive Committee of the NAIC promptly formed the Capital and Surplus Relief Working Group, which solicited the advice of various technical working groups and task forces of the NAIC and held a public hearing regarding the Proposal on January 27, 2009. Soon after that hearing, the Capital and Surplus Relief Working Group recommended that the Executive Committee adopt many aspects of the Proposal, including some in slightly modified form. However, the Executive Committee overwhelmingly rejected the Proposal, in its entirety, on a January 29, 2009 conference call. On that conference call, certain Executive Committee members noted that no insurer had indicated an express need for the proposed relief and suggested that the Proposal warranted additional study and consideration prior to adoption.

Continuing the NAIC’s consideration of the Proposal, the Capital and Surplus Relief Working Group, now a working group of the E Committee, met during the Spring Meeting and referred many aspects of the Proposal back to the various technical working groups and task forces of the NAIC. The Working Group hopes to have a recommendation for

consideration by the Executive Committee and the NAIC plenary at the 2009 Summer National Meeting to be held from June 13 through 16 (the “Summer Meeting”). It is unclear whether this recommendation will differ from the Working Group’s January 2009 recommendation to the Executive Committee and how the Executive Committee and plenary will react to a revised recommendation.

For additional detail regarding the Proposal, please see our client update dated December 12, 2008, available at www.debevoise.com.

REGULATION OF ANNUITY SALES

The Annuity Disclosure (A) Working Group (the “Annuity Disclosure Working Group”) was charged at the 2008 Fall National Meeting held in September to consider changes to the NAIC Annuity Disclosure Model Regulation in order to improve the disclosure of information provided for annuity products and to provide insurers with uniform guidance on developing disclosure practices and monitoring the distribution of annuities. During the Spring Meeting, the Annuity Disclosure Working Group considered the requirements in Section 19 of the Life and Health Insurance Guaranty Association Model Act prohibiting persons, including insurers, from using the existence of insurance guaranty funds for the purpose of selling or soliciting any form of covered insurance and requiring that a notice concerning guaranty fund coverage be delivered to policyholders at the time of policy delivery. The Annuity Disclosure Working Group will continue this discussion on conference calls to be held prior to the Summer Meeting and will begin to develop specific disclosures concerning guaranty fund coverage.

The Annuity Disclosure Working Group also continued its examination of the use of illustrations in the marketing of annuities. Specifically, the Working Group reviewed a discussion draft of proposed annuity illustration guidelines prepared by the American Council of Life Insurers and considered whether the insurer or the producer should be responsible for creating the illustration and whether annuity illustrations should be mandatory or optional. The Annuity Disclosure Working Group expects to continue its discussion of these issues on conference calls to be held prior to the Summer Meeting.

Additionally, at the Spring Meeting, the Suitability of Annuity Sales (A) Working Group (“Suitability Working Group”) continued its discussion of proposed revisions to the Suitability in Annuity Transactions Model Regulation. Among other issues, the Suitability Working Group considered whether an insurer should be required to take steps to ensure that producers have been adequately trained to ensure compliance with the suitability requirements and whether an insurer should be prohibited from issuing an annuity unless the annuity is suitable based on information provided at the time of sale. As a next step, the Suitability Working Group tentatively plans to hold an in-person meeting prior to the Summer Meeting to further discuss these proposed revisions.

PRINCIPLES-BASED RESERVING

At the Spring Meeting, the NAIC continued its work on a principles-based reserving approach for life insurers. The Life and Health Actuarial Task Force (“LHATF”) discussed a near final draft of the Standard Valuation Law (“SVL”) and, at the request of the Corporate Governance Subgroup of the Principles-Based Reserving Working Group, integrated language into the draft SVL that would specifically allow state insurance regulators to “issue such regulations deemed necessary to ensure that adequate procedures and oversight are implemented . . . in order to protect the policyholders of [the state or jurisdiction] and in furtherance of the public interest.” LHATF hopes to adopt (and hopes that the A Committee will adopt) the draft SVL prior to the Summer Meeting. If adopted by LHATF and the A Committee during the interim period, the SVL could be considered by the Executive Committee at the Summer Meeting.

MODERNIZATION OF REINSURANCE REGULATION

After the adoption of a detailed reinsurance regulatory modernization framework proposal (the “Modernization Proposal”) at the 2008 Winter National Meeting, the Reinsurance (E) Task Force (the “Reinsurance Task Force”) began work on legislation to implement the Modernization Proposal. During the Spring Meeting, the Reinsurance Task Force noted that it plans to expose draft federal legislation related to the implementation of the Modernization Proposal for comment soon after the Spring Meeting. After a shortened comment period, the Reinsurance Task Force plans on providing the draft legislation to the U.S. Congress. The Modernization Proposal recommends federal enabling legislation to provide appropriate legislative authority for a proposed NAIC Reinsurance Supervision Review Department and to eliminate constitutional concerns regarding provisions in the Modernization Proposal that contemplate regulatory mutual recognition agreements between U.S. States and non-U.S. jurisdictions.

In addition, the Reinsurance Task Force discussed the need to create model state legislation for states that wish to become a “point of entry” supervisory state or “home state” as described in the Modernization Proposal (for additional detail regarding the Modernization Proposal, please see our client update dated September 26, 2008 available at www.debevoise.com). The Reinsurance Task Force requested comments regarding this legislation, and plans to convene a meeting in April 2009 to receive these comments.

USE OF CREDIT SCORES IN PROPERTY AND CASUALTY UNDERWRITING

At the Spring Meeting, the NAIC's Executive Committee discussed the use of credit scores in the underwriting process for homeowners, renters and automobile insurance policies. As a result of this discussion, the Executive Committee asked that the Property and Casualty Insurance (C) Committee and the Market Regulation and Consumer Affairs (D) Committee hold a joint public hearing of insurers to:

- define what constitutes a credit-based insurance score;
- evaluate how insurers use credit-based insurance scores; and
- determine how current economic conditions have affected policyholder premiums related to credit-based insurance scores.

The two Committees plan to hold the public hearing and provide a report of their findings prior to the NAIC's 2009 Fall National Meeting to be held in September.

If you would like more information on these or other topics of interest, please contact the undersigned or any insurance industry lawyer at Debevoise & Plimpton LLP.

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