CLIENT MEMORANDUM

NAIC Report: 2016 Spring National Meeting

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The 2016 Spring National Meeting (the "Spring National Meeting") of the National Association of Insurance Commissioners ("NAIC") was held in New Orleans, Louisiana on April 2-6, 2016.

The highlights included a discussion of the newly introduced Insurance Data Security Model Law ("Cyber Model Law") and reports that 42 states representing more than 75% of the total U.S. life insurance industry premium have adopted the NAIC Model Standard Valuation Law (the "SVL") and that there will be a further delay in the adoption of the XXX/AXXX Model Regulation (as defined below). Additionally, the Spring National Meeting was the last for two state insurance commissioners who are resigning from their positions: Kevin McCarty, Florida Insurance Commissioner, and Susan Donegan, Commissioner of the Vermont Department of Financial Regulation.

This report summarizes some of the key activities at the Spring National Meeting and NAIC interim meetings and conference calls leading up to the meeting that may be of interest to our clients in the insurance industry.

I. TOPICS OF GENERAL INTEREST

A. Cybersecurity

1. NAIC Adoption of the Cybersecurity Model Law Will Be a Marathon—but a Quick One

Last month, the Cybersecurity (EX) Task Force ("Cyber TF") released a draft of the Cyber Model Law for public comment. A significant and controversial feature of the Cyber Model Law, which is broadly applicable to licensed insurers, producers and other state insurance department licensees (the "Licensees"), is the intent to preempt the application of federal or other state cyber laws to Licensees and to establish exclusive data security, investigation and notification requirements for breaches of data security.

The Cyber Model Law, among other measures:

- requires a Licensee to (x) develop, implement and maintain a comprehensive written information security program with specified safeguards, and (y) engage in certain related risk assessment and risk management activities;
- specifies standards for a Licensee's oversight of third-party service providers' data;
- obligates a Licensee to make certain disclosures to consumers with respect to collected personal information (including personal information that is shared with third-party contract providers);
- requires a Licensee to conduct an investigation and, when certain conditions are met, notify regulatory authorities, law enforcement agencies, consumers and other parties if the Licensee believes that a data security breach has or may have occurred; and
- authorizes state insurance regulators, after reviewing a notification concerning a particular data breach, to prescribe consumer protection measures following that data breach (including, at a minimum, requiring a Licensee to offer to pay for at least 12 months of identity theft protection for affected consumers).

As noted above, the Cyber Model Law states that, with respect to Licensees, the Cyber Model Law preempts both state and federal laws and regulations regarding data security otherwise applicable to Licensees. The Cyber Model Law states that this preemption is "[c]onsistent with authority to regulate the business of insurance pursuant to the McCarran-Ferguson Act." As reported in our NAIC Winter 2015 Report, the federal Cyber Information Sharing Act was signed into law last year, and the Data Security Act of 2015 (the "Data Security Act") is currently pending in Congress. The NAIC opposes the Data Security Act in particular as applied to Licensees on the grounds that the Data Security Act imposes a federal "ceiling" on cybersecurity standards applicable to "covered entities" that access, maintain, communicate or handle sensitive financial account or personal information. The NAIC argued in a letter addressed to the U.S. House of Representatives in December that the Data Security Act will both frustrate the existing state regulatory framework relating to cybersecurity and prevent states from imposing any additional requirements or prohibitions with respect to the responsibilities of any person to safeguard private information or to mitigate the consequences of a data breach. Accordingly, the NAIC seeks to preempt these federal laws with the Cyber Model Law.

During the Cyber TF session at the Spring National Meeting, so many interested parties sought to provide comments (most of them negative) on the draft Cyber Model Law that each was afforded only three minutes to state its concerns. Among the concerns expressed were:

- the potential difficulties for small insurance companies and insurance agencies in complying with the onerous requirements of the Cyber Model Law;
- a concern that state regulators' authority to review policyholder notices could effectively engender a 50-state patchwork of cybersecurity-related policyholder notification requirements;
- a query whether state legislatures would enact a law that expressly preempts federal laws;
- concerns that the Cyber Model Law privacy provisions duplicate existing privacy laws; and
- general concern that many of the provisions in the current draft of the Cyber Model Law are overly broad, not risk-based, and/or potentially excessively onerous.

On the other hand, commenters overwhelmingly noted their support for a single cybersecurity model act that would replace the existing patchwork of state laws relating to cybersecurity, but urged the NAIC to proceed slowly and to carefully consider each of the requirements set forth in the current draft of the Cyber Model Law. These requests—seemingly—fell on deaf ears. The Cyber TF noted that, given the comments received, the implementation of the Cyber Model Law would certainly be a "marathon—but a quick one," and that the Cyber TF fully intends to have the Cyber Model Law adopted in 2016.

With the Data Security Act pending in Congress, the NAIC appears to be eager to adopt the Cyber Model Law as quickly as possible; indeed the extremely aggressive timeline for this project could see the adoption of the Cyber Model Law as early as the 2016 Summer National Meeting—mere months after the Cyber Model Law's initial exposure in March. This aggressive timeline is problematic for the industry, which is vigorously opposing a significant number of provisions in the current draft of the Cyber Model Law.

2. International Developments

On April 14, 2016, the International Association of Insurance Supervisors ("IAIS") released an issues paper on cyber risk to the insurance sector that seeks to raise awareness of the challenges presented by cyber risk, including present and potential supervisory approaches for addressing such risks. The issues paper states that it is primarily descriptive and "is not meant to create supervisory expectations," but "may shed light on the need for additional, more specific IAIS material to support supervisors in addressing cyber risk." The IAIS is seeking feedback on the issues paper through public consultation, with comments due by May 13, 2016.

B. Reinsurance Update

1. Covered Agreement Update

Last November, during the 2015 Fall National Meeting, the U.S. Department of the Treasury ("Treasury") and the Office of the U.S. Trade Representative ("USTR") announced that they would exercise their authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") to negotiate a "covered agreement" with the European Union ("EU"). The Treasury and the USTR identified their goals in letters to the House of Representatives and Senate, including: (i) obtaining "equivalent" treatment of the U.S. insurance regulatory system by the EU under Solvency II; (ii) obtaining recognition by the EU of the "integrated state and federal insurance regulatory and oversight system in the United States" (including with respect to group supervision); (iii) facilitating the exchange of confidential regulatory information among lead supervisors; (iv) affording nationally uniform treatment in the United States of reinsurers based in the EU (including with respect to reinsurance collateral); and (v) obtaining permanent equivalent treatment for the solvency regime in the United States applicable to insurance and reinsurance undertakings.

In February, U.S. and EU authorities met in Brussels to discuss the approximate parameters of the covered agreement. Thereafter the U.S. and EU representatives issued a joint statement (the "Joint Statement"), which stated that the sides have agreed "to move forward efficiently and expeditiously and affirmed their good faith pursuit of an agreement on matters relating to group supervision, exchange of confidential information between supervisory authorities on both sides, and reinsurance supervision, including collateral."

The NAIC does not favor the implementation of a covered agreement because (i) the covered agreement may result in the preemption of state laws that are less favorable to a non-U.S. insurer than the covered agreement and (ii) the NAIC's amended Credit for Reinsurance Model Act, which has been adopted by many states, establishes a state-based system for recognizing non-U.S. reinsurers including the recognition of the reinsurer's domiciliary jurisdiction. Whether state regulators or the NAIC will be given an opportunity during the EU/U.S. covered agreement negotiations to express this view or to otherwise participate in, or attempt to influence, the negotiations is, at this point, unclear.

Initially, the Treasury and USTR said that state insurance regulators will have a "meaningful role" in the negotiations of the covered agreement, and the Joint Statement confirmed that U.S. and EU representatives had agreed to "meaningful stakeholder consultation and engagement throughout the negotiations." Notwithstanding these assurances, Superintendent Eric A. Chioppa of the Maine Bureau of Insurance and Chair of the Financial Condition (E) Committee (the "(E) Committee") recommended a new covered agreement-related charge to the (E) Committee, noting that the covered agreement negotiations are unlikely to be open to all interested regulators and stakeholders, and that state insurance laws or regulations would very likely be affected by the covered agreement. At the Spring National Meeting, the (E) Committee approved its new charge to "[c]onsider and develop contingency regulatory plans to continue to protect U.S. consumers and U.S. ceding insurance companies from potential adverse impact resulting from covered agreement negotiations." In a memorandum to the (E) Committee, Superintendent Chioppa noted that this charge would permit the (E) Committee to consider possible outcomes from the covered agreement negotiations and begin planning for their potential impact.

2. Amended Credit for Reinsurance Models Made an Accreditation Standard

The covered agreement with the EU will seek, among other things, to afford nationally uniform treatment in the United States of reinsurers based in the EU with respect to reinsurance collateral requirements. This is a sensitive subject for the NAIC, which has spearheaded a long-standing effort for adoption by the states of the amended Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation (the "Amended Credit for Reinsurance Models"), which generally permit an alien reinsurer that is domiciled in a "qualified jurisdiction" and that has qualified as a "certified reinsurer" to post reduced collateral for reinsurance assumed from a U.S. insurer. According to the NAIC, as of March 2016, a total of 32 states representing approximately 66% of insurance premium written in the United States had adopted the Amended Credit for Reinsurance Models. Because the remaining U.S. jurisdictions have not adopted the Amended Credit for Reinsurance Models, many industry members see the covered agreement process as a useful path for ensuring that reduced collateral requirements for EU-based reinsurers (and, in the future, potentially for other alien reinsurers) will be adopted in the United States as a nationwide standard.

The NAIC has its own mechanism for ensuring the implementation of a model act on a nationwide basis—i.e., the accreditation standard process, which requires every state to adopt each NAIC model act or regulation that constitutes an accreditation standard, or risk losing the state's accredited status at the NAIC. The reduced collateral requirements in the Amended Credit for Reinsurance Models are currently merely an "optional" accreditation standard—meaning that a state is not required to adopt the Amended Credit for Reinsurance Models, but that any state adoption of reduced collateral requirements for non-U.S. reinsurers must conform with the requirements of the Amended Credit for Reinsurance Models. In 2015, calls for nationwide reinsurance collateral standard uniformity and rumors (later confirmed) of potential covered agreement negotiations to be entered into by the federal authorities led the Financial Regulation Standards and Accreditation (F) Committee (the "Accreditation Committee") to commence the process to make the Amended Credit for Reinsurance Models a mandatory accreditation standard. Not surprisingly, this process concluded successfully at the Spring National Meeting with the Accreditation Committee voting to make the Amended Credit for Reinsurance Models an accreditation standard, to become effective January 1, 2019.

3. Other Updates

At the Spring National Meeting the Reinsurance (E) Task Force (the "Reinsurance Task Force") reported that this year no further jurisdictions have formally requested to be added to the NAIC List of Qualified Jurisdictions, and exposed for comment certain changes to the uniform application checklist for certified reinsurers.

In addition, the Reinsurance Task Force voted to expand the List of Qualified U.S. Financial Institutions that may be used as issuers of letters of credit in support of reinsurance arrangements under the Credit for Reinsurance Model Law or state provisions based on the Credit for Reinsurance Model Law to include eligible non-bank financial institutions.

C. Group Capital Standards

1. IAIS to Continue Field Testing of Insurance Capital Standard

In 2010, the IAIS started developing the Common Framework for the Supervision of Internationally Active Insurance Groups (“ComFrame”). The IAIS subsequently announced its commitment to develop a global insurance capital standard (“ICS”) applicable to Internationally Active Insurance Groups (IAIG), including Globally Systemically Important Insurers (“G-SII”). The IAIS anticipates adoption of “version 1” of the ICS by June 2017, which will permit confidential reporting of the ICS and enable further refinements to the ICS requirements. “Version 2” of the ICS will be adopted within ComFrame in 2019 or 2020. In order to complete development of ComFrame (including the ICS) within this timeline, the IAIS is expected to push forward with field testing and public consultation in 2016.

2. More Input Needed for Development of U.S. Group Capital

In 2015, the ComFrame Development and Analysis (G) Working Group (“CDAWG”) began to explore the possibility of developing a U.S. insurance group capital calculation that could be compatible with the ICS. CDAWG considered several approaches and ultimately opted to pursue a calculation based on a risk-based capital (“RBC”) aggregation approach. In February 2016, the Group Capital Calculation (E) Working Group (“Group Capital WG”) was created and charged with constructing a U.S. group capital calculation using such an approach.

The Group Capital WG met for the first time in New Orleans. Members of the Group Capital WG reiterated their commitment to work with interested stakeholders to construct a group capital calculation that could be adopted in 2016. Members of the Group Capital WG then heard a joint presentation from the American Council of Life Insurers and the American Insurance Association, which provided an overview of how capital could be aggregated across legal entities and calibrated across jurisdictions. Discussion of this presentation highlighted a number of key issues facing the Group Capital WG with respect to a U.S. group capital calculation, including how capital of noninsurance entities will be measured, the appropriateness of a small group exemption, when the calculation will be completed, whether field testing will be required before the calculation is finalized, and how the calculation itself will be implemented.

In addition, interested parties queried whether the intent of the Group Capital WG was to produce a U.S. calculation that would satisfy international standards and be compatible with or equivalent to the ICS under development by the IAIS. The Group Capital WG noted that its charge contemplates coordination with the Federal Reserve and CDAWG with respect to ongoing developments but stopped short of any commitment that its U.S. group capital calculation will be equivalent to the ICS. Industry members who frequently request that redundant regulation be avoided are likely to continue to request that the U.S. group capital calculation be equivalent to the ICS and any capital standard developed by the Federal Reserve. In light of the Group Capital WG's commitment to work with interested stakeholders, only time will tell if interested parties' requests will fall on deaf ears.

D. International Matters

1. The IAIS Continues to Refine its Methodology for Designation of Global Systemically Important Insurers

On January 29, 2016, the IAIS closed a public consultation period during which it sought feedback on its assessment methodology for the designation of G-SIIs. Although the results of the public consultation have not been released to the public, an update at the meeting of the Financial Stability (EX) Task Force identified two likely changes: (i) greater reliance upon reference to absolute values, rather than relative values, in the process for designating G-SIIs and (ii) the addition of a discovery period to the assessment methodology, during which non-quantitative factors could be reviewed and discussed. The IAIS is expected to make recommendations with respect to G-SII designations in October of this year.

2. Initiatives Under Way to Increase Stakeholder Engagement with the IAIS

The Spring National Meeting was notable for its frequent discussion of IAIS initiatives to improve stakeholder engagement, including ways to increase participation in the annual global seminar. Stakeholders were also able to participate in a question-and-answer session with a representative of the IAIS at the Spring National Meeting, who solicited feedback with respect to things the IAIS is doing well and things that could use improvement. Stakeholders noted a number of flaws in the consultation process, including the inability for stakeholders to provide input or comments until such time as a consultation document is released for public comment and the short timeframes for responding to consultation documents. In light of the forthcoming push for initial adoption of the ICS, stakeholder engagement will be increasingly useful to ensure that industry voices are heard and considered.

3. The NAIC Responds to FSAP Results

The results of the most recent Financial Sector Assessment Program ("FSAP") review of the U.S. insurance regulatory system were released by the International Monetary Fund last July. The FSAP recognized improvements in some areas of regulation since the 2010 FSAP, while noting some areas that need or continue to need improvement. At the end of 2015, the International Insurance Relations (G) Committee ("International Relations Committee") adopted an NAIC assignment plan to respond to certain recommendations made in the 2015 FSAP. The International Relations Committee assigned (or flagged for future consideration) responses to eight such recommendations to the (E) Committee, including recommendations regarding consolidated, group-level stress testing, monitoring of investment activities at the group level to avoid "regulatory arbitrage," consideration of whether ORSA and internal audit function requirements should be expanded, and other items. At the Spring National Meeting, the (E) Committee agreed to make referrals to its working groups and technical groups for consideration of these recommendations, noting that not all such recommendations may be acted upon. Although the (E) Committee has begun the process of responding to at least some of the items identified in the most recent FSAP review, a discussion at the International Relations Committee meeting noted that the FSAP process may be amended going forward to focus on key areas of macroprudential focus.

E. Industry Preparations for Publication of Final Regulations by the U.S. Department of Labor

The Spring National Meeting concluded shortly before publication by the U.S. Department of Labor ("DOL") of its final regulations clarifying the standards for becoming a "fiduciary" of an employee benefit plan under the Employee Retirement Income Security Act of 1974 and an individual retirement account ("IRA") under the Internal Revenue Code of 1986. These final regulations were released on April 6, following more than five years of proposals, meetings, and public testimony. Industry members were anxious to see the final regulations, which have the potential to transform the way financial services firms, including insurance companies, market and sell their products and services to plans and IRAs. For example, under the final definition of "fiduciary," most insurance advisors would be considered fiduciaries and would be required to comply with the Best Interest Contract Exemption (the "BIC Exemption"), which was also released by the DOL on April 6. Among other conditions, the BIC Exemption would require advisers to provide advice that is in the "best interest" of the retirement investor when advising IRAs and small plans. Advisers to these plans and IRAs will need to examine whether their existing compensation structures and practices remain compliant under the final regulations, the BIC Exemption and other exemptions. It was anticipated that insurance trade associations might pursue legal action to block implementation of the rules if they were unhappy with the language of the final regulations. For Willkie's initial response to the final regulations, please read our client alert.

F. Briefly Noted

1. Permitted Practice Update

Shortly prior to the 2015 Fall National Meeting, the Statutory Accounting Principles (E) Working Group ("SAPWG") received a charge from the (E) Committee to "obtain, analyze and review information on permitted practices, prescribed practices, or other accounting treatments suggesting that issues or trends occurring within the industry may threaten the consistency and uniformity of the U.S. solvency framework." The intent of this charge is not to do away with permitted practices, but to provide for a more consistent nationwide approach to statutory accounting. In reviewing this charge, SAPWG has noted that the permitted practice disclosure requirement in SSAP No. 1—which is intended to encompass all permitted and prescribed practices—could be interpreted to require disclosure only where the permitted or prescribed practice results in impact on surplus or on RBC. At the Spring National Meeting, SAPWG adopted revisions to SSAP No. 1, A-205 and the annual statement instructions to clarify that insurance companies should disclose in their financial statements all permitted and prescribed practices (and not only those that result in an impact on surplus or on RBC), as well as identify the line items in the financial statements impacted by such permitted and prescribed practices.

2. NAIC Governance

The NAIC's search for its next CEO is under way in the wake of last October's announcement by Senator Ben Nelson that he would not seek renewal of his contract as CEO of the NAIC. At the Executive Committee Meeting, Louisiana Insurance Commissioner James Donelon made a proposal that the NAIC consider adopting a policy with respect to potential conflicts of interest that could arise from appointment of a CEO who was recently a sitting regulator. His proposal would have limited the applicant pool to those who had not been an insurance regulator for two years. This proposal was not well received, with commissioners expressing dismay that the NAIC might voluntarily limit the pool of applicants for the CEO position. Commissioner Donelon later decided not to pursue this proposal.

3. TRIA – Update on U.S. Department of Treasury Initiatives

At the session of the Terrorism Insurance Implementation (C) Working Group, it was announced that, on April 1, 2016, the Treasury had issued proposed rules to implement changes to the Terrorism Risk Insurance Program ("TRIP"), a federal program that has been reauthorized three times, most recently by the Terrorism Risk Insurance Program Reauthorization Act of 2015 (the "2015 Reauthorization Act"). Each reauthorization of TRIP has modified the program's operational provisions, thereby requiring the Treasury to issue new rules and regulations.

The 2015 Reauthorization Act requires the Treasury to prepare periodic reports regarding the operation and effectiveness of TRIP. The proposed rules establish a data collection process that would allow the Treasury to collect the information it needs from insurers participating in TRIP. In addition, the Treasury has proposed for the first time a civil penalties rule, which was authorized by the Terrorism Risk Insurance Act of 2002 but never utilized by the Treasury. The proposed rules also call for the adoption of the previously proposed rule regarding the final netting of payments for a calendar year, with certain minor changes. Lastly, the Treasury has asked several questions regarding the role of self-insurance arrangements and captive insurers in TRIP, requesting information it can use to formulate a rule in the future. Comments are due on May 31, 2016.

The 2015 Reauthorization Act authorized the formation of the Advisory Committee on Risk-Sharing Mechanisms ("ACRSM"). In its announcement last fall, the Treasury said the purpose of ACRSM is to provide advice and recommendations to the Treasury (through the Federal Insurance Office) "with respect to the creation and development of nongovernmental, private market risk-sharing mechanisms for protection against losses arising from acts of terrorism." ACRSM, which consists of nine members from the insurance industry, held its first meeting in February.

4. **NARAB II – Effort to Streamline Nonresident Insurance Producer Licensing Requirements Moves Forward—Slowly**

At the meeting of the Producer Licensing (EX) Task Force, it was announced that a fifth member has been nominated by the President to serve on the board of directors of the National Association of Registered Agents and Brokers ("NARAB"). Under the federal law governing the establishment of NARAB, NARAB is required to have a 13-member board of directors—each of whom must be nominated by the President and confirmed by the Senate. Each of the five nominated individuals is still subject to Senate confirmation. Until such time as all 13 members of the Board of Directors have been nominated and confirmed, progress in establishment of NARAB and implementation of true insurance producer reciprocity will remain on hold.

5. **Derivatives Model Regulation Unchanged and Remains an NAIC Model**

At the Spring National Meeting, the (E) Committee finalized work on its previously outstanding charge to review the Derivative Instruments Model Regulation (the "Derivatives Model Regulation") and to determine whether the Derivatives Model Regulation should be retained as a model regulation and/or amended. Based on the results of a detailed study conducted by the NAIC Securities Valuation Office, the (E) Committee determined that many of the states with significant U.S. insurer derivatives exposure have adopted the Derivatives Model Regulation, and that no new derivative risks have arisen that would require new or more specialized requirements to be incorporated into the Derivatives Model Regulation. As a result, the (E) Committee voted to keep the Derivatives Model Regulation as a model regulation, with no changes from its current version.

6. **Updated RBC Factors**

The Investment Risk-Based Capital (E) Working Group (the "Investment RBC Working Group") has been considering a proposal by the American Academy of Actuaries to increase the number of NAIC designations for RBC purposes from six to a greater number. At the Spring National Meeting, the Investment RBC Working Group exposed for comment a document entitled "A Way Forward," which, among other things, proposes expanding the number of NAIC credit quality designations for RBC purposes from the current six to 20 with respect to life insurers' assets (these RBC-related designations would be consistent with each asset's bond rating and/or NAIC Securities Valuation Office designation). Consideration will be given to keeping the six-designation RBC system with updated factors for non-life RBC statements. The general purpose of this change is to eliminate the large jumps in the RBC C1 factors and to better align these C1 factors with investment risks, while enabling the more granular set of categories to better track changes in portfolio distributions by not relying on average assumptions. Further, the document proposes increasing the property/casualty and health RBC common stock factors from their current levels of 15% to 19.5% (which would bring these RBC factors in line with the current RBC common stock factor for life companies). The Investment RBC Working Group hopes to have changes in place by year-end 2017.

II. TOPICS OF INTEREST TO THE LIFE INSURANCE INDUSTRY

A. Captive Update

1. Credit for Reinsurance Model Law Changes Adopted by the NAIC; Drafting of XXX/AXXX Model Regulation Still Ongoing

Over the last two years, state insurance regulators and the NAIC have devoted significant energy to reassessing their regulation of captive XXX and AXXX transactions, leading to the adoption of: (a) a new regulatory framework for such transactions, the XXX/AXXX Reinsurance Framework (the "Framework"), and (b) Actuarial Guideline 48 ("AG 48"), an important component of the Framework. The purpose of AG 48 was to implement the substantive requirements of the Framework effective as of January 1, 2015, pending the development and adoption by the states of the new Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees (the "XXX/AXXX Model Regulation").

Earlier this year, after much debate at the Reinsurance Task Force, the Executive (EX) Committee and Plenary adopted the amendments to the Credit for Reinsurance Model Law necessary for the implementation of the XXX/AXXX Model Regulation. These revisions permit state insurance commissioners to implement not only the XXX/AXXX Model Regulation, but also regulations relating to variable annuities with guaranteed death or living benefits, long-term care insurance policies, and other life and health products.

In the meantime, the XXX/AXXX Model Regulation—after an exposure and a comment period—remains pending at the XXX/AXXX Captive Reinsurance Drafting (E) Subgroup. The only aspect of the XXX/AXXX Model Regulation that has been voted on by the Reinsurance Task Force to date (during a conference call held last year) is the penalty for noncompliance with the provisions of the XXX/AXXX Model Regulation—which will be the so-called "All or Nothing" approach, pursuant to which reinsurance credit for a captive transaction will be lost if: (i) the collateral posted for the transaction does not meet the required levels of "Primary Security" (i.e., the types of "hard assets" required to collateralize the portion of the total statutory reserve approximately equal to the principle-based reserving ("PBR") level) and/or the required levels of "Other Security" (i.e., any security acceptable to the insurance commissioner that is required to collateralize any remaining portion of the total statutory reserve); and (ii) such shortfall in Primary Security and/or Other Security is not remediated within a designated time period. This approach is different from the noncompliance penalty in AG 48, which generally provides for a dollar-for-dollar reduction to credit for reinsurance ceded based on the shortfall between the actual level and the required level of posted collateral. At the Spring National Meeting, certain members of the Reinsurance Task Force and industry members urged the Reinsurance Task Force to reconsider the "All or Nothing" approach to the noncompliance penalty, but were met with stern resistance from the representative of the Chair of the Reinsurance Task Force, John Finston of the California Department of Insurance. For now, it appears that the "All or Nothing" noncompliance penalty will remain a key feature of the XXX/AXXX Model Regulation.

The XXX/AXXX Captive Reinsurance Drafting (E) Subgroup will continue its work on revising the XXX/AXXX Model Regulation. It is possible that the XXX/AXXX Model Regulation will become adopted by the NAIC at the 2016 Summer National Meeting.

2. **Accreditation for the XXX/AXXX Model Regulation and the 2016 Credit for Reinsurance Model Law Revisions**

At the meeting of the Accreditation Committee, it was noted that the XXX/AXXX Model Regulation and the Credit for Reinsurance Model Law revisions adopted earlier this year providing authority, among others, to promulgate the XXX/AXXX Model Regulation, are closely related and that, therefore, these two items should be considered for adoption as accreditation standards together—at some point after the XXX/AXXX Model Regulation is finalized and adopted by the NAIC.

B. PBR Update

Early this year, a milestone was reached in the NAIC's project to implement, on a nationwide basis, a principle-based approach to life insurers' reserving methods, when the amendments to the SVL providing for a PBR approach were enacted in three additional states. As a result, as of the time of the Spring National Meeting, 42 states representing over 75% of total U.S. life insurance industry premium had enacted, in some form, the amendments to the SVL.

In order for PBR to become effective as of January 1, 2017 (which is the current target date), no fewer than 42 states representing 75% of total U.S. life insurance industry premium must enact laws "substantially similar" to the amended SVL by July 1, 2016. The only key issue that must be resolved before the NAIC can declare victory in its decade-long effort to adopt PBR is whether each of the 42 states that has enacted the amended SVL to date can be considered to have enacted a law "substantially similar" to the amended SVL.

By way of background, at the 2015 Fall National Meeting, the Principles-Based Reserving Implementation (EX) Task Force (the "PBR Implementation Task Force") adopted the criteria for making a determination whether a state's adoption of the amended SVL should be considered "substantially similar" to the amended SVL. These criteria are being used as "initial guidance" by a group of regulators, which is currently conducting a thorough survey of state enactments of the amended SVL to make this determination. During the meeting of the PBR Implementation Task Force at the Spring National Meeting, this group reported that it is continuing its review, and requested input from the PBR Implementation Task Force with respect to certain unnamed issues that have been identified to date. This discussion was conducted during a regulator-only call shortly after the Spring National Meeting.

While the outcome of the "substantially similar" determination introduces some uncertainty into the timeline for the effective date of PBR, all NAIC PBR-related work streams are proceeding under the tacit assumption that PBR will become effective in January of next year. Further, since the date of the Spring National Meeting, at least one further state

(Washington) enacted the amended SVL, and the SVL amendments were pending in four further states. As a result, we continue to expect that PBR will become effective as of January 1, 2017.

C. Variable Annuities Update

In 2015, the NAIC formed the Variable Annuities Issues Working Group ("VAIWG"), with a charge to study, and provide a recommendation for addressing, variable annuities captives. This initiative stems at least in part from the identification of variable annuity captive transactions as an area of particular concern potentially warranting regulatory attention in the 2014 Financial Stability Oversight Council ("FSOC") Annual Report. Last year, the VAIWG drafted a preliminary framework (the "VA Framework") based on a report by an outside consultant, which proposed revisions to Actuarial Guideline 43; the C3 Phase II component of the life RBC formula; and state laws as well as statutory accounting rules pertaining to hedging activities. Importantly, the changes preliminarily recommended in the VA Framework are subject to the results of a quantitative impact study by the VAIWG's outside consultant, which is currently under way, and which is scheduled to run through July of this year—with the outside consultant tentatively scheduled to report on the results of the quantitative impact study to the VAIWG in September. It is currently unclear whether this timeline will provide sufficient time for the VAIWG to meet its current goal of having all of its work completed by December 31 of this year.

D. Briefly Noted

1. The NAIC's Forthcoming Retirement Security Initiative

NAIC President and Missouri Insurance Director John Huff announced that the NAIC is preparing to launch a "Retirement Security Initiative." The themes of the Retirement Security Initiative will include education, consumer protection and product innovation. With respect to consumer protection, the NAIC will review existing model laws and regulations (and consider adoption of new model laws and regulations) with a focus on practices that might target elderly individuals.

2. New Working Group Formed to Consider Adopting a Longevity Risk RBC Charge or Reserves Adjustment

During the meeting of the Life Risk-Based Capital (E) Working Group (the "Life RBC Working Group"), it was announced that a joint subgroup of the Life RBC Working Group and Life Actuarial (A) Task Force is being formed to consider longevity risk issues. The Life RBC Working Group is considering whether a longevity risk charge should be introduced into the RBC calculation and/or the reserves to account for factors including sizable mortality improvements; an increase in products with considerable longevity risk; other jurisdictions having such charges; and today's low interest rate environment. The newly created joint subgroup will aid this effort by monitoring the activities of the newly created Longevity Risk Task Force established by the American Academy of Actuaries, which is evaluating the current U.S. and international practices for considering longevity risk in reserves and required capital for life and annuity products. The joint subgroup's charges have not yet been finalized.

If you have any questions regarding this memorandum, please contact Leah Campbell (212-728-8217; lcampbell@willkie.com), Michael Groll (212-728-8616; mgroll@willkie.com), Donald Henderson, Jr. (212-728-8262; dhenderson@willkie.com), Allison Tam (212-728-8282; atam@willkie.com) or the Willkie attorney with whom you regularly work.

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