

Client Update

NAIC 2015 Spring National Meeting

NEW YORK

Eric R. Dinallo
edinallo@debevoise.com

Ethan T. James
etjames@debevoise.com

Thomas M. Kelly
tmkelly@debevoise.com

Marilyn A. Lion
malion@debevoise.com

Nicholas F. Potter
nfpotter@debevoise.com

John Dembeck
jdembeck@debevoise.com

Eugene Bengler
ebengler@debevoise.com

Chen Xu
cxu@debevoise.com

Angela W. Lee
awlee@debevoise.com

Nicholas C. Scholten
ncscholten@debevoise.com

The National Association of Insurance Commissioners (NAIC) held its 2015 Spring National Meeting from March 28 – 31, 2015 in Phoenix, Arizona. This Client Update highlights some of the developments from the Spring 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.
- “ComFrame” means the Common Framework for the Supervision of International Active Insurance Groups.
- “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.
- “SEC” means the U.S. Securities and Exchange Commission.
- “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 the state implementation of the 2011 amendments to the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation. Twenty-six states have enacted the Model Law amendments, representing more than 60% of direct written insurance premiums. An additional two states currently have legislation enacting the Model Law amendments awaiting governor approval, and 11 additional states are considering enacting the Model Law amendments.

EU Covered Agreement Suggested by Interested Parties

At the Task Force meeting, several interested parties suggested entering a covered agreement with the EU directed at statutory capital requirements. A covered agreement is a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that (1) is entered into between the U.S. and one or more foreign governments, authorities, or regulatory entities, and (2) relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under state insurance or reinsurance regulation. The Treasury Secretary (with FIO’s assistance) and the U.S. Trade Representative may jointly negotiate and enter into covered agreements on behalf of the U.S.

Representatives from two reinsurers stated that their U.S. companies already face barriers to entry in Poland and the Netherlands, and they anticipate facing similar barriers across all of Europe and other jurisdictions following the European model if a covered agreement is not in place when Solvency II is

implemented on January 1, 2016. Other interested parties cautioned against a covered agreement. The Task Force members stated that they were not convinced that a covered agreement is necessary to maintain strong transatlantic cooperation.

NAIC Qualified Jurisdictions List

The **Executive (EX) Committee/Plenary** approved seven foreign jurisdictions as qualified jurisdictions on December 16, 2014 under the recommendation of the Qualified Jurisdiction (E) Working Group. Non-U.S. reinsurers must be domiciled in a qualified jurisdiction in order to become certified reinsurers and eligible for reduced collateral under the 2011 amendments to the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation. These qualified jurisdictions now include: Bermuda Monetary Authority, France: Autorité de Contrôle Prudentiel et de Résolution (ACPR), Germany: Federal Financial Supervisory Authority (BaFin), Central Bank of Ireland, Japan Financial Services Agency (JFSA), Switzerland: Financial Market Supervisory Authority (FINMA) and United Kingdom: Prudential Regulation Authority of the Bank of England (PRA). Each qualified jurisdiction is subject to reevaluation every five years unless there is a material change in circumstances. The Working Group has received inquiries from a number of jurisdictions that are considering applying for qualified jurisdiction status, but none have formally requested initiating the application process.

Adding Non-Bank Financial Institutions to the NAIC Bank List

The Task Force approved asking the SVO to develop criteria for adding non-bank financial institutions that are at least as experienced and well regarded as banks to the NAIC Bank List that is used for qualifying issuers of letters of credit that are provided as collateral for reinsurance credit under Credit for Reinsurance Model Law Section 4.A(3).

Securities Listed by the SVO

The Task Force adopted a recommendation from the SVO to amend the Purposes and Procedures Manual of the NAIC Investment Analysis Office to more formally define investment securities as excluding regulatory transactions, such as “bespoke securities” and add sub-lists of securities deemed to be appropriate for use as reinsurance collateral as “securities listed by the Securities Valuation Office” under Credit for Reinsurance Model Law Section 3.B.

(2) CORPORATE GOVERNANCE

Annual Financial Reporting Model Regulation

During the 2014 Summer National Meeting, the **Executive (EX) Committee and Plenary** adopted revisions to the Annual Financial Reporting Model

Regulation to incorporate an internal audit function requirement for large insurers. In an effort to supplement these revisions, the Corporate Governance (E) Working Group adopted, and referred to the Financial Regulation Standards and Accreditation (F) Committee, a memorandum that recommended Part A Accreditation Standards implement the internal audit function revisions. During the 2015 Spring National Meeting, the Financial Regulation Standards and Accreditation (F) Committee voted to expose the revisions for a 30-day comment period.

Corporate Governance Annual Financial Reporting Model Act and the Corporate Governance Annual Disclosure Model Regulation

During the 2014 Summer National Meeting, the **Executive (EX) Committee and Plenary** adopted the Corporate Governance Annual Disclosure Model Act and the Corporate Governance Annual Disclosure Model Regulation. In an effort to supplement these revisions, the Corporate Governance (E) Working Group adopted, and referred to the Financial Regulation Standards and Accreditation (F) Committee, a memorandum that recommended Part A Accreditation Standards include a requirement for insurers to provide confidential annual disclosure of their corporate governance practices substantially similar to these recently adopted models. During the 2015 Spring National Meeting, the Financial Regulation Standards and Accreditation (F) Committee voted to expose the revisions for a 30-day comment period.

(3) GROUP-WIDE SUPERVISION

The **Group Solvency Issues (E) Working Group** adopted amendments to the Insurance Holding Company System Regulatory Act on December 3, 2014 to provide for group-wide supervision of internationally active insurance groups. An internationally active insurance group is defined as having premiums written in at least three countries, at least 10% of its gross written premiums outside of the U.S., and total assets of at least \$50 billion or direct written premiums of at least \$10 billion. The amendments allow the state insurance regulator to select a group-wide supervisor over an internationally active insurance group based on the following factors: (1) the domicile of the insurers, (2) the domicile of the top-tiered insurer, (3) the location of the executive office or largest operational office, (4) whether another regulator is seeking to act as group-wide supervisor, and (5) whether the other regulator provides reciprocal recognition and cooperation. The Working Group members discussed plans for introducing legislative changes in their respective states for the amendments.

(4) RECEIVERSHIP AND INSOLVENCY

Key Attributes of Effective Resolution Regimes for Financial Institutions

The **Receivership Model Law (E) Working Group** discussed the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes). Working Group members expressed concerns regarding the Key Attributes, which they had previously raised during FSB interviews, most notably that the Key Attributes are bank-oriented and may not be appropriate in the insurance context. Working Group members also observed that the FSB has indicated that the goal of the Key Attributes is to protect policyholders and ensure financial stability, whereas the Working Group has always seen insurer receivership as being solely for the purpose of protecting policyholders. The Working Group voted to conduct a survey of state insurer receivership laws in order to compare existing state law with the Key Attributes. The goal of the survey is to (1) identify potential areas of improvement in state insurer receivership law, and (2) provide the FSB with recommendations for improvements to the Key Attributes from an objective basis.

Guaranty Fund Coverage of Factored Structured Settlements

The **Receivership and Insolvency (E) Task Force** heard a presentation from the ACLI on guaranty fund coverage of factored structured settlements. The ACLI believes that the current Life and Health Guaranty Association Model Act is intended only to cover original payees, not secondary payees. The ACLI representative proposed clarifications to the Model Act to signal that factored structured settlements would not receive protection from a guaranty association if and when the Task Force opens up the Model Act for revisions. The Task Force agreed to revisit the issue at the 2015 Summer National Meeting.

(5) INTERNATIONAL INSURANCE RELATIONS

Regulatory Cooperation

The **International Regulatory Cooperation (G) Working Group** received a report on recent NAIC activities that have fostered international cooperation, including the International Fellows Program, the upcoming Asia-Pacific International Forum and past and upcoming seminars for the Association of Latin American Insurance Supervisors, the China Insurance Regulatory Commission, Thailand's Office of Insurance Commission and Japan's Financial Services Agency. The Working Group also reported on the IAIS' Implementation Committee. NAIC staff stated that the IAIS has approved adjustments to the schedule for self-assessments on Insurance Core Principles 3 (Information Exchange and Confidentiality Requirements), 25 (Supervisory Cooperation and Coordination) and 26 (Cross-border Cooperation and Coordination on Crisis

Management) so that they occur in 2017 rather than in 2015 and 2016. The IAIS has also supported increased focus on implementation monitoring.

The **International Insurance Relations (G) Committee** received a report on the U.S./European Union (EU) Insurance Dialogue Project, which has recently worked towards implementation of the 2011 amendments to the Credit for Reinsurance Model Law. While 60% of direct written premiums need to be covered by the Model Law in order to achieve sufficiently impactful transatlantic cooperation, 26 jurisdictions have enacted the Model Law amendments and over 30 certified reinsurers currently enjoy reduced collateral requirements. Additionally, a total of 10 states have signed on to the IAIS multilateral Memorandum of Understanding on confidentiality and professional secrecy, which represents an internationally accepted standard with regards to global information-sharing and provides jurisdictions worldwide with international cooperation.

ComFrame

The **ComFrame Development and Analysis (G) Working Group** received a report on the IAIS ComFrame field-testing process. Qualitative questionnaires were developed and sent out in 2014 to IAIG volunteers and their group supervisors for completion. The questionnaires largely assessed group structure and group corporate governance, and preliminary review at the IAIS determined that ComFrame requirements were largely implemented or in practice by both volunteers and group supervisors. Additional review and analysis is still necessary to ensure a full understanding of responses. The next round of qualitative questionnaires will concern enterprise risk management, and questionnaires are due to the IAIS by the end of April 2015.

The quantitative field testing is more labor-intensive, and the first round was also completed in 2014. The second round will begin in April 2015, with responses due by June 2015. This second round uses the basic template from the first round of quantitative testing, but company technical specifications have been enhanced to reflect more information in areas like capital resources, valuation (especially for purposes of developing a GAAP-plus approach) and stresses to be applied to specific risk categories for use in standard methods. This round will focus on contract boundaries, charges for sovereign bonds rated below a certain level, longevity stresses, and variable annuity stresses, to name a few topics. Technical specifications will be made publicly available in June 2015 for the sake of transparency.

A question was raised as to whether the IAIS has discussed potential consequences if the insurance capital standard (ICS) were breached. An IAIS

representative stated that such an issue of supervisory response would be addressed in Module 3, whose progress depends on the Module 2 ICS terms currently under development. This is an issue that will be addressed in the future.

Adoption of the draft NAIC position statements on ComFrame and capital was delayed for a few weeks so that industry representatives would have adequate time to review and comment, in the interests of demonstrating the importance of transparency and stakeholder engagement.

IAIS Capital Developments

The **ComFrame Development and Analysis (G) Working Group** received a report on IAIS capital developments, including IAIS adoption of the Basic Capital Requirement (BCR). The BCR is a simple factor-based methodology that was adopted by the G-20 in November 2014. Even though adopted, the IAIS is in the process of further refining the BCR as necessary based on the results of IAIS data collection. Potential refinements include allocation of business lines to be used in the BCR and changing BCR factors to more appropriately align capital requirements with risk inherent in business activities. The BCR is intended to serve as a comparable base across jurisdictions for applying higher loss absorbency (HLA) requirements, which will serve as capital uplift requirements. As part of developing HLA requirements, the IAIS is in the process of deciding the methodology used to calculate HLA, the target level that the BCR and HLA are intended to achieve, and the definition of allowable capital resources under the HLA. The IAIS intends to finalize the HLA method by fall 2015 and begin applying HLA to G-SIIs beginning in 2019.

Eventually, the IAIS intends for the BCR and HLA to be replaced by a global insurance capital standard (ICS) that is currently under development. While a first draft of a consultative document was published in December 2014, key issues that still need to be finalized include issues of valuation, capital requirements and capital resources (classifying capital instruments as Tier 1 instruments or Tier 2 instruments). With regard to capital resources, the U.S. insurance industry is arguing that senior debt should qualify as capital and surplus notes should be counted as Tier 1 capital. This is not how such instruments are classified under the current ICS consultative document, and many members of the IAIS capital resources subgroup are not convinced a change would be appropriate. Industry representatives have suggested that the NAIC view the issue of capital resources as a broader issue of companies being able to obtain necessary capital in times of stress. In light of similar concerns expressed by companies in Asia under this broader issue, industry representatives recommend that the NAIC coordinate with regulators in Asia in addressing the

IAIS on this issue. The IAIS has also decided to slow down the timeline for ICS development by focusing on interim goals.

IAIS Transparency and U.S. Coordination

The **International Insurance Relations (G) Committee** held a discussion about changes to stakeholder participation in the IAIS process. An IAIS representative reiterated the deeply held belief by IAIS that effective dialogue and interaction with all interested stakeholders is critical to the development of meaningful international standards. The representative characterized the structural changes to stakeholder participation as an egalitarian move – the elimination of “pay-for-play” observer status allows all stakeholders to be equally engaged without favoring any individual groups. Numerous industry representatives and state insurance regulators expressed concern with the lack of transparency in the new rules. Insurance industry representatives asked that the IAIS once again commit to opening its working group meetings as the NAIC does, characterizing the new procedures as closing out and restricting all stakeholders from participating in the dialogue.

Joint Forum

The **International Insurance Relations (G) Committee** heard an update on the Joint Forum, which had its final meeting in Basel from March 31 – April 1, 2015. Several Committee members stated that eliminating the Joint Forum was a step in the wrong direction because it eliminates a regular multilateral meeting that does valuable work.

(6) FINANCIAL STABILITY (EX) TASK FORCE

The **Financial Stability (EX) Task Force** heard an update on the FSOC from North Dakota Commissioner Adam Hamm, who was appointed to the FSOC in September 2014. Commissioner Hamm stated that he disagreed with the FSOC’s designation of MetLife as a nonbank SIFI and was shocked by the FSOC’s misunderstanding of the insurance business model and the regulatory protections for insurer failure. Commissioner Hamm updated the Task Force on changes to the FSOC’s practices for reviewing nonbank financial companies for potential SIFI designation, including engaging with companies earlier in the designation process, providing more transparency during the designation process, and engaging with the companies’ state regulators earlier in the designation process. While Commissioner Hamm is supportive of these changes, he believes that even more changes need to be made, including an exit plan from the SIFI designation.

The Task Force discussed FSB and IAIS developments on whether Total Loss Absorbency Capacity (TLAC) is appropriate for G-SIIs. The Task Force members expressed concern that TLAC is not appropriate in the insurance context because an insurance company failure will likely not affect the overall economy to the same extent as a bank, an insurer is not susceptible to a “run on the bank” because insurance liabilities become due over time, and the TLAC concept of converting debt into equity does not reflect how an insurer is capitalized.

The Task Force heard an update on the IMF’s Financial Sector Assessment Program. Task Force members expressed concern that the IMF, through its use of the FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions, does not sufficiently recognize the fundamental differences between bank and insurer resolution. The IMF is expected to publish its U.S. Financial System Stability Assessment in the summer of 2015.

(7) REINSURANCE CAPTIVES

RBC and Captive Reinsurance Transactions

The **Life Risk-Based Capital (E) Working Group** heard industry comments on Exposure 2014 33-L and Exposure 2014 35b-L, two proposals relating to AG48 RBC charges.

Exposure 2014 33-L would, under the Interest Rate and Market Risk portion of the RBC instructions, modify Interrogatory 1.1 to ask whether the insurer submitted a qualified actuarial opinion based on asset adequacy testing or one qualified opinion due solely to the direction provided in AG48. New instructions on Page LR027 state that Interrogatory 1.1 should be answered “yes” if the opinion is qualified but the only reason for qualification is because the direction of AG48. Industry commenters generally supported this proposal, stating that AG48 should not result in additional capital requirements on products outside its scope.

Exposure 2014 35b-L would increase authorized control level RBC by any aggregate shortfall in an insurer’s “Primary Security” under AG48 multiplied by two (new Line 68 to the Calculation of Authorized Control Level Risk-Based Capital). New instructions on Page LR031 state that the adjustment has a floor of zero and will result in dollar for dollar increase in authorized control level RBC for the total of Primary Security shortfalls. Industry reception to this proposal was mixed. Some commenters supported the proposal, while others asserted that any shortfall in an insurer’s “Primary Security” under AG48 should be either subtracted from total adjusted capital or added to company action level RBC rather than added to authorized control level RBC. The Working Group has a conference call scheduled for April 8, 2015 to consider these proposals as well as

a third related proposal, Exposure 2014-42-L Consolidated RBC Shortfall, related to calculation of the RBC cushion associated with reinsurance of XXX/AXXX risks.

Reinsurance Captives and NAIC Accreditation Standards

At the 2014 Summer National Meeting, the **Financial Regulation Standards and Accreditation (F) Committee** discussed comments it received in response to proposed changes to the preambles to the NAIC accreditation standards relating to “multi-state reinsurers.” The proposed changes would have required that, in order to maintain its NAIC accredited status, 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” would cover 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 also includes any captive that assumes risk written in a state other than the captive’s domestic state, which would have imposed multiple new capital, corporate governance, and disclosure obligations on captives.

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 accredited status, and not be recognized as an adequate state insurance regulator by the other states.

After the 2014 Summer National Meeting, NAIC staff were directed to prepare revised preambles to provide that certain captive insurers, special purpose vehicles and other entities assuming insurance business would be subject to the general accreditation standards, but the application would be limited to only the following lines of reinsurance business: (1) XXX/AXXX policies (which will be deemed to comply with the Part A accreditation standards if the reinsurance satisfies the NAIC XXX/AXXX Reinsurance Framework requirements, including AG48), (2) variable annuities, and (3) long-term care insurance. The Committee exposed the revised preambles for comment on February 24, 2015, followed by a March 17, 2015 clarification memo from the Chairs of the Financial Regulation Standards and Accreditation (F) Committee and the Financial Condition (E) Committee.

During the 2015 Spring National Meeting, the Financial Regulation Standards and Accreditation (F) Committee discussed the 50 comment letters received, most of which opposed the February 2015 revisions. For example, the ACLI expressed concerns with (1) the application of Part A accreditation standards to captive insurers licensed in only one state, (2) the lack of grandfathering for variable annuity and long term care captive reinsurers, and (3) the application of Part A accreditation standards to variable annuity (no “safe harbor” like AG48) and long term care (not aware of widespread use) captive reinsurers.

The Committee directed NAIC staff to revise the preambles to clarify that the accreditation standards only apply to the three types of reinsurance business noted above. The Committee will expose the revisions for public comment when they are available and may hold an interim meeting before the 2015 Summer National Meeting.

Financial Analysis Handbook Changes – Captive and SPV Review

At the 2014 Fall National Meeting, the **Financial Regulation Standards and Accreditation (F) Committee** exposed a referral from the Financial Analysis Handbook (E) Working Group for a 20-day comment period. The referral includes proposed revisions to the Review Team Guidelines relating to procedures for states’ review of XXX/AXXX reinsurance transactions with captives and special purpose vehicles. During the 2015 Spring National Meeting, the Committee adopted the referral, effective immediately.

XXX/AXXX Model Regulation

The **Reinsurance (E) Task Force** received a status report from the XXX/AXXX Captive Reinsurance Regulation Drafting Group. The Drafting Group was formed in 2014 to draft a new model regulation on XXX/AXXX reinsurance. The goal of the Drafting Group is to implement AG48 through a new model regulation. The Drafting Group intends to present the first draft of the model regulation at the 2015 Summer National Meeting.

Variable Annuity Reinsurance Captives – New Working Group

The NAIC has established a new working group of its Financial Condition (E) Committee to evaluate life insurers’ use of captive reinsurers for variable annuity risk. The working group will be chaired Iowa Commissioner Nick Gerhart. As part of this effort, the NAIC has authorized about \$200,000 for a consultant to advise the NAIC on hedging risk to evaluate the variable annuity captive reinsurance landscape.

(8) PRIVATE EQUITY OWNERSHIP OF INSURERS

During the 2014 Fall National Meeting, the **Private Equity Issues (E) Working Group** heard a presentation from Igor Rozenbilt of the SEC that provided an overview of private equity investments in insurers. Among other things, Mr. Rozenbilt advised the Working Group that state insurance regulators should be aware of the use of related party and near-related party transactions. The discussion of near-related party transactions drew particular attention from the Working Group, and on February 17, 2015, the Working Group voted to expose for public comment Revised Proposed Changes to the Financial Analysis Handbook that included new guidance to state insurance regulators reviewing acquisition of control applications to consider reviewing arrangements with parties that are not affiliates by definition, but that are acting in a manner similar to affiliates. The Working Group received one comment from AIA that sought to clarify (without substantive change) certain provisions in the new guidance. The Working Group adopted most of AIA's proposed changes as non-substantive, and adopted the Revised Proposed Changes to the Financial Analysis Handbook, representing new narrative guidance for items to consider in reviewing Form A applications.

Although it was not formally dissolved, the Working Group noted that it had completed its sole charge.

(9) LIFE INSURER DEVELOPMENTS

Principles-Based Reserving – State of PBR Adoption

During the 2014 Fall National Meeting, the **Principle-Based Reserving Implementation (EX) Task Force** heard an update on state implementation of principle-based reserving legislation and discussed which sections of the Standard Valuation Law should be considered in determining whether a state has adopted “substantially similar” terms and provisions for determining the operative date of the Standard Valuation Manual. The Task Force exposed for comment a proposal to use certain highlighted sections of the Standard Valuation Law (Sections 3, 4, 11, 12, and 14) that are used to determine whether legislation is “substantially similar” for accreditation purposes, in order to determine the operative date of the Valuation Manual. At the 2015 Spring National Meeting, the cochair of the Task Force, Rhode Island Superintendent Joseph Torti, asked for volunteers to begin considering this issue. Regulators from Tennessee, which cochairs the Task Force, and Washington volunteered.

The Task Force announced that a total of 23 states, representing approximately 37% of premium volume, have adopted principle-based reserving legislation. In 2015, 13 additional states are expected to adopt principle-based reserving, which

would bring the total to 40 states representing 79% of premium volume. The Valuation Manual becomes “operative” the January 1 after the first July 1 when at least 42 jurisdictions representing at least 75% of premium volume (as of 2008) have adopted the Standard Valuation Law.

Principles-Based Reserving – VM-20 Small Company Exemption

The **Life Insurance and Annuities (A) Committee** adopted the VM-20 small company exemption. The Life Actuarial (A) Task Force and the Principle-Based Reserving Implementation (EX) Task Force had previously discussed exempting insurers with less than \$300 million of ordinary life premiums or less than \$600 million in the case of a group of affiliated insurers, and no material ULSG business. The New York committee member expressed strong disagreement with the exemption and voted against its adoption, stating that there was no need for the exemption at this time, and that it is not grounded in an actuarial basis. New York characterized the exemption as a political maneuver to incentivize state legislatures to adopt principle-based reserving. The representative from California abstained on the motion to adopt the exemption.

Unclaimed Life Insurance Benefits Model Law Development

At the 2014 Fall National Meeting, the **Life Insurance and Annuities (A) Committee** adopted the report of the Unclaimed Life Insurance Benefits (A) Working Group, including the adoption of the Working Group’s model law development request to develop a new NAIC model law relating to unclaimed life insurance benefits. During the 2015 Spring National Meeting, the Committee discussed whether the starting point for the Committee’s drafting of the model law should be the NCOIL model related to unclaimed funds or the recent regulatory settlement agreement. The Committee formed a subgroup to begin the drafting process.

Contingent Deferred Annuities

The **Executive (EX) Committee and Plenary** adopted revisions to the Annuity Disclosure Model Regulation, Suitability in Annuity Transactions Model Regulation, Advertisements of Life Insurance and Annuities Model Regulation, and Life Insurance and Annuities Replacement Model Regulation to address contingent deferred annuities (CDA). The revisions were adopted by the Contingent Deferred Annuity (A) Working Group during the 2014 Fall National Meeting.

The **Contingent Deferred Annuity (A) Working Group** continued its discussion of the draft “Guidelines for the Financial Solvency and Market Conduct Regulation of Insurers Who Offer Contingent Deferred Annuities,”

which will be exposed for additional comment after substantive revisions have been made. The Working Group heard a presentation from ACLI and IRI (including representatives from Transamerica, Prudential and Great Western) on potential nonforfeiture/cancellation benefits that may be available to policyholders if a financial institution (rather than the policyholder) cancels a CDA and replacement covered funds cannot be obtained. The Working Group stated that an important issue is identifying whether a cancellation is initiated by the policyholder or by the financial institution, which is a third party to the CDA contract. The Working Group posited a situation in which the life insurer (not the financial institution) requires that the covered fund hold very conservative investments, but the policyholder disagrees, thus forcing the policyholder to cancel the CDA. The Working Group suggested that a policyholder's awareness of the life insurer's requirements at inception of the CDA would be important in determining whether or not the cancellation was by the policyholder.

(10) RISK-BASED CAPITAL DEVELOPMENTS

RBC for Investment Affiliates (Subsidiaries)

The **Capital Adequacy (E) Task Force** adopted a revision to the health insurer RBC charges and corresponding instructions to simplify the RBC charge for ownership of investment affiliates (affiliate type 5, defined as affiliates that only exist to invest the funds of the parent health insurer). The revised RBC charge is now equal to a fixed 30% of the carrying value of the common stock or preferred stock of the investment affiliate. Under the prior approach, a health insurer was required to "look-through" to the assets held by the investment affiliate and apply an RBC charge based on the charge applicable to the underlying asset, pro-rated to the insurer's ownership interest in the investment affiliate.

The **Property and Casualty Risk-Based Capital (E) Working Group** is considering adopting an identical change to the RBC charge for property/casualty insurer investment affiliates (affiliate type 7). Working Group members reiterated their concerns with the difficulty in verifying the RBC charge for the ownership of investment affiliates since such affiliates are not currently required to submit RBC filings and emphasized that the proposal would address those concerns. Industry commenters, however, expressed skepticism for the proposal, noting that a fixed RBC charge rather than a "look-through" would reduce regulatory visibility and run counter to the principle that the RBC charges should be applied to these subsidiaries the same as if the assets were held directly. Industry commenters wishing to retain the current RBC treatment proposed to address the Working Group's concerns through the creation of a schedule that would report assets held by investment affiliates. The Working Group indicated that it would be willing to instruct NAIC staff to

investigate the possibility of additional reporting as an alternative to the simplified RBC charge.

Since the RBC approach to investment affiliates has previously been consistent across life, property/casualty and health insurer RBC instructions, it remains to be seen how the NAIC will reconcile its action on the above-mentioned change in the RBC charge for investment affiliates for health insurers with the RBC approach for investment affiliates for life and property/casualty insurers. No action has yet been proposed for changes to RBC for investment affiliates of life insurers.

RBC for Derivatives

The **Investment Risk-Based Capital (E) Working Group** referred a Life Insurer RBC for Derivatives report to the Capital Adequacy (E) Task Force. The report makes three recommendations regarding the RBC asset charges arising from life insurer derivatives use including: (1) a change to the potential exposure formula for written credit default swaps to reflect recovery experience consistent with the RBC approach for bonds, in contrast to “current exposure method” adopted under the U.S. implementation of the Basel III capital framework, (2) various changes to the RBC and Asset Valuation Reserve calculations concerning required derivative collateral for over-the-counter, centrally-cleared derivatives to bring the calculations in line with the Dodd-Frank Wall Street Reform and Consumer Protection Act, and (3) referrals to other committee groups. In its meeting, the Life Risk-Based Capital (E) Working Group discussed a proposal that would implement the second of the report’s recommendations concerning various changes that would eliminate overcharging of risk for cash collateral pledged for derivatives transactions.

RBC Factors and Permitted Practices

The **Capital Adequacy (E) Task Force** adopted a proposal that clarified that RBC Requirement, Total Adjusted Capital and RBC factors could not be modified for the calculation of authorized control level RBC. The Task Force stated that in its review of annual statement and RBC reporting, some insurers had been modifying the RBC requirement for the calculation of authorized control level RBC at the request of their domiciliary states. The Task Force clarified that permitted practices would not be permitted for RBC calculations.

RBC Factor for Property/Casualty Reinsurance

The **Property and Casualty Risk-Based Capital (E) Working Group** adopted revisions to the property/casualty RBC instructions that would require insurers to calculate certain of its RBC charge for reinsurance recoverables based on a Reinsurance Association of America proposal that incorporates the use of rating

agency ratings. The additional requirements will be implemented on an informational basis only and will result in no additional RBC charge to affected insurers.

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 via simple expansion of the number of rating classes from the current five to 13.

The Academy also stated that the NAIC's current risk factors for C-1 risk are based on modeling corporate bond exposures and that neither the NAIC nor the rating agencies provide models for sovereign or municipal exposures. The Academy requested that the Working Group look into the possibility of applying different factors for so-called non-modeled exposures within a rating class based on credible experience of defaults and loss severity.

(11) VALUATION OF SECURITIES

Investment-Related SSAP Review

The **Valuation of Securities (E) Task Force** heard a presentation on proposals received by the Statutory Accounting Principles (E) Working Group related to its project to review investment-related statements of statutory accounting principles. Many of the issues identified by the Working Group as part of this review reflect the difference in professional orientation between the Working Group and the SVO. Traditionally, the SVO is less concerned with what an instrument is called and more concerned with whether it contains a promise to pay that can be assessed for likelihood of payment. The Working Group has been more concerned with instrument classification. This project is the first step to bridging the difference between these two professional orientations.

Catastrophe Bond Capital Treatment

The Task Force had previously heard a proposal from Nationwide to modify capital treatment for catastrophe bonds. Based on a discussion between the chairs of the NAIC groups that would be affected by the principle, it was agreed that the Statutory Accounting Principles (E) Working Group should first develop statutory accounting guidance for catastrophe bonds. The Task Force also instructed the ACLI to evaluate the demand for these types of investments by life insurers. The Task Force would later decide whether to devote more resources to evaluating this proposal based on the results of ACLI's survey. The proposal was officially referred to the Statutory Accounting Principles (E) Working Group.

Clarification of “Structured Securities”

The Task Force received a proposal from the SVO to amend the Purposes and Procedures Manual of the NAIC Investment Analysis Office in order to clarify the meaning of the term “structured securities” (commonly referred to as the 5*/6* rule) after there was confusion during the 2014 year-end filing process as to whether such “structured securities” referred to structured finance securities. The SVO has determined that the phrase refers to a group of complex corporate securities and not structured finance securities. The proposal was released for a 45-day comment period ending May 14, 2015.

Electronic Filing of Securities

The Task Force received a report from the SVO recommending that the SVO and industry representatives work together to develop a proposal to modernize how insurers file securities from a paper-based system to an electronic system.

Purposes and Procedures Manual: Role of NAIC Structured Securities Group

The Task Force received a proposal amending the Purposes and Procedures Manual of the NAIC Investment Analysis Office to substitute references to the SVO with references to the NAIC Structured Securities Group to reflect appropriate reapportionment of duties between these two analytical staff groups. The proposal was exposed for a 45-day comment period.

Purposes and Procedures Manual: Change to Annual Publication

The Task Force received a proposal that the Purposes and Procedures Manual of the NAIC Investment Analysis Office be published once a year instead of twice a year, with any interim changes to be reflected on the SVO website.

Reclassification of Certain Non-Recourse Loans

The Task Force received a report from the SVO regarding the reclassification of certain non-recourse loans. These non-recourse notes involve mortgage or business loans made to persons meeting a charity’s criteria. The loans are pooled and sold to investors through notes which entitled the holder to receive a cash flow from the loans. Insurers are paid if the loans generate sufficient cash flow. The SVO originally entered the non-recourse notes in the Valuation of Securities Database based on an analysis that the SVO has since determined did not comply with applicable standards. Specifically, the SVO’s concern lies with the fact that the issuer is not obligated to repay these notes, regardless of the socially responsible aspect of such loans. When this error was discovered, SVO management reassessed the notes and directed that they be deleted from the database.

Derivative Instruments Model Regulation Review

The Task Force discussed a referral from the Financial Condition (E) Committee requesting that the Task Force review the Derivative Instruments Model Regulation against the NAIC model law criteria and make a recommendation as to whether the model regulation should be retained, amended, converted to a guideline or archived. The Task Force instructed the SVO to identify experts in the derivatives market to provide comments to the Task Force so they could formulate recommendations.

(12) CYBERSECURITY

Cybersecurity (EX) Task Force Charges

The **Cybersecurity (EX) Task Force** was created at the 2014 Fall National Meeting to monitor cybersecurity issues and make recommendations, and coordinate cybersecurity activities with NAIC Committees and Task Forces. The Task Force's 2015 work plan includes: (1) coordinating with the Property and Casualty Insurance (C) Committee to add a cybersecurity supplement to the property/casualty annual statement, (2) coordinating with the Financial Condition (E) Committee to develop cybersecurity protocols, (3) creating a working group for evaluating state cybersecurity regulation, and (4) developing a cybersecurity consumer bill of rights.

New York Cybersecurity Priorities

New York Superintendent Lawsby stated that New York is particularly focused on increasing the cybersecurity protection of third-party vendors, universalizing the use of multi-factor authentication, and expanding the use of encryption for data at rest. On March 26, 2015, the New York Department of Financial Services served a request on 160 New York-licensed insurers to report on their information security practices by April 27, 2015. In the request, the Department stated that it intends to schedule IT/cybersecurity examinations after conducting a comprehensive risk assessment of each institution. Separately, the Department has advised that it would expect to see some discussion of cybersecurity in insurers' ORSA filings this year.

Anthem Data Breach Update

The Task Force received an update from representatives of Anthem regarding their data breach. Anthem has been working closely with the FBI who has informed Anthem that no compromised information from the data breach has shown up on black market websites, which is a promising sign because industry experts claim that stolen data is almost always used quickly within the first six to nine months. The FBI's investigation into the data breach will likely conclude in the next 30-60 days. Anthem's representatives informed the Task Force that Anthem will complete mailing all of the people potentially affected by the data

breach for which they have a valid address on March 30, 2015. Anthem's representatives explained that their biggest recommendation to the industry is to move faster in developing and adopting increased cybersecurity measures such as perimeter defense, multi-factor authentication, and encryption.

Principles for Effective Cybersecurity Insurance Regulatory Guidance

The Task Force received comments on the Draft Principles for Effective Cybersecurity Insurance Regulatory Guidance. Many interested parties provided recommendations on the Principles, including emphasizing that the ultimate goal is the protection of consumers, asking for coordination with federal efforts to ensure a consistent approach, and removing the issue of cyber insurance from the Principles. The window for written comment submissions has been extended through April 10, 2015. The Task Force will have a conference call on April 16, 2015 to review the additional comments, make any changes to the Principles, and motion to adopt the Principles.

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Please do not hesitate to contact us with any questions.