

CLIENT MEMORANDUM

NAIC Report: 2015 Fall National Meeting

December 14, 2015

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The 2015 Fall National Meeting (the “Fall National Meeting”) of the National Association of Insurance Commissioners (“NAIC”) was held in National Harbor, Maryland on November 18-22, 2015.

The highlights included the announcement that the U.S. Department of the Treasury and the European Union are working on a covered agreement that could preempt state laws on reinsurance. This report summarizes some of the key activities at the Fall 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.

Executive officers of the NAIC for the calendar year 2016 were elected. The following regulators will serve in those roles:

- **President:** Missouri Insurance Director John M. Huff
- **President-Elect:** Kentucky Insurance Commissioner Sharon P. Clark
- **Vice President:** Wisconsin Insurance Commissioner Ted Nickel
- **Secretary-Treasurer:** Tennessee Insurance Commissioner Julie Mix McPeak

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The NAIC also recognized the contributions of Senator Ben Nelson, who will be departing as NAIC CEO on January 31, 2016; Joseph Torti III, who is retiring as Superintendent of the Rhode Island Department of Insurance; and Mr. Steve Johnson, who is retiring as Deputy Insurance Commissioner from the Pennsylvania Insurance Department. A successor to Senator Nelson has not yet been identified.

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TOPICS OF GENERAL INTEREST

A. Group Supervision Initiatives – United States

Accreditation Update on HCA Amendments

At the end of 2014, the NAIC adopted amendments to the Insurance Holding Company System Regulatory Act (the “HCA Amendments”), which focused primarily on U.S. regulators’ authority to lead or participate in the group-wide supervision of international insurance groups. At the Fall National Meeting, the Executive (EX) Committee and Plenary (“Executive and Plenary”) voted to expose the HCA Amendments for a one-year comment period for consideration as an accreditation standard. As of November 17, 2015, the NAIC reported that 10 states have adopted the HCA Amendments.

Executive and Plenary also voted to expose the Corporate Governance Annual Disclosure Model Act and Corporate Governance Annual Disclosure Model Regulation (the “Corporate Governance Model”) for a one-year period for consideration as an accreditation standard. As of November 17, 2015, the NAIC reported that only five states have adopted the Corporate Governance Model.

B. Group Supervision Initiatives – International

ComFrame Field Testing Update

The two main areas of work currently underway by the IAIS with respect to its Common Framework for the Supervision of Internationally Active Insurance Groups (“ComFrame”) are field testing and development of group capital standards.

It was reported at the ComFrame Development and Analysis (G) Working Group (“CDAWG”) meeting that the second round of quantitative field testing began in the spring and ended in September 2015. The quantitative field testing analysis team has met several times, but it is too early for the IAIS to draw any conclusions as to quantitative data submissions. Some of the key issues going into 2016 include valuation, capital resources (including treatment of surplus notes and senior debt), calibration levels, and aggregation of risk charges. Field testing has also been conducted on governance requirements. Key findings from the governance field testing were communicated to the IAIS for discussion and resolution, including the need for enhanced clarity in parts of the ComFrame text.

G-SII Update

On November 3, 2015, the Financial Stability Board (“FSB”), in consultation with the IAIS, identified a list of nine global systemically important insurers (“G-SIIs”). The list was the result of the FSB’s third annual assessment and

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differed from the previous years' lists by removing Italy-based insurer Assicurazioni Generali SpA and adding life insurer Aegon NV. The current G-SII list also includes American International Group, Inc., Metropolitan Life Insurance Co. Inc., Prudential Financial Inc., Prudential plc, Allianz SE, Aviva plc, AXA S.A., and Ping An Insurance Company of China Ltd. The FSB postponed a decision regarding the G-SII status of major reinsurers pending further refinement of the G-SII assessment methodology.

It was reported at the Fall National Meeting that the IAIS is working on two projects related to G-SIIs—an update to the G-SII assessment methodology and a review of non-traditional non-insurance activities conducted by insurers.

C. Group Capital Initiatives – United States

NAIC Group Capital Calculation

Since last year, CDAWG has been evaluating insurance group capital standards in the United States and working on developing regulatory tools for group capital assessment and oversight for U.S.-based insurance groups.

CDAWG considered several possible approaches to group capital assessment and ultimately recommended an approach based on risk-based capital (“RBC”) aggregation, which calculates group capital as the sum of existing regulatory capital calculations for all entities within the holding company system (including, for example, RBC for U.S. insurers and Basel capital requirements for banking entities). CDAWG rejected other possible approaches, such as (i) an approach that would have established consolidating Statutory Accounting Principles (“SAP”) rules for all entities in an insurance holding company system and would require use of consolidated SAP financial statements in the RBC formula, and (ii) an approach that would have used existing generally accepted accounting principles (“GAAP”) consolidated financial statement results in an adjusted RBC formula. The RBC aggregation approach was considered to have the least impact on industry and regulators because it is most similar to, or compatible with, U.S. RBC.

At the Fall National Meeting, the NAIC Executive Committee adopted the recommendation of CDAWG and the following charge for the Financial Condition (E) Committee (the “(E) Committee”): “Construct a U.S. group capital calculation using an RBC aggregation methodology; liaise as necessary with [CDAWG] on international capital developments and consider group capital developments by the Federal Reserve Board, both of which may help inform the construction of a U.S. group capital calculation.”

Commissioner Kevin McCarty (FL) said that the group capital calculation, once established by the (E) Committee, will serve as a tool to complement the work regulators do on an individual entity level and will be a valuable solvency enhancement. He emphasized that it is not intended to be a capital requirement or standard and noted that the NAIC will make an effort to coordinate with the IAIS’s development of a global capital standard that is inclusive of the U.S. system.

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Federal Reserve Board

The Financial Stability (EX) Task Force heard a report from Tom Sullivan, a senior advisor for insurance to the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the Federal Reserve Board is responsible for the consolidated supervision of U.S. Systemically Important Financial Institutions (“SIFIs”) as well as insurance groups that include federally chartered thrifts or banks. Mr. Sullivan stated that the role of the Federal Reserve Board is to “supplement existing legal entity supervision.”

At the international level, the Federal Reserve Board joined the IAIS in 2013 (and recently joined the IAIS executive committee) and will continue to be engaged in the development of consistent global regulatory standards.

On the domestic front, Mr. Sullivan spoke positively about the Federal Reserve Board’s collaborations with state insurance departments and other supervisors, including meetings with state regulators to discuss their views on insurers’ ORSA submissions. Mr. Sullivan stated that the Federal Reserve Board has an “ambitious domestic agenda that will hopefully align with our international work.” The first priority item is to launch a domestic capital regime for the insurance companies that come under the Federal Reserve Board’s supervision pursuant to Dodd-Frank. The Federal Reserve Board has been “in the laboratory” working on this and expects to come out with a proposed rulemaking “soon.” When asked about any areas where he might expect to see conflict between state-based insurance regulation and the proposed rulemaking, Mr. Sullivan said that the Federal Reserve Board has been highly deferential to the work of the states.

D. Group Capital Initiatives – International

Update on IAIS Group Capital Developments

Director Peter Hartt (NJ) gave CDAWG an update on the following group capital standards being developed with ComFrame: (i) Basic Capital Requirements (“BCR”), which was approved by the IAIS and the G-20 last year, and is scheduled to go into effect for G-SIIs in 2019; (ii) Higher Loss Absorbency (“HLA”), which is scheduled to go into effect for G-SIIs in 2019; and (iii) the global Insurance Capital Standard (“ICS”), which will someday replace BCR as the base group capital standard applicable to all internationally active insurance groups.

On October 5, the IAIS released an initial methodology for HLA, which is expected to be approved by the G-20 before year end. In 2016, HLA will be reported on a confidential basis and will be shared with the IAIS for purposes of approving a final HLA. BCR reporting began this year. HLA is expected to become effective in 2019, and the IAIS will consider refinements in the interim, especially in connection with revisions to the G-SII assessment methodology.

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With respect to ICS, Commissioner Julie Mix McPeak (TN) reported that the first round of ICS field testing, which took place in 2015, will culminate in the release of a second ICS consultation document and a second round of field testing in mid-2016.

E. FSAP Assignment Plan

The Financial Sector Assessment Program (“FSAP”) of the United States was completed by the International Monetary Fund earlier this year. The 2015 FSAP recognized improvements since the last U.S. FSAP in 2010 with respect to compliance with the Insurance Core Principles promulgated by the International Association of Insurance Supervisors (“IAIS”). However, the following areas were noted as needing, or continuing to need, improvement: (i) objectives, powers and responsibilities of supervisors, (ii) supervisors’ independence, accountability, and resources, (iii) corporate governance, (iv) valuation, and (v) group-wide supervision.

On a November 3rd conference call, the International Insurance Relations (G) Committee adopted a plan to assign some of the recommendations of the 2015 FSAP to certain NAIC sub-groups for consideration (the “FSAP Assignment Plan”). On that call, the Committee noted that (i) some of the recommendations are already being addressed by current NAIC work streams (such as the NAIC’s effort to make the Corporate Governance Model an accreditation standard); (ii) the NAIC disagrees with some of the recommendations in their entirety (for example, the NAIC strongly disagrees with the recommendation that a federal insurance regulatory body with nationwide oversight authority be created); and (iii) some of the recommendations require further consideration. The recommendations in the third category are outlined in the FSAP Assignment Plan and raise issues that include insurers’ own risk and solvency assessments (“ORSA”), stress testing, examinations, investment monitoring, and information sharing. The Committee emphasized that it is not a foregone conclusion that the recommendations in the third category will be adopted by the NAIC, but rather that these will each be taken up and considered on its merits by the appropriate NAIC subgroup.

F. Reinsurance Update

U.S. Federal Authorities to Negotiate Covered Agreement with EU

While state insurance regulators were meeting at National Harbor, arguably the most important event of the season for the insurance industry was brewing right next door, in Washington, DC. The third day of the Fall National Meeting brought news that the U.S. Department of the Treasury (“Treasury”) and the Office of the U.S. Trade Representative (“USTR”) intend to exercise their authority under the Dodd-Frank Act to negotiate a covered agreement with the European Union (“EU”) to address the following five areas:

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- Obtaining “equivalent” treatment of the U.S. insurance regulatory system by the EU under Solvency II, effective as of January 1, 2016, so as to allow for a level playing field for U.S. insurers and reinsurers operating in the EU;
- 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);
- Facilitating the exchange of confidential regulatory information between lead supervisors across national borders;
- Affording nationally uniform treatment in the United States of reinsurers based in the EU, including with respect to reinsurance collateral requirements; and
- Obtaining permanent equivalent treatment for the solvency regime in the United States applicable to insurance and reinsurance undertakings.

State insurance regulators have historically opposed the concept of covered agreements negotiated by the federal authorities, since such covered agreements would operate to transfer some of the regulatory supervisory authority over the insurance sector from state insurance regulators to the federal government. As a result, we expect that state insurance regulators and the NAIC will almost certainly oppose the covered agreement with the EU. For now, state insurance regulators have been promised a “meaningful role” in the negotiations of the covered agreement. Time will tell what this “meaningful role” could entail.

According to Michael McRaith, director of the Federal Insurance Office, if negotiations with the EU are successful, Treasury and the USTR may also pursue covered agreement negotiations on similar or identical insurance and reinsurance topics with other non-U.S. jurisdictions soon thereafter. Our client memorandum discussing the negotiations with the EU in more detail may be found [here](#).

Too Little, Too Late? – NAIC Moves to Make the Credit for Reinsurance Models 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 four-year 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 November 17, 2015, a total of 32 states had adopted the Amended Credit for Reinsurance Models. As previously reported by the Reinsurance (E) Task Force (the

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“Reinsurance Task Force”), these states represent approximately 66% of insurance premium written in the United States. As a consequence, the Financial Regulation Standards and Accreditation (F) Committee commenced a process intended to result in the Models becoming an accreditation standard.

Briefly Noted – Other NAIC Reinsurance Developments

The Qualified Jurisdictions Working Group reported that no new foreign jurisdictions have applied to be granted the status of a “qualified jurisdiction” for the purpose of the Amended Credit for Reinsurance Models. As a result, as of year-end 2015, the list of qualified jurisdictions will be the same as it was as of year-end 2014, and will include only the following jurisdictions: Bermuda, Germany, France, Ireland, Japan, Switzerland, and the United Kingdom.

The Valuation of Securities (E) Task Force exposed the Standard Valuation Office’s proposal to permit the addition of non-bank financial institutions to the NAIC bank list utilized for reinsurance collateral purposes.

G. Cybersecurity

Cybersecurity Bill of Rights

The Cybersecurity (EX) Task Force (the “Cybersecurity Task Force”) exposed the Cybersecurity Bill of Rights (the “Bill of Rights”) for comment at the NAIC’s 2015 Summer National Meeting. The Bill of Rights is intended to create standards and protocols for consumers if their personal information is compromised and includes the consumer’s right to know the kinds of information maintained by an insurer, and to receive timely notice of a data breach as well as assistance from the insurer in addressing issues arising from such data breach. Cybersecurity Task Force Chair Commissioner Adam Hamm (ND) has described the Bill of Rights as an “aspirational” document, the major provisions of which the Cybersecurity Task Force plans to incorporate into future model law developments.

The Bill of Rights was adopted on an interim Cybersecurity Task Force conference call in October despite objections from interested parties, who were concerned that the Bill of Rights may confuse consumers since it may lead them to think they are protected in ways in which no protection currently exists, notwithstanding the document’s disclaimer stating that specific rights may vary based on state and federal law.

While the Bill of Rights was not, as was expected, addressed or finally adopted by the Executive Committee at the Fall National Meeting, it is on the agenda for a year-end Executive and Plenary conference call, scheduled for December 17.

New IT Examination Standards

On an interim conference call in September, the IT Examination (E) Working Group adopted changes to the *Financial Condition Examination Handbook* to specifically address cybersecurity within the review of IT general

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controls. The changes are intended to modernize the examination protocols for financial examiners and offer guidance so examiners can determine whether an insurer has significant exposure to cybersecurity risks and assess an insurer's level of controls and processes for managing such risks. In addition, the revisions add questions that are related to cybersecurity issues so that relevant information can be gathered from an insurer's officers and board members. The Cybersecurity Task Force reported that these changes will be included in the 2016 version of the handbook. The IT Examination (E) Working Group has noted that it will be an ongoing chore to update the IT-related guidance in the examiners handbook since the Working Group must be vigilant with respect to cybersecurity.

2016 Charges

At the 2015 Summer National Meeting, the Executive Committee authorized the Cybersecurity Task Force to revise and update existing model laws related to consumer privacy in order to implement the "latest cybersecurity expectations" as well as the National Institute of Standards and Technology ("NIST") Cybersecurity Framework developed by the NIST (an agency of the U.S. Department of Commerce) last year.

It was stated at the 2015 Summer National Meeting that the goal is to develop amendments to the models within a year. Although this item was not discussed at the Cybersecurity Task Force or Executive Committee sessions at the Fall National Meeting, the Executive Committee did adopt 2016 charges for the Cybersecurity Task Force, including a new charge to review the *NAIC Insurance and Privacy Protection Model Act* (#670); the *Privacy of Consumer Financial and Health Information Regulation* (#672); the *Standards for Safeguarding Consumer Information Model Regulation* (#673); and the *Insurance Fraud Prevention Model Act* (#680) and make recommendations to the Executive Committee.

New York Cybersecurity Action

On November 9, Acting New York Department of Financial Services ("NYDFS") Superintendent Anthony Albanese sent a letter to the members of the Financial and Banking Information Infrastructure Committee ("FBIIC") to describe the NYDFS's preliminary views on a potential cybersecurity regulation, and to invite feedback from the FBIIC members. The FBIIC is comprised of various financial regulatory agencies (e.g., the NAIC and the U.S. Securities and Exchange Commission) and its mission is to coordinate efforts to improve the resiliency and security of the financial sector. Superintendent Albanese's letter described policies and procedures that "covered entities" could be required to undertake with respect to information security and data privacy, including taking measures to protect data accessible to third-party service providers, adopting multi-factor authentication procedures, designating a Chief Information Security Officer who would annually report to the NYDFS, conducting annual audits, and immediately notifying the NYDFS of any material cybersecurity incident. The letter stated that such proposals do not represent a complete list of all the components of a potential cybersecurity regulation that the NYDFS is considering.

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Although the NAIC was a recipient of the NYDFS letter, it was not a topic of discussion at the Fall National Meeting and the extent to which the NAIC and other financial regulators will coordinate with the NYDFS remains to be seen.

Federal Legislation

At the Fall National Meeting the Cybersecurity Task Force received an update on federal cybersecurity legislation. Eleven data breach laws have been introduced in the U.S. Senate. In particular, S. 961/H.R. 2205, the Data Security Act of 2015, may be considered by Congress before the end of the year. With respect to covered entities that access, maintain, communicate, or handle sensitive financial or personal information, the bill would create data protection standards and mandate a process for data breach notifications. The NAIC has expressed its opposition to the bill to the bill sponsors.

H. ORSA Accreditation

Since 2013, the Financial Regulation Standards and Accreditation (F) Committee has been working toward the Risk Management and Own Risk Solvency Assessment Model Act (“ORSA Model Act”) becoming an NAIC accreditation standard (the “ORSA Accreditation Proposal”). The ORSA Model Act requires insurers or an insurance group to maintain a risk management framework, regularly perform an ORSA and annually file an ORSA summary report. The ORSA Accreditation Proposal was exposed for comment in 2013 and then again in 2014, and has been delayed due to the industry’s concerns regarding confidentiality.

At the Fall National Meeting, it appeared that the confidentiality concerns have largely been put to rest, with several industry groups speaking in favor of the ORSA Accreditation Proposal. Executive and Plenary adopted the ORSA Accreditation Proposal and the ORSA Model Act will become an accreditation standard on January 1, 2018. Director Huff urged regulators of states that have not yet adopted the ORSA Model Act to work closely with state legislatures to adopt confidentiality language that is as close to the ORSA Model Act as possible. As of November 17, 2015, the NAIC reported that 34 states have adopted the ORSA Model Act.

I. Permitted Practices

During a conference call prior to the Fall National Meeting, the (E) Committee adopted a charge to the Statutory Accounting Principles (E) Working Group 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.” During the (E) Committee’s discussion, it was noted that the intent of this work stream is not to do away with permitted practices, but to provide for a more consistent nationwide approach to statutory accounting.

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J. Briefly Noted

Changes to the Financial Analysis Process

At the direction of the Risk-Focused Surveillance (E) Working Group, NAIC staff is working on reorganizing the Financial Analysis Handbook to address new requirements placed on state financial analysts and examiners in terms of reviewing ORSAs and enterprise risk reports (Forms F). The proposed reorganization would conform to nine “branded risk assessment categories”: credit, legal, liquidity, market, operational, pricing and underwriting, reputational, reserving, and strategic risk assessments. The reorganization is expected to be a “paradigm shift” for analysts. The timing for such a reorganization is yet to be determined.

Corporate Bond Base Factors for Life Companies

In our report of the 2015 Summer National Meeting, we discussed an initiative proposed by the American Academy of Actuaries to increase the number of C1 corporate bond base factors for life insurers in the RBC calculation from six to fourteen. This proposal, which was exposed for comment at the 2015 Summer National Meeting, is intended to eliminate the large jumps between the current bond base factors.

We understand that life insurers currently hold approximately 7% of all U.S. debt securities (an amount equal to approximately \$2.7 trillion). With this in mind, the Investment Risk-Based Capital (E) Working Group (the “Investment RBC Working Group”) has announced that it will examine this item carefully, with the goal of avoiding disruptions to the debt capital markets. No action was taken with respect to this item at the Fall National Meeting and deliberations at the Investment RBC Working Group are ongoing.

Amendments to NAIC Bylaws

Following accusations of failed leadership and dysfunction within the NAIC in late 2013 by then-Connecticut Commissioner Thomas Leonardi, the NAIC created a Governance Review (EX) Task Force (the “Governance Task Force”) to consider and address issues with NAIC corporate governance. At the Fall National Meeting, the Governance Task Force adopted changes to the NAIC bylaws, effective January 1, 2016, following a survey project and a report by a governance review consultant. The bylaw amendments are intended to increase transparency of communications, streamline voting and enhance representation on standing committees. The changes include requiring the Executive Committee to meet monthly, increasing the number of standing committee members from 13 to 15, requiring all NAIC members to complete a conflict of interest disclosure form, codifying existing practices regarding voting by proxy, and reducing the size of the Executive Committee to have only the most recent past president of the NAIC serve as a voting member (as opposed to all past presidents). The changes will likely be finally adopted by Executive and Plenary on a conference call scheduled for December 17.

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In 2016, the Governance Task Force will consider additional issues related to transparency, primarily to evaluate the methods and communications related to decision-making among various organs of the NAIC.

New Travel Insurance Working Group

The Property and Casualty Insurance (C) Committee heard a presentation regarding travel and tourism insurance from the U.S. Travel Insurance Association and the Tourism and Travel Industry Consumer Coalition. It also adopted a new committee charge to appoint a Travel Insurance (C) Working Group to consider development of a model law or guideline to establish appropriate regulatory standards for the travel insurance industry in light of the distinctive nature of travel insurance products.

TOPICS OF INTEREST TO THE LIFE INSURANCE INDUSTRY

A. Captive Update

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 new regulatory framework for such transactions, the XXX/AXXX Reinsurance Framework (the “Framework”) and Actuarial Guideline 48 (“AG 48”). AG-48 is an actuarial guideline that implemented the substantive requirements of the Framework effective as of January 1, 2015, pending the development and adoption by the states of the new Non-Universal Life and Universal Life with Secondary Guarantees Credit for Reinsurance Model Regulation (the “XXX/AXXX Model Regulation”).

The XXX/AXXX Model Regulation was first exposed for comment at the 2015 Summer National Meeting, with an ambitious goal of having the XXX/AXXX Model Regulation finalized by December 31, 2015. Comments received by the NAIC were voluminous, and it is now expected that the XXX/AXXX Model Regulation will not be finalized until the NAIC Spring 2016 National Meeting at the earliest. In the meantime, prior to the Fall National Meeting, the Reinsurance Task Force did take action on one critical aspect of the XXX/AXXX Model Regulation: the noncompliance penalty provision. As decided by a 12-to-8 vote of the Reinsurance Task Force, the XXX/AXXX Model Regulation will incorporate the “All or Nothing” approach to the noncompliance penalty, pursuant to which a cedent would receive no credit for reinsurance in the event of a shortfall in Primary Security assets (*i.e.*, the types of “hard assets” required to collateralize the portion of the total statutory reserve approximately equal to the PBR level) or Other Security assets. The “All or Nothing” approach is not consistent with Actuarial Guideline 48—which, instead, provides for a so-called “Dollar-for-Dollar” approach, pursuant to which credit for reinsurance would be reduced by the amount of shortfall in Primary Security assets, while giving full credit for Other Security assets.

A parallel drafting effort at the NAIC involves amending the Credit for Reinsurance Model Law so as to give authority to state insurance regulators to promulgate the XXX/AXXX Model Regulation. On December 9, 2015,

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after lengthy deliberations with numerous versions of the Credit for Reinsurance Model Law revisions exposed for comment, the Reinsurance Task Force voted to expose for comment a version of the revised Credit for Reinsurance Model Law that would grant to state insurance regulators the authority to promulgate the XXX/AXXX Model Regulation, as well as other regulations relating to credit for reinsurance of variable annuities, long-term care products, and such other insurance and annuity products as to which the NAIC may adopt model regulatory requirements making reference to the Credit for Reinsurance Model Law. In addition, the exposure will include a so-called “professional reinsurer” exemption, clarifying that the authority granted to state insurance regulators will not apply to cessions to a reinsurer that either qualifies as a certified reinsurer in certain states, or is licensed and/or accredited in a relatively large number of states and meets certain minimum capital and surplus requirements. Following the exposure period, this amendment will need to be adopted by Executive and Plenary, at which point states can begin the legislative process of enacting the amendment. Even though the NAIC’s original goal was to have the Credit for Reinsurance Model Law revisions adopted by the 2015 year-end, it now appears likely that adoption of these revisions will be delayed until early 2016.

B. PBR Update

For over a decade, the NAIC has been working on developing a principle-based approach to life insurers’ reserving methods, in which actuarial judgment and the risks faced by a life insurer would have greater weight on that insurer’s reserves than the current formulaic approach. The implementation of principle-based reserving (“PBR”), the result of these efforts, now appears to be mere months away. It was reported during the Fall National Meeting that 39 states have now enacted the amendments to the NAIC Model Standard Valuation Law (the “SVL”), and that the amendments were under consideration in one further state. These 40 states represent 75% or more of total industry premium volume. As a reminder, 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 the total industry must enact laws “substantially similar” to the amended SVL by July 1, 2016.

At the Fall National Meeting, with only seven months remaining until July 1, 2016, the PBR Implementation Task Force voted to adopt the criteria for consideration as to whether a state’s adoption of the amended SVL should be considered “substantially similar” to the amended SVL. Given the tight deadline, it is perhaps unsurprising that these criteria were further relaxed in comparison to the draft list of such criteria that was discussed during the 2015 Summer National Meeting. In addition, the finalized list of criteria has been amended to note that the criteria will be used only as “initial guidance” to be considered by the PBR Implementation Task Force in making its determination. As a next step, a survey of state adoptions of the amended SVL will be presented to the PBR Implementation Task Force at the NAIC Spring National Meeting—only a few months from the key July 1, 2016 adoption date.

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C. Variable Annuities

With its XXX/AXXX captive project nearly completed, the NAIC has now turned its attention to variable annuities captive transactions. The Financial Stability Oversight Council (“FSOC”) identified in its 2014 Annual Report variable annuity and long-term care captive transactions as areas of particular concern potentially warranting regulatory attention. The NAIC responded earlier this year by forming the new Variable Annuities Issues Working Group (“VAIWG”) to study, and provide a recommendation for addressing, variable annuities captives. The VAIWG has drafted a preliminary framework (the “VA Framework”) based on a report by an outside consultant, which currently proposes 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. In addition, the VA Framework is intended to make changes that will apply retrospectively, and recommends that once the revisions recommended by the VA Framework are effective, domestic regulators of insurers ceding variable annuities business to captives should request that such business be recaptured and the captives be subsequently dissolved. These recommendations are subject to the results of a quantitative impact study, which will be conducted by the VAIWG’s outside consultant during 2016. The VAIWG has set an aggressive timeline of having all of its work completed by December 31, 2016. The VAIWG’s efforts could potentially meet with opposition from the NYDFS—particularly if the finalized VA Framework results in the elimination of the C3 Phase II standard scenario—which we understand the NYDFS considers a necessary objective floor.

D. Unclaimed Life Insurance Benefits

The Unclaimed Benefits Model Drafting (A) Subgroup (the “Unclaimed Benefits Subgroup”) was formed following the Spring National Meeting to develop a new NAIC model law to address the issue of unclaimed death benefits. The Unclaimed Benefits Subgroup did not meet at the Fall National Meeting but has been meeting regularly by conference call and on November 16 exposed a draft model for comment for 30 days. The draft model is based on a combination of two proposals, one created by the National Conference of Insurance Legislators (“NCOIL”), and the other by the chief regulators of the Investigations of Life/Annuity Claims Settlement Practices (D) Task Force member states that have acted as lead states for multistate targeted market conduct examinations of the 40 largest life insurers (known as the “Lead State” proposal). Approximately 19 states have already adopted the NCOIL model.

E. New Working Group to Explore Life Insurance Policy Illustration Issues

Following the 2015 Summer National Meeting, the Life Insurance and Annuities (A) Committee (the “(A) Committee”) set a public comment period regarding proposed changes to the Life Insurance Illustrations Model Regulation (the “Illustration Regulation”). Several stakeholders submitted comment letters describing their concerns and what they think needs to be addressed with respect to life insurance policy illustrations.

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Members of the (A) Committee expressed reluctance to reopen the entire Illustration Regulation without a clear plan for what changes should be made and in the absence of a “clear issue that is taking place in the market.” Accordingly, the (A) Committee passed a limited motion to establish a new working group that will explore how the narrative summary required by Section 7B of the Illustrations Regulation and the policy summary required by Section 5A of the Life Insurance Disclosure Model Regulation can be enhanced to promote consumer readability and understandability. The (A) Committee emphasized that the models have not yet been officially reopened. The new working group will be tasked with reporting its preliminary recommendations to the (A) Committee by the time of the 2016 Summer National Meeting.

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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December 14, 2015

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