

# Client Update

## NAIC 2015 Summer National Meeting

### NEW YORK

Alexander R. Cochran  
arcochran@debevoise.com

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

Eugene Bengler  
ebengler@debevoise.com

John Dembeck  
jdembeck@debevoise.com

Risa B. Gordon  
rgordon@debevoise.com

Angela W. Lee  
awlee@debevoise.com

Nicholas C. Scholten  
ncscholten@debevoise.com

The National Association of Insurance Commissioners (NAIC) held its 2015 Summer National Meeting from August 15 to 18, 2015 in Chicago, Illinois. 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:

	<b>Page #</b>
<b>(1)</b> Reinsurance Captives	2
<b>(2)</b> Other Reinsurance Matters	6
<b>(3)</b> Corporate Governance	7
<b>(4)</b> Cybersecurity	8
<b>(5)</b> Risk-Based Capital Developments	9
<b>(6)</b> International Insurance Relations	11
<b>(7)</b> Group-Wide Supervision	13
<b>(8)</b> Life Insurer Developments	14
<b>(9)</b> Receivership and Insolvency	16
<b>(10)</b> Financial Stability (EX) Task Force	16

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 CAPTIVES

#### **XXX/AXXX Credit for Reinsurance Model Regulation**

The **Reinsurance (E) Task Force** exposed for a 45-day comment period a Key Discussion Topics Memorandum (discussing the four options noted below), a draft XXX/AXXX Credit for Reinsurance Model Regulation and amendments to the Credit for Reinsurance Model Law (#785) to provide states with specific authority to implement the new model regulation. A member of the Task Force proposed an amendment to the Model Law to allow states to adopt regulations related to variable annuity and long-term care reinsurance.

The Model Law amendments and the new XXX/AXXX Model Regulation were drafted by the XXX/AXXX Captive Reinsurance Regulation Drafting Group, which was formed in 2014 with the goal of implementing AG 48 through a new model regulation. The Task Force hopes to complete its work on the XXX/AXXX Model Regulation by the end of 2015, but has included finalizing the Model Law amendments and the XXX/AXXX Model Regulation in its 2016 charges.

The Task Force stated that the XXX/AXXX Model Regulation does not make any substantive modifications to the AG 48 approach. The primary discussion related to the consequence for noncompliance with the XXX/AXXX Model Regulation. Specifically, the Drafting Group noted that to be consistent with AG 48 the new model regulation must provide that, in order to get full reinsurance credit, the ceding insurer must hold Primary Security equal to the Required Level of Primary Security and Other Security up to the balance of the ceded AG 48 reserves. The Drafting Group considered four options for reducing the amount of reinsurance credit if the ceding insurer had a shortfall in either the Primary Security or Other Security. In considering the four options, the Drafting Group assumed that the shortfall would, as a practical matter, be most likely in the

Primary Security, because state insurance regulators have discretion to determine what qualifies as Other Security.

The four options considered by the Drafting Group were: (1) an “all or nothing” approach under which the ceding insurer would not receive any credit for reinsurance in the event of a shortfall; (2) a dollar-for-dollar reduction to the ceding insurer’s credit for reinsurance for any shortfall in assets; (3) a percentage reduction to the ceding insurer’s credit for reinsurance equal to the percentage of the shortfall; and (4) a primary security limitation whereby the ceding insurer may only receive credit for reinsurance for the amount of Primary Security that is held.

An interested party noted that because AG 48 includes a choice for the ceding insurer to take a dollar-for-dollar reduction in its reinsurance credit if the assets are insufficient, the dollar-for-dollar reduction is the most consistent approach to AG 48 and should be included in the XXX/AXXX Model Regulation.

Although not unanimous, the Drafting Group recommended to the Task Force the “all or nothing” approach and drafted the XXX/AXXX Model Regulation accordingly. The majority of the Drafting Group concluded that companies that seek to finance part of their reserves are being granted a “privilege,” which should only be granted if the company fully complies with the applicable requirements, including the requirement to hold Primary Security in an amount equal to or in excess of the Required Level of Primary Security.

### **Reinsurance Captives and NAIC Accreditation Standards**

At the 2014 Fall National Meeting, NAIC staff were directed to prepare a new Accreditation Preamble 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 AG 48); (2) variable annuities; and (3) long-term care insurance. The new Part A Accreditation Preamble was exposed for public 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.

At the 2015 Spring National Meeting, the **Financial Regulation Standards and Accreditation (F) Committee** discussed comments received during the

exposure period and instructed NAIC staff to revise the Preamble to clearly indicate that only those captives that reinsure the lines of business noted above would be included in the scope of the Accreditation Program.

Another concern that was addressed by the revised Preamble is the potential impact of the NAIC accreditation standards on captive insurers, special purpose vehicles and other entities that are only licensed in one state but assume business that was written in at least two states. The revised Preamble partly changes the definition of “multi-state reinsurer” from one that reinsures business that was “directly written in at least two states” to reinsures business “covering risks residing in at least two states.” The revised Preamble also explicitly states that the accreditation standards apply to a state’s domestic insurers licensed or organized under the state’s captive or special purpose vehicle statutes or any similar statutory construct.

The revised Preamble was exposed for public comment on April 28, 2015 and six comments were received, two of which opposed the revised Preamble. The Committee held an interim meeting by conference call on May 26, 2015 to discuss the comments received. During the call, the Committee discussed the changes made by NAIC staff and technical amendments suggested in the comment letters. The Committee agreed to make further revisions to the Preamble based on the comments provided, and adopted the language in the revised Preamble, with the understanding that additional items such as effective dates and grandfathering provisions would be discussed at the 2015 Summer National Meeting.

At the 2015 Summer National Meeting, the **Financial Regulation Standards and Accreditation (F) Committee** decided that the accreditation standards will apply to XXX/AXXX captives effective January 1, 2016 and adopted the grandfathering provision of the revised Preamble, which excludes from the Part A standards assumed XXX/AXXX policies that were issued prior to January 1, 2015 and ceded so that they were part of a reinsurance arrangement as of December 31, 2014. The Committee did not adopt any effective dates or grandfathering provisions for variable annuity or long-term care insurance captives. The Committee will monitor the work of the Variable Annuities Issues (E) Working Group as it considers a possible effective date with respect to captives that assume variable annuities and long-term care insurance.

### **Variable Annuity Reinsurance Captives**

At the 2015 Spring National Meeting, the NAIC established the **Variable Annuities Issues (E) Working Group** to evaluate life insurers' use of captive

reinsurers for variable annuity risk. The Working Group had its first meeting by conference call on August 7, 2015. Iowa Commissioner Nick Gerhart, who chairs the Working Group, explained that the Working Group would not be meeting during the 2015 Summer National Meeting because it only recently engaged Oliver Wyman as a consultant to review information about the use of variable annuity captive reinsurers and to make recommendations to the Working Group.

The Working Group scheduled an in-person interim meeting on September 10, 2015 in Chicago, which will have a regulator-only portion followed by an open meeting. During the regulator-only part of the meeting, Oliver Wyman will provide the Working Group with a summary of information collected from individual companies with respect to their use of variable annuity captive insurance companies. During the open portion of the meeting, the Working Group will begin to address the core portion of its charge, including the regulatory issues involved in variable annuity captive reinsurance transactions.

Commissioner Gerhart also stated that he had asked the industry to develop disclosures for year-end 2015 regarding insurers' use of variable annuity captives to improve transparency. During the conference call, the Working Group considered disclosures proposed by ACLI, which would provide information concerning the type of benefits being reinsured, a description of any retrocessions and the significant terms of reinsurance agreements. The proposed disclosures would also require information about the reserve credit taken, the value of the assets supporting the variable annuities, a description of the nature and amount of collateral supporting any reserve credit taken, and an RBC-type calculation.

The Working Group noted that the proposed 2015 disclosures would be a first step to provide some information this year and that they would be a free form exhibit, which would be easier for companies to provide in a shorter time frame. Because the proposed disclosures involve changes to the Statements of Statutory Accounting Principles, the Working Group scheduled a conference call on September 3, 2015 to discuss its proposed recommendations to the Statutory Accounting Principles (E) Working Group regarding ACLI's proposed disclosures.

## (2) OTHER 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 revised Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786). Thirty-two states have enacted the Model Law revisions, representing more than 66% of direct written insurance premiums. Nineteen of those states have also enacted the Model Regulation. The Task Force emphasized the importance of every state enacting the Model Law and Model Regulation in order to avoid the threat of state preemption via a Covered Agreement with the EU.

### **AG 48 Qualified Actuarial Opinion Requirement**

The **Financial Stability (EX) Task Force** heard a report on captives from Rhode Island Superintendent Joseph Torti. The report noted that AG 48's requirement that a ceding company that fails to meet collateral requirements must file a qualified actuarial opinion with its statutory financial statements may be eliminated. However, no process or timeline related to this potential change was discussed.

### **Securities Listed by the SVO**

The **Reinsurance (E) Task Force** approved a recommendation from the Valuation of Securities (E) Task Force to amend the Purposes and Procedures Manual of the NAIC Investment Analysis Office to add U.S. Treasury Securities and U.S. Government Exempt Securities not owned by an insurance company to the list of eligible collateral for reinsurance ceded to an unauthorized insurer. The Valuation of Securities (E) Task Force will now act upon the Task Force's new recommendation and the Task Force's recommendation from the 2015 Spring National Meeting 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 the Credit for Reinsurance Model Law (#785), Section 3.B.

### **Passporting**

The Task Force received a report from the Reinsurance Financial Analysis (E) Working Group that included a recommendation to adopt amendments to the Uniform Application Checklist for Certified Reinsurers regarding disputed and overdue reinsurance claims. The report also included a memorandum from the

Working Group proposing changes to the passporting process, including changes to the timeline for passport renewals and creating a website to help make the passporting process more transparent. The Task Force exposed the amendments and memorandum for a 30-day comment period. The passporting website is expected to be accessible prior to the 2015 Fall National Meeting.

### (3) 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 (#205) 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 that the Part A Accreditation Standards include the internal audit function revisions.

During the 2015 Summer National Meeting, the **Financial Regulation Standards and Accreditation (F) Committee** voted to expose the recommendation to include the 2014 revisions for a one-year comment period, beginning January 1, 2016.

#### **Corporate Governance Annual Disclosure Model Act and Model Regulation**

During the 2014 Summer National Meeting, the **Executive (EX) Committee and Plenary** adopted the Corporate Governance Annual Disclosure Model Act (#305) and the Corporate Governance Annual Disclosure Model Regulation (#306). 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 that the 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 Summer National Meeting, the **Financial Regulation Standards and Accreditation (F) Committee** voted to expose the recommendation to include both models as new Part A Accreditation Standards for a one-year comment period beginning January 1, 2016.

#### (4) CYBERSECURITY

##### **Data Breach Updates**

Representatives from Premera Blue Cross and Anthem, Inc. reported to the **Cybersecurity (EX) Task Force** on the status of remediation efforts related to recent data breaches. Premera reported that it has completed a number of systems remediation steps and is currently in the planning process for longer-term system upgrades. Premera reported that a security consulting service it hired found that no data was removed from its systems during the breach and there has been no evidence that personally identifiable information has been used inappropriately or sold.

Anthem similarly reported that it has completed a number of systems remediation steps in its data breach, which the FBI believes was perpetrated by a nation-state for the purpose of intelligence gathering rather than of financial fraud. Anthem reported that for 2015 and 2016 the data breach will cost approximately \$128 million in remediation expenses and \$250 million in additional non-remediation expenses.

##### **Cybersecurity Bill of Rights**

The Task Force stated that the comment period for the Cybersecurity Bill of Rights has been extended to August 31, 2015, and the Task Force will discuss the comments on a September 8, 2015 conference call. In response to a question from an interested party about the purpose of the Bill of Rights, the Task Force stated that it expects the Bill of Rights will be (1) distributed to states, who will decide whether to distribute to consumers; (2) potentially incorporated into model laws; and (3) potentially incorporated into federal legislation.

##### **Legislative Developments**

The Task Force received an update on federal cybersecurity legislation. The NAIC expects that the U.S. Senate will consider the Cybersecurity Information Sharing Act of 2015 (S. 754) in October 2015. The bill, in part, provides protection from prosecution for industry participants who share information about cyber vulnerabilities with government and law enforcement. The NAIC has not adopted a position on the bill.

##### **Exam Revisions to the Financial Condition Examiners Handbook**

The Task Force received an update from the **IT Examination (E) Working Group** on the status of exam revisions to the Financial Condition Examiners Handbook. Exposure of the exam revisions will continue through September 8,

2015, and the revisions are expected to be quickly adopted thereafter for inclusion in the 2016 Handbook.

## (5) RISK-BASED CAPITAL DEVELOPMENTS

### **RBC for Investment Affiliates (Subsidiaries)**

The **Capital Adequacy (E) Task Force** received a referral from the Property and Casualty Risk-Based Capital (E) Working Group to review the RBC charge for investment affiliates across health, life and property and casualty lines. The Working Group wants to ensure that the formulas are straight forward for filers, easily validated for regulators and consistent across all lines unless valid explanations exist for differences. The Task Force sent this referral to the Investment Risk-Based Capital (E) Working Group.

The original approach for each of the health, life and property and casualty lines was to “look-through” the investment affiliate 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. At the 2015 Spring National Meeting, the Task Force adopted a revision to the health insurer RBC charge for ownership of investment affiliates to equal a fixed 30% of the carrying value of the common stock or preferred stock of the investment affiliate. The Property and Casualty Risk-Based Capital (E) Working Group considered an identical change to the property and casualty insurer RBC charge for investment affiliates. No action has yet been proposed for changes to the life insurer RBC charge for investment affiliates.

### **RBC Proposals**

The Task Force received comments from interested parties on the Task Force and RBC Working Groups’ proposed procedures that were exposed for public comments on June 30, 2015. The comments addressed the publication date of the RBC forecasting and the exposure dates for RBC proposals. The Task Force stated that it will review the comments and determine whether any editorial changes are needed at an interim meeting, but the Task Force does not anticipate exposing any additional changes.

### **Corporate Bond Base Factors for Life Insurers**

The **Investment Risk-Based Capital (E) Working Group** received a report from the American Academy of Actuaries regarding its recommendations for revising the asset risk base factors for fixed income securities held by life insurers.

The Academy's report advocates for increased granularity via an expansion of the number of rating classes from the current five to 13.

Interested parties expressed that it is inappropriate to apply the same risk factors to non-corporate fixed income securities held by life insurers, such as sovereign and municipal bonds, because the risk factors are based on modeling corporate bond exposures. The Academy stated that using the same risk factors is appropriate because ratings agencies use a global ratings process whereby expected loss and default experience is the same for a given rating across all fixed income securities.

The Working Group exposed the Academy's report for a 45-day comment period ending September 29, 2015.

#### **Real Estate Base Factors for Life Insurers**

The **Investment Risk-Based Capital (E) Working Group** exposed a proposal by ACLI to revise the asset risk base factor for real estate held by life insurers for a 45-day comment period ending September 29, 2015. The proposal recommends lowering the base factor for real estate from the current 15% to 8.5%.

#### **Information-Only Operational Risk Charge**

The **Life Risk-Based Capital (E) Working Group, Health Risk-Based Capital (E) Working Group, and Property and Casualty Risk-Based Capital (E) Working Group** each received a report from the Operational Risk (E) Subgroup regarding an operational risk charge that will appear on the 2015 RBC reports for informational purposes only.

While there is some variation between the life, health, and property and casualty lines, the form of the charge will be similar. The charge will contain two components, (1) a charge for growth risk and (2) a charge for general operational risk. The charge for growth risk will add an RBC charge for gross direct premiums that exceed a certain threshold of such premiums from the previous year (e.g. 120% for life insurance and annuity writings). The charge for general operational risk will be computed in two ways. First, a factor will be applied to both premiums and reserves with the higher of the two used as an RBC charge. Second, a 3% capital add-on charge will be applied.

Interested parties suggested that the operational risk charge should include a qualitative component imposing a smaller add-on charge for companies that take significant measures to combat operational risk. A qualitative component is currently used for operational risk charges in other jurisdictions such as Bermuda.

The **Operational Risk (E) Subgroup** will use the information collected to determine the final methodologies and factors for the operational risk charge that is anticipated to go live in 2017.

## (6) INTERNATIONAL INSURANCE RELATIONS

### ComFrame

The **ComFrame Development and Analysis (G) Working Group** received a report on the IAIS ComFrame field testing process. The IAIS has completed its analysis of qualitative responses received in response to the field test of ComFrame corporate governance standards. The analysis is still subject to review, but the applicable working groups are scheduled to present their analysis in mid-September 2015. Submissions were also received with respect to field-testing of Enterprise Risk Management standards and analysis is slated to begin later this year.

The IAIS is currently in the midst of its second quantitative field-testing exercise. Submission of this year's data templates by volunteer IAIGs has begun, with the last phase due by September 4, 2015. Despite many corrections to the template, submissions appear to be on track and the IAIS has begun data analysis on submissions received so far. Analysis of the GAAP Plus adjustment valuation approach will not begin until September 2015.

### IAIS Capital Developments

The **ComFrame Development and Analysis (G) Working Group** received a report on IAIS capital developments. The IAIS issued a consultation draft on higher loss absorbency (HLA) requirements on June 25, 2015 with a comment deadline of August 21, 2015. The draft poses questions about the calibration of the combined Basic Capital Requirement (BCR) and HLA, and how to achieve a balance between risk sensitivity, complexity and volatility in applying HLA to individual GSIs. The revised document will go to the IAIS and the Financial Stability Board for approval, with G-20 endorsement slated to occur in November. State insurance regulators and the NAIC are drafting comments that were circulated to interested parties with request for final input by August 17, 2015 and were discussed during an open committee call on August 20, 2015.

The IAIS has also recently established an ultimate goal and interim goals with respect to development of the global insurance capital standard (ICS), which contemplate a longer timeline to implementation than previously discussed. The ultimate goal for the IAIS is to develop a common method by which a single ICS can achieve comparable results across jurisdictions. There is no set date for

completion of this goal. The first interim goal for the IAIS is to develop two types of approaches to the ICS and one standard for calculating ICS capital requirements, and the projected timeline for completion aims to achieve adoption by 2017 and confidential reporting by year-end 2017. The second interim goal for the IAIS involves improved comparability and potentially two valuation approaches that include other calculations (i.e. internal models), with no set timeline for the implementation of this goal. The IAIS also revised the principles of the ICS to reflect the consultation process. Principle 3 was revised to reflect that the ICS will eventually serve as the foundation for the HLA for GSIIIs, and Principle 6 was revised to reflect that the ICS promotes sound risk management by IAIGs and GSIIIs. The first consultation will be in May or June of 2016 with comments due by September or October of 2016.

### **Financial Sector Assessment Program**

The **International Insurance Relations (G) Committee** received a report on the recent Financial Sector Assessment Program (FSAP) report published by the International Monetary Fund in April 2015. The FSAP report provided a detailed assessment of the U.S. insurance regulatory system as it measured against the Insurance Core Principles, acknowledging broad compliance on the part of state and federal regulators and recognizing that certain state and federal reforms are pending and will take time to fully implement. While there were constructive observations and recommendations, the NAIC felt that certain of the lower ratings lacked evidence or rationale. While the NAIC will take some of the FSAP recommendations into consideration, certain other recommendations (i.e. a recommendation that the U.S. change the system under which some of its state commissioners are appointed) are not viewed as necessary.

### **Solvency II**

The **International Insurance Relations (G) Committee** received a report on the U.S./European Union (EU) Insurance Dialogue Project, under which 32 jurisdictions representing 66% of direct premiums written have adopted the model credit for reinsurance regime. Industry representatives expressed concern regarding reinsurance collateral requirements in light of the fact that Solvency II is scheduled to go into effect on January 1, 2016. Because the U.S. has not achieved equivalence under Solvency II, certain European countries, such as Poland and the Netherlands, have imposed increased collateral requirements on U.S. reinsurance companies. Industry representatives pushed for greater regulatory certainty and expressed concern that there is no mechanism for enforcing any agreement made under the Dialogue Project, suggesting that a federally-negotiated Covered Agreement could provide a path forward in the near future. The NAIC continues to oppose a Covered Agreement amid concerns

that the Covered Agreement would preempt state insurance law. In addition, the Committee stated that it was uncertain whether the NAIC would be involved in discussions about such an agreement.

## (7) GROUP-WIDE SUPERVISION

### Group Capital

On July 23, 2015, the **ComFrame Development and Analysis (G) Working Group** released a Discussion Draft on Approaches to a Group Capital Calculation. It identified three potential methods of calculating group capital: the RBC Aggregation Approach, the SAP Consolidated Filing for RBC and the GAAP Consolidated Filing for RBC-Plus. The Working Group clarified during the 2015 Summer National Meeting that the group capital calculation is not a group capital requirement, but is intended as an “enhancement tool” to assist state regulators in their quantitative analysis of insurance groups. It is intended to serve as a tool for all insurance groups, not just IAIGs, and the Working Group feels that it will be helpful in discussions on a federal level as well as an international level. The group capital assessment is still in its early stages, and this preliminary discussion is centered on desirability of looking at capital on a group level. The Working Group asserted that it was appropriate to use the ComFrame forum to discuss the benefits and drawbacks of a group capital analysis from a U.S. regulatory perspective and noted that if the assessment moved forward, it would be referred to the appropriate NAIC committee.

Industry representatives expressed concern that the capital assessment would be treated as a group capital requirement, but indicated approval of using the group capital assessment as a tool leveraging existing information on capital.

Discussions about the group capital assessment stressed the importance of open and collaborative dialogue during the development process. The Working Group noted that it was considering capital from a U.S. business model perspective, and the report focuses exclusively on internal models that already exist within the U.S. system, but there is a willingness to consider other models (e.g., cash flow) at a later stage.

### Group Solvency Issues

The **Group Solvency Issues (E) Working Group** adopted proposed changes to the Financial Analysis Handbook concerning supervisory college guidance and referred the proposed changes to the Financial Analysis Handbook (E) Working Group for further study with the goal of implementing acceptable changes in the 2016 Financial Analysis Handbook.

The changes, which are intended to improve consistency and incorporate best practices learned from the past year's supervisory college experiences, were made after comments were submitted in response to a second exposure draft, and the Working Group adopted many of the comments received. The Working Group intends to continue the dialogue among regulators and interested parties as insurers gain more experience with supervisory colleges and will consider making additional changes based on such experience.

## **(8) LIFE INSURER DEVELOPMENTS**

### **Principles-Based Reserving – State of PBR Adoption**

The **Principle-Based Reserving Implementation (EX) Task Force** announced that a total of 36 states, representing approximately 60% of premium volume, have adopted principle-based reserving legislation. An additional five states are actively considering adopting principle-based reserving, which would bring the total to 41 states representing approximately 76% 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. The Task Force expects the Valuation Manual will become operative on January 1, 2017.

During the 2015 Spring National Meeting, the Task Force asked for volunteers to draft a proposal for how to interpret the Valuation Manual Operative Date. Specifically, the drafting group was asked to interpret the requirement in the Standard Valuation Law that a state's adoption of the Model Law counts toward the Valuation Manual Operative Date threshold (of 42 states representing 75% of premium) only if the state law adopts “substantially similar terms and provisions” as the Model Law. At the 2015 Summer National Meeting, the Task Force exposed for a 30 day comment period a draft proposal prepared by the drafting group, comprising officials from Tennessee, Alabama, Indiana, Washington and NAIC staff. The comment period ends on September 16, 2015.

### **PBR Pilot**

The **Principle-Based Reserving Implementation (EX) Task Force** adopted the report of its PBR Review (EX) Working Group and assigned a new charge to the Working Group to plan and conduct a PBR pilot. The goal for the pilot would be to aid implementation of PBR by evaluating the regulatory processes and company submissions and making changes to the regulatory review process or instructions in the Valuation Manual prior to PBR becoming operative.

The current plan is to conduct a PBR pilot in 2016 similar to the final ORSA pilot conducted in 2014. Under the pilot, the **PBR Review (EX) Working Group** will develop plans for a PBR pilot and communicate them to states. States would be asked to solicit company participation and then participate in the PBR pilot. State representatives would communicate any identified issues or concerns to the Working Group for evaluation of potential changes to the PBR review processes or to the Valuation Manual. The Working Group would recommend consideration of changes to the Valuation Manual to the Life Actuarial (A) Task Force.

### **Contingent Deferred Annuities**

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,” and whether the guidance document could be completed notwithstanding the few charges that remain outstanding. Before finalizing the document, the Working Group agreed to make some minor revisions to the document and ask the Life Risk-Based Capital (E) Working Group for clarification about its outstanding charge.

The Working Group reviewed and recommended for adoption by the Life Insurance and Annuities (A) Committee draft revisions to the Synthetic Guaranteed Investment Contracts Model Regulation (#695) exempting CDAs from the scope of the Model Regulation (which the Committee adopted at its meeting), and discussed draft language on cancellation (non-forfeiture) benefits to be added to the guidance document.

### **Life Insurance Illustrations**

The **Life Insurance and Annuities (A) Committee** discussed appointing a new working group to review illustration issues for possible revisions to the Life Illustrations Model Regulation (#582). In order to further refine the possible issues that the proposed new working group could review with respect to the Model Regulation, and possibly outside of the Model Regulation, the Committee decided to set a 30-day public comment period within which to receive information from stakeholders on their issues and concerns and what needs to be addressed with respect to illustrations.

## (9) RECEIVERSHIP AND INSOLVENCY

### State Survey on Receivership Laws

The **Receivership Model Law (E) Working Group** discussed the FSB's October 2014 Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes). Earlier in 2015, regulators and NAIC staff participated in the Financial Sector Assessment Program, which measured U.S. resolution regimes against the Key Attributes. The Working Group stated that while analysis of U.S. resolution regimes against some Key Attributes identified inconsistencies among state insurer receivership laws, other Key Attributes are not applicable to insurers. The Working Group voted to send a survey, with questions generated from issues raised by the Key Attributes, to states requesting information on topics including grounds for insurer receivership, multi-jurisdictional coordination, qualified financial contracts and stays. The results will inform feedback that the NAIC can provide to the FSB on the assessment methodology and suggest areas in which states could standardize their laws. States will have 30 days to submit the survey after it is distributed, with a preliminary report and recommendations based on the survey results to be presented at the 2015 Fall National Meeting.

### Guaranty Association Coverage of Factored Structured Settlements

The **Receivership and Insolvency (E) Task Force** considered whether factored structured settlement annuities (structured settlement annuity benefits that have been sold to a third party by the original annuitant) should be covered by state guaranty funds. The Task Force heard general opposition to coverage and stated that NAIC staff had determined that the Life and Health Insurance Guaranty Association Model Act (#520) did not address this issue. The Task Force passed a motion to draft a Request for Model Law Development to begin the process of opening the Model Act for revision to address this narrow issue. On August 24, 2015, the Task Force released the draft of the Request for Model Law Development and announced its intent to conduct an E-vote to adopt the draft, with any comments due by August 26, 2015.

## (10) FINANCIAL STABILITY (EX) TASK FORCE

The **Financial Stability (EX) Task Force** heard a report on FSOC developments, including that FSOC's 2015 Annual Report listed increased risk taking in asset selection by insurers due to the low interest rate environment as an area of concern. The Task Force then heard a report on the impact of the low interest rate environment on the insurance industry. The report, which was generated from a study of 713 life insurance legal entities between 2007 and 2014, stated

that the spread between net asset portfolio yield and guaranteed valuation interest rate has declined over 0.5% over the studied time period. This decline translates to a loss of approximately \$100 billion in revenue to these companies. As longer-term assets mature, the decline in spread will continue.

\* \* \*

Please do not hesitate to contact us with any questions.