

Client Update

NAIC 2015 Fall National Meeting

NEW YORK

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The National Association of Insurance Commissioners (NAIC) held its 2015 Fall National Meeting from November 19 to 22, 2015 in National Harbor, Maryland. This Client Update highlights some of the developments from the Fall 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 CAPTIVES

XXX/AXXX Credit for Reinsurance Model Law and Regulation

The **Reinsurance (E) Task Force** modified its timeline for developing the XXX/AXXX Credit for Reinsurance Model Regulation and amending the Credit for Reinsurance Model Law (#785). The Task Force stated that it intends to finalize the amendment to the Model Law by the end of 2015, but will likely complete the Model Regulation no earlier than the spring of 2016. The Task Force will hold a conference call in December 2015 to finalize the amendment to the Model Law.

The amendment to the Model Law adds a provision authorizing state insurance regulators to adopt regulations related to captive reinsurance transactions. The only outstanding issue for the amendment is the scope of this new regulatory authority. The options that were previously exposed would allow state insurance regulators to promulgate regulations relating to (1) XXX/AXX business (“Option 1”), (2) XXX/AXXX, variable annuity and long-term care business (“Option 2”), or (3) “particular types of reinsurance arrangements”, an approach that gives regulators broad discretion (“Option 3”). Task Force members were split in their support of Option 2 and Option 3. Proponents of Option 3 expressed a desire for greater flexibility to add additional types of reinsurance in the future in order to avoid seeking state legislative approval for every new type of reinsurance business. Proponents of Option 2, however, were concerned that the discretion offered by Option 3 would be too broad.

Most interested parties expressed strong opposition to Option 3. New York Life Insurance Company proposed adding a provision to Option 2 allowing the scope to be expanded in the future to include additional types of reinsurance, but only if adopted by the NAIC. ACLI proposed an alternative exempting professional

reinsurers because the stated intent to only cover captive reinsurance was not clear enough in the current language. Both of these alternatives, as well as a few minor staff edits to all of the options, were exposed for public comment through December 6, 2015.

The Model Regulation, which is intended to implement AG 48, was not discussed at the Task Force meeting due to the lengthy discussion about the Model Law. However, during a conference call on October 26, 2015, the Task Force made a decision on the recommendation made at the 2015 Summer National Meeting by the XXX/AXXX Captive Reinsurance Regulation Drafting Group regarding the consequence for noncompliance with the Model Regulation. 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 and recommended an “all or nothing” approach under which the ceding insurer would not receive any credit for reinsurance in the event of any shortfall. The Task Force adopted the “all or nothing” approach echoing the Drafting Group’s conclusion 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

Since the 2014 Fall National Meeting, the NAIC has been considering revisions to the Part A Laws and Regulations 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 revisions to the Part A Accreditation Preamble were exposed multiple times for public comment.

At the 2015 Fall National Meeting, the **Executive (EX) Committee and Plenary** adopted the revised Part A Accreditation Preamble that 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. Although

the revised Preamble applies to variable annuity and long-term care insurance captives, no effective date was adopted with respect to those lines of business.

The **Financial Regulation Standards and Accreditation (F) Committee** received an update on the internal process that will be used in 2016 to assess compliance with the new Part A Preamble guidance for captive reinsurers that assume XXX/AXXX business. The NAIC distributed a memo outlining the process, which includes remediation of a Primary Security Shortfall or an Other Security Shortfall by March 1 and, if not cured, further remediation steps. If remediation is not completed, NAIC staff will contact the domestic state of the captive reinsurer to assess whether the state has properly applied the Part A standards to the captive reinsurer. NAIC staff expects to report its findings at the 2016 Summer National Meeting.

Regulators expressed some concern that states that are the domestic states of captive insurers have not been given sufficient input into the internal process. The Committee clarified that the assessment is intended to provide technical advice to the Committee going forward.

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 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. Oliver Wyman presented a preliminary report to the Working Group on September 10, 2015 that summarized insurers' motivations for using captive reinsurance and included specific criticism of the existing statutory framework (i.e., the interplay of the C3 Phase II standard for capital charges and AG43 introduced complexity into variable annuity statutory capital management, which motivated companies to use captives).

At the 2015 Fall National Meeting, the **Financial Condition (E) Committee** adopted the Working Group's report on the Variable Annuity Framework for Change, which is a key initiative in modifying the current solvency framework to be more consistent across different regulators, mitigate or remove the motivation for insurers to use captive reinsurance and provide an incentive for insurers to recapture the variable annuity business that has been ceded to captives. As part of this effort, the NAIC has engaged Oliver Wyman to conduct a quantitative impact study to assess the efficacy and potential impact of the recommendations contained in the preliminary report. Oliver Wyman will work

with 14 selected companies that write variable annuities and intends to provide preliminary information from the study by mid-2016.

Risk Retention Group Captives

The **Financial Regulation Standards and Accreditation (F) Committee** exposed proposed revisions to the Part A Laws and Regulations Standards Preamble and the Part B Regulatory Practices and Procedures Preamble for a short 20-day comment period that will end December 9, 2015. The Part A revisions identify criteria by which a risk retention group (RRG) organized as a captive is considered a multi-state insurer: (1) an RRG domestic insurer registered in at least one state other than its state of domicile; (2) an RRG domestic insurer operating in at least one state other than its state of domicile or (3) an RRG domestic insurer reinsuring business covering risks residing in at least two states. If these revisions are adopted, an RRG that meets any of the criteria will be considered a multi-state insurer and will be subject to the Part A standards. The Part B revisions are intended to maintain consistency with the Part A Preamble. The Committee intends to adopt the proposed provisions by December 31, 2015 in order to incorporate them into the 2016 Preambles.

(2) LIFE INSURER DEVELOPMENTS

Proposed Disclosure for Variable and Fixed Annuities

The **Variable Annuities Issues (E) Working Group** had also been working with the industry on proposed disclosures for year-end 2015 regarding insurers' use of variable annuity captives and the RBC impact. The Working Group had expected that the proposed 2015 disclosures, as a free-form exhibit, would be a first step to providing some information this year. However, through several meetings of the Working Group over the summer and fall, members added additional items to the disclosure that expanded its scope.

At the 2015 Fall National Meeting, the Working Group exposed for a 60-day public comment period a draft disclosure proposal for both variable and fixed annuities as part of its Variable Annuity Framework for Change. The disclosure would take the form of new blanks that would be included in the notes of the annual statement and would consist of two parts. In the first part, companies would be required to list their variable and fixed annuity contractual liabilities, along with their assumed lapse and discount rates. The second part would subject these assumptions to various stress tests, requiring that companies disclose, for instance, what would happen to their annuity liabilities and income if there was a 100 basis point spike or drop in interest rates as well as changes to utilization and lapse rates. Some members of the working group and trade representatives

expressed concern over the breadth of the proposed disclosure, and the amount of work that would be required to develop financial models for the stress tests. The public comment period ends on January 29, 2016, with the goal that the disclosure requirements become effective by December 31, 2017 or earlier.

After the 2015 Fall National Meeting, the Working Group decided to additionally expose the draft blanks proposal to interested parties of the Life Actuarial (E) Task Force, because fixed annuity issuers may not be following the activities of the Variable Annuities Working Group. The Working Group noted that it anticipates receiving comments that would likely significantly modify the draft proposal and that it is open to modifying the information included in the draft as long as it satisfies the goal of providing needed public transparency on how the annuities business performs under different economic scenarios.

Principle-Based Reserving—State of PBR Adoption

The **Principle-Based Reserving Implementation (EX) Task Force** announced that a total of 39 states, representing approximately 71% of premium volume, have adopted the Standard Valuation Law, the principle-based reserving legislation. Additional states are expected to adopt principle-based reserving in the first half of 2016. If the threshold of at least 42 jurisdictions representing at least 75% of premium volume (as of 2008) is met by July 1, 2016, the Valuation Manual will become “operative” on January 1, 2017, with a three-year phase-in period.

The Task Force also adopted a plan to evaluate whether states have enacted principle-based reserving legislation that has “substantially similar terms and provisions” as the Standard Valuation Law in order to determine whether a state’s enactment should count toward the Valuation Manual Operative Date threshold. In adopting the plan, the Task Force noted that the standard in this case will not be the same standard that is used to determine NAIC accreditation and that a state’s adoption of a broader small company exemption than exists in the Standard Valuation Law will not automatically disqualify that state’s enactment from being considered substantially similar.

Life Insurance Illustrations

The **Life Insurance and Annuities (A) Committee** passed a motion to create a new working group to explore how the narrative summary required under the Life Insurance Illustrations Model Regulation (#582) and the policy summary under the Life Insurance Disclosure Model Regulation (#580) can be enhanced to promote consumer readability and understandability of life insurance policy summaries, including how they are designed, formatted and accessed by

consumers. The new working group's goal is to submit any recommended enhancements to the Committee by the 2016 Summer National Meeting.

(3) INTERNATIONAL INSURANCE ISSUES

ComFrame Field Testing

The **ComFrame Development and Analysis (G) Working Group** received a report on the IAIS ComFrame field testing process. The field testing analysis team has nearly completed its "data scrubbing" process that will allow it to draw conclusions about the quantitative data submissions. Key field testing issues that will receive additional attention in 2016 include approaches to valuation and capital resources, including how to treat subordinated debt and surplus notes, the design and aggregation of risk charges and design of calibration levels. The IAIS Governance Working Group has received field testing findings for governance requirements, which have demonstrated the importance of clarifying the intent of ComFrame with respect to group-level functions. Field testing of ComFrame's enterprise risk management requirements is currently in progress.

IAIS Capital Developments

The Working Group received a report on IAIS capital developments, including the IAIS's adoption of the initial methodology for Higher Loss Absorbency (HLA). Field testing for the IAIS's Insurance Capital Standard (ICS) was submitted in September 2015. The second ICS consultation document will be released in 2016 with comments due in September or October 2016. The first iteration of the ICS that is released is expected to include two valuation approaches: GAAP-plus adjustment and market adjusted. The second iteration of the ICS that is released may allow for two valuation approaches. The Working Group noted that the U.S. team is resolute in maintaining the GAAP-plus adjustment valuation approach as part of the second ICS iteration.

The IAIS is currently reviewing the definition of nontraditional noninsurance (NTNI) activities that are used in the various IAIS capital standards. The Working Group noted this issue is particularly important to the U.S. because it is largely U.S. products, such as variable annuities, that have been captured by the definition of NTNI.

Certified Reinsurers and Covered Agreement

After much discussion by regulators and interested parties, including the threat of preemption of state regulation if the Treasury and the U.S. Trade Representative were to negotiate a covered agreement relating to reinsurance

collateral with the European Union, the **Financial Regulation Standards and Accreditation (F) Committee** directed NAIC staff to prepare a presentation to the Committee at the Spring 2016 National Meeting on the seasoning process for making the certified reinsurer provisions in the Credit for Reinsurance Model Act (#785) and Credit for Reinsurance Model Regulation (#786) a mandatory accreditation standard (they are currently optional). Committee members discussed the growing consensus related to making the certified reinsurer provisions an accreditation standard, which is driven primarily by a desire for uniformity among states. Currently, 32 states, representing 66 percent of gross premiums, have adopted the Model Act, but only a small fraction have adopted the Model Regulation, which is necessary to provide collateral relief.

Notably, the Treasury and the U.S. Trade Representative announced on November 20, 2015 that they would begin negotiations on a covered agreement, which would include reinsurance collateral, group supervision and sharing of confidential information. The NAIC, which has opposed a covered agreement due to its potential to pre-empt state laws, softened its opposition because it had been assured that it would have “direct and meaningful participation” in such negotiations.

(4) CORPORATE GOVERNANCE

Annual Financial Reporting Model Regulation

The **Executive (EX) Committee and Plenary** adopted a one-year exposure period, beginning on January 1, 2016, for the 2014 revisions to the Annual Financial Reporting Model Regulation (#205), which incorporate an internal audit function requirement for large insurers, to be included as a Part A Accreditation Standard.

Risk Management, ORSA and Insurance Holding Company System

The **Executive (EX) Committee and Plenary** adopted the Risk Management and Own Risk Solvency Assessment Model Act (#505), which has been adopted by 34 states, as an additional Part A accreditation standard effective January 1, 2018. It also adopted a one-year exposure period, beginning on January 1, 2016, for the 2014 revisions to the Insurance Holding Company System Regulatory Act (#440), which include authority for state insurance regulators to act as group-wide supervisors, to be included as Part A Accreditation Standards.

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), which require insurers or insurer groups to file an annual summary of the insurer's or group's corporate governance structure, policies and practices in order to permit the regulator to gain and maintain an understanding of the insurer's or group's corporate governance framework. The Model Act expressly does not prescribe or impose corporate governance standards or internal procedures beyond what is required under applicable state corporate laws.

At the 2015 Fall National Meeting, the **Executive (EX) Committee and Plenary** adopted a one-year exposure period, beginning on January 1, 2016, for the Model Act and Regulation to be included as Part A Accreditation Standards. California has already adopted the Model Act.

(5) GROUP-WIDE SUPERVISION

Group Capital

Following recommendations from the **ComFrame Development and Analysis (G) Working Group** (CDAWG) and the **International Insurance Relations (G) Committee**, the **Executive (EX) Committee** adopted the NAIC Group Capital Calculation recommendation and the related charge to the **Financial Condition (E) Committee**. The charge directs the Financial Condition (E) Committee to “construct a U.S. group capital calculation using an RBC aggregation methodology; liaise as necessary with [CDAWG] on international capital developments and consider group capital developments by the Federal Reserve Board, both of which may help inform the construction of a U.S. group capital calculation.” The proposed group capital calculation would serve as a tool to assist regulators in developing a better understanding of the risks and financial position of U.S. insurance groups. CDAWG noted that key issues for the Financial Condition (E) Committee to consider include the scope of the calculation, the method for including non-RBC filers and non-insurance entities, whether the calculation should focus on going or gone concern, how the calculation should treat subordinated debt, how to avoid double counting and how to complement a group capital calculation with stress testing.

(6) RISK-BASED CAPITAL DEVELOPMENTS

RBC for Investment Affiliates (Subsidiaries)

At the 2015 Summer National Meeting, the **Investment Risk-Based Capital (E) Working Group** received a referral from the **Capital Adequacy (E) Task Force** to review the RBC charge for assets held by investment affiliates across life, property and casualty, and health lines. The intent of the review is 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 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. The Task Force had previously adopted a revision to the health insurer RBC charge for ownership of investment affiliates and the **Property and Casualty Risk-Based Capital (E) Working Group** was considering an identical change to the property & casualty insurer RBC charge for investment affiliates.

At the 2015 Fall National Meeting, the **Property and Casualty Risk-Based Capital (E) Working Group** decided to postpone any action on Type 7 Investment Subsidiaries until the **Investment Risk-Based Capital (E) Working Group** finishes its review.

Corporate Bond Base Factors for Life Insurers

At the 2015 Summer National Meeting, the **Investment Risk-Based Capital (E) Working Group** exposed for comment 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 advocated updating the current bond factors and increasing granularity via an expansion of the number of bond factors from the current six to 14 or 19. The Working Group spent most of the meeting discussing this topic.

The Working Group members all supported updating the bond factors, but they were more split in their support of expanding the number of bond factors. Multiple members of the Working Group stressed the importance of taking the time necessary to implement changes correctly so that there is no disruption to the capital markets.

The Working Group also discussed whether municipal and sovereign debt should have the same factors as corporate bonds. The Working Group previously had regulator-only conference calls with Moody's and S&P to discuss this issue, and confirmed that both ratings agencies used a global rating scale for corporate, municipal and sovereign bonds. Several interested parties stated that treating municipal and sovereign bonds the same as corporate bonds would be inappropriate and agreed to send the Working Group data supporting their positions.

After the Working Group concludes its discussion on this topic, any recommendation it makes for changing the current bond factors will be referred to the Capital Adequacy (E) Task Force and from there to the Financial Condition (E) Committee.

(7) LONG-TERM CARE AND HEALTH INSURERS

Collaborative Long-Term Care Rate Review Process

The **Long-Term Care Actuarial (B) Working Group** heard a presentation from an insurance regulator in the Minnesota Department of Commerce on developing a framework for a collaborative long-term care rate review process intended to make the process more uniform among states. The presentation noted that developing a collaborative approach to rate review was preferable over specific rules because each rate increase request presents its own unique set of circumstances. No model law or regulation is being suggested at this time.

The current proposal is to establish a uniform method of review and a list of all of the information that state insurance regulators would require from a company requesting a rate increase. Although no formal action is being proposed at this time, the Minnesota insurance regulator expressed a desire to receive any comments that state insurance regulators or interested parties may have.

Long-Term Care Pricing

The **Health Insurance and Managed Care (B) Committee** discussed long-term care pricing concerns after hearing a report on the subject from the Health Actuarial (B) Task Force. The chair of the Committee, New Hampshire Insurance Commissioner Roger Sevigny, stated that a few months ago his state adopted a rule that defined how long-term care would be rated going forward and a rule on legacy policies that would cap increases based on age. The new rules, however, have been met with industry opposition, and New Hampshire has been sued by both America's Health Insurance Plans and ACLI.

Long-Term Care Innovation and Guidance

The **Senior Issues (B) Task Force** voted to form a new Long-Term Care Innovation (B) Subgroup to study the future of financing long-term care. The Subgroup will focus on possible products and reforms that could place long-term care on a more stable financial footing, rather than on legacy rating issues. The Task Force believes this is a particularly pertinent issue now for many states where long-term care costs have added significantly to their Medicaid budgets.

Antitrust Investigation of Health Insurer Mergers

The **Health Insurance and Managed Care (B) Committee** heard a presentation from antitrust lawyer David Balto on the recent proposed mergers of Aetna-Humana and Anthem-Cigna. Balto argued that state regulators were better positioned than the federal government to investigate the deals because of their expertise in the insurance field, and the broader powers the insurance commissioners have to investigate whether the mergers serve the public interest. He recommended that (1) the insurance regulator of each state in which Anthem and Aetna must submit a Form A should investigate the mergers to the fullest extent afforded by state statute, and (2) the NAIC should form a task force to investigate the mergers and bring expertise together in a collective fashion.

ERISA Handbook Updates

The **ERISA (B) Working Group** reported that it was in the process of updating the Health and Welfare Plans Under the Employee Retirement Income Security Act: Guide to State and Federal Regulation (ERISA Handbook). The Working Group plans to expose sections of the ERISA Handbook over the next year and anticipates completing revisions to the ERISA Handbook by the end of 2016. The ERISA Handbook will include a new section on the Affordable Care Act and its effect on ERISA.

(8) RECEIVERSHIP AND INSOLVENCY

State Survey on Receivership Laws and the Key Attributes

The **Receivership Model Law (E) Working Group** discussed the results of the multistate survey comparing existing state insurance resolution laws to the FSB's October 2014 Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes). Thirty-seven states responded to the survey, which included questions about the grounds for receivership, jurisdictional issues, authority, qualified financial contracts, stays and operations. In general, the Working Group noted that state laws are designed to resolve separate legal entities, while the Key Attributes are focused on resolving insurance groups. The

result was that much of the terminology in the Key Attributes and in the survey did not translate well when applied to existing state insurance receivership laws. Working Group members suggested using the results to develop a number of critical items that states could address. These recommendations would not include sweeping changes to make state law entirely compliant with the Key Attributes, but rather would be focused on increasing consistency between states. The Working Group voted to expose the survey for comments until January 31, 2016, with the aim to make recommendations to the FSB on improvements to the Key Attributes by the 2016 Spring National Meeting.

Consultative Document on Developing Resolution Plans for SIFs

The **Receivership and Insolvency (E) Task Force** discussed the release of the FSB's consultative document on Developing Effective Resolution Strategies and Plans for Systemically Important Insurers. The Property Casualty Insurers of America expressed concern that the provisions the FSB is examining could be adopted as international standards even though they are not consistent with existing state guaranty fund laws. The guidance might be equally inconsistent with insurance regulation in many foreign jurisdictions. The Task Force decided to set up a small working group to review the document to determine whether the NAIC should submit comments, and if so, to draft them. The public has until January 4, 2016 to submit comments.

Policyholder Protection Act

The Task Force also heard a federal legislative update on the status of the Policyholder Protection Act of 2015, which the House of Representatives recently passed without notable objection. The new law would fix a drafting error in the Dodd-Frank Act, and would require the FDIC to consult with applicable state insurance regulators before exercising its statutory authority to take a lien on the assets of an insurer that is within a bank holding company or a savings and loan holding company in order to fund an orderly liquidation and would allow such a lien only if, after such consultation, the FDIC determines "that such lien will not unduly impede or delay the liquidation or rehabilitation of the insurance company, or the recovery by its policyholders." The proposed law has bipartisan support and has been rolled into the broader Financial Regulatory Improvement Act in the Senate, which contains more controversial changes to Dodd-Frank. One possible scenario is that the Senate will approve a smaller package of bipartisan fixes to the Dodd-Frank Act, including the Policyholder Protection Act, which will then be signed by the President.

(9) FINANCIAL STABILITY TASK FORCE

International Developments

The **Financial Stability (EX) Task Force** heard an update on international insurance regulatory developments. In November 2015, the FSB published its annual list of G-SIIs. The update added Aegon and removed Generali from the existing list, and included the three insurers based in the United States, which have been on the list since it was first published in 2013 (AIG, MetLife and Prudential).

In addition, the IAIS Resolution Working Group is providing input on Insurance Core Principles (ICPs) relevant to resolution, including ICP 12 (Winding-up and Exit from the Market) and ICP 26 (Cross-border Cooperation and Coordination on Crisis Management). The final drafts for ICPs 12 and 26 are expected in June 2016. The Working Group is also looking into whether recovery plans should be required for all international insurance groups, as well as whether the Total Loss-Absorbing Capacity (TLAC) regulation for global systemically important banks should be applicable to G-SIIs. There will be a meeting in Basel in 2016 to decide if TLAC will be applied to insurers.

Update From the Federal Reserve

The Task Force heard an update from Federal Reserve Senior Advisor Tom Sullivan, who stated that he believed the “Team USA” partnership between the NAIC and federal government represented U.S. interests well in the 2015 IAIS Annual Conference in Marrakech. He also stated that he is committed to working closely with state regulators to prevent unnecessary regulatory duplication. Sullivan stated that the Federal Reserve has tried to be highly deferential to the work of state regulators and hopes to leverage the work of the states’ Own Risk and Solvency Assessments (ORSAs) when doing its own risk management assessment. He also said that the Federal Reserve is looking into developing a capital framework for insurance holding companies, and expects to issue a Notice of Proposed Rulemaking on the subject soon.

(10) VALUATION OF SECURITIES TASK FORCE

Derivative Instruments Model Regulation Review

The **Valuation of Securities (E) Task Force** released a final report from the Investment Analysis Office (IAO) and ACLI that concluded that the Derivative Instruments Model Regulation (#282) did not need to be modified. The report found that since 2007 new federal derivatives regulation had not created any new

derivative risks, nor did it have an impact on how insurers used derivatives. The IAO also suggested that the Task Force seek permission from the Executive Committee to look into whether the model regulation should continue to be a standard due to the low rate of state adoption. The Task Force approved a motion to expose the report for a 60-day public comment period.

Catastrophe Bond Accounting Guidance

The Task Force heard a status update from the **Statutory Accounting Principles (E) Working Group** on developing accounting guidance for catastrophe bonds. The proposal was referred to the Working Group after the Task Force heard a recommendation from Nationwide to modify the capital treatment for catastrophe bonds. The Working Group had the ACLI poll its membership and found that most did not support such a proposal. The Working Group still plans to consider accounting treatment for catastrophe bonds as part of its investment classification project.

Bank List Credit Rating Framework

The Task Force released a report from the SVO that recommended that the list of banks authorized to issue letters of credit to insurers (the Bank List) be revised to include non-banks. The SVO proposed that the list be based on credit ratings produced under a specified analytical framework that treats non-banks and banks alike. The SVO also recommended that it actively monitor financial institutions on the list on an ongoing basis, as approximately 20% of banks on the list failed or were below investment grade during the financial crisis. The Task Force voted to expose the report for a 60-day public comment period.

Quality Assessment of Credit Tenant Loans

The Task Force adopted a recommendation that allows the SVO, in its discretion, to use the financial statements of a parent when assessing the quality of a subsidiary's credit tenant loans. The issue arose when, due to reorganization, Walgreen Co. became the wholly owned subsidiary of Walgreen Boots Alliance, and thus no longer issued its own audited financial statements. Without such discretion the Purposes and Procedures Manual would have required the SVO to mark Walgreen Co.'s credit tenant loans as no longer designated. Industry participants strongly supported this proposal.

Reporting of Mandatory Convertible Securities

The Task Force approved an amendment to the IAO Purposes and Procedures Manual that expands the definition of mandatory convertible securities to include preferred stock and removes the requirement that insurers manually

insert RBC for common stock when reporting such securities. The Task Force also requested that the Capital Adequacy (E) Task Force advise it on applicable RBC guidance.

Private Stock Valuation and Reporting

The Task Force adopted an amendment to the Purposes and Procedures Manual that clarifies that insurers must file private common stock with the SVO only when it wants an SVO-produced value for the stock.

(11) CYBERSECURITY

The **Cybersecurity (EX) Task Force**, which is closely following federal developments related to cybersecurity, received a report on cybersecurity legislation. The Task Force is particularly interested in proposals that would preempt existing state laws and regulations. The Task Force also heard presentations on the importance of information sharing to thwarting cybersecurity attacks.

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Please do not hesitate to contact us with any questions.