

CLIENT ALERT

NAIC Report: 2017 Summer National Meeting

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The 2017 Summer National Meeting of the National Association of Insurance Commissioners was held in Philadelphia, Pennsylvania on August 6-9, 2017. Progress was made on initiatives in several areas, including significant steps toward adoption of an NAIC cybersecurity model law, announcement of a work plan for the NAIC's new macro-prudential initiative, and coordinating various work streams related to long-term care insurance. Meeting attendees also heard reports on long-running NAIC projects such as PBR and ERM/ORSA, and relevant international and federal activities, including the EU/U.S. covered agreement.

This report summarizes some of the key activities at the Summer National Meeting and, as indicated, 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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Definitions used in this Report include:

- “ACLI” means The American Council of Life Insurers.
- “Accreditation Committee” means the NAIC’s Financial Regulation Standards and Accreditation (F) Committee.
- “(C) Committee” means the NAIC’s Property and Casualty Insurance (C) Committee.
- “ComFrame” means the Common Framework for the Supervision of Internationally Active Insurance Groups being developed by the IAIS.
- “Executive and Plenary” means the NAIC’s Executive Committee and Plenary.
- “Executive Committee” means the NAIC’s Executive (EX) Committee.
- “FIO” means the Federal Insurance Office.
- “FSB” means the Financial Stability Board.
- “FSOC” means the Financial Stability Oversight Council.
- “(G) Committee” means the NAIC’s International Insurance Relations (G) Committee.
- “G-SII” means Global Systemically Important Insurers, as designated by the Financial Stability Board.
- “IAIG” means an internationally active insurance group.
- “IAIS” means the International Association of Insurance Supervisors.
- “ICP” means an Insurance Core Principle, as developed by the IAIS.
- “ICS” means the Insurance Capital Standard being developed by the IAIS to apply to IAIGs including G-SIIs.
- “NAIC” means the National Association of Insurance Commissioners.
- “NFIP” means The National Flood Insurance Program.
- “NIST” means the National Institute of Standards and Technology.
- “NYDFS” means the New York State Department of Financial Services.
- “ORSA” means Own Risk and Solvency Assessment.
- “P&P Manual” means the Purposes and Procedures Manual of the NAIC Investment Analysis Office.

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- “PBR” means Principle-Based Reserving.
- “RBC” means risk-based capital.
- “ReFAWG” means the Reinsurance Financial Analysis (E) Working Group.
- “SIFI” means a systemically important financial institution, as designated by FSOC.
- “SVO” means the NAIC’s Securities Valuation Office, now part of the NAIC Capital Markets and Investment Analysis Office.
- “Treasury” means the U.S. Department of the Treasury.

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TOPICS OF GENERAL INTEREST

Innovation and Technology

1. Cybersecurity

a. NAIC Cyber Model

At the Summer National Meeting, the Cybersecurity (EX) Working Group and its parent committee, the Innovation and Technology (EX) Task Force, adopted the draft Insurance Data Security Model Law (the “NAIC Cyber Model”). The Executive Committee granted an extension of time for its final review, and we expect the Executive and Plenary will consider it for adoption later this year.

The Working Group began work on the NAIC Cyber Model in March 2016, and the draft adopted during the Summer National Meeting has been through several iterations. Early drafts focused exclusively on the protection of consumers’ personal information, whereas the NAIC Cyber Model adopted by the Task Force requires licensees to protect both consumers’ non-public information and the licensee’s own “information systems.” Early drafts provided for the preemption of federal laws on cybersecurity and such preemption language was removed from the current draft. Early drafts prescribed licensees’ risk management measures and security protections. The draft adopted by the Task Force is less prescriptive and permits licensees to design, maintain and test information security measures based on their own risk assessment and the size and complexity of each licensee’s activities. Importantly, the proposed NAIC Cyber Model applies to all “licensees” including insurance companies, insurance producers, adjusters and others required to be licensed, authorized or registered by the state insurance department. However, risk retention groups chartered in another state, assuming insurers domiciled in another state and risk purchasing groups are exempt from the proposed draft.

The drafting period for the NAIC Cyber Model and the cyber regulation promulgated by NYDFS (the “NY Cyber Regulation”) overlapped significantly, and many of the same considerations were weighed by both drafting groups. The Working Group considered six drafts of the NAIC Cyber Model over that period, as well as reviewing by comparison the NY Cyber Regulation, which became effective March 1, 2017 and under which the first deadlines for partial compliance have just passed.¹ At times the Working Group seemed to be deadlocked on certain issues, particularly regarding actions to be taken following a cyber incident, and at the Spring National Meeting, Director Raymond Farmer (SC), Chairman of the Working Group, invited NYDFS Superintendent Maria Vullo to present on the NY Cyber Regulation and invited members of the Working Group to consider which provisions should be borrowed from it in order to break the impasse. While the NAIC Cyber Model does not completely track the NY Cyber Regulation, there is significant overlap and, moreover, a drafting note in the Model advises that compliance with the NY Cyber Regulation should be deemed to be compliance with the NAIC Cyber Model.

¹ Please see Willkie Farr & Gallagher LLP’s [client memorandum of January 11, 2017](#) reporting on the NY Cyber Regulation.

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The NAIC Cyber Model, as adopted by these committees, provides for each licensee to comply with requirements including maintenance of plans and protocols around cyber risk, and annual reporting and certifications regarding compliance on cyber measures, as well as establishing steps to be taken in the event of a cyber incident, including notifying the home state insurance regulator and/or potentially other affected states' insurance regulators within 72 hours and, if applicable under the state's data breach notification law, notifying consumers pursuant to that law and providing a copy of that notice to the home state insurance regulator.

The NAIC Cyber Model shares certain aspects of the NY Cyber Regulation, such as the 72-hour timeframe to report qualifying cyber incidents to NYDFS and the requirement of an annual report to the board of directors on relevant compliance. However, there are some differences. The NY Cyber Regulation defines a "cybersecurity event" as a successful or unsuccessful attempt to gain unauthorized access to information systems, while the NAIC Cyber Model defines a "cybersecurity event" as an event "resulting in unauthorized access," not simply an attempt. The NY Cyber Regulation also requires the formal appointment of a "Chief Information Security Officer". While there are distinctions between the NAIC Cyber Model and the NY Cyber Regulation, one of the key concerns for all parties involved has been to promote ease of compliance across jurisdictions, and as such the NAIC Cyber Model purposefully acknowledges the NY Cyber Regulation as being comparable for compliance purposes.

b. Federal Initiatives

The Working Group also received an update on federal cybersecurity initiatives. The NAIC is a member of Treasury's Financial and Banking Information Infrastructure Committee (FBIIC), and Director Farmer recently participated in cyber tabletop exercises at Treasury in order to discuss strategies for how to respond following cyber incidents. Cyber resiliency is a top priority for Treasury Secretary Steven Mnuchin. Treasury has emphasized the importance of cyber security to the country's overall financial stability and may review data standards applicable to financial institutions at the federal and state levels. Such review would be undertaken with the goal of strengthening regulatory collaboration and communication and leveraging the NIST framework. It was also noted that since the Spring National Meeting President Trump signed an Executive Order regarding cyber issues, which included certain reporting requirements for the private sector. In addition, several bills have been introduced in Congress addressing cyber issues.

2. Big Data Discussion Continues

The Big Data (EX) Working Group met at the Summer National Meeting and discussed its charges, which include reviewing the current regulatory framework for overseeing insurers' use of consumer data, reviewing regulators' data tools for monitoring the marketplace, and developing a mechanism to facilitate insurance regulators' review of complex models used by insurers for underwriting, rating, and claims. The Working Group's mission is to help insurance regulators understand "what data is collected, how it is collected, and how it is used" by insurers and third parties. The Working Group's goals include protecting and weighing consumer interests, ensuring data usage is appropriate under relevant law, and exploring ways to use data to improve insurance regulation.

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Currently, the Working Group's most active work stream involves developing a tool for regulators to review insurers' complex models. This charge is a priority for the Working Group because the ultimate work product will set the groundwork for both assessing insurers' use of consumer data and monitoring the marketplace. In this respect, the Working Group is considering an NAIC-based structure including the formation of (i) a "Predictive Analytics Team" (PAT) comprising NAIC employees who possess predictive analytics modeling, insurance and actuarial experience and (ii) a Predictive Analytics Working Group (PAWG) (within the NAIC committee structure) made up of 5-10 regulatory actuaries charged with developing PAT procedures and monitoring its performance. The Working Group emphasized that the draft structure proposed in June was merely a first draft intended for discussion purposes and that the NAIC is still pursuing its own review of the proposal. Interested parties have expressed concerns about the proposal, including with regard to the quasi-regulatory role that PAT and the NAIC would seem to occupy, the usurpation of states' regulatory authority, and protection of confidentiality and trade secrets.

With the assistance of NAIC staff, the Working Group is reviewing current state law/regulation regarding insurers' use of consumer and non-insurance data for underwriting, rating and claims. In addition, the Working Group has received industry presentations regarding external or non-traditional data used by insurers in some contexts such as: an applicant's social media data, risk-exposure data focused on property valuation, enhanced exposure data not collected through traditional sources, and credit information. Insurers and actuaries are working to identify new ways to use data that has a statistical correlation to the potential for loss, and regulators are considering the consumer protection aspects of such data usage. Some of the issues the Working Group plans to consider are whether current law provides sufficient consumer protection against unfair trade practices, the use of credit and non-credit information, how big data and models can and should be used by insurers, the appropriate granularity of insurance groupings, consumer privacy issues, data accuracy and the potential for consumer challenges thereto, and the overall effect of any current or proposed regulation on insurance innovation.

With regard to the Working Group's charge to evaluate regulators' existing tools to monitor the marketplace and evaluate big data practices, the NAIC staff is helping to identify how data is currently collected and used by regulators, after which the Working Group will assess regulators' data needs for this purpose and whether there is a need to collect additional data for the review of models.

3. Innovation and Technology

At the Summer National Meeting, in addition to hearing the reports of its sub-groups described above, the Innovation and Technology (EX) Task Force continued to hear presentations from the industry on initiatives related to innovation. These included representatives of two InsurTech accelerators who presented on their experience in the industry, and an industry representative who discussed issues including artificial intelligence and the use of big data. The focus of the Task Force's interest in microinsurance was also discussed and will be taken up in future meetings.

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There was further discussion of how to facilitate innovator and regulator dialogue, with the Task Force agreeing a structure for it would be helpful but reluctant to commit to supporting the “sandbox” approach, in which innovators are permitted to test pilot insurance programs without being required to comply with full regulatory oversight. Various presenters at past meetings have emphasized that this approach has been used in other jurisdictions to good effect, but regulators are wary of relaxing regulation as well as considering the framework to be difficult to implement in a 50-state system. It was suggested that the accelerators/incubators might have helpful suggestions, and also that regulators of other jurisdictions which have tried the approach might be open to discussing their results with U.S. regulators. The NAIC staff will consider how to move forward on these issues.

Group Capital and Group Supervision

1. The NAIC Group Capital Calculation Tool

Work continued on the proposed approach to group capital calculation. Although the NAIC does not intend to incorporate the proposal into law, under the proposed “inventory” approach, regulators would apply the group capital calculation tool to an inventory of all the entities in a group regardless of their structure or jurisdiction, in order to aggregate the group’s available capital.

At the Summer National Meeting, the Group Capital Calculation (E) Working Group focused on the treatment of group members that are not traditional U.S. insurance companies. Certain other issues, including the group’s appropriate size and scope and the incorporation of stress testing, will be taken up in the future. The Working Group does not have a strict timeline for implementation of the capital tool but has mentioned a target of 2020 based on 2019 data.

a. Group Capital Calculation for Certain Entities

Since the Spring National Meeting, the Working Group has been considering how the group capital calculation tool should approach the following topics: (i) insurers for which there is no RBC formula (e.g., financial guaranty, mortgage guaranty and title insurers); (ii) U.S. captive insurers; (iii) non-U.S. insurers; and (iv) prescribed and permitted accounting practices.

- U.S. Insurers Exempt from RBC. During an interim meeting, the Working Group tentatively agreed that where a U.S. insurer exempt from RBC standards is a group member, the entity’s “required capital amount” should be the minimum capital requirements applicable to the insurer per the applicable NAIC model, NAIC guideline or state law.
- Captive Insurers. The Working Group discussed a memorandum prepared by NAIC staff regarding the treatment of U.S. captive insurers for group capital calculation purposes. NAIC staff identified four categories of captives and proposed capital approaches for each, as follows:
 - captives outside a U.S. insurance holding company system—the group capital calculation tool would not apply to any group that does not include a traditional U.S. insurance company;

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- pure captives (*i.e.*, captives exclusively providing insurance to their owners, employees and/or affiliates)—the captive would be treated as a non-insurance affiliate in the group capital calculation and receive whatever treatment the Working Group ultimately decides to assign to these entities (*e.g.*, a 22.5% charge, which the Working Group has previously considered as a potential charge for such entities);
- non-XXX/AXXX captives—captives that reinsure any type of business other than XXX/AXXX would be required for purposes of the group capital calculation to complete an RBC calculation with certain limited accounting adjustments under statutory accounting; and
- XXX/AXXX captives—NAIC staff has proposed that XXX/AXXX captives be required to complete an RBC blank and make the same accounting adjustments as captives that do not assume XXX/AXXX business.

With respect to the first three categories of captives, no comments were received and the Working Group has tentatively agreed to accept the approaches outlined by NAIC staff. However, for XXX/AXXX captives, there were a number of suggestions received from interested parties regarding the approach to the RBC calculation and proposed adjustments. The Working Group exposed a memorandum summarizing these comments for 90 days to obtain further input from interested parties.

With respect to treatment of prescribed and permitted accounting practices granted to members of the group, the Working Group noted that there is widespread consensus based on interested party feedback that the group capital calculation should disclose prescribed and permitted practices within a group (*i.e.*, such practices that have been approved by a regulator and disclosed in the notes to financial statements should not be unwound for the purpose of the group capital calculation). NAIC staff has proposed that prescribed and permitted accounting practices be included as “on-top” adjustments in the final group capital calculation for a group so that the results are comparable across companies. Some interested parties agree with this approach, while others have suggested it should be up to the judgment of the lead state regulator to decide what adjustments to make, if any. Working Group members suggested that they lean toward the on-top adjustment approach, but requested more information as to the types of prescribed and permitted practices involved. NAIC staff will collect additional data and likely incorporate it into the ongoing baseline exercise discussed below.

With respect to non-U.S. insurers in a group that includes a U.S. insurer, the Working Group has reached a tentative consensus that “scalars” should be developed for purposes of the group capital calculation tool. A scalar refers to the multiplication of the non-U.S. insurer’s local capital requirement by a certain factor, intended to result in an adjusted required capital level that is comparable to U.S. requirements.

Prior to the Summer National Meeting, the Working Group asked interested parties to identify jurisdictions that should be subject to a scalar and to provide reliable sources of data for each jurisdiction. Responses were somewhat limited and the Working Group requested that NAIC staff put together a data call to all IAIGs in the United States to provide further information as to which jurisdictions they conduct business in, and to research potential sources of data to develop scalars for such jurisdictions.

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b. Update on Baseline Exercise

Since the Spring National Meeting, NAIC staff has been working with volunteer insurance groups to perform a “baseline exercise” to help inform the decisions of the Working Group with respect to components of the group capital calculation tool. Staff reported that “Round 1” of the exercise is close to completion and that select data and observations were shared with the Working Group on an August 4 regulator-only call. The next step is to hold a call with all the volunteers and lead states to discuss the NAIC’s observations and get feedback before such observations are reported publicly. This call will likely occur sometime in August.

NAIC staff stated that the baseline exercise is primarily a data collection effort, and that a more formal field testing process would be established once there is a proposed calculation tool to test. Additional data points, including with respect to prescribed and permitted practices and scalars as noted above, will be incorporated into Round 2 of the baseline exercise.

2. Financial Stability (EX) Task Force Announces Work Plan for New Macro-Prudential Initiative

For several years, the Financial Stability (EX) Task Force has been monitoring federal and international activities in macro-prudential surveillance and regulation, which the NAIC describes as “analyzing how the insurance sector is impacted by, reacts to, and contributes to financial, economic and other common risk exposures.”

At the Spring National Meeting the Financial Stability (EX) Task Force adopted a new charge to “[a]nalyze existing post-financial crisis regulatory reforms for their application in identifying macro-economic trends, including identifying possible areas of improvement or gaps, and propose...enhancements and/or additions to further improve the ability of state insurance regulators and industry to address macro-prudential impacts...” In furtherance of this goal, during the Summer National Meeting the Task Force unveiled a proposed work plan for a new Macro-Prudential Initiative or “MPI.”

The MPI will take post-crisis efforts a step further in recognition of the continued scrutiny on the insurance sector in terms of “understanding how insurers react to financial stress, and how that reaction can impact, via various risk transmission channels, policyholders, other insurers and financial market participants, and the broader public.”

The goal of the MPI is to expand on the states’ current entity- and group-focused supervisory tools to: (i) better monitor and respond to the impact of external financial and economic risks on supervised entities; (ii) better monitor and respond to risks emanating from or amplified by supervised entities that might be transmitted externally; and (iii) increase public awareness of NAIC/state monitoring capabilities regarding macro-prudential trends within the U.S. insurance sector and their implications.

In furtherance of these goals, NAIC staff conducted a review of macro-prudential measures used in other jurisdictions and provided results to the Task Force. NAIC staff also reviewed and compiled an inventory of existing NAIC tools that could be leveraged on a macro-prudential basis (e.g., certain capital markets and industry analysis reports).

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Based on the work to date, the Task Force has determined that the MPI should focus on an assessment of currently available regulatory tools and consideration of possible enhancements in the following areas: Liquidity, Capital Stress Testing, Recovery and Resolution, and Counterparty Exposure/Concentrations.

In terms of timing, the initial MPI enhancements are expected to be a two- to three-year project. The immediate focus will be on liquidity. At the Summer National Meeting, the Task Force formed a new Liquidity Assessment (EX) Subgroup to perform a comprehensive review of regulatory requirements regarding liquidity management, including liquidity stress testing, and identify areas that may benefit from strengthening, including the proposed scope of companies to which any changes will apply (e.g., large life insurers). The new Subgroup is charged with (i) proposing recommendations to enhance existing disclosures related to liquidity risk (to be completed by the 2017 Fall National Meeting), and (ii) constructing a liquidity testing framework and identifying the scope of the companies to be included in such framework (by the 2018 Spring National Meeting).

With respect to Capital Stress Testing, the Task Force is to consider the need for stress testing in the context of macro-prudential surveillance and outline its conclusions in a letter to the Group Capital Calculation (E) Working Group by the end of 2017. Work on the Recovery and Resolution and Counterparty Exposure/Concentration Work Streams will be initiated in 2018.

At the Task Force meeting, industry representatives expressed support for the MPI work plan. Director Peter Hartt (NJ), Chair of the Task Force, noted that there will be ample opportunity for interested parties to comment during the process outlined above and that there is still potential for the MPI work plan to “pivot significantly” in response to any comments received.

3. International Developments

At the Summer National Meeting, various NAIC working groups heard updates on the work of the IAIS. In 2010, the IAIS started developing ComFrame, which is expected to be adopted in 2019. The IAIS has worked since 2013 on developing an ICS as part of ComFrame, including two quantitative field testing exercises in 2015 and 2016 with a group of volunteer firms. ICS would be applicable to IAIGs, including those designated as G-SIIs.

On July 21, the IAIS announced the release of ICS Version 1.0 for Extended Field Testing. Version 1.0 reflects a “narrowing of options” for valuation and capital requirements based on field testing conducted to date. Further testing will be conducted on valuation approaches, capital requirements, capital resources and the scope of application of the ICS. While field testing is a voluntary exercise, the IAIS aims for all potential IAIGs to be involved as the ICS project further develops toward ICS Version 2.0, which is expected to be implemented as part of ComFrame in late 2019 following a public consultation in 2018.

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It was reported at the (G) Committee meeting that, despite a recent “mis-interpretation” that the NAIC might “walk away” from the IAIS’s efforts to develop an ICS, the NAIC will continue to be engaged with the IAIS and to advocate for the U.S. regulatory system.

With respect to the qualitative aspects of ComFrame, the IAIS is continuing to work on incorporating ComFrame elements applicable to IAIGs into its existing ICPs framework. The ICPs are intended to set out the elements required for an effective supervisory regime in all jurisdictions. The NAIC has been engaged in providing comments regarding the integrated ICP and ComFrame material via written feedback and in person as part of the IAIS drafting process. Current consultations are underway on revised ICPs related to the responsibilities of the supervisor, conduct of business, supervision of intermediaries and macro-prudential surveillance, and the NAIC expects to review these revisions and provide comments through the Fall. The IAIS’s goal is to have the revised ComFrame/ICP material ready in 2018.

The (G) Committee also heard an update on the new IAIS Systemic Risk Task Force, which is working on a variety of issues including an “activities-based approach” for systemically risky activities, improving the G-SII assessment process, and a cross-sectoral risk assessment of banking and insurance sectors.

The IAIS’s annual G-SII assessment process is also underway. Based on a quantitative and qualitative analysis of data submitted by more than 50 IAIGs, the IAIS will make recommendations to the FSB in September as to what IAIGs should be designated as G-SIIs. The FSB will publish the G-SII list in November.

4. U.S. Federal Regulators

Director Peter Hartt (NJ), the state insurance commissioner representative on FSOC, reported that FSOC met on July 28 and discussed the ongoing annual reevaluation of non-bank SIFIs. Director Hartt stated that the NAIC continues to provide insights on the state regulatory system and insurance business model to FSOC, reflecting the NAIC’s “ongoing concerns about the designation decisions made to date.” Meanwhile, on April 21, President Trump issued a memorandum ordering the Secretary of the Treasury to conduct a “thorough review” of FSOC processes, including non-bank SIFI designations. The memorandum directs Treasury to issue a report by October 2017 outlining its conclusions and including recommendations on how FSOC processes could be improved.

ORSA and Form F Updates

1. ORSA Accreditation Guidelines

At the Summer National Meeting, the Accreditation Committee voted to expose for a 30-day comment period recommendations from the ORSA Implementation (E) Subgroup for ORSA-related standards for regulators to be included in Part B of the NAIC Financial Regulation Standards and Accreditation Program. Part B identifies base-line regulatory practices and procedures required to support enforcement of the states’ financial solvency laws in order for the states to attain substantial compliance with the core standards established in Part A of the Accreditation Program.

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The proposed ORSA recommendations address the nature of the ORSA review to be performed by insurance regulators, including the lead state, the incorporation of results into the financial analysis and examination processes, and the obligation to share the results of an ORSA review with other impacted states that are not the lead state.

Given the limited amount of experience and variation across states, the guidelines do not yet include recommendations regarding the timing for regulators to complete their ORSA review. The proposed recommendations are open for comment until September 13, 2017.

2. Form F Drafting Group

At the Spring National Meeting, the Group Solvency Issues (E) Working Group decided it needed to better understand the function and role of the Form F as compared to the ORSA and to identify what is uniquely useful about each reporting process. The Working Group commissioned a few states (Connecticut, Illinois, Nebraska and Texas) that regularly review both ORSA reports and Forms F to form a “drafting group”, which is currently reviewing each state’s Form F and ORSA filings to “look for gaps” in reporting and to identify potential improvements to the Form F. The Working Group did not meet at the Summer National Meeting but reported on an interim conference call that the drafting group hopes to reconvene in late August or early September to discuss its findings and consider next steps, with the ultimate goal of giving guidance to the Working Group on streamlining the Form F process or reopening the underlying model law if required (*e.g.*, to expand on the definition of “enterprise risk” in order to enhance the utility of Form F reporting). We expect additional information about the work and goals of the drafting group to be released prior to the 2017 Fall National Meeting.

Reinsurance

1. Covered Agreement

The Reinsurance (E) Task Force heard an update at the Summer National Meeting on the status of the proposed EU/U.S. Covered Agreement, which addresses reinsurance, group supervision and the exchange of information between supervisory authorities. On July 14, Treasury and the Office of the U.S. Trade Representative announced their intent to sign the Covered Agreement “in the coming weeks” and that the Administration plans to issue a U.S. policy statement on implementation. After execution of the Covered Agreement, among other terms, U.S. states would have five years to remove collateral requirements for EU reinsurers that meet certain standards, or face federal preemption determinations by FIO, while EU Member States would have two years to revise their laws such that U.S. reinsurers would not need to establish a branch or subsidiary to operate in the EU. The announcement states that the Covered Agreement “benefits the U.S. economy and consumers by affirming the state-based system of insurance regulation, providing regulatory certainty, and increasing growth opportunities for U.S. insurers.”

The Task Force stated that the NAIC will not be holding formal discussions on how to react to the Covered Agreement until it has been executed and any associated advisory opinions have been issued. Previously, the NAIC expected it would need to consider measures to protect U.S. policyholders, such as requiring additional capital on the part of U.S.

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cedents for the risk of unsecured reinsurance. Many think that revisions will be necessary to the Credit for Reinsurance Models. While the Task Force and interested parties raised a number of questions about the ramifications of the Covered Agreement and its implementation, no action was taken at the Task Force meeting. It was noted throughout the meeting that there is significant “legislative fatigue” around reinsurance issues due to the fact that the Credit for Reinsurance Model Law was amended several times during recent years to add the reduced collateral requirements for certified reinsurers and to authorize the promulgation of the XXX/AXXX Model Regulation.

Separately, the European Council adopted a decision authorizing the signing of the Covered Agreement on May 29, 2017. The European Council has also requested the consent of the European Parliament for the conclusion of the Covered Agreement.

2. Qualified Jurisdictions

The Reinsurance Task Force also heard a report from the Qualified Jurisdiction (E) Working Group, which described pending issues that will largely await resolution after the Covered Agreement has been executed. For example, the Working Group’s efforts in evaluating the implementation of Solvency II in EU Member States and its impact on approved qualified jurisdictions was halted pending execution of the Covered Agreement. The Working Group reported that it has received a request to evaluate another unnamed EU state as a qualified jurisdiction, that a reinsurer from that jurisdiction intends to apply for certified reinsurance status, and that New York has agreed to act as lead state for the process. The Task Force agreed that the evaluation process could begin in advance of execution of the Covered Agreement. Additionally, the Working Group reminded the Task Force that the reevaluation of current qualified jurisdictions is approaching, as all seven of the currently qualified jurisdictions were approved in January 2015 but will need to requalify after five years, and noted the need to consider which of those jurisdictions will be covered by the Covered Agreement versus those which will not be covered (either upon execution of the Covered Agreement or following Brexit).

3. Reinsurance Investment Security (E) Subgroup

The Reinsurance Task Force has formed a new Reinsurance Investment Security (E) Subgroup, chaired by Connecticut. Its charge is to “discuss and consider the need to clarify the concept of investment security” as used in the Credit for Reinsurance Model Law and Model Regulation,” and was described as being to reevaluate the concept of the Primary Security in connection with the Model Law, the Model Regulation and the XXX/AXXX Regulation. The Subgroup’s members are recommending that guidance be issued, possibly in the P&P Manual, regarding concepts to be used in determining which securities should be listed with the SVO for reinsurance collateral or as Primary Securities. The Task Force agreed to expose for 30 days a memorandum where its Subgroup’s majority position is to (i) recommend against specific identification of investments that qualify as reinsurance collateral, as that limits regulators’ discretion and (ii) recommend against blanket decisions for securities as “qualifying” as Primary Security, and that no security be considered a “Primary Security” under the XXX/AXXX Regulation when “the receipt of cash flows from the issuer of the investment is impacted by the financial condition, actions, assets or obligation of the investment’s holder, the holder’s affiliates or the

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holder's overall holding company group" as these securities will be considered part of a "Regulatory Transaction" and should not be considered SVO-Listed securities or assets qualifying for use as a Primary Security, and that furthermore such transactions should not be considered individually as an investment at the reporting entity level but must be considered collectively with all other transactions.

4. XXX/AXXX Regulation and Law

The Reinsurance Task Force heard a status report on the adoption of the latest amendments to the Credit for Reinsurance Model Act and Model Regulation, which establish requirements regarding the reinsurance of XXX/AXXX policies. As of June 27, twelve states have adopted the 2016 amendments to the Model Act, providing the authority to the insurance commissioners of their states to promulgate the XXX/AXXX Model Regulation. No states were noted as having adopted the new XXX/AXXX Model Regulation, but at the Summer National Meeting the Task Force adopted a proposed related accreditation standard related to that Model Regulation for referral to the Accreditation Committee. The Task Force decided against incorporating the related changes to the Model Act into this accreditation standard proposal, as the changes to the Model Act that enable the promulgation of the XXX/AXXX Model Regulation also enable the promulgation of regulations regarding the treatment of products including long-term care insurance policies and variable annuities. As those topics have not yet been fully addressed by the NAIC, it was considered premature to include enabling such regulations in a mandatory accreditation standard.

The Task Force plans to continue to recommend that the Accreditation Committee consider allowing this accreditation standard proposal to become an accreditation standard effective as of January 1, 2020, and requiring that it be adopted by the states in a "substantially similar" manner (the Accreditation Committee noted in separate discussion that any alterations by individual states with regard to the actuarial method would need to be addressed). It was noted that it may not be feasible in every state to adopt the revisions by January 1, 2020 due to other legislative priorities, and that in such cases the state's compliance with Actuarial Guideline 48 may be considered satisfactory in the interim.

In addition, the Task Force heard a status report on the adoption of the 2011 amendments to the Credit for Reinsurance Model Act and the Credit for Reinsurance Model Regulation, which set forth the reduced collateral requirements for certified reinsurers. As of June 27, 41 states had adopted amendments to their credit for reinsurance law to add the 2011 revisions to the Model Act regarding certified reinsurers (most recently including Texas) and 32 states had adopted the updated Model Regulation.

5. Reinsurance Financial Analysis (E) Working Group.

It was reported that ReFAWG continues its work on passporting and renewal, as well as including new NRSROs as rating agencies for purposes of evaluating certified reinsurers.

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Pre-Dispute Mandatory Arbitration Clauses

Last summer, Peter Kochenburger, an NAIC consumer liaison representative, raised concerns with the Market Regulation and Consumer Affairs (D) Committee regarding the increased use of mandatory arbitration clauses in insurance contracts. Mr. Kochenburger argued that insurers have an unfair advantage when using such clauses because they understand the arbitration process and select the arbitrator, and he disagreed with arguments that arbitration is necessarily quicker and cheaper than litigation. Mr. Kochenburger suggested a ban on the use of mandatory arbitration clauses before a dispute has arisen. In response to such concerns, the (D) Committee formed the Pre-Dispute Mandatory Arbitration Clauses (D) Working Group, which has held a number of meetings and calls on the subject.

At the Summer National Meeting the Working Group discussed revising its charge to broaden the range of options available for addressing pre-dispute mandatory arbitration, choice-of-law and choice-of-venue clauses and to allow different recommendations regarding personal and commercial lines of business. The (D) Committee approved the following new charge for the Working Group.

Consider the use of: 1) pre-dispute mandatory arbitration clauses and 2) choice-of-law and choice-of-venue clauses and, if appropriate, prohibit their use in any individual or commercial insurance policies by amending the Unfair Trade Practices Model Act (#880), developing a new model act, or developing other guidance regarding their usage.

TOPICS OF INTEREST TO THE LIFE INSURANCE INDUSTRY

Annuity Issues

The Annuity Suitability (A) Working Group is charged with reviewing and, if necessary, revising the NAIC's Suitability in Annuity Transactions Model Regulation, as well as considering how to promote greater uniformity across the states regarding annuity suitability regulation. At the Summer National Meeting, trade associations made suggestions and raised issues including adopting a "best interest" standard instead of the current undefined "suitability" standard, whether the scope of the Model Regulation (or a new model) should be broadened to life products used for investment purposes in addition to annuities (NYDFS expressed interest), to what extent conflicts of interest can or should be prohibited and how compensation structures play into such concerns, and whether harmonized regulation of annuities among the various state and federal regulators is possible. The Working Group intends to hold several conference calls in order to receive all stakeholder input.

Principle-Based Reserving

At the Summer National Meeting, the Executive and Plenary adopted the 2009 revisions to the Standard Valuation Law as an accreditation standard to become effective as of January 1, 2020, matching the date that PBR will become broadly applicable. The Standard Valuation Law authorizes PBR and the use of the Valuation Manual.

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PBR went live in most states on January 1, 2017, and so a significant portion of the role of the Principle-Based Reserving Implementation (EX) Task Force is now to coordinate and improve implementation of PBR. At the Summer National Meeting, the Task Force heard updates regarding those efforts in areas such as the revision of handbooks and blanks, and the adoption of revisions to the Valuation Manual, including the VM-20 companywide exemption.

Long-Term Care Insurance Initiatives

Following the Spring National Meeting, a joint Long-Term Care Insurance (B/E) Task Force was created to be the “one coordinating body” for the various NAIC work streams relating to long-term care insurance (LTC). The Task Force is charged with (i) assessing the financial solvency of LTC writers, (ii) evaluating current financial reporting and actuarial valuation standards, (iii) assessing state regulatory activities regarding rate increase requests on blocks, (iv) coordinating state revisions of guaranty fund laws, (v) monitoring the development of regulatory policy regarding short duration LTC policies, and (vi) considering product innovations and other potential solutions for stabilizing the LTC market. On interim conference calls, the Task Force adopted its charges, heard a proposal by PricewaterhouseCoopers and International Solutions LLC to create an LTC run-off facility, and learned that the Financial Analysis (E) Working Group is developing a data request for the domestic states of LTC insurers with the largest blocks of business. The presentations on a possible run-off facility discussed the advantages of such an approach and also outlined the case of the first transfer mechanism used in the United States, which International Solutions had done in Rhode Island in 2015 with regard to commercial business, and which was based on the concept of UK Part VII transfers. The proposals did not address the issue of funding, which presenters said would depend on regulators.

At the Summer National Meeting, the Task Force received reports from the various NAIC groups with work streams related to LTC, including with regard to the drafting or revising of actuarial guidelines, valuation assumptions, models, asset adequacy testing, annual experience forms, and more.

In particular, during the Summer National Meeting, the Receivership Model Law (E) Working Group discussed a plan for a drafting group, comprised of nine states and 18 interested parties, to begin drafting proposed revisions to the Life and Health Insurance Guaranty Association Model Act (Model #520). The proposed revisions would address guaranty association assessment and coverage issues with respect to LTC insurer insolvencies. A recent liquidation of an LTC insurer has led to certain regulators and industry members questioning the efficacy and fairness of the current system for providing guaranty association coverage for liquidations and insolvencies of LTC carriers. As a result, the Working Group’s goal in this project will be to reevaluate the Model so as to ensure that assessments for LTC liquidations and insolvencies would be distributed equitably and fairly among industry members. The focus of recent conference calls of the Working Group has been on potential changes to Section 9 of the Model Act (Assessments). At the Summer National Meeting, the Working Group agreed that Colorado should chair the drafting group since Colorado regulators worked on a draft of similar legislation last year, and that the Colorado draft legislation will form the basis of the drafting group’s efforts.

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Following the Summer National Meeting, the Working Group held an interim conference call to consider options for revising the Model Act with regard to guaranty fund coverage of LTC business, such options having been approved by Executive and Plenary at the Summer National Meeting. The first option discussed is to aggregate life/annuity and health insurance accounts for the purpose of making Class B assessments (*i.e.*, assessments in connection with a guaranty association's duty regarding an impaired/insolvent insurer, as opposed to regarding administrative costs for the association) with respect to LTC policies issued by an insolvent member insurer, while the accounts remain separate for all other purposes. The other option discussed is to include HMOs as members of the guaranty association, with Class B assessments with respect to LTC policies to be legislatively apportioned between three accounts: life/annuity, health, and HMOs. This option would require other adjustments to be made in connection with the inclusion of HMOs. As noted during the conference call, the drafting group's goal is to complete the proposed revisions in time for adoption by the Executive and Plenary at the 2017 Fall National Meeting or the 2018 Spring National Meeting.

Unclaimed Life Insurance Benefits (A) Working Group Disbanded

The Unclaimed Life Insurance Benefits (A) Working Group's effort to adopt a new Unclaimed Life Insurance and Annuities Model Act stalled earlier this year, having failed to reach consensus on a number of major issues. Accordingly, the Life Insurance and Annuities (A) Committee voted at the Summer National Meeting to disband the Working Group. The disbandment was prompted by concerns outlined in a letter from the ACLI that any NAIC model on this subject would undermine insurance standards and uniformity, given that at least 27 states have already adopted laws addressing insurance company obligations to use the Social Security Death Master File to identify deceased insureds. A consumer representative expressed disappointment that the effort to adopt a uniform model had failed and encouraged states to continue to pursue the return of unclaimed benefits through market conduct examinations, noting that previous efforts by the states in this area have returned millions of dollars to consumers and have been "a huge win" for the state insurance regulatory system. North Dakota voted against the motion to disband.

TOPICS OF INTEREST TO THE P/C INSURANCE INDUSTRY

Flood Issues

The Catastrophe Insurance (C) Working Group and (C) Committee heard an update on the reauthorization of the NFIP, which is set to expire on September 30. Neither of the House and Senate committees working on reauthorization was able to reach consensus on a bill before the August recess began, and the NAIC expects that an interim short-term reauthorization measure will be adopted in September while Congress continues to work on a long-term reauthorization bill.

The NAIC has voiced its support to Congress for a long-term reauthorization and for the growth of a state-regulated private flood insurance market. It is expected that the House version of the bill ultimately proposed will include the NAIC-endorsed Flood Insurance Market Parity and Modernization Act, which requires recipients of financial assistance from federal agencies for acquisition or construction purposes, or mortgages, to have flood insurance coverage on the

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underlying property if it lies in an area of special flood hazard where NFIP insurance is available. In addition, the NAIC expects the bill to include certain measures to support the growth of the private market, including rules that allow policyholders to cancel NFIP policies mid-term and receive a refund if they decide to replace their coverage with a private policy, and provisions related to the sharing of NFIP data in order to help the private market more accurately assess flood risk. One important issue related to private flood insurance continues to be whether banks will accept private flood insurance in connection with financing real estate transactions and, if so, whether they will do so in a timely and efficient manner. It was noted that the House wants to await the return of Congressman Steve Scalise, who has always been very involved in these issues, while a key issue in the Senate deliberations is how to treat policyholders who leave the NFIP market but then wish or need to return.

Travel Insurance Update

The Travel Insurance Working Group is charged with considering development of a model law or guideline (the “NAIC Travel Model”) to establish appropriate regulatory standards for the travel and tourism insurance industry. The industry had found that, as travel insurance products do not cleanly fit into standard interpretations of current insurance laws and regulations due to their transient nature and global application, there is a great deal of regulatory uncertainty around providing this type of coverage which threatens its availability and affordability. The NAIC’s view is that clarity around what is and is not considered to be travel insurance, as well as a uniform approach to its regulation, would benefit all sides of the transactions: consumer protection would be enhanced by tailoring regulation appropriately to the products and allowing fair and effective competition, and a clear path to regulatory compliance for issuers (regarding, e.g., licensing, tax issues, and enforcement) would allow growth in the marketplace. At the Summer National Meeting, the Working Group discussed the documents that would be used to begin the process of determining language, section by section, for the next version of the NAIC Travel Model. The Working Group also adopted a request from consumer representatives that the Working Group ask the industry to provide actual data on travel insurance to provide a basis for the Working Group’s deliberations. The Working Group plans to hold an interim meeting in person to work through the NAIC Travel Model and address comments.

Creditor-Placed Insurance Work Stream Bifurcates

The NAIC has been considering changes to the Creditor-Placed Insurance Model Act (#375) for several years in response to criticisms of the industry following the financial crisis. Following discussion on several interim conference calls, at the Summer National Meeting, the (C) Committee reported that the Creditor-Placed Insurance Model Act Review (C) Working Group intends to bifurcate their approach to revising the Model Act and address creditor-placed insurance on automobiles and personal property separately from insurance on real property. The Working Group has concluded that the existing Model Act is geared toward personal property, while the Working Group’s focus following the foreclosure crisis is really on real property. It proved too complicated to merge these topics into one model, so the Working Group put forward and the Executive Committee approved in Philadelphia a new Model Law Development Request for a Creditor-Placed Real Property Insurance Model Act.

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At the Executive Committee meeting, Commissioner Mike Chaney (MS) asked whether abuses associated with lender placed insurance for homeowners still exist today or have already been addressed by the states following the financial crisis. Working Group Chair Commissioner Altmaier responded that the Working Group believes it would be helpful to have a Model Act to bring consistency to state approaches and ensure that practices not in the consumer's best interest are adequately addressed. While the revision process has taken much longer than expected, Commissioner Altmaier's goal is now to move forward in the drafting process as quickly as possible.

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