

Client Update

NAIC 2016 Summer National Meeting and Subsequent Developments

NEW YORK

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The National Association of Insurance Commissioners (“NAIC”) held its 2016 Summer National Meeting from August 26 to 29, 2016 in San Diego, California. This Client Update highlights some of the developments from the Summer National Meeting and subsequent developments (designated in the sections headed “**UPDATE**” below) 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.
- “IMF” means the International Monetary Fund.
- “ORSA” means Own Risk Solvency Assessment.
- “PBR” means Principle-Based Reserving.
- “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) LIFE INSURER DEVELOPMENTS

Principle-Based Reserving

As previously announced, the requisite number of states (42) representing at least 75% of premium have adopted the Standard Valuation Law, which implements PBR. A total of 46 states, representing more than 85% of premium have adopted PBR, with Massachusetts and Wyoming considering adoption soon. The New York Department of Financial Services announced in July that it will adopt some form of PBR effective January 1, 2018 and appointed a working group representing industry and consumers to assist New York in “establishing the necessary reserve safeguards.” PBR will become effective January 1, 2017 with a three-year phase-in period, during which PBR will be voluntary. PBR will become mandatory and an accreditation standard on January 1, 2020.

At the Summer National Meeting, the **Principle-Based Reserving Implementation (EX) Task Force** discussed the NAIC’s various initiatives to implement PBR. The Task Force noted that since the NAIC will serve as statistical agent for the collection of company experience data on behalf of the states, NAIC staff have made significant progress in developing and implementing technology to collect company experience data and maintain confidentiality of the data collected. NAIC staff will be reviewing the results of a pilot project involving the Kansas Insurance Department and about a dozen companies that have submitted 2014 experience data. NAIC will use the

information to develop, evaluate and test the technology needed to collect and analyze the data while assessing the costs, resources and confidentiality.

The Task Force noted that the NAIC is close to approving modeling software and an application that will be used by companies to upload experience data. The NAIC also intends to hire two additional actuaries to assist with the review of PBR data and plans to have regulator-to-regulator calls in the fall to discuss the PBR reports that have been submitted as part of the pilot project.

The **PBR Review (EX) Working Group** heard a report from the Society of Actuaries on the results of its PBR company survey. It was reported that out of 218 surveys sent, 72 responses were received and, of those 72 responses, 16 respondents indicated they would be valuing at least one product under PBR in 2017. Many of the other respondents stated that they will use the three-year phase-in option, and three companies noted they will still cede PBR-subject business to captives.

The **Financial Regulation Standards and Accreditation (F) Committee** expects a referral from the Life Actuarial (A) Task Force during either the Fall 2016 or Spring 2017 National Meeting concerning the PBR revisions to the Standard Valuation Law (#820). The Committee will then consider which elements to include in the Part A: Laws and Regulations Accreditation Standards. Any changes to the accreditation standard will be on a going forward basis.

Variable Annuities Issues (E) Working Group

The **Variable Annuities Issues (E) Working Group** met on August 3, 2016 to receive the quantitative impact study conducted by Oliver Wyman. The study assessed various proposals to reform variable annuity regulation in order to reduce the need for captives. The report proposed, among other recommendations, to (i) modify accounting regulations for hedges to align variable annuity hedge assets with their liabilities, (ii) calibrate the AG 43 standards for reserves with the C3 Phase II standards for risk-based capital in order to reduce volatility and minimize complexity in calculating Total Asset Requirements, (iii) increase the admissibility threshold for deferred tax assets, and (iv) standardize capital market assumptions by using the VM-20 interest rate generator as the prescribed generator.

The Working Group also adopted changes to the proposed variable annuity disclosure regarding use of variable annuity captives and their RBC impact. The proposal was forwarded to the **Statutory Accounting Principles (E) Working Group** for consideration.

The **Market Analysis Procedures (D) Working Group** discussed adding data elements to the Life Market Conduct Annual statement concerning death benefit master file claims, escheated property claims and retained asset accounts. Industry and consumer representatives voiced their support for this proposal. The Working Group also discussed developing market conduct annual statements for additional lines of business. Lines discussed included dental, flood and lender-placed property insurance.

(2) PROPERTY/CASUALTY INSURER DEVELOPMENTS

The **Big Data (D) Working Group** heard presentations from both the Center for Economic Justice and TransUnion on insurers' use of predictive analytics as an underwriting and pricing tool. The Center for Economic Justice expressed its view that the use of predictive analytics presents significant dangers to consumers. TransUnion, on the other hand, stated that, by allowing carriers to achieve greater market segmentation, predictive analytics increases insurance availability and pricing accuracy. The Center for Economic Justice questioned the precision of predictive models, noting that underwriting decisions may be based on spurious relationships derived through "p-hacking," and warned that predictive analytics may perpetuate historical biases by allowing insurers to discriminate under the guise of neutral algorithms. The Center for Economic Justice also expressed skepticism about the notion that increased market segmentation leads to increased availability and warned that such practices may instead result in an exclusionary market. Following the presentations, the Working Group acknowledged the potential value of predictive analytics from a pricing perspective, but expressed concerns about potential violations of unfair trade practice laws.

The Working Group intends to gain a more concrete understanding of precisely what data is being used by insurers and how that data is being sourced and used. The Working Group will also focus on the transparency of insurers' use of data and whether current uses of data are unfair and/or discriminatory.

Sharing Economy

The **Sharing Economy (C) Working Group** heard a presentation from Marsh & McLennan Companies on the kinds of insurance available for members of the sharing economy. According to the presentation, surplus line insurers continue to be the biggest underwriters within the sharing economy. However, personal line insurers are beginning to include riders covering sharing economy activities. The Working Group is working with states to pass transportation network company ("TNC") laws and tailor their worker compensation laws to allow participants in the sharing economy to receive such coverage. The Working

Group also agreed to draft a white paper on home-sharing insurance based on the information collected. The draft will be submitted for comment before the Fall Meeting.

UPDATE: The Working Group will hold a conference call on October 11 to hear a presentation from HopSkipDrive, a ride sharing company that helps parents arrange transportation for their children's activities, and to discuss the initial draft of the home-sharing white paper.

Risk Retention Group Regulation

The **Risk Retention Group (E) Task Force** examined overlap in CPA audits standards between the Model Risk Retention Act (#705) and the Model Annual Financial Reporting Model Regulation (#205) in preparation for the Risk Retention Act going into effect in January 2017. The Task Force proposed updating the audit standards so that either model act may be used where they overlap. The recommendation was exposed by the **Financial Regulation Standards and Accreditation (F) Committee** for a 30-day comment period. The Committee also noted that the Model Risk Retention Act contains a drafting note allowing state insurance commissioners to relieve auditors from rotation requirement regulations, as is already provided for in the Annual Financial Reporting Model Regulation. In addition, the Committee adopted the recommendation from the Risk Retention Task Force to have the accreditation Review Team Guidelines apply to all Risk Retention Groups, rather than only captives.

(3) CAPTIVE REINSURANCE

XXX/AXXX Credit for Reinsurance Model Regulation

At the Spring National Meeting, the **Reinsurance (E) Task Force** discussed comments that were received in response to the February 2016 draft of the Model Regulation and noted that, in case of a shortfall in either the Primary or Other Security, state insurance regulators would need flexibility to work with a company on the remediation process, specifically questioning whether the 15-day remediation timeline (the period between the valuation date of February 15 and the remediation date of March 1) would be sufficient. The Task Force directed NAIC staff to work with the **XXX/AXXX Captive Reinsurance Regulation Drafting Group** to revise the Model Regulation to reflect the discussion held during that meeting.

After the Spring National Meeting, the Drafting Group considered whether extending the time to remediate any shortfall would add significant complexities

with respect to the reporting and filing of annual and quarterly financial statements, including a potentially significant increase in amended financial statements to, for example, correct a reported zero reinsurance credit that was ultimately cured after a statement was filed. In addition, the Drafting Group noted that to properly reflect the transaction, including the potential for adjustments made to the financial statements to show full/zero credit for reinsurance (as well as the impact on RBC), additional disclosures and supplements would be required if the remediation period was extended.

On June 17, 2016, the Drafting Group recommended that the “all or nothing” option be changed to one that is consistent with the AG 48 framework: in case of an unremediated shortfall of Primary Security or Other Security, credit is permitted up to the amount of Primary Security held. The Drafting Group also revised the Model Regulation to provide that the remediation process occur quarterly rather than annually, but did not extend the annual remediation process deadline beyond the March 1 filing date. The June 17 revision of the Model Regulation, which was exposed for public comment until July 20, also added the recapture of ceded reinsurance as an additional remediation option in case of a shortfall and an additional requirement to the professional reinsurer exemption.

The Task Force held a conference call on July 28, 2016, to discuss the June 17 draft of the Model Regulation and the comments that were received. The Task Force did not resurrect the “all or nothing” approach and agreed to remove recapture as an acceptable form of remediation, clarifying that if discretion is used, it would be disclosed as a prescribed or permitted practice. The Task Force also considered whether an insurance regulator should have the discretion to lengthen the remediation period beyond March 1 and/or provide a different form of remediation in the event of non-compliance with the Model Regulation. It directed NAIC staff to prepare a drafting note to the remediation section clarifying that a commissioner’s discretion is limited to the authority existing under applicable state law, should be exercised only in extraordinary circumstances and would be captured as a prescribed or permitted practice under statutory accounting. A revised Model Regulation was exposed for comment on August 4, 2016.

At the Summer National Meeting, the Task Force, after discussing the comments received, adopted the August 4 draft with only technical edits, including renaming the regulation the “Term and Universal Life Insurance Reserve Financing Model Regulation.” The Task Force sent the Model Regulation to the NAIC Legal Division for review, after which the Model

Regulation and a project history document will go to the Financial Condition (E) Committee for consideration prior to the Fall National Meeting.

UPDATE: On September 30, 2016, the **Financial Condition (E) Committee** held a conference call to consider adoption of the Model Regulation. After discussing the drafting note about the commissioner's discretion, the Committee adopted the Model Regulation unanimously, deleted the drafting note and agreed to add the discussion concerning the commissioner's discretion in the record of the Committee's proceedings. The Model Regulation should be ready for consideration by the full membership at the Fall National Meeting in December.

(4) CYBERSECURITY

The **Cybersecurity (EX) Task Force** heard an update from the NAIC on federal cybersecurity legislation. The White House Commission on Enhancing National Cybersecurity, which seeks to collect information and make cybersecurity recommendations to the President, issued a request for information on cybersecurity insurance. The NAIC also noted that legislation is scheduled to be introduced in Congress that would amend the Internal Revenue Code to provide tax credits to businesses for purchasing data and cybersecurity insurance. Under the proposed legislation, businesses will only be eligible to receive tax credits if they adopt the NIST Cybersecurity Framework, the International Organization for Standardization or a similar specified standard.

The Task Force heard a report from Georgia Tech researchers on the difficulties of creating repeatable quantitative tools for measuring cybersecurity risk. The report focused on the current lack of clear tools for measuring such risk, noting that the current state of cybersecurity insurance underwriting is more akin to an art than a science. The researchers called upon interested parties to collaborate in order to create improved models.

Insurance Data Security Model Law

The Task Force heard comments on the second draft of the NAIC Insurance Data Security Model Law (Draft Model Law), which was released for comment on August 17, 2016. Interested parties, including the ACLI, expressed significant concerns that the Draft Model Law's failure to provide uniform standards from state to state would make nationwide compliance costly and complex. Interested parties also criticized several specific revisions made to the original draft, including the expansion of the definition of personal information, the elimination of a harm trigger and the amendment to the third-party service provider provisions. The written comment deadline for the second draft of the

Draft Model Law was September 16, 2016, and a conference call is scheduled for October 17 to further discuss comments.

UPDATE: On September 13, the New York Department of Financial Services proposed new cybersecurity regulations that, if adopted, would increase compliance burdens significantly for banks, insurers and other financial services providers under New York's jurisdiction. The Proposed Regulations are far-ranging in scope, including not only specific technical safeguards but also requirements regarding governance, incident planning, data management and system testing, and an aggressive 72-hour time frame to notify the regulator of certain cyber incidents. For more information on New York's proposed cybersecurity regulations, please see our [Client Update dated September 15, 2016](#).

(5) INTERNATIONAL INSURANCE ISSUES

Solvency II Implementation

The **International Insurance Relations (G) Committee** heard presentations from representatives of six U.S. insurers and reinsurers, who presented their experiences doing business in European Union jurisdictions that have adopted Solvency II. Many representatives expressed concern about the uncertain business environment and negative effects on U.S. insurers and reinsurers due to the uneven implementation of Solvency II and because the U.S. has not been designated an equivalent jurisdiction.

Additionally, the **Reinsurance (E) Task Force** requested that the **Qualified Jurisdiction (E) Working Group** study and report on the implementation by EU member states of Solvency II and the potential impact on qualified jurisdiction status. In making the referral, the Task Force noted that in June 2016, the German Insurance Supervision Act was revised, which led the German Federal Financial Supervisory Authority ("BaFin") to begin restricting third-country insurance and reinsurance undertakings, as result of which U.S. reinsurers could no longer operate on a cross-border basis without forming and capitalizing a branch or subsidiary in Germany. BaFin has sent letters to U.S. reinsurers advising them of this change in law and of a narrow exemption for U.S. reinsurers that allows them to conduct (cross-border) reinsurance business, including renewals, in Germany through "insurance by correspondence." However, U.S. reinsurers that wish to conduct insurance by correspondence may not utilize the services of broker.

Similarly, in late 2015, the UK Prudential Regulatory Authority ("PRA") began requiring U.S. groups, including even those that have a UK or EU holding

company, to apply for a waiver of the requirement that group capital information adhere to Solvency II requirements. Representatives from the reinsurance industry argued that the waiver requirement demonstrates that the UK does not recognize the strength of the U.S. state-based insurance regulatory system, because the UK looks to whether U.S. companies have one group-wide supervisor. Although waivers were granted to U.S. companies, they are revocable at any time and are set to expire towards the end of 2017.

Insurance industry representatives explained that this issue is becoming particularly pressing because insurers and reinsurers are negotiating their January 1 renewals. They noted that although the FIO is working with BaFin to address the impact of the restriction on U.S. companies, state insurance regulators should consider what other steps may be appropriate in case the FIO's efforts are not successful and timely.

Interested parties expressed concern that other EU countries may take actions similar to what Germany has done, noting that Poland already has, and they encouraged regulators to establish a permanent and comprehensive solution for reinsurance and group supervision on a global basis through supervisory colleges, continued dialogue between U.S. and EU regulators and/or a covered agreement, which would recognize the equivalence of the U.S. insurance regulatory system. The Task Force encouraged industry representatives to communicate their concerns to the FIO and the Office of the U.S. Trade Representative, which are negotiating a covered agreement, and to share such communications with the Task Force.

IAIS Activities

The **International Insurance Relations (G) Committee** received a report on IAIS activities. The IAIS is beginning the process of integrating ComFrame with Insurance Core Principles, which process will be finalized in 2019. Going forward, revised Insurance Core Principles that are released for public consultation will include applicable ComFrame standards and guidance in a box.

The **ComFrame Development and Analysis (G) Working Group** heard an update on the second public consultation on the IAIS Insurance Capital Standard. The Working Group is drafting responses to a number of the questions posed in the public consultation document and held a conference call on September 27 to discuss the comments. The **International Insurance Relations (G) Committee** will consider the comments during a call scheduled for October 14, before the IAIS' October 19, 2016 comment deadline.

(6) CORPORATE GOVERNANCE

Enterprise Risk Report (Form F) Survey

The **Group Solvency Issues (E) Working Group** discussed the results of a survey distributed to NAIC members in May 2016 assessing the effectiveness of Form F reports that states have received. Responses to the survey were submitted by 36 jurisdictions. In general, states reported dissatisfaction with the Form F, with only three responding they found the Form F effective or very effective in providing valuable information on enterprise risks. States reported that many filers respond “no change” to various topics, and that the form does not provide significant information on non-insurance enterprise risk. Members of the Working Group suggested that there may be confusion about the differences between ORSA filings and the Form F, and NAIC staff presented a memo comparing their various aspects. The Working Group discussed ways to improve the effectiveness of the Form F reports, including holding regulator or industry training sessions and drafting a guidance manual. The Working Group asked NAIC staff to begin drafting a guidance manual that will provide instructions to insurers about the information they are expected to provide in their Form F reports.

ORSA Implementation

During its February 10 conference call, the **Group Solvency Issues (E) Working Group** discussed its ongoing oversight of the implementation of ORSA requirements. The Working Group noted that 35 states have adopted ORSA reporting requirements and a number of those states received their first ORSA Summary Reports in 2015. In an effort to support the states in their review of ORSA filings, the NAIC has added guidance to its handbooks and provided hands-on training for state regulators. Finding that regulators are beginning to see a need for additional guidance and oversight in this area, the Working Group decided to form an **ORSA Implementation (E) Subgroup**, which will collect feedback on ORSA guidance and tools developed by the NAIC, encourage consistency in states’ review of ORSA filings, and address issues encountered by states in first-year ORSA reviews.

At the 2016 Spring National Meeting, the Working Group discussed the status of the newly created **ORSA Implementation (E) Subgroup**, which will be co-chaired by representatives from Connecticut and Iowa. Ten states are members of the Subgroup, including the majority of jurisdictions receiving U.S. ORSA filings. While the Subgroup’s first meeting will be limited to regulators, the Working Group expects that most meetings will be open to interested parties.

(7) GROUP-WIDE SUPERVISION

Group Capital

The **Group Capital Calculation (E) Working Group** continued its discussions on the development of a U.S. group capital calculation using an RBC aggregation methodology. The Working Group heard a presentation from the Blue Cross and Blue Shield Association on the potential for using existing RBC formulas to develop the capital calculation. The members of the Working Group also discussed a memo from NAIC staff proposing treatment for U.S. insurers that are not subject to RBC requirements, U.S. captive insurance companies, permitted practices and certain adjustments to GAAP. With respect to U.S. captives, the memo assumes that any captive could be used by a group with a traditional U.S. insurance company to “circumvent the policyholder protections put in place by the states.” The memo suggests that all entities that do not meet certain exceptions would be required to complete an NAIC RBC formula with limited adjustments.

The Working Group continued to focus on exploring an inventory-based methodology, which originated in a presentation by the ACLI and the American Insurance Association at the Spring 2016 National Meeting and has been discussed on several subsequent Working Group conference calls. The method would create an inventory of all of the entities in a group and identify certain financial factors associated with each entity, such as the authorized control level regulatory capital amount and the total available capital amount. The Working Group exposed a nine-question survey focusing on the inventory method, divided into three areas that have generated significant attention: (1) how to treat non-insurance entities that are not subject to other capital requirements; (2) how to treat non-insurance entities that are subject to capital requirements; and (3) the use of scalars for non-U.S. insurers. Upon the request of interested parties and in recognition that development of the calculation would be aided by an understanding of the entities to which it would apply, the Working Group agreed to add a question about the scope of the group that should be subject to the calculation. Answers to the survey are due by October 25, 2016.

(8) RISK-BASED CAPITAL DEVELOPMENTS

RBC Factors for Bonds and Common Stocks

During the Spring National Meeting, the **Investment Risk-Based Capital (E) Working Group** released a draft of its “A Way Forward” document (“Way Forward”), which outlines the Working Group’s plan to update the RBC factors for bonds and common stocks by year-end 2017. The Way Forward document is

a high-level summary of principles to guide the Working Group's consideration of updates to the RBC factors. The Working Group intends to reach agreement on the high-level items in the document before undertaking any work to implement them.

The principles for updating bond factors include expanding (for RBC purposes) the six NAIC designations to 20, which will become part of a new electronic-only column in the annual statement. The current six NAIC designations will remain in place for statutory accounting and state law purposes, and the Working Group will consider maintaining the six-designation RBC system with updated factors for non-life annual statements. Initially, the Working Group plans to apply the same factors across all classes of bonds, but will determine later whether different factors are warranted for certain asset classes, such as municipal bonds or sovereign debt.

The Working Group held a conference call on June 2, 2016, to discuss the nine comment letters it received on the Way Forward document. Health insurance and property/casualty insurance trade associations expressed opposition to adopting the proposed bond structure of 20 designations or an increased common stock factor. The American Academy of Actuaries expressed support for expanding the number of bond factors from six to 20 and implementing updated factors for corporate bonds, common stock, and investment real estate for year-end 2017 RBC.

UPDATE: Although the Working Group did not meet during the Summer National Meeting, it held a conference call on September 8, 2016 and voted to expose until October 6 detailed proposed changes to the Life RBC formula and instructions to implement the principles noted above (e.g., 20 categories for bonds). The proposal includes designating the 20 bond categories as, for example, RBC Factor Category 1-A, 1-B, 2-A, 3-A, etc., to distinguish them from the current 1 through 6 framework. Subtotals to reconcile back to each category for NAIC 1-6 bonds have been incorporated into the RBC schedules. The Working Group expects to have several iterations of exposures and comments before these documents are finalized.

During the September 8 conference call, the Working Group began its high level discussion of whether and how to include the decisions reached for the Life RBC formula into the Health and Property/Casualty RBC formulas. There was extensive discussion but no conclusions were reached. One regulator said that the many differences between life and non-life companies need to be addressed before concluding that 20 factors are appropriate. Several industry representatives had similar objections, but a representative of the ACLI noted

that its multiline members are in support of the same structure for all three formulas.

(9) CONSUMER PROTECTION ISSUES

Market Conduct Accreditation

The **Market Regulation and Consumer Affairs (D) Committee**, by a very close vote (the chair had to break a tie), adopted a Market Regulation Certification Program, which is intended to establish an accreditation or certification program in market conduct regulation for the states, similar to the existing accreditation program for financial examinations. The program is still in the very early stages and many questions remain unanswered.

The Committee had been working on a market regulation accreditation program for state regulators, which was expected to ensure states adhered to a certain minimum level of market regulation capabilities. Prior to the Committee's discussion, the **Market Regulation Accreditation (D) Working Group** explained that the original charge was to develop an accreditation program, but because of concerns expressed by regulators (especially with respect to possible confusion with the solvency accreditation program) the decision was made to change "accreditation" in the name of the Working Group and the program to "certification." This led to questions by Working Group members, and later Committee members, as to whether the name change meant that the program would be voluntary without any penalty for states that do not meet its standards.

During the Committee's consideration, several regulators expressed concern over whether, despite the change from accreditation to certification, the new program may impose new market conduct standards on states that may conflict with existing state laws. Notably, New York's new Superintendent, Maria Vullo, who was attending her first NAIC national meeting and is not a member of the Committee or the Working Group, expressed her concern that whatever new market regulation standards may be adopted should not water down existing state consumer protections.

Even after adoption, it was still unclear to many observers and regulators whether the certification proposal was a step toward standards, if or how states would be required to meet the standards and what the potential penalty (if any) would be for not meeting the standards.

Mandatory Arbitration

On the heels of the Consumer Financial Protection Bureau's announcement of its intention to ban mandatory arbitration clauses from financial services agreements over which it has regulatory authority, the **Market Regulation and Consumer Affairs (D) Committee** discussed the use of mandatory arbitration clauses by insurance companies. Industry trade representatives described the benefits of mandatory arbitration as providing a more streamlined and effective tool for dispute resolution, and noted that binding arbitration was rare in personal lines insurance except for uninsured motorist claims and the appraisal process for the value of a property claim.

Regulators, on the other hand, focused on several well-publicized abuses, such as requiring consumers to arbitrate in states (or countries) other than where the policy was issued and under different laws, with arbitrators chosen to reflect the views of insurers. Industry representatives responded that regulators can object to any policy clause before approving it, but that banning arbitration completely would increase litigation and costs. The Committee agreed to continue its discussion.

(10) RECEIVERSHIP AND INSOLVENCY

The **Receivership and Insolvency (E) Task Force** adopted the revisions to the Life and Health Insurance Guaranty Association Model Act that it exposed for comment during the Spring National Meeting. The adopted revisions clarify that factored structured settlement annuity payments are not eligible for guaranty association coverage. In adopting the revisions, the Task Force noted that the revisions were supported by several comment letters and align with the overarching policy objectives of guaranty associations.

Assets on Deposit as Restricted Assets

The Task Force received and discussed a referral from the **Capital Adequacy (E) Task Force** regarding the classification of "assets on deposit with states for the benefit of all policyholders" as a restricted asset. Currently, there is general agreement that these assets meet the definition of a restricted asset. By classifying them as restricted, however, the Task Force noted that the reporting entity incurs an additional RBC charge. Given that the purpose of requiring assets to be held on deposit is to protect policyholders, questions were raised whether such additional charges are prudent. The Task Force has been asked to focus on the extent to which an RBC charge might be justified given the difficulties in releasing these deposits in the event of a rehabilitation or

liquidation and to provide any relevant information to the **Capital Adequacy (E) Task Force** before the Fall National Meeting.

State Survey on Receivership Laws

The Task Force also adopted a report by the **Receivership Model Law (E) Working Group** on the results of a 2015 survey of states' receivership laws and practices. The survey indicated that some states have adopted intentionally broad definitions of "insurer" in order to expand receivership court jurisdiction. The survey also examined state practices for recognizing stays and injunctions issued by other states.

(11) FINANCIAL STABILITY TASK FORCE

Brexit Implications

The **Financial Stability Task Force** heard a presentation from Prudential plc regarding the implications of Brexit, which impacted equity markets, the British pound and interest rates. The presentation noted that while there is no clear timeline for the UK's withdrawal from the EU under Article 50 of the Lisbon Treaty, the potential long-term implications of Brexit could be an economic recession resulting in lower demand of UK products, low interest rates and increased volatility of debt and equity markets. It was also noted that the EU will likely require UK equivalence with EU regulations, including Solvency II, as a condition for the UK to continue trading with the EU.

Federal Reserve Activities

The Task Force heard a report from Prudential Financial and New York Life regarding the Federal Reserve's NPR (notice of proposed rulemaking) on Enhanced Prudential Standards for Systemically Important Insurance Companies, and the Federal Reserve's ANPR (advanced NPR) on Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities. A comment provided to the NPR is that insurance companies have business models and risk profiles different from banks and standards should be tailored for insurance companies. A number of principles in the insurance capital standards have been recognized in the ANPR, particularly the recognition of loss absorption capacity. New York Life reported that it has not been designated systemically important and is not considered an international insurance company, so the NPR and ANPR standards should not apply. However, concerns have been raised that these standards may become the industry standard for best practices.

During the Executive/Plenary session at the Summer National Meeting, it was announced that Peter L. Hartt, Director of New Jersey's Insurance Division, will be appointed to a two-year term as the state insurance commissioner representative on FSOC, replacing North Dakota Insurance Commissioner Adam Hamm.

(12) VALUATION OF SECURITIES TASK FORCE

The **Valuation of Securities (E) Task Force** received a report from the **Reporting Exception Analysis (E) Working Group**, which was formed at the Spring National Meeting to study and recommend solutions to reconcile how certain securities reported as rated by a credit provider were not appearing in credit rating provider data feeds. The Working Group identified a number of causes of these discrepancies, of which private placement securities are the most significant. The Working Group began to examine a number of potential solutions to this issue, including an amendment to the Purposes and Procedures Manual to include a designation that would identify private placement securities. The Working Group also discussed verifying private placement security ratings annually.

Belgian GAAP

The Task Force received an SVO report recommending that the NAIC add Belgian GAAP as a national financial presentation standard. This would allow Belgian insurers to file securities with the SVO without having to reconcile to U.S. GAAP or the International Financial Reporting Standards of the International Accounting Standards Board. The report was exposed for a 30-day comment period.

SSG Cycling Model

The Task Force approved a study to be conducted on adopting a “through-the-cycle” framework for modeling mortgage-backed securities. The current models are pro-cyclical with the model’s scenarios changing year to year based on the economic cycle. The ACLI has expressed concern that the pro-cyclical models make it difficult for life insurers to predict capital needs.

Infrastructure Investments

The Task Force added a special session to discuss insurer investments in infrastructure projects. A cross-section of industry representatives, including U.S. and European insurers, actuaries and ratings agencies, discussed various aspects of the infrastructure market and encouraged more infrastructure investments by insurers. Participants discussed the mutual benefits that states, municipalities

and insurers can achieve by working together to fund needed infrastructure projects.

The insurer representatives noted that infrastructure projects entail long term investments and long term social benefits and discussed the different risk profile that infrastructure investments provide from corporate bonds. For example, Swiss Re explained that European regulators recognize that infrastructure investments carry less risk of default, which led to a one-third reduction of the capital risk charge for such investments. The ratings agencies explained that defaults result from the contractual relationship (e.g., improper maintenance, faulty operation) as opposed to credit risk, but the recovery rate on infrastructure deals is about 80% and in more than 65% of defaulted loans, investors recovered 100%.

Other insurers encouraged the SVO to modify its review and rating procedures to account for the different risk profile of infrastructure investments. It was noted, for example, that the SVO focuses extensively on credit risk and requires three years of financial statements to rate an issuance. Many infrastructure project vehicles, on the other hand, are formed for specific deals and do not have three years of financials and pose less credit risk.

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Please do not hesitate to contact us with any questions.