

## CLIENT MEMORANDUM

# NAIC Report: 2014 Summer National Meeting

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The 2014 Summer National Meeting was held in Louisville, Kentucky from August 16 to 19, 2014. At this meeting, certain representatives of state and federal regulators as well as members of the industry expressed their interest in working together to present a unified U.S. position at international standard-setting meetings, such as at meetings of the International Association of Insurance Supervisors (the "IAIS"). It was noted that international standards, such as those developed by the IAIS, are currently impacting U.S. insurers and regulators. In particular, the IAIS standards are the benchmark against which the International Monetary Fund is currently evaluating the strength and scope of the U.S. regulatory system in the course of its Financial Sector Assessment Program ("FSAP") review. In several meetings, there seemed to be an acknowledgment that in the absence of a coordinated effort by U.S. constituents, the interests of the United States will not be properly represented on the world stage.

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## NAIC Report: 2014 Summer National Meeting

Continued

<b>I. <u>TOPICS OF GENERAL INTEREST</u></b>	<b>4</b>
A. <u>U.S.-Based Approach to International Regulation</u>	4
1. <u>International Capital Standards Prompt Collaboration by U.S. Regulators</u>	4
a. <u>International Capital Standards Forum Held at the Summer National Meeting</u>	4
i. <u>Federal Reserve Board</u>	5
ii. <u>State Regulators</u>	5
iii. <u>Industry Perspective</u>	5
b. <u>International/Group Supervision Discussions at the Summer National Meeting</u>	5
i. <u>Federal Regulators</u>	6
ii. <u>State Regulator Responses</u>	6
2. <u>IAIS' Step Away From Transparency Faces Harsh Criticism</u>	6
B. <u>Holding Company Act Developments</u>	7
1. <u>2010 Amendments to the Model Holding Company Act Update</u>	7
2. <u>Re-opening of the Model Holding Company Act</u>	7
C. <u>Corporate Governance Model Act Nears Completion</u>	8
1. <u>Model Act Requirements and Next Steps</u>	8
2. <u>Confidentiality Under the Model Act</u>	9
3. <u>Redundancies</u>	10
D. <u>Reinsurance Update</u>	10
1. <u>Amended Credit for Reinsurance Model Act Update</u>	10
2. <u>Qualified Jurisdiction Working Group</u>	10
3. <u>Reinsurance Financial Analysis Working Group Continues "Passporting" Work on Reinsurers</u>	11
4. <u>First Evaluation of Reinsurers as G-SIIs</u>	11
E. <u>NAIC Governance Concerns Continue</u>	11
<b>II. <u>TOPICS OF INTEREST TO THE LIFE INSURANCE INDUSTRY</u></b>	<b>12</b>
A. <u>XXX/AXXX Framework Adopted by Executive Committee, but Much Work Remains Ahead</u>	12
B. <u>Captive Update – No Steps Taken on "Multistate Insurer" Definition for Accreditation</u>	13
C. <u>PBR Update</u>	14
D. <u>Briefly Noted</u>	14

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## NAIC Report: 2014 Summer National Meeting

Continued

1. <u>Unclaimed Property Model Law May Be on the Horizon</u>	14
2. <u>Private Equity Working Group Still Gathering Information</u>	15
<b>III. <u>TOPICS OF INTEREST TO P&amp;C INSURERS</u></b>	<b>16</b>
A. <u>TRIA Working Group Ready to Act if TRIA Is Reauthorized</u>	16
B. <u>New Requirements for Mortgage Guaranty Insurance Are Closer to Implementation—But Maybe Not as a Model Act</u>	16

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## NAIC Report: 2014 Summer National Meeting

Continued

### I. TOPICS OF GENERAL INTEREST

#### A. U.S.-Based Approach to International Regulation

##### 1. International Capital Standards Prompt Collaboration by U.S. Regulators

In recent years, the NAIC has had a different view of group supervision from the approach supported by the IAIS. One topic on which they diverge is on whether group capital requirements should be imposed on international insurance groups. NAIC members that have spoken publicly on this topic have generally opposed the threatened imposition of a global capital standard by the IAIS as part of its development of its Common Framework for the Supervision of Internationally Active Insurance Groups (commonly referred to as “ComFrame”). As recently as earlier this summer, some NAIC leaders were quoted as contemplating refusal to comply with the IAIS standards. Representatives of the Federal Insurance Office (“FIO”) and Federal Reserve Board (“FRB”) have been less vocal on these points. At a special forum held at the meeting on the subject, these positions began to change. By the end of the meeting, members of the NAIC and FRB had agreed to work together to try to develop a group capital framework that would work in the U.S. and would also fit globally into a group capital standard.

##### a. International Capital Standards Forum Held at the Summer National Meeting

The international capital standards forum was chaired by Commissioner Michael Consedine of Pennsylvania, and included not only various state regulators but also representatives of the FRB, FIO, Financial Stability Oversight Council (“FSOC”) and certain members of the industry. Tom Sullivan, a former Commissioner of Insurance in Connecticut, attended in his role as adviser to the FRB. Representative Roy Woodall of FSOC was in attendance but did not speak, and Director Mike McRaith of FIO was not in attendance.

Commissioner Kevin McCarty of Florida led off the forum by describing the three-tier approach proposed by the IAIS:

- (i) **Basic Capital Requirements (BCR):** A basic capital requirement applicable to global systemically important insurers (“G-SIIs”) on a consolidated, group-wide basis. The second consultation period on BCR concluded on August 8, 2014, and it is expected that the final version will be submitted to the Financial Stability Board and then go to the G-20 for consideration in November 2014.
- (ii) **Higher Loss Absorbency (HLA):** A higher standard also applicable to G-SIIs, building on BCR. An initial consultation paper is expected to be released in December by the IAIS, with the standard to be developed in 2015 and implemented in 2019.
- (iii) **Insurance Capital Standard (ICS):** A capital standard to be applicable to internationally active insurance groups (“IAIGs”). An initial consultation paper is expected to be released in December by the IAIS, with the standard to

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## **NAIC Report: 2014 Summer National Meeting**

Continued

be developed in 2016. There has been discussion of the possibility that this standard might eventually supplant the BCR.

### **i. Federal Reserve Board**

Mr. Sullivan discussed the differences in the FRB's approach to this issue, which focuses on whether businesses are a going-concern, as opposed to insurance regulators, who view their primary concern as policyholder protection. He noted that since the FRB does not regulate G-SIIs, his concern about these issues is based on the potential for the global capital standards to be applied more broadly in the future.

### **ii. State Regulators**

Commissioner Leonardi of Connecticut noted that there are some potential benefits to global capital standards, if they are developed appropriately. For instance, he said that having these standards could be useful in evaluating entities that are not currently regulated, in helping regulators look at risks, and ensuring that all companies have a certain level of capital buffer. However, he questioned whether it is possible to have a capital standard without a common measurement system. He also noted that these standards would be misleading if they did not specify where the capital is located, and warned that they would create an additional burden on regulators and companies – which would mean expenses that get passed on to policyholders.

### **iii. Industry Perspective**

The forum then turned to the industry for comments. Concerns raised included the question of where additional capital would be required to be held and how that would play out in an insolvency scenario, questions about the requirements of and restrictions on modeling, the importance of tailoring the capital requirements to the length of the risks taken on, the problem for life insurers of using fair market value as the basis for capital standards in light of their typical practice of investing in long-term investments and concerns about the lack of accounting convergence.

Several speakers noted that the United States is not exerting as much influence in international decisions as it could be if all parties (i.e., state and federal regulators, along with industry) came to a consensus view and approached the IAIS as the unified face of the largest insurance market in the world.

### **b. International/Group Supervision Discussions at the Summer National Meeting**

As the results of the international capital standards forum were discussed further at the national meeting, this idea of a united front gained momentum. In particular, Mr. Sullivan's participation in the Financial Stability (E) Task Force (the "Financial Stability Task Force") meeting seemed to be the deciding factor, as he declared that he was committed to working with the NAIC as "Team USA" for influence at the IAIS.

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## NAIC Report: 2014 Summer National Meeting

Continued

### i. Federal Regulators

Mr. Sullivan made a presentation at the Financial Stability Task Force meeting regarding his role at the FRB, which was met with great interest by the Task Force members. His views were couched in terms both of respect for the NAIC and also recognition of the FRB's separate authority in insurance-related matters. He had previously noted that although the FRB joined the IAIS in November 2013, they are not yet as fully staffed on IAIS committees and working groups as they would like to be. He was asked and responded that in his view the FRB should not only be participating in supervisory colleges for insurers that are under its authority, but that the FRB should be at the head of that table, sharing the gavel with the NAIC. At this point, Commissioner Leonardi then took the opportunity to reiterate his position that FIO should not be included in supervisory colleges as it is not a regulator.

### ii. State Regulator Responses

Mr. Sullivan was asked whether he thought it is important for regulation to be coordinated internationally, and he agreed, saying that if U.S. firms want to be international, then as a leading economy the United States should be leading this discussion, not walking away and refusing to participate. Commissioner Leonardi noted that a year ago he had actually felt that the NAIC should give up on the IAIS and walk away, but that having heard Mr. Sullivan as a federal regulator expressing his willingness to work together, he feels this new cooperation would resolve the issues that most concerned him. He reiterated that the influence of U.S. state regulators has been minimized at the IAIS over the last three years, and that the IAIS needs to recognize that U.S. state regulators will not agree to standards that will hurt U.S. companies. Further, he noted that the IAIS imposing its standards will not work in the United States if state regulators do not impose them and the industry does not support them. Task Force Chair Commissioner Kobylowski of New Jersey agreed that the time for refusing to participate in the IAIS has passed, and that U.S. regulators need to come up with a real solution.

It was decided that parties who want to make a proposal on developing Team USA's position should write them up and submit them to the ComFrame Development and Analysis Working Group ("CDAWG") for consideration.

***It appears the NAIC-Federal Reserve approach, supported by industry, will be to establish U.S.-based rules that would be recognized as equivalent supervisory and capital standards in order to satisfy the IAIS and other international regulators and standard-setters. Multiple parties agreed to unite in this effort in order to develop a unified United States message.***

## 2. IAIS' Step Away From Transparency Faces Harsh Criticism

One constant refrain at the national meeting was criticism of the IAIS' move away from transparency and the accompanying call for U.S. regulators to push back against it. The IAIS is in the process of abolishing its "Observer" status that previously allowed pre-cleared industry representatives and other persons to participate in its meetings. Going forward, only select invited members of the public may do so. This point was repeatedly raised in meetings where

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## **NAIC Report: 2014 Summer National Meeting**

Continued

international issues were addressed. NAIC regulators also consistently re-affirmed their commitment to maintaining transparency in the NAIC.

### **B. Holding Company Act Developments**

#### **1. 2010 Amendments to the Model Holding Company Act Update**

At the meeting of the Financial Regulation Standards and Accreditation (F) Committee (the “Accreditation Committee”), it was noted that 38 states have adopted the 2010 amendments (the “2010 Amendments”) to the NAIC Model Insurance Holding Company Act and Regulation (the “Model HCA”). The Accreditation Committee strongly encouraged the other states to take proactive steps to adopt the 2010 Amendments, which will become part of the NAIC’s accreditation standards as of January 1, 2016.

#### **2. Re-opening of the Model Holding Company Act**

At the Spring National Meeting, the NAIC voted to consider changes to the Model HCA affecting group supervision, including international group supervision. The Group Solvency Issues (E) Working Group (the “Group Solvency Working Group”) was therefore tasked with considering whether to amend the Model HCA to address the following:

- (i) Provide the states with clear legal authority and delineated powers to act as the group-wide supervisor for internationally active insurance groups and other large insurance groups;
- (ii) Provide direct legal authority over the insurance holding company, including the authority to set group capital requirements;
- (iii) Provide for group-wide financial reporting for large insurance groups; and
- (iv) Consider resolution plans for internationally active insurance groups and other larger insurance groups.

During the meeting, the Group Solvency Working Group agreed that it should devote all of its resources to promulgating a draft revision of the Model HCA by the end of 2014 that addresses item (i) above, with the remaining items to be considered following the accomplishment of this goal. Deputy Commissioner Johnson of Pennsylvania noted that authorizing state regulatory authorities to lead supervisory colleges for international groups requires U.S. consensus, because failure to address it will endanger the state-based regulatory system. Rob Essen of the NAIC observed that if the IAIS endorses an international capital standard, as now seems certain, it will be likely that the IAIS – and the FSAP process – would look to the laws of the various states to ensure that there is appropriate authority to regulate on a group-wide basis. He advised that therefore it is important for the Group Solvency Working group to carefully consider appropriate group-wide powers. He noted that a new working group of the IAIS has been formed to address insurance

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## NAIC Report: 2014 Summer National Meeting

Continued

group authority issues, which will be meeting soon. Its progress will likely be of great interest to the Group Solvency Working Group.

The Group Solvency Working Group considered how to approach drafting the language to give state insurance regulators group-wide supervisory authority for certain internationally active insurance groups. While several states have some version of this language, the Group Solvency Working Group decided that the draft revision to the Model HCA should be based on law that was recently enacted in Pennsylvania. When Pennsylvania adopted the 2010 revisions of the Model HCA, it added a section on group-wide supervision for international insurance groups (the “Pennsylvania Statute”), which authorizes the Pennsylvania insurance regulator to act as the group-wide supervisor for any international insurance group whose ultimate controlling person is domiciled or incorporated in Pennsylvania and which maintains substantial operations in the state.

The Group Solvency Working Group stated that it hoped to get a proposal to the Financial Condition (E) Committee (“E Committee”) by year-end. Subsequent to the meeting, it exposed draft language for comments by September 22, 2014, in the form of a new Section 7A to the Model HCA on “Group-wide Supervision of International Insurance Groups”, which regulates “insurance group[s] operating internationally” that have an insurer domiciled in the subject state.

***The state adoption of laws authorizing U.S. state regulators to lead international supervisory colleges is considered a crucial step for U.S. participation in international regulation. Nonetheless, state legislatures have been asked not to delay their efforts to adopt the 2010 Amendments while these new changes are being discussed.***

### C. Corporate Governance Model Act Nears Completion

At the meeting, the E Committee adopted the new Corporate Governance Annual Disclosure Model Act (the “Corporate Governance Model Act”) and the new Corporate Governance Annual Disclosure Model Regulation (the “Corporate Governance Model Regulation” and, together with the Corporate Governance Model Act, the “Corporate Governance Models”), capping a long and intense effort. Substantive discussion at the meeting was limited to airing final comments made with regard to the confidentiality language.

#### 1. Model Act Requirements and Next Steps

The Corporate Governance Model Act sets forth the procedural requirements and applicable confidentiality provisions with respect to a new corporate governance annual disclosure (the “CGAD”). The Corporate Governance Model Act expressly states that the insurer or insurance group shall have discretion over its responses in the CGAD so long as the CGAD contains the material information necessary for the relevant regulator to understand the insurer’s or group’s corporate governance structure, policies and practices. Insurers or insurance groups will be able to provide information required by

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## NAIC Report: 2014 Summer National Meeting

Continued

the CGAD by cross-referencing to other filings submitted to the relevant insurance regulator or other filings made with other state or federal regulators.

The CGAD's substantive requirements will be governed by the Corporate Governance Model Regulation, which attempts to provide insurers and insurance groups with flexibility in their responses (e.g., the CGAD can be completed in the format of the insurer's choice). Further flexibility is built in by allowing the CGAD to be completed at the level of an individual legal entity, intermediate holding company, or ultimate controlling parent, depending upon how the insurer or insurance group has structured its system of corporate governance.

The Corporate Governance Model Regulation also sets forth a detailed list of topics that are to be reported in the CGAD, which must include a description of four key elements of corporate governance: (i) the insurer's or insurance group's corporate governance framework and structure; (ii) the policies and practices of the most senior governing entity and significant committees; (iii) the policies and practices for directing senior management; and (iv) the processes by which the Board of Directors, its committees and senior management ensure an appropriate amount of oversight to the critical risk areas impacting the insurer's business activities.

The NAIC expects the CGAD disclosure requirements to go into effect in 2016, with the first CGAD due on or before June 1 of that year. In the meantime, the Corporate Governance (E) Working Group (the "CGWG") will work on the development of accreditation standards with respect to corporate governance, following which it will be disbanded.

### **2. Confidentiality Under the Model Act**

Prior to the E Committee's adoption of the Corporate Governance Models, Susan L. Donegan, Commissioner of the State of Vermont Department of Financial Regulation and chair of the CGWG, noted that the CGWG had deliberated extensively concerning the confidentiality provisions in the Corporate Governance Model Act. In response to comments from the California Department of Insurance, the CGWG added a drafting note to the Corporate Governance Model Act requesting states to consider whether to specifically invoke their examination statutes by framing the review of the CGAD as an examination, thereby providing additional confidentiality protection for such confidential documents by ensuring the documents submitted with the CGAD would not become public because of disclosure to third-party consultants. The CGWG also considered an objection from the Florida Office of Insurance Regulation to the provision in the Corporate Governance Model Act indicating that the CGAD and other documents submitted therewith "shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action". In its comment letter, the Florida Office of Insurance Regulation had indicated that such a provision, if enacted in Florida, might raise constitutionality concerns as encroaching upon the exclusive authority of the Florida Supreme Court to establish the practices and procedure of the courts. The CGWG decided not to incorporate alternative language into the Corporate Governance Model Act, however, as it felt that presenting a second option would encourage states to adopt the Corporate Governance Models in a non-uniform manner. As a result, the Florida Office of Insurance Regulation voted against the CGWG's and E Committee's adoption of the Corporate Governance Models.

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## NAIC Report: 2014 Summer National Meeting

Continued

### 3. Redundancies

The CGWG has also engaged in significant discussions concerning corporate governance filing redundancies, a subject that has been aggressively pursued by the industry. Commissioner Donegan indicated in her report to the E Committee that the CGWG wanted to ensure flexibility with respect to the applicable filing requirements, and did not wish to create a new data-gathering burden for the industry. The E Committee moved to the NAIC Executive (EX) Committee (the “Executive Committee”) to have redundancy added to the E Committee’s charges. In addition, the Texas Department of Insurance, as Co-Chair of the RFSWG, invited the industry to identify and submit redundancies for the Risk-Focused Surveillance (E) Working Group’s (the “RFSWG”) consideration.

***The completion of this initiative will mark a milestone in the NAIC’s response to the financial crisis of 2008 and the results of the most recent FSAP of the United States. We expect these Models will be promptly adopted at the next action of the NAIC’s Executive Committee and Plenary.***

#### D. Reinsurance Update

##### 1. Amended Credit for Reinsurance Model Act Update

The Reinsurance (E) Task Force (“Reinsurance Task Force”) advised that as of the meeting, the NAIC’s amendments to its Credit for Reinsurance Model Law and Regulations (the “Amended Credit for Reinsurance Model Act”), which allow for reduced reinsurance collateral requirements for unauthorized reinsurers, have been adopted in 23 states. They announced that insurers domiciled in these states together constitute more than 60% of the primary insurance premium in the United States, and that several more states have legislation pending or planned in 2014 and 2015 to adopt the Amended Credit for Reinsurance Model Act, which will bring the volume up to 80%. It was also announced that more than 30 reinsurers are currently certified to operate with reduced collateral, and that more applications are in progress.

The Reinsurance Task Force also discussed potential charges with regard to the Framework (defined below), as discussed in Section II.A.

##### 2. Qualified Jurisdiction Working Group

The Qualified Jurisdiction (E) Working Group (the “Qualified Jurisdiction Working Group”) has continued its work on reviewing foreign jurisdictions for certification as “qualified jurisdictions” by adding the regulators in France, Ireland and Japan to its slate for review. Once countries become certified, U.S. states that have adopted the Amended Credit for Reinsurance Model Act can implement reduced collateral requirements with respect to reinsurers domiciled in that country. The original group of four regulatory jurisdictions that were previously reviewed and conditionally certified by the Qualified Jurisdiction Working Group are Bermuda, Germany, Switzerland and the United Kingdom.

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## **NAIC Report: 2014 Summer National Meeting**

Continued

### **3. Reinsurance Financial Analysis Working Group Continues “Passporting” Work on Reinsurers**

The Reinsurance (E) Financial Analysis Working Group (the “Reinsurance-FAWG”) reported during the Reinsurance Task Force meeting that it has reviewed and approved, or “passporting”, a total of 25 certified reinsurers. It also has two applications in progress, and has rejected several more for reasons that were not disclosed. Once a reinsurer has become certified in one state, it can apply to Reinsurance-FAWG to be “passporting”, which essentially is the NAIC’s recommendation that other states defer to the original state’s conclusion that the reinsurer meets the standards appropriate for certification and collateral reduction.

### **4. First Evaluation of Reinsurers as G-SIIs**

It was noted in the Financial Stability Task Force meeting that in 2014 the Financial Stability Board will not only be re-evaluating the insurer G-SIIs identified last year and other candidate insurer G-SIIs, but also will be evaluating reinsurers for the first time to determine whether they should be designated as G-SIIs. Determinations are expected in November 2014.

### **E. NAIC Governance Concerns Continue**

In December 2013, at the NAIC Fall National Meeting, Commissioner Tom Leonardi of Connecticut made a public call for scrutiny of the NAIC’s own internal corporate governance practices, which he described as being burdened by cronyism and unduly influenced by a small subset of NAIC officers past and present. In response, a new task force, the Governance Review (EX) Task Force (the “Governance Task Force”) was created to consider the issue and determine whether an outside consultant should be hired to improve the NAIC’s governance practices. Chaired by Director John Huff of Missouri, the Governance Task Force released a Request for Proposals, with proposals due August 15th.

At the national meeting, at a meeting that had been cancelled and belatedly rescheduled, the Governance Task Force revealed that the Executive Committee had separately voted to create a subcommittee of itself that would be tasked with the job of reviewing the responses to the RFP. The members of this subcommittee are Wisconsin Insurance Commissioner Ted Nickel, NAIC President-elect Monica Lindeen of Montana, NAIC Vice President Michael Consedine of Pennsylvania, Commissioner Roger Sevigny of New Hampshire (former NAIC president) and Commissioner Jim Donelon of Louisiana (former NAIC president).

At the Governance Task Force meeting, several speakers including Commissioner Leonardi objected to the diversion of their authority on this point, particularly to a group of which the strong majority are current or former NAIC officers and of which a strong majority voted against the proposal to hire a consultant. A motion was made to request that the Executive Committee rescind its establishment of the subcommittee of the Executive Committee, but the motion did not pass. It is therefore expected that the subcommittee will review the responses to the RFP and interview candidates in order to make its recommendation. The RFP sets forth that the decision on the consultant is expected on September 12, 2014.

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## NAIC Report: 2014 Summer National Meeting

Continued

### II. TOPICS OF INTEREST TO THE LIFE INSURANCE INDUSTRY

#### A. XXX/AXXX Framework Adopted by Executive Committee, but Much Work Remains Ahead

Unsurprisingly, the most heated discussion during the meeting of the Executive Committee involved the Executive Committee's proposed adoption of the XXX/AXXX Reinsurance Framework (the "Framework"). The Framework is part of the NAIC action plan to develop further regulatory requirements specific to XXX and AXXX transactions. During the meeting, Rhode Island Superintendent of Insurance Joseph Torti III indicated that the Framework aims to set standards applicable to XXX and AXXX transactions without restricting them outright. The Framework is also intended to provide an interim solution with respect to XXX and AXXX transactions, since the NAIC expects that there will no longer be a need for XXX and AXXX transactions after the full implementation of the NAIC's Principles-Based Reserving ("PBR") initiative.

The Framework would apply only prospectively, and only to XXX transactions and AXXX transactions. The Framework would not change statutory reserve requirements applicable to a ceding insurer, but would instead change the types of assets necessary to back those reserve liabilities as follows: (i) a portion of the total statutory reserve approximately equal to the PBR level would be required to be collateralized with "hard assets" (e.g., cash and securities listed with the NAIC's Securities Valuations Office ("SVO")); and (ii) the remainder of the reserve could be collateralized with other assets identified as acceptable by regulators. The Framework would also require the opining actuary of the ceding insurer to issue a qualified opinion if the Framework is not followed. The NAIC plans to issue an actuarial guideline before the end of this year to implement this requirement. In addition, as another enforcement tool, a note to the annual audited financial statement would require the cedent and its independent auditor to indicate whether the Framework is being followed.

The Framework would also require the cedent to disclose the assets used to support the reserves and hold an RBC cushion if the captive does not file RBC reports.

The Framework would be codified through the Credit for Reinsurance Model Law (#785) with the creation of a new model regulation to establish requirements regarding the reinsurance of XXX and AXXX policies. The Executive Committee adopted a number of charges to various NAIC groups to implement the above requirements, in addition to adopting model law development requests for a new XXX/AXXX Reinsurance Model Regulation and amendments to the Credit for Reinsurance Model Law (#785) and the Actuarial Opinion and Memorandum Regulation (#822) (the "Actuarial Opinion Regulation").

The Executive Committee's vote to adopt the above items was by no means unanimous. During the Executive Committee meeting, New York and North Carolina regulators both expressed opposition to the Framework and were among the vocal minority of Executive Committee members who voted against the Framework's adoption. In addition, the California Department of Insurance presumably continues its previously stated opposition to the Framework. The California Department of Insurance is not currently a member of the Executive Committee, but voted against the adoption of the Framework by the PBR Task Force earlier this summer.

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## NAIC Report: 2014 Summer National Meeting

Continued

It is important to note that the adoption of the Framework by the Executive Committee is but one of many steps in its implementation and much work is still required. As described above, various NAIC groups have been charged with developing the details to create the Framework for subsequent consideration by the entire NAIC membership. In this regard, the NAIC has set an ambitious year-end timetable for many of the tasks associated with implementation of the Framework.

### **B. Captive Update – No Steps Taken on “Multistate Insurer” Definition for Accreditation**

The NAIC Financial Regulation and Accreditation Program is a process by which accreditation is given to a state insurance department if it meets certain legal, financial and organizational standards as determined by peer regulators. Such standards include adopting certain Model laws and regulations developed by the NAIC.

During the 2014 Spring National Meeting of the NAIC, the Accreditation Committee exposed for comment draft revisions to the NAIC’s Accreditation Standards that would impose the Accreditation Standards on certain types of captives not currently required to comply with them. The proposed amendments were aimed at including within the definition of “multi-state insurers” those insurer-owned captives and special purpose vehicles that are single-state licensed but assume reinsurance from cedents operating in multiple states, thereby subjecting them to all the Accreditation Standards applicable to other insurers.

The implementation of such an accreditation standard would mean that states that have licensed such captives and special purpose vehicles would have to revise existing state laws in order to apply, among other items, capital and surplus requirements, risk-based capital requirements, investment laws and credit for reinsurance laws that are applicable to traditional multi-state insurers to the extent such existing laws have different capitalization, reinsurance and related standards applicable to these insurer-owned captives and special purpose vehicles.

The Accreditation Committee received many comment letters on the exposed language, many of which opposed the draft revisions as being overly broad in their scope as they encompassed too many types of captives – most particularly including “traditional” captives.

In response to these comment letters, Superintendent Torti of Rhode Island stated that it had never been the Accreditation Committee’s intent to encompass all types of captives under the definition of a “multi-state insurer” but rather to additionally encompass only those captives participating in XXX and AXXX reserve financing transactions. As a result of this unintended consequence of the language as drafted, Superintendent Torti stated that the Accreditation Committee would not take any action on the draft revisions at this time, but would instead keep them open until the NAIC’s Fall 2014 National Meeting in Washington, DC.

Separately, several comment letters received by the Accreditation Committee expressed concern about the limited 45-day length of the comment period with respect to the proposed changes to the definition of a “multi-state reinsurer”. During

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## **NAIC Report: 2014 Summer National Meeting**

Continued

the Accreditation Committee's meeting, the Delaware Department of Insurance likewise expressed its concern with the compressed timing process with respect to the comment period, and asked the Accreditation Committee whether the proposed changes would be exposed for the usual 365-day comment period as per the usual NAIC procedure. The questions raised by the Delaware Department of Insurance did not elicit any response from Superintendent Torti, who instead promptly adjourned the meeting.

### **C. PBR Update**

Principles-Based Reserving ("PBR") is intended to replace the current formulaic approach to determining life insurance policy reserves with an approach aimed at better aligning policy reserves to product risks. PBR comprises three principal components: (i) the Model Standard Valuation Law, which was revised by the NAIC in 2009; (ii) the Standard Nonforfeiture Law for Life Insurance, which was amended by the NAIC in August 2012; and (iii) a Valuation Manual, which was adopted by a supermajority of NAIC members in December 2012.

At the meeting, it was reported that eighteen states have enacted the amended Model Standard Valuation Law, with five more states expected to enact it in 2014 and one more state expected to enact it in 2015. PBR will become effective, however, only upon legislative adoption of the amended Model Standard Valuation Law by a supermajority of jurisdictions (42) representing at least 75% of the applicable U.S. premium. It is expected that the earliest probable operative date for PBR's Valuation Manual is January 1, 2017.

Further, the Accreditation Committee adopted a new charge to consider work products adopted by the Principle-Based Reserving (EX) Task Force, Executive Committee, and Plenary for inclusion in the Accreditation Standards.

### **D. Briefly Noted**

#### **1. Unclaimed Property Model Law May Be on the Horizon**

The Unclaimed Life Insurance Benefits (A) Working Group (the "Unclaimed Benefits Working Group") has been gathering information in order to complete its 2014 charge to undertake a study to determine whether recommendations should be made to address unclaimed death benefits. To that end, during the meeting, the Unclaimed Benefits Working Group heard a presentation from ACLI and Bailey Cavalieri LLC urging the NAIC to develop a uniform national framework in order to secure the benefits of settlement agreements entered into by state insurance regulators with certain life insurers for all purchasers of life insurance.

In response to the presentation, the Chair of the Unclaimed Benefits Working Group, Tennessee Commissioner for Commerce and Insurance Julie Mix McPeak, noted that the Unclaimed Benefits Working Group has now gathered a great deal of information and should be ready to discuss the next steps towards potentially making a recommendation to the Life Insurance and Annuities (A) Committee (the "A Committee"). This view was supported by Bruce R. Ramge, Director

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## NAIC Report: 2014 Summer National Meeting

Continued

of the Nebraska Department of Insurance, who suggested that the members of the Unclaimed Benefits Working Group take several weeks to deliberate prior to holding a conference call concerning the issue. Similarly, Commissioner Donelon of Louisiana voiced his support for further action by the NAIC with respect to unclaimed death benefits, culminating, in Commissioner Donelon's words, with a new Model Law.

These suggestions by the Unclaimed Benefits Working Group generated a flurry of responses by interested parties and regulators. Suggestions and comments ranged from statements in full support of the possible implementation of a new Model Law or other guidance to technical suggestions to statements of strong opposition to any such initiative.

In response to these comments, Commissioner McPeak noted only that the Unclaimed Benefits Working Group has yet to decide whether its recommendation to the A Committee, if any, will suggest the development of a new Model Law, a new Model Regulation, or some other form of guidance.

### **2. Private Equity Working Group Still Gathering Information**

The Private Equity Issues (E) Working Group (the "Private Equity Working Group") is continuing to review issues related to the ownership of insurance companies by private equity firms. To that end, during the meeting the Private Equity Working Group heard a presentation from A.M. Best concerning the impact of the inflow of private equity capital into the insurance industry.

A.M. Best presented the results of its survey of a large number of companies—which were asked to respond to the question whether the increased flow of private equity into the insurance industry had any impact on the company's strategies. A.M. Best noted during its presentation that the majority of the responders had indicated that there was "no impact" on their companies due to the increased flow of private equity into the industry.

A.M. Best then presented the results of its comparison of the balance sheets of life and health insurers owned by private equity firms against the balance sheets of the industry as a whole. The differences highlighted by A.M. Best were: (i) that insurers owned by private equity firms had lower invested assets as compared to their total assets; and (ii) that insurers owned by private equity firms carried more cash. The A.M. Best representative noted that it was difficult to place much emphasis on this data.

During the meeting, it was noted that the Private Equity Working Group intends to discuss during its meeting in November issues related to transactions between insurers and "favored investors" of private equity companies. The expressed concern was that regulators do not get to review such transactions for fairness, and that it is possible that such "favored investors" may be benefitting at the insurers' expense. It was noted for future discussion that this might be an area where regulatory involvement would be beneficial.

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## **NAIC Report: 2014 Summer National Meeting**

Continued

It was also noted in the meeting that the Private Equity Working Group would be very interested in being able to discuss the matters under its review with a member of the SEC.

### **III. TOPICS OF INTEREST TO P&C INSURERS**

#### **A. TRIA Working Group Ready to Act if TRIA Is Reauthorized**

During its meeting, the Property and Casualty Insurance (C) Committee Terrorism Risk Insurance Implementation (C) Working Group (the “TRIA Working Group”) heard an update concerning Federal legislative developments with respect to the reauthorization of the Terrorism Risk Insurance Act (“TRIA”), which is due to expire on December 31, 2014. The NAIC continues to strongly support the viewpoint that some version of TRIA should be reenacted as soon as possible.

Two separate bills seeking to reauthorize TRIA are currently pending in the U.S. House of Representatives and the U.S. Senate, and the NAIC has not taken a formal position as to its preference for either of those bills. However, legislators will be meeting for only a few weeks this fall prior to the start of election season, and members of the TRIA Working Group thought it unlikely that either of the reauthorization bills would be passed through the legislature during this short time period. Instead, the TRIA Working Group expects any reauthorization of TRIA to be signed into law only a very short time prior to TRIA’s expiration on December 31, 2014. The TRIA Working Group indicated that it stands ready to update the relevant guidance documents and bulletins on very short notice after any expected reauthorization of TRIA.

#### **B. New Requirements for Mortgage Guaranty Insurance Are Closer to Implementation—But Maybe Not as a Model Act**

During its meeting, the Mortgage Guaranty Insurance (E) Working Group (the “Mortgage Guaranty Working Group”) discussed the status of the proposed revisions of the Mortgage Guaranty Insurance Model Act. It was noted that much progress has recently been made on the Model Act, and that only a list of certain specific items remains open. One such area is the issue of reinsurance of mortgage guaranty policies—an item that the Mortgage Guaranty Working Group has decided to revisit at such later date when the provisions of the Mortgage Guaranty Insurance Model Act concerning capital standards are appropriately finalized.

The current version of the Mortgage Guaranty Insurance Model Act is lengthy and detailed. As such, regulators have expressed some concern that, as a practical matter, the requirements under the draft Mortgage Guaranty Insurance Model Act are too detailed to be sent to state legislatures. Thus, some support was expressed for transferring the detailed requirements currently present in the draft Mortgage Guaranty Insurance Model Act to a nonlegislative source of guidance, such as a procedures manual. This view was vehemently opposed by Deputy Commissioner Johnson of Pennsylvania, who noted that the adoption of the new requirements by state legislatures is absolutely critical and “the heart of the issue”. The Mortgage Guaranty Working Group did not reach a conclusion concerning this issue, but we expect further debates and deliberations on this item to occur in the coming months.

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## NAIC Report: 2014 Summer National Meeting

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## NAIC Report: 2014 Summer National Meeting

Continued

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## **NAIC Report: 2014 Summer National Meeting**

Continued

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