CLIENT MEMORANDUM

NAIC Report: 2016 Summer National Meeting

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The 2016 Summer National Meeting (the "Summer National Meeting") of the National Association of Insurance Commissioners (the "NAIC") was held in San Diego, California on August 25-29, 2016. The highlights included continued discussion of the draft Insurance Data Security Model Law ("Cyber Model Law"), the adoption by the Reinsurance (E) Task Force (the "Reinsurance Task Force") of the Term and Universal Life Insurance Reserve Financing Model Regulation (the "XXX/AXXX Model Regulation"), and NAIC initiatives on "covered agreement" negotiations between the U.S. federal authorities and their EU counterparts.

This report summarizes some of the key activities at the Summer 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.

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I. TOPICS OF GENERAL INTEREST

A. Cybersecurity

1. Cyber Task Force Presses on With Revised Cyber Model Law, Despite Continued Opposition from Interested Parties

The Cybersecurity (EX) Task Force (the "Cyber Task Force") is charged by the NAIC Executive Committee to "consider issues concerning cybersecurity as they pertain to the role of state insurance regulators." Last year, the Cyber Task Force outlined standards and protocols for consumers whose personal information is compromised in the so-called "Roadmap for Cybersecurity Consumer Protections." The NAIC envisioned the Roadmap as a starting point for converting the consumer protections contained therein into a full NAIC Model Law for adoption by the states to provide state insurance regulators authority over the cybersecurity practices of insurance licensees.

The Cyber Task Force accordingly released a draft of the Cyber Model Law in March 2016. As reported in our NAIC Spring 2016 Report, interested parties took serious issue with many features of the original model—especially the risk that the Cyber Model Law, federal law and other state laws would lead to duplicative or inconsistent standards. Following the Spring National Meeting, the Cyber Task Force held a special interim meeting in Washington, D.C. on May 24-25 to hear more comments from interested parties, and released a second draft model on August 17, 2016 in response to comments received. Like the original draft, the Cyber Model Law, as revised, would require insurers, insurance producers and others entities required to be licensed under state insurance laws ("Licensees") to develop and maintain a written information security program and conduct risk assessments; oversee the data security practices of third-party vendors; investigate and notify consumers and regulators of data security breaches; and implement remedial measures following breaches as prescribed by the applicable state insurance commissioner.

Commissioner Adam Hamm (ND), Chair of the Cyber Task Force, stated that it had done its best to address all concerns of interested parties and expressed the hope that the revised Cyber Model Law comes closer to a finished product.

Although the Cyber Task Force only allotted about 10 minutes total for interested parties to address the revised model at the Summer National Meeting, many interested parties sought to be heard and expressed continued "fundamental concerns." In particular, industry representatives believe that the Cyber Model Law does not provide a sufficiently uniform approach to data security and breach notifications and will conflict with or be duplicative of existing regimes (*e.g.*, data breach notification laws currently on the books in 47 states, HIPAA requirements, etc.). In addition, interested parties noted that the Cyber Task Force had eliminated the "harm trigger" for providing consumer and other notices in the case of a data breach and now would require notifications whenever a Licensee determines that an unauthorized acquisition of personal information has occurred, regardless of whether the breach is likely to cause harm to consumers to whom the information relates. It was stated that eliminating the harm trigger will ultimately harm consumers who will be alarmed unnecessarily by breach notifications. Finally, interested parties echoed previous concerns that the Cyber Model Law is

overly broad, vague (*e.g.*, a requirement that Licensees use “state of the art” risk management techniques) and potentially excessively onerous (in particular, the third-party oversight and remediation provisions).

On the positive side, interested parties were pleased that the revised draft: (i) eliminates a requirement that Licensees make certain disclosures to consumers with respect to collected personal information, because such requirement is duplicative of the federal Gramm-Leach Bliley Act and other existing rules; (ii) eliminates a section that would have provided a private right of action for individuals against Licensees who fail to comply with the Cyber Model Law; and (iii) includes language to the effect that the required information security system should be tailored to the size and business of the Licensee. Commissioner Hamm also emphasized that the revised model includes a drafting note stating that the data breach investigation and notice provisions may be duplicative of current state law and that each state should conduct an analysis to determine whether such provisions are necessary. No consumer representatives spoke during the Cyber Task Force meeting, however, and it seems likely that some consumer groups may take issue with the aspects of the revised draft praised by the industry, particularly the elimination of the private right of action.

Interested parties stated that they will continue to oppose the Cyber Model Law, including by opposing it becoming an accreditation standard and working against its passage in state legislatures, if the above concerns are not addressed. The comment period on the revised Cyber Model Law closed on September 16, 2016, and a conference call is expected to be held to discuss further revisions. The NAIC is seeking to adopt the Cyber Model Law by the end of the year—an aggressive timetable in light of the continued opposition by the industry.

2. Cybersecurity Insurance Coverage Updates

The Cyber Task Force heard a report on the Cybersecurity Insurance and Identity Theft Coverage Supplement (the “Supplement”), which was added to the Property and Casualty Annual Statement for 2015 to allow regulators to gather information to better understand the cybersecurity insurance markets. Based on information reported in the Supplement, insurers writing standalone cybersecurity insurance products reported approximately $500 million in direct written premium, and those writing cybersecurity insurance as part of a package policy reported roughly $1.0 billion in premium writings (out of a total $522.4 billion in net written premium reported by property and casualty insurers for 2015). The most common form of cybersecurity insurance is in the form of identity theft coverage. The reported $1.5 billion does not include alien surplus lines insurers, which may write a significant amount of cybersecurity insurance premium, and NAIC staff recommended that the Cyber Task Force take action to require alien insurers to file the Supplement as a condition to being listed on the *Quarterly Listing of Alien Insurers*. NAIC staff noted that estimates about the growth of the cybersecurity insurance market are “all over the place,” with industry sources predicting the market to reach anywhere from $7.5 billion to $1 trillion over the next 5-10 years.

At the federal level, the Cyber Task Force heard a report on the President’s Commission on Enhancing National Cybersecurity, which was founded in February and has issued a request for information on cybersecurity insurance. The NAIC may submit some materials in response to this request. The Commission will deliver a final report to the President

by December 1, 2016. In addition, a piece of legislation has been introduced by Congressman Ed Perlmutter (CO) that would amend the Internal Revenue Code to incentivize businesses to purchase cyber or data breach insurance by providing a tax credit.

3. New York Actions on Cybersecurity

Since late 2015, the New York Department of Financial Services ("NYDFS") has been, separately from the NAIC, considering a potential cybersecurity regulation for those banking and insurance entities under the NYDFS's jurisdiction. On September 13, 2016, the NYDFS released a proposed regulation for a 45-day comment period. The proposed regulation would require any person operating under a license or similar authorization under the New York banking, insurance or financial services law ("covered entities") to establish a cybersecurity program meeting certain core functions, adopt a cybersecurity policy, appoint a Chief Information Security Officer, and oversee the cybersecurity practices of third-party service providers, among other requirements. It remains to be seen how the NYDFS proposal will interact with the NAIC Cyber Model Law.

B. Reinsurance

Last November, 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 Act to negotiate a "covered agreement" with the European Union ("EU"). The principal focus of the negotiations is for the United States and EU to obtain "equivalent" treatment of their insurance/reinsurance industries and to facilitate the exchange of confidential regulatory information, particularly with respect to the coordinated supervision of internationally active insurance groups.

At the Summer National Meeting, the NAIC's International Task Force and Reinsurance Task Force received reports regarding trade barriers imposed against the U.S. insurance industry in certain EU jurisdictions (including, *e.g.*, the United Kingdom, Germany, Poland, and the Netherlands) as a result of Solvency II, which became effective on January 1, 2016. With respect to the United Kingdom, these trade barriers are coupled with the uncertainty facing the U.S. insurance industry as a result of the United Kingdom's impending exit from the EU ("Brexit"). Echoing the industry's concerns, John M. Huff, NAIC President and Missouri Insurance Director, noted that Solvency II has been described as "quite patchy and messy and likely to stay this way for some time to come," and that certain EU jurisdictions have imposed additional, potentially discriminatory requirements on U.S. insurers.

The NAIC and federal authorities are pursuing their own separate paths toward resolving the challenges facing the U.S. insurance industry as a result of Solvency II, Brexit and certain EU countries' discriminatory trade practices. Those approaches are described below.

1. The Federal Solution – Covered Agreement

Following the announcement in November 2015 that covered agreement negotiations had commenced, only very limited information concerning these negotiations has been made public. In February 2016, negotiations of the covered agreement began in Brussels, resulting in a release of a joint statement by the U.S. and EU representatives stating that the sides had 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." These negotiations were followed by further meetings in Washington, D.C. in late May and in Brussels in late July. The joint statement released by the U.S. and EU representatives on July 28, 2016, after the conclusion of their latest meeting, states that the EU and U.S. representatives "exchanged concrete ideas in a constructive atmosphere, and addressed next steps towards completing negotiations [of the covered agreement] in a timely manner."

Separately, we understand that the Federal Insurance Office has reached out to the insurance regulators of certain EU jurisdictions that had imposed trade barriers on the U.S. insurance industry (including, *e.g.*, Germany) in order to advocate for the reduction or the elimination of such trade barriers.

2. The NAIC Solution – Reduced Collateral Initiative; Opposition to Covered Agreement

The NAIC does not favor the implementation of a covered agreement because (i) state laws that afford less protection to non-U.S. insurers than provided by the covered agreement may be preempted and (ii) the NAIC's amended Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation (the "Amended Credit for Reinsurance Models)," which have been adopted by many states, establish a state-based system for recognizing non-U.S. reinsurers, including the recognition of the reinsurer's domiciliary jurisdiction.

It appears that the NAIC has not been given a meaningful opportunity during the EU/U.S. covered agreement negotiations to express this view or to otherwise participate in, or attempt to influence, the covered agreement negotiations. Initially, Treasury and USTR had stated that state insurance regulators would have a "meaningful role" in the negotiations of the covered agreement, and the joint statement issued by the U.S. and EU representatives in February confirmed an intent to seek "meaningful stakeholder consultation and engagement throughout the negotiations." However, according to Director Huff, only a small group of insurance commissioners has been involved as observers in the covered agreement discussions, and these commissioners' ability to gather feedback or consult with their fellow state insurance regulators has been "simply non-existent"—meaning that only a "select few" currently have actual knowledge or insight into the covered agreement negotiations.

As a result, the NAIC is currently pursuing a three-pronged approach designed to ensure that any initiative to reduce collateral for non-U.S. reinsurers assuming business from U.S. cedents remains a state-based solution and that no state insurance laws are preempted by any federally negotiated covered agreement.

First, the NAIC has spearheaded a long-standing effort for adoption by the states of 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 July 2016, a total of 35 states had adopted one or both of the Amended Credit for Reinsurance Models. The remaining U.S. jurisdictions have not adopted the Amended Credit for Reinsurance Models, and many industry members therefore 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. In order to address these concerns, earlier this year, the NAIC began the process of making the Amended Credit for Reinsurance Models a mandatory accreditation standard.

The NAIC's accreditation process 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. As a result, the NAIC is able to use the accreditation process as a mechanism for ensuring the implementation of a model act on a nationwide basis. 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. However, the reduced collateral requirements in the Amended Credit for Reinsurance Models will become a mandatory accreditation standard effective as of January 1, 2019, as voted by the NAIC's Executive (EX) Committee and Plenary ("Executive and Plenary") at the Summer National Meeting.

Second, at the Summer National Meeting, the Financial Condition (E) Committee (the "(E) Committee") adopted the report of the Reinsurance Task Force, including a referral to the Qualified Jurisdiction (E) Working Group (the "Qualified Jurisdiction Working Group") to study and report on the implementation of Solvency II by the current EU member states (including Germany and the United Kingdom) and any potential impact thereof on the "qualified jurisdiction" status of such current EU member states. As noted above, the Amended Credit for Reinsurance Models permit a non-U.S. reinsurer to apply for "certified reinsurer" status only if such reinsurer is domiciled in a "qualified jurisdiction." Effective as of January 1, 2015, the NAIC approved a total of seven jurisdictions—including Germany, the United Kingdom, and three other EU member states—for recognition as qualified jurisdictions. If the "qualified jurisdiction" status of any or all of these EU member states were revoked by the NAIC, non-U.S. reinsurers domiciled in such EU member states and otherwise qualifying as "certified reinsurers" would no longer be eligible to post reduced collateral in connection with assuming business from U.S. cedents. The Qualified Jurisdiction Working Group will hold an open meeting shortly to begin work on this project, which may ultimately result in the revocation of the "qualified jurisdiction" status of those EU jurisdictions that have imposed, or would impose, trade barriers on the U.S. insurance industry.

Third, earlier this year, the (E) Committee received a charge to consider and develop contingency regulatory plans to continue to protect U.S. consumers and U.S. cedents from potential adverse impact resulting from covered agreement negotiations. The suggested methods discussed at the Summer National Meeting include:

- Method 1 – expanding the process for a non-U.S. insurer's qualification as a "certified reinsurer," with the goal of increasing the number of non-U.S. reinsurers qualifying as "certified reinsurers."

- Method 2 – requiring the U.S. cedent to hold added required capital in connection with reinsurance cessions (including, *e.g.*, no additional capital required with respect to cessions to a certified reinsurer, but more onerous capital requirements for cessions to other non-U.S. reinsurers).

- Method 3 – requiring all reinsurers not already subject to "the same laws and regulations as other U.S. insurance companies" to go through a new "certification" process in the U.S. by submitting to the NAIC certain "limited" information (including, *e.g.*, information on the reinsurer's rating and certain basic financial information concerning the reinsurer).

Overall, the NAIC continued to be adamant in its warning to the industry that those who seek a federal solution with respect to matters related to insurance regulation should be careful of what they wish for. At the same time, it appears that the U.S. insurance industry is seeking a solution to the issues that have currently arisen in the EU, but is wary that the NAIC's efforts could instead result in an escalation of hostilities between U.S. and EU insurance regulatory authorities. Only time will tell how this complex set of problems is going to be resolved.

C. Group Capital and Group Supervision

1. International Developments

a. Insurance Capital Standard and ComFrame

At the Summer National Meeting, various NAIC working groups heard updates on the work of the International Association of Insurance Supervisors (the "IAIS"). In 2010, the IAIS started developing the Common Framework for the Supervision of Internationally Active Insurance Groups ("ComFrame"), which is expected to be adopted in 2019. As part of ComFrame, the IAIS has been developing a global insurance capital standard ("ICS") applicable to internationally active insurance groups ("IAIGs"), including those designated as "Global Systemically Important Insurers" ("G-SIIs"). The IAIS still expects to deliver "Version 1.0" of ICS in 2017. Version 1.0 will allow for confidential reporting by IAIGs and enable further refinements leading to "Version 2.0" of the ICS, which is expected to be adopted with ComFrame in 2019. The IAIS has been conducting field testing of ICS this year with IAIG volunteers and in July released a second consultation document to solicit feedback from stakeholders on the proposed ICS before Version 1.0 is released. The NAIC's ComFrame Development and Analysis (G) Working Group ("CDAWG") is planning to convene an open meeting in

Washington, D.C. on September 27, 2016 to gather input and prepare a response to the ICS consultation document. Comments are due on October 25. The IAIS is also planning to release consultation documents on governance, supervisory processes, and resolution topics following committee meetings in November.

It was also reported at the Summer National Meeting that the IAIS is undertaking a restructuring of ComFrame, which is currently structured in three modules, with several "elements" within each module specifying standards that IAIGs and their supervisors should meet. The modules will be eliminated and ComFrame will be incorporated into the IAIS's existing Insurance Core Principles ("ICPs"), which are generally applicable to insurance supervision (not just with respect to IAIGs). Pursuant to the ComFrame restructuring, each ICP will now contain a separate box listing additional elements from ComFrame that are applicable to IAIGs. The IAIS expects this move to reduce duplicative standards between ComFrame and IAIGs and clarify what standards are meant to apply to IAIGs. The re-worked ICPs are expected to be adopted when ComFrame is adopted in 2019.

Since the ICPs serve as the basis for the Financial Sector Assessment Program ("FSAP") of insurance supervisory regimes, interested parties expressed concern that including ComFrame in the ICPs could mean that ComFrame will become part of FSAP standards. Christy Neighbors (NE), Chair of the NAIC's Group Solvency Issues (E) Working Group and member of IAIS working groups, acknowledged a concern about how to ensure that there is no confusion that ComFrame applies to IAIGs, while ICPs apply "to everyone."

b. IAIS Stakeholder Engagement

In response to criticisms about a lack of transparency in IAIS proceedings, the IAIS has opened its 2016 Annual Conference (to be held in Paraguay from November 10-11, 2016) to non-member stakeholders. The conference will, however, be preceded by three days of closed members-only meetings. The IAIS's Stakeholder Engagement Task Force plans to present further recommendations to the IAIS Executive Committee later this year to enhance stakeholder engagement.

2. NAIC Group Capital Calculation Tool

In 2015, CDAWG began to explore the possibility of developing a U.S. insurance group capital calculation tool that could be compatible with the ICS, and ultimately decided to pursue a tool based on a risk-based capital ("RBC") aggregation approach. In February 2016, the Group Capital Calculation (E) Working Group (the "Group Capital WG") was created and charged with constructing a U.S. group capital calculation using such an approach. Since February, the Group Capital WG has been working with NAIC staff to develop an RBC aggregation tool that uses a so-called "inventory" method, which the Group Capital WG expects would present an inventory of all the entities in a group and thus provide a simple method for regulators to aggregate the available capital and the minimum capital in a way that applies to all types of companies regardless of their structure. The Group Capital WG has continued to emphasize that that calculation is a

"tool," not a requirement, and has expressed hope that the tool will generate useful interactions between regulators and companies.

a. Risk-Based Capital Calculation of Non-Insurance Group Members

At the Summer National Meeting, the Group Capital WG voted to expose for comment a questionnaire seeking input from interested parties regarding the application of the inventory method to different types of entities in U.S. insurance groups. In particular, the questionnaire focuses on the treatment of non-insurance entities that are not subject to existing capital requirements. For such entities, the Group Capital WG is considering a flat equity charge of 22.5% that could be applied to the entity's book/adjusted carrying value. Interested parties expressed serious concerns that a flat charge is not risk sensitive. NAIC staff defended the flat equity charge on the grounds that it (i) is similar to the current RBC formula, (ii) is a simple approach requiring minimal additional data, and (iii) fits with the position that "all non-insurance entities should be treated the same no matter where they are owned in the holding company structure." In addition, NAIC staff believes the 22.5% charge is appropriate because most non-insurance affiliates use GAAP accounting, which is less conservative than the statutory accounting principles (SAP) used by insurers. The questionnaire also asks whether a hybrid approach, in which a flat charge is applied at first but more risk-sensitive measures are developed as data on entities is collected over time, would be acceptable to interested parties.

With respect to non-insurance entities that are subject to existing capital requirements (primarily, U.S. banks), the Group Capital WG is considering two options—using the entity's existing capital requirement or applying a flat charge such as 22.5%—and has asked for input on this item as well.

b. Risk-Based Capital Calculation of Non-U.S. Entities

Finally, the questionnaire asks about treatment of non-U.S. insurers in a group; the Group Capital WG is considering the use of "scalars" for these entities—*i.e.*, the multiplication of the local capital requirement by some factor to equate the local requirement to an adjusted required capital level that is comparable to U.S. levels. The Group Capital WG needs time to collect the data necessary to develop scalars for specific countries and it was mentioned that a country's designation as a qualified jurisdiction under the Model Credit for Reinsurance Act or its FSAP reviews could somehow be used as a scalar. An interested party at the meeting said it would be monumental to evaluate all the countries in the world and that FSAP reviews are subjective and may not be useful, and suggested that the Group Capital WG take a simpler approach.

c. Scope of "Group"

In response to comments from several interested parties at the meeting, the Group Capital WG added an item to the questionnaire about the scope of the group for purposes of the group capital tool. Interested parties said that some boundaries should be drawn and that location of entities on a group's organizational chart should be considered because an entity's ownership relationship to an insurer has an impact on the risk to the group's insurers and policyholders. For

example, it may not be appropriate to include non-financial entities that are not directly owned by an insurance company in the group capital calculation. Interested parties noted that answering such questions will be key to how the calculation tool is ultimately constructed, and essentially suggested that it would be a waste of time to comment on the specifics of the inventory method or any other method until scope issues are resolved.

The questionnaire is being exposed for 60 days, with comments due by October 25. Other issues on the Group Capital WG's radar for future analysis and discussion include the approach to U.S. insurers that do not file RBC, U.S. captive insurance companies, and adjustments for prescribed and permitted practices.

3. Financial Stability Oversight Council

Commissioner Hamm (ND) has completed his tenure as the state insurance commissioner representative on the Financial Stability Oversight Council ("FSOC"), the federal body created by the Dodd-Frank Act to monitor the safety and stability of the nation's financial system, including by designating the systemically important financial institutions ("SIFIs") that are subject to consolidated supervision by the Board of Governors of the Federal Reserve System (the "FRB").

Peter Hartt, Director of New Jersey's Insurance Division, was elected by the NAIC to replace Commissioner Hamm for a two-year term. Director Hartt will be a non-voting member on FSOC and serve in an advisory capacity only. (The one voting member of FSOC with insurance expertise, S. Roy Woodall, Jr., has one year left of his six-year term.) In sessions at the Summer National Meeting, Commissioner Hamm urged Director Hartt to continue to press the interests of the NAIC, noting that all FSOC representatives (from banking and other financial agencies) are "incredibly bright," but that "many of them have come to different conclusions" than state insurance regulators, who should be recognized as the experts in insurance regulation. Commissioner Hamm stated that "our conclusion is the correct one" and pressed Director Hartt to "be tenacious" and "keep trying to win hearts and minds on FSOC."

Commissioner Hamm also commented that, with respect to the FSOC's rescission of GE Capital's SIFI status after GE Capital transformed to a captive finance company and exited all third-party financing business, FSOC did not "do any robust analysis" or undertake the "hard work of identifying specific risks to the financial system and whether risks have been mitigated." Commissioner Hamm stated that FSOC needs to do this work so that SIFIs can become de-designated "short of full dismantlement." The NAIC will push to ensure that FSOC does this work.

4. FRB Rulemaking on Prudential and Capital Standards

As reported in our June 6, 2016 Client Memorandum, the FRB has invited public comment on two proposals related to insurance groups over which it has supervisory authority: (i) an Advance Notice of Proposed Rulemaking ("ANPR") regarding group capital requirements for supervised institutions significantly engaged in insurance activities and (ii) a Notice of Proposed Rulemaking ("NPR") to apply enhanced prudential standards to systemically important insurance companies.

The NPR proposes enhanced prudential standards aimed at bolstering enterprise risk management ("ERM"), corporate governance and liquidity risk management measures. Such standards would be applicable to "systemically important insurance companies," defined as enterprises that (i) have been designated by the FSOC as nonbank SIFIs; and (ii) have 40% or more of their total consolidated assets related to insurance activities. The FRB is also seeking comment on this definition itself.

The NAIC submitted a comment letter on August 17, 2016 in response to the NPR, expressing general support for the FRB's proposed use of use of ERM and corporate governance frameworks to assist in supervision of systemically important insurance companies, but cautioning against rigid application of such frameworks not tailored to individual companies. With respect to liquidity risk management measures proposed by the FRB, the NAIC is again generally supportive of assessments of liquidity risks and appropriate contingency plan requirements, but believes some requirements (*e.g.*, daily cash-flow projections) may be excessive and not tailored to the attributes of insurance products. The NAIC is also concerned that the FRB's stress-testing proposal overweighs liquidity risk compared to other risks, which could actually weaken the company's earning capacity and urged the FRB to consider that stress testing is a resource-intensive activity and weigh the costs of stress testing against the benefits. Finally, the NAIC has concerns that the eligible asset categories for the liquidity buffer required to be maintained by systemically important insurers under the NPR are overly stringent. The NAIC encouraged the FRB to leverage the existing state-based system of regulatory reporting and oversight and pointed out the measures taken by state insurance regulators following the 2008 financial crisis to enhance enterprise-wide supervision—*e.g.*, the Enterprise Risk Report ("Form F") and Own Risk and Solvency Assessment ("ORSA").

In a presentation to the Financial Stability (EX) Task Force, an interested party echoed the NAIC's comments, stating that the core principles of enhanced prudential standards around governance and liquidity risk management "make sense" but that the standards require additional tailoring to reflect that insurance companies have different risk profiles than banks.

The ANPR outlines a bifurcated approach to capital standards based on two conceptual capital frameworks: the Building Block Approach ("BBA") and the Consolidated Approach ("CA"). The former would apply to insurance groups that include a bank holding company or a savings and loan holding company ("Depository Groups"); the latter would apply to SIFIs designated for supervision by FSOC. The FRB has proposed two frameworks because it believes that Depository Groups and SIFIs present different risks to the financial system. BBA would build on the existing requirements placed on insurance affiliates of the Depository Group by their insurance regulators, while CA would be a consolidated approach based on risk categories applied to assets and liabilities across the holding company system.

At the Financial Stability (EX) Task Force meeting, an interested party voiced concerns about the bifurcated approach, stating that the BBA is more appropriate for all groups subject to FRB jurisdiction and that BBA can accomplish all of the FRB's objectives. Another interested party expressed concerns about possible spillover effects if the FRB's standards become considered industry best practice over time, even for non-SIFIs, and influence state regulators and insurance

rating agencies. The deadline for comments to be submitted on the ANPR was extended from August to September 16, 2016 and we will continue to monitor developments on this topic.

D. Infrastructure Investments

During the Summer National Meeting, the NAIC Valuation of Securities (E) Task Force (the "VOSTF") held an initial exploratory session to discuss the role that insurance companies could play in addressing the growing need for investment in infrastructure projects in the United States. Several policy-driven bodies, including the U.S. Bipartisan Policy Center and the Organization of Economic Cooperation and Development, have recently discussed this growing need for infrastructure investments, and it appears that the insurance industry—and particularly the life insurance industry, given the long-term duration of its liabilities—could be one suitable source of capital for infrastructure investments.

The VOSTF is leading an exploratory effort this year to identify impediments to the participation of insurance companies in these projects and to propose possible solutions. The VOSTF's initial exploratory session at the Summer National Meeting included a useful initial discussion concerning this topic. The NAIC has initially taken a cautious stance concerning insurance company participation in infrastructure investments, with Director Huff emphasizing that the NAIC's actions with respect to this project should not provide improper incentives to insurance companies to make investment decisions that are not sound from an investment perspective or are not financially prudent.

E. Form F Assessment Project

In May 2016, the Group Solvency Issues (E) Working Group ("GSIWG") sent a survey to all state insurance departments to solicit feedback on the Enterprise Risk Report (Form F) reporting process. Thirty-six states responded, and the GSIWG discussed the results of the survey at the Summer National Meeting.

1. Effectiveness of Form F

Only three states said that the Form F reporting process is "effective" or "very effective." Twenty-one states said that the Form F is "somewhat effective," and 10 said it is "ineffective." Two states have not yet received any Form F filings. The reasons for such limited effectiveness, according to an NAIC memorandum summarizing the survey results, included that many filers simply answer "no changes" or "none" in response to the topics listed in the Form F and indicate that no enterprise risks have been identified; many filers do not provide information on non-insurance enterprise risks—filings are often presented at the insurer level as opposed to addressing all enterprise risks at the ultimate controlling person ("UCP") level; many filers appear to treat the Form F as merely a compliance requirement to be completed rather than a tool to communicate important information on risk exposure; many filers limit their filing to referencing publicly available information (*e.g.*, SEC filings); some filers provide only a list of generic risks without providing detail regarding their specific exposures; and the Form F does not require reporting on the group's ERM processes. Some states commented

that initial filings provided limited value but have improved to some extent, in part as a result of pressure from regulators on companies to provide additional information.

2. Suggestions for Improvement to Form F

To increase the value of Form F reporting, some states suggested that the definition of "enterprise risk" that must be reported on Form F be amended to clarify that all activities of the UCP (including non-insurance activities) can be enterprise risks, or otherwise expanding the definition to reduce the likelihood that companies underreport risks. Many states recommended providing additional guidance or instructions to industry, *e.g.*, an NAIC guidance manual. Finally, some states suggested that insurers required to file ORSA Summary Reports should be exempted from filing the Form F, since many of the items in Form F may be addressed in the ORSA, and in greater detail. Most states reported that ORSAs have provided much more information and detail on individual risks than the Form F, and are generally more valuable. However, several states indicated that neither Forms F nor ORSA have provided a detailed assessment of non-insurance risks.

3. Next Steps

GSIWG members were in agreement that the Insurance Holding Company System Model Act and Model Regulation should not be reopened to, *e.g.*, amend the definition of enterprise risk or exempt ORSA filers from the Form F. The GSIWG felt that it would be premature to reopen the Models at this point, but would consider making adjustments to filing requirements in the future depending on how the Form F reporting process develops. In the meantime, the GSIWG will work on creating some guidance materials as requested by many of the survey responders. Such guidance may be in the form of bullet points identifying issues regulators have seen with Forms F and recommendations on how to correct problems. It was noted that the guidance may be beneficial, not only for industry but for regulators reviewing Form F filings.

F. Briefly Noted

1. Big Data

The NAIC has established the Big Data (D) Working Group ("Big Data Working Group"), with the goal to explore insurers' use of big data for claims, marketing, underwriting and pricing, as well as to explore potential opportunities for regulatory use of big data to improve efficiency and effectiveness of market regulation. It is currently expected that the Big Data Working Group will initially focus on the insurers' use of big data in rating and underwriting, and on transparency regarding insurers' use of big data in claims. As an initial step, the Big Data Working Group is currently exploring the establishment of work streams for this project. The Big Data Working Group has a charge to make a recommendation with respect to next year's charges to the Market Regulation and Consumer Affairs (D) Committee to address the recommendations

identified via the Big Data Working Group's exploratory effort this year. We will continue to monitor the Big Data Working Group's activities and any potential recommendations stemming from this project.

One potential example of use of big data in the insurance industry is accelerated underwriting of life insurance and annuities, which generally permits certain customers to qualify for coverage without additional medical examinations or lab testing, based on certain underwriting criteria. During the meeting of the Life Insurance and Annuities (A) Committee, it was briefly noted that accelerated underwriting is a big data application and that, consequently, the utilization of big data concerns not only the property and casualty insurance industry, but also the life insurance industry.

2. Factored Structured Settlements

At the Summer National Meeting, the Receivership and Insolvency (E) Task Force adopted revisions to the Life and Health Insurance Guaranty Association Model Act (Model #520) to clarify that factored structured settlement annuity benefits (*i.e.*, structured settlements that have been sold by the original beneficiary to a third party) are not eligible for state guaranty association coverage. Interested parties were in support of this revision, expressing the view that the state guaranty system is not intended to provide coverage to sophisticated private investors or factoring companies that purchase structured settlement annuity payments in order to make a profit.

3. NARAB II Update

In early 2015, the National Association of Registered Agents and Brokers Reform Act of 2015 ("NARAB II") was enacted and signed into law. This federal act is intended to aid the implementation of streamlined producer licensing requirements on a nationwide basis. NARAB II requires the President to nominate, and the U.S. Senate to confirm, 13 individuals who will serve as the board of directors of the National Association of Registered Agents and Brokers ("NARAB"). Between January and May of this year, President Obama nominated Raymond Farmer, South Carolina Department of Insurance Director; Mike Rothman, Minnesota Department of Commerce Commissioner; Marguerite Salazar, Colorado Insurance Commissioner; along with four insurance industry executives, to serve on the board of NARAB. In July, President Obama nominated Director Huff, Lori Wing-Heier, Alaska Division of Insurance Director, and a further industry representative to serve as directors of NARAB. As a result, 10 of 13 NARAB board members have now been nominated. Each of the nominated individuals is still subject to U.S. Senate confirmation. Until such time as all 13 members of the NARAB board of directors have been nominated and confirmed, progress in establishment of NARAB and implementation of true insurance producer reciprocity will remain on hold.

II. TOPICS OF INTEREST TO THE LIFE INSURANCE INDUSTRY

A. XXX/AXXX Model Regulation

Over the last several 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 XXX/AXXX Model Regulation.

Earlier this year, after much debate at the Reinsurance Task Force, the Executive and Plenary adopted the amendments to the NAIC Credit for Reinsurance Model Law ("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.

At the Summer National Meeting, after several months of deliberations and discussions, the Reinsurance Task Force adopted the XXX/AXXX Model Regulation. Some of the highlights of the adopted XXX/AXXX Model Regulation are as follows:

- Consequence Option. Last year, the Reinsurance Task Force voted to include an "All or Nothing" noncompliance penalty in the XXX/AXXX Model Regulation, pursuant to which all credit for reinsurance ceded to the captive would be lost if: (i) the collateral posted for the transaction did 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 were not remediated within a designated time period.

  The adopted XXX/AXXX Model Regulation does not include the "All or Nothing" noncompliance penalty. Instead, the noncompliance penalty provision in the adopted XXX/AXXX Model Regulation states that if the collateral requirements of the XXX/AXXX Model Regulation are not followed, and if such noncompliance is not remediated within a designated time period, then the ceding insurer will be required to establish a liability equal to the excess of the credit for reinsurance taken for the transaction over the actually posted amount of Primary Security. In effect, this permits the ceding insurer to always take credit for reinsurance equal to the amount of the actually posted Primary Security—even if there is a shortfall in the actually posted amount of Primary Security and/or the actually posted amount of Other Security.

- Quarterly Analysis Requirement. In contrast to the previous draft of the XXX/AXXX Model Regulation, which required the analysis of collateral underlying each captive treaty to be performed annually, the adopted XXX/AXXX Model Regulation requires such analysis to be performed prior to the due date of each quarterly or annual statement.

- Ongoing Requirement to Cure Known Deficiencies in Collateral. The adopted XXX/AXXX Model Regulation includes a new express requirement that a ceding insurer that becomes aware at any time that a deficiency in Primary Security or Other Security exists with respect to a captive reinsurance arrangement must use its best efforts to arrange for the deficiency to be eliminated as expeditiously as possible.

- Recognition of Permitted Practices for Remediation. The adopted XXX/AXXX Model Regulation includes a footnote expressly recognizing that the insurance commissioner, under limited and extraordinary circumstances and for good cause shown, may grant a disclosed permitted practice by extending the time period to remediate the deficiency in Primary Security or Other Security or by permitting recapture of the ceded business as an alternative form of remediation.

- Expansion of Scope of XXX/AXXX Model Regulation. Pursuant to a recommendation from the Life Actuarial (A) Task Force ("LATF"), the XXX/AXXX Model Regulation includes in its scope certain policies that were not within the scope of AG 48, including attained-age-based yearly renewable term life insurance policies that satisfy the criteria for exemption in Section 6.F. of the Valuation of Life Insurance Policies Model Regulation ("Regulation 830"); certain renewable term life insurance policies that satisfy the criteria for exemption in Section 6.G of Regulation 830; and yearly renewable term reinsurance that satisfies the criteria for exemption in Section 6.E of Regulation 830. Such policies would fall within the scope of the XXX/AXXX Model Regulation only when issued at a time when the ceding insurer has begun to apply the PBR provisions of VM-20 to establish the ceded policies' statutory reserves.

It is expected that the Financial Condition (E) Committee, which is the parent committee of the Reinsurance Task Force, will consider the adoption of the XXX/AXXX Model Regulation during an interim conference call, with the goal of the XXX/AXXX Model Regulation being adopted by the Executive and Plenary before the end of the year.

After the XXX/AXXX Model Regulation is adopted by the Executive and Plenary, it is also expected that the Financial Regulation Standards and Accreditation (F) Committee will consider the adoption as accreditation standards of both 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. For now, it appears that this accreditation project will be completed at some point next year.

In the meantime, states have slowly begun to adopt the above-referenced revisions to the Credit for Reinsurance Model Law. According to the NAIC, as of late June 2016, only two states had adopted these revisions.

B. PBR Update

With PBR scheduled to become effective as of January 1, 2017, a multifaceted effort is underway at the NAIC to ensure a smooth transition for the industry to the new PBR regime. To that end, several technical projects have recently been, or are close to being, completed—including adoption by the Statutory Accounting Principles (E) Working Group ("SAPWG") of updates to the change in valuation basis guidance in *SSAP No. 51—Life Contracts* to reflect PBR, and adoption by LATF of a number of amendments to the Valuation Manual.

In the meantime, more and more states are adopting amendments to the NAIC Model Standard Valuation Law (the "SVL") that provide for PBR. During the Summer National Meeting, it was reported that 46 states representing approximately 85.7% of total U.S. life insurance industry premium have now enacted the amended SVL, and that bills proposing to enact the amended SVL were pending in two further states (*i.e.*, Massachusetts and Wyoming). Separately, the NYDFS—which has for years been the most vocal critic of PBR at the NAIC and elsewhere—issued a press release earlier this summer announcing that New York will adopt PBR for its regulated life insurers, beginning in January 2018. At the same time, the NYDFS has established a working group comprising industry and consumer representatives that will provide input to the NYDFS on the "appropriate reserving safeguards," including a "minimum reserve floor for all products sold to consumers, regardless of company experience." At the same time, the NYDFS has also promised to engage with the NAIC in order to "properly calibrate [PBR] components to safeguard industry solvency" and ensure regulatory uniformity with respect to PBR across the United States. We will continue to closely monitor these efforts by the NYDFS.

While it has been clear for some time that the NAIC intends PBR to become an accreditation standard, the precise accreditation requirements with respect to PBR have not yet been developed. It is currently expected that the Financial Regulation Standards and Accreditation (F) Committee will receive from LATF and expose a proposal regarding accreditation requirements for PBR either later this year or in early 2017. The current expectation is that the accreditation standard will become effective as of January 1, 2020—which will coincide with the end of the three-year phase-in period for PBR.

C. Variable Annuities Update

In 2015, the NAIC formed the Variable Annuities Issues (E) 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 FSOC Annual Report. Last year, the VAIWG drafted a preliminary framework proposing revisions to Actuarial Guideline 43 and the C3 Phase II component of the life RBC formula, as well as recommending that revisions to statutory accounting rules be considered with respect to hedge accounting treatment for designated derivative instruments hedging interest rate risk in variable annuities portfolios.

In order to assess the efficacy of the VAIWG's proposal, the VAIWG engaged an outside consultant to conduct a quantitative impact study ("QIS") with selected variable annuities writers. The outside consultant finished the QIS in July of this year, and reported its initial findings to the VAIWG in late August. While the outside consultant's proposal recommends that a second phase of the QIS be conducted in order to perform testing to inform the proper setting and fine-tuning of certain parameters of its proposal, it is sufficiently clear at this point that the outside consultant's work will eventually result in the VAIWG considering revisions to the capital and reserving standards for variable annuities set forth in Actuarial Guideline 43 and C3 Phase II.

While the VAIWG's initial goal was to complete all of its work this year, it has now become clear that more time will be needed for the VAIWG and its parent committees to consider and fully vet the outside consultant's recommendations. As a result, it was reported during the Summer National Meeting that it is now expected that the VAIWG will complete its work at some point next year, with the goal of its work product becoming effective as of January 1, 2018. In the meantime, the outside consultant's report on the QIS and current recommendations to the VAIWG based on the results of the QIS are exposed for comment on the VAIWG's website until November 14, 2016.

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