

NAIC 2018 Spring National Meeting

April 6, 2018

The National Association of Insurance Commissioners (“NAIC”) held its 2018 Spring National Meeting from March 24 to 27, 2018 in Milwaukee. In this client update, we highlight developments from the meeting of particular interest to our insurance industry clients.



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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.
- “G-SII” means a global systemically important insurer.
- “IAIS” means the International Association of Insurance Supervisors.
- “IAO” means the NAIC Investment Analysis Office.
- “RBC” means NAIC risk-based capital.
- “SVO” means the NAIC Securities Valuation Office.

(1) Life Insurers

Suitability in Annuity Transactions

At the 2017 Fall National Meeting, the **Annuity Suitability (A) Working Group** reviewed and discussed an initial draft of proposed revisions to the Suitability in Annuity Transactions Model Regulation. Among the new provisions is a requirement that insurers and producers recommend annuity products that are suitable for and in the “best interest” of the consumer, which is defined as acting in a manner that “puts the interest of the consumer first and foremost.” The Working Group exposed the draft revisions for public comment until January 22, 2018.

Only days before the Spring Meeting, however, a decision by the Fifth Circuit Court of Appeals struck down the U.S. Department of Labor (“DOL”) fiduciary rule. After a presentation from NAIC legal staff on this development, the Working Group heard comments from interested parties, who encouraged the NAIC to pause and reconsider its revisions to the Model Regulation, given that there is no longer any urgency to conform state insurance laws to the DOL rule.

This suggestion was positively received by the chair of the Working Group, who reopened the comment period for 30 days in order to give all interested parties that had submitted comments a chance to review them in light of the Fifth Circuit decision. The chair then suggested that the Working Group hold an in-person meeting of commissioners and interested parties in the next couple of months to discuss all of the comments. In response to questions from a regulator and a consumer representative, the chair said that the comments do not have to be limited to the current proposed draft and its “best interest” standard; parties may comment on the existing “suitability” standard, the best interest standard or on a different standard.

The **Life Insurance and Annuities (A) Committee** adopted the Working Group report reopening the comment period. The New York regulator objected, however, because no vote had been taken by the Working Group regarding the reopening. The chair of the Committee responded that adopting the report of the Working Group would only result in re-opening the comment period and not in any substantive action.

Reinsurance

The **Reinsurance (E) Task Force**, NAIC leadership and a number of insurance commissioners held a public hearing in February to hear suggestions about how states may satisfy the reinsurance collateral requirements of the Covered Agreement, including potential amendments to the Credit for Reinsurance Model Law and Model Regulation (the “Reinsurance Models”). The 18 speakers at the hearing included U.S.

insurers, U.S. and international insurance trade associations, international reinsurers and two representatives from the U.S. Department of the Treasury. Three related themes dominated the discussion:

- Whether to amend the Reinsurance Models to eliminate the reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement;
- Whether to extend the elimination of reinsurance collateral requirements to reinsurers from other (non-EU) qualified jurisdictions, such as Bermuda, Japan, Switzerland and the United Kingdom after Brexit; and
- Whether additional “guardrails” should be imposed on U.S. ceding companies, such as changes to the RBC formula or additional capital requirements to help address the perceived increase in solvency risks that may result from the elimination of reinsurance collateral.

Many of the parties recommended that the NAIC amend the Reinsurance Models so that reinsurers domiciled in NAIC-qualified jurisdictions other than the EU would have reinsurance collateral requirements similar to those of EU reinsurers under the Covered Agreement. Nearly all of the domestic insurers and/or their trade organizations pointed out that in order for reinsurers domiciled in qualified jurisdictions other than the EU to obtain Covered Agreement-like treatment, those qualified jurisdictions must provide to the states the same treatment and recognition afforded by EU countries pursuant to the Covered Agreement. These speakers suggested that revisions to the Reinsurance Models incorporate the standards of the Covered Agreement, including that the qualified jurisdiction must agree to recognize the states’ approach to group supervision, including group capital.

Furthermore, many commenters at the February hearing recommended that the NAIC and states address the enforcement mechanisms and other protections in the model law framework in the event that a reinsurer, an EU jurisdiction or another qualified jurisdiction were to breach the Covered Agreement, or, in the case of a non-EU qualified jurisdiction, fail to adhere to the Covered Agreement-like obligations to which it must agree under the proposed model law revisions.

At the Spring National Meeting, the Task Force recommended and the **Financial Condition (E) Committee** adopted a request for NAIC model law development to revise the Reinsurance Models so that they would conform to the requirements in the Covered Agreement regarding EU reinsurers and provide reinsurers domiciled in NAIC-qualified jurisdictions other than within the EU with similar reinsurance collateral reductions as those to be implemented to comply with the Covered Agreement, with

provisions regarding group supervision, group capital, information sharing and enforcement. The Committee also adopted charges to various Task Forces and Working Groups, directing them to make the necessary revisions to the Reinsurance Models and to develop the necessary implementation processes.

The Task Force also recommended that NAIC staff begin drafting proposed changes to the Reinsurance Models for consideration and review by the Task Force, consistent with the approach proposed at the February public hearing. The Task Force set a deadline of November 2018 to develop draft revisions to the Reinsurance Models.

(2) Risk-Based Capital Developments

RBC and Tax Reform Update

The **Life Risk-Based Capital (E) Working Group** heard presentations from the American Academy of Actuaries and the ACLI on how life risk-based calculations were affected by the federal tax reform legislation enacted at the end of last year. Among other topics, the presentations described how authorized control level RBC (*i.e.*, the required capital that is multiplied by 200% and compared to a company's total adjusted capital in order to determine a company's action level risk-based capital percentage) is calculated on an after-tax basis. Currently, that after-tax effect is determined using hard-coded factors of 26.25% and 35%. Revising the life RBC instructions to apply tax factors that reflect the reduction of the corporate tax rate to 21% would increase the authorized control level RBC in the denominator of the RBC calculation, thereby reducing RBC ratios. The American Academy of Actuaries and the ACLI then presented various changes to the life RBC formula the Working Group should consider in light of tax reform.

The Working Group expressed a desire to develop updates to the life RBC formula in time for the RBC filings for 2018, which are filed in early 2019, but recognized that revisions to the RBC formula would have to have been approved soon to be effective for 2018. The Working Group noted that this timeline might not be feasible, in which case the implementation date would be pushed back to 2019. The ACLI expressed support for the 2019 target date and concern that attempting to meet a 2018 deadline would cause the proposal to be implemented in a piecemeal fashion, with the easiest fixes implemented in 2018 and further refinements coming into effect at a later date.

Discussion regarding the impact of tax reform on life RBC continued at a Working Group conference call held on March 29.

RBC Factors for Bonds

The **Investment Risk-Based Capital (E) Working Group** set the end of 2019 as the target date to implement the increase of the RBC bond factors from six to 20 in order to provide additional granularity to the RBC formula. The current proposal is focused primarily on life insurance companies. However, the American Academy of Actuaries has formed a working group to study how the proposal would impact the property/casualty and health lines of business. The Working Group plans to submit its report by the 2018 Summer National Meeting with recommendations for adjustment to the new bond factor formula for property/casualty and health insurance companies.

Credit for Long-Horizon Equity Investments

The **Capital Adequacy (E) Task Force** voted to refer a proposal to the **Life Risk-Based Capital (E) Working Group** that would reduce the current 30% C-1 capital charge on equity holdings for certain long-term payout annuities that have no disintermediation risk, such as structured settlements. According to the proposal, investing in equities over the long term can be both safer and provide a higher rate of return than investing in bonds or other alternative forms of investment, since any significant declines in equity values during one year will be counterbalanced by increases in other years. The proposal would align the RBC formula with investment theory, allowing insurance companies to benefit from long-horizon equity investments without being unduly penalized by the RBC formula.

(3) Property/Casualty Insurers

Big Data

At the 2017 Summer National Meeting, the **Big Data (EX) Working Group** discussed an initial draft of a proposed structure for reviewing complex rating models used for personal auto and homeowners insurance. The proposed structure sought to provide resources that would enhance the ability of states to conduct technical analysis of, and data collection related to, their review of complex models used by insurers for underwriting, rating and claims. The Working Group decided to focus initially on models used for personal automobile and homeowner insurance rate filings.

At the Spring National Meeting, the Working Group continued its discussion of the principles and structures needed to assist state insurance regulators in reviewing complex models and recommended that state regulators maintain their rate regulation authority, work to share information that encourages speed to market, share expertise on technical issues regarding complex predictive models and seek out legal assistance to ensure the applicability of each state's confidentiality provisions. The discussion was

highly engaging, with particular attention given to fostering the protection and promotion of intellectual innovation while also encouraging information sharing.

The Working Group then discussed changes to the Product Filing Examiners Handbook proposed by the **Casualty Actuarial and Statistical (C) Task Force**. The Working Group adopted the proposed revisions, including the addition of best practices for the review of predictive models and analytics filed by insurers to justify insurance rates, providing state guidance on rate filings that are based on complex predictive models and facilitating training on predictive analytics through webinars.

Based on the Working Group's recommendation, the **Innovation and Technology (EX) Task Force** requested that the **Executive (EX) Committee** conduct research into the skills needed and the potential resources required to address the needs of the NAIC membership in conducting reviews of predictive complex models. The Task Force also asked the NAIC Legal Division to prepare a memorandum analyzing methods and procedures to be followed in sharing predictive modeling information while incorporating applicable confidentiality protections.

A major point of contention throughout the meeting was the role of the NAIC in training, educating and assisting state insurance departments in the review of complex models. Commissioners and interested parties expressed concern that having the NAIC play a significant role in the states' review of rates based on complex models carries the risk of giving the NAIC a regulatory function—potentially conflicting with the states' regulatory powers. Further discussions on the implementation and early stage usage of complex models will continue.

(4) Group-Wide Supervision

Group Capital

The **Group Capital Calculation (E) Working Group** continued its work on developing a group capital calculation, releasing and receiving comments on memoranda focused on treatment of non-regulated entities and defining the scope of a "group." The Working Group intends to resolve open issues related to the calculation prior to the 2018 Summer National Meeting so that the group can spend the second half of 2018 developing a formal field testing program.

The memorandum on non-regulated entities elicited a number of comment letters from industry groups and insurance companies. Several commenters requested that the group capital calculation adhere as closely to the existing RBC framework as possible, including implementing the existing RBC charge for non-regulated entities. NAIC staff

will be incorporating feedback from the comment letters and releasing a revised version of the memo.

The Working Group also heard comments on a preliminary version of a memorandum related to defining the scope of a group. Comments focused on the memorandum's suggestion that the starting point would be the ultimate controlling person. The memorandum contemplates that the lead state regulator could use its discretion to define a group's scope differently, and several questions in the memorandum address the consequences of such discretion, the criteria that should be used to make this determination and the ways in which the regulator should communicate its decision to other states. Comments are due on the memorandum by May 8.

The Working Group will discuss the comment letters received on its memorandum on the treatment of captives in the group capital calculation and has scheduled a conference call for April 19.

Group Solvency

The **Group Solvency Issues (E) Working Group** discussed comments received during the exposure of the Form F Implementation Guide and the Form F/ORSA Comparison Chart. Concerns were raised as to the quality of information that was being provided through Form F filings, as expressed by results of a survey administered in 2017 in which more than half of regulators participating expressed disappointment in the information provided in the Form F. In adopting the Form F Implementation Guide and the Form F/ORSA Comparison Chart, the Working Group noted that these documents are meant to be used by state regulators to assist registrants in the preparation of a Form F, but are not intended to constitute or override authoritative guidance.

(5) International Insurance Issues

IAIS Activities

The **International Insurance Relations (G) Committee** heard a report on IAIS activities. Work on the IAIS' major initiatives related to ComFrame and the insurance capital standards ("ICS") continues. The IAIS recently approved the resolution of comments that were received in response to the March 2017 ComFrame consultation and held a conference call on March 27 to report on the resolution. A full consultation for all of ComFrame is scheduled to begin in August 2018.

The IAIS is in the process of resolving outstanding issues related to ICS 2.0, including issues related to the technical aspects of valuation and capital resources. Field testing is

expected to begin in May 2018. A consultation on ICS 2.0 is scheduled to begin in August 2018 and is expected to be open for 90 days. In the IAIS Secretariat Q&A Session with Interested Parties, industry representatives suggested that the consultation provide more specificity around the expected final ICS 2.0. IAIS Deputy Secretary General and Head of Capital and Solvency Romain Paserot noted that the next ICS 2.0 consultation will include a narrower range of options for various aspects of the ICS.

The Committee heard that the IAIS has revised its committee structure and has a new macroprudential initiatives committee, which is focused on an activities-based approach and a revised G-SII methodology. The IAIS is reviewing the comments it received on its consultation document, “Activities Based Approach to Systemic Risk Consultation,” which was released in December 2017. One topic of consideration is whether the activities-based approach is a substitute for, or a complement to, an entity-based approach. Additionally, the IAIS has been discussing an appropriate process for the 2018 G-SII assessment, and it expects to provide its recommendations to the FSB soon.

The IAIS continues its work on its five-year strategic plan, which will be adopted at the November 2018 general meeting. The IAIS has sought feedback on the plan from stakeholders, particularly with respect to issues relating to emerging risk, such as FinTech, cybersecurity and climate risk sustainability.

(6) Long-Term Care Insurance

The **Long-Term Care Insurance (B/E) Task Force** heard a presentation from representatives of ACLI and America’s Health Insurance Plans, which noted that insurance companies must contend with a lack of uniform decisions from state regulators considering requests for long-term care insurance rate increases. The representatives requested that industry and regulators cooperate to quickly develop common tenets and methodologies that would govern the long-term care insurance rate increase process. The regulator from Utah requested that the Task Force schedule a conference call at which Utah could present its proposed uniform methodology related to long-term care insurance rate increases.

The **Receivership and Insolvency (E) Task Force** adopted referrals to the **Health Insurance and Managed Care (B) Committee** and the **Capital Adequacy (E) Task Force** related to making conforming changes to various statutes following the adoption of the Life and Health Insurance Guaranty Association Model Act. The amendments that were adopted at the 2017 Fall National Meeting included expanding the assessment base by adding life and annuity insurers to the health account for purposes of long-term

care insurance insolvencies, splitting future assessments between member life and health insurers evenly and adding HMOs as members of a guaranty association.

The Task Force noted that states should proceed to update their guaranty association laws without waiting for the conforming work to be finished. A health insurance company representative raised the question of whether long-term care insurance should be considered health insurance, but the Task Force declined to address this.

(7) Financial Stability Task Force

Macro-Prudential Monitoring

As part of the NAIC Macro-Prudential Monitoring Initiative, the **Financial Stability (EX) Task Force** appointed a **Liquidity Assessment (EX) Subgroup** to review existing data on liquidity risk, identify any data gaps based on regulatory needs, and construct a liquidity stress-testing framework proposal for consideration by the **Financial Condition (E) Committee**. At the Spring National Meeting, the Task Force adopted the Subgroup's Baseline Blanks Proposal and Note Blanks Proposal, which expands the scope of the data that is collected as part of the Macro-Prudential Monitoring Initiative, and sent it to the **Blanks (E) Working Group**.

The Task Force directed NAIC staff to monitor the Working Group's process and provide any necessary background information related to the proposal. The Task Force noted that it had received only a few comments on the proposal, some of which requested that the filing deadline be moved from March 1 to May 1. The Task Force agreed to allow a May 1 deadline for the first year of data collection but will require that the requested information be submitted with other filings due on March 1 after the first year.

The Task Force heard a report on the **Liquidity Assessment (EX) Subgroup's** work to develop a liquidity stress-testing framework for large life insurers. The Subgroup has held regulator-only calls to discuss the liquidity stress testing used by certain large life insurance companies and soon plans to hold calls open to non-regulators. The Subgroup's report noted that it was behind schedule in developing a draft liquidity stress-testing framework but aimed to have a proposal for the Task Force to consider at the 2018 Summer National Meeting.

The **Receivership and Insolvency (E) Task Force** began the process of considering the three referrals that it received from the **Financial Stability (EX) Task Force**, which relate to assessing recovery and resolution planning and laws in light of the macroprudential initiative. The Task Force chair asked for members to volunteer to

serve on subgroups focused on each referral. It is expected that each subgroup will develop a timeline and goals for completing the referral, which may include referring work to other NAIC committees. The Task Force chair noted that the Task Force expected to collaborate with interested parties and suggested that interested parties contact the Task Force to identify particular areas of interest.

(8) Valuation of Securities Task Force

Private Letter Ratings

The **Valuation of Securities (E) Task Force** exposed an amendment to the Purposes and Procedures Manual of the IAO (the “P&P Manual”) to establish policies governing the Filing Exempt (“FE”) designation process for private placement securities. This amendment follows the transfer of the FE designation process to the SVO in November 2017. The policies are based on the memo adopted by the Task Force during the 2017 Spring National Meeting that was written to reduce reporting exceptions that arise from the FE designation process. The amendment was exposed for a 30-day comment period.

Last November, the Task Force also transferred the private letter rating securities verification procedure to the SVO. The NAIC is currently developing a blanks proposal to add certain symbols and interrogatories to the reporting instructions for the verification procedure and is working with nationally recognized statistical ratings organizations to obtain private letter credit rating data feeds electronically.

Bond Investment Funds

The Task Force exposed a proposal to consolidate all guidance concerning bond investment funds in a new part of the P&P Manual. Under this proposal, the SVO would provide an NAIC designation to pooled investments in fixed income assets by looking through the investment vehicle to the risk profile of the underlying assets.

The SVO already provides NAIC designations for many fixed income investment funds, such as bond exchange traded funds and money market funds. The new section of the P&P Manual, however, would expand this treatment to include any investment company that is registered with the Securities and Exchange Commission and invests in fixed-income-like assets eligible for an NAIC designation, such as bond mutual funds. The proposal was exposed for a 90-day comment period.

Subsidiary, Controlled and Affiliated Investments

The Task Force approved an amendment to the P&P Manual to provide the SVO with additional means to issue an NAIC designation to subsidiary, controlled and affiliated

(“SCA”) investments that resemble unaffiliated investments. Currently, the SVO, where possible, will issue an NAIC designation in the same manner as if these SCA transactions were unaffiliated investments. However, some SCA transactions are too complex to evaluate with the methodology used for a similar unaffiliated transaction.

The proposal creates three new methods to evaluate SCA transactions where the SVO has initially been unable to provide an NAIC designation. Insurers will now be able to request a meeting with the SVO to discuss and develop a credit methodology specific to the SCA transaction, file a Regulatory Treatment Analysis Service application to request that the SVO provide an explanation for its determination and request that their domiciliary state regulator, with the assistance of the SVO, provide an NAIC designation. This proposal will align the instructions for SCA investments with statutory accounting guidance.

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Please do not hesitate to contact us with any questions.

Please [click here](#) for a recording of the recent NAIC Spring National Meeting client briefing highlighting these topics.

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