

CLIENT ALERT

NAIC Report: 2020 Summer National Meeting

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The 2020 Summer National Meeting of the National Association of Insurance Commissioners (the “Summer National Meeting”) was held virtually from July 28, 2020 through August 14, 2020.

Two national topics were central themes of the conference: responding to issues and monitoring risks related to the COVID-19 pandemic and developing initiatives to address racial inequities in the insurance industry. NAIC President and Director of the South Carolina Department of Insurance Raymond G. Farmer said that the NAIC’s ongoing development of a group capital calculation and its Macroprudential Initiative remain important priorities “to ensure our system is prepared for the shocks and market disruptions of the future,” noting that the COVID-19 pandemic provides a clear example of how quickly our markets can be disrupted.

As described in greater detail below, the NAIC issued guidance on the accounting treatment of premium refunds in connection with coverages affected by the COVID-19 pandemic, the Group Capital Calculation (E) Working Group continues to develop a group capital calculation and the NAIC adopted artificial intelligence guiding principles. The NAIC received reports on state legislatures’ and regulators’ adoption of amendments to the NAIC Suitability in Annuity Transactions Model Regulation (#275) and the NAIC Credit for Reinsurance Model Law and Regulation.

This report summarizes some of the key activities at the Summer National Meeting and, as indicated, NAIC interim meetings and conference calls and other developments leading up to and following the meeting, that may be of interest to our clients in the insurance industry.

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GLOSSARY

Definitions used in this report include:

“AXXX Reserves” means statutory reserves recorded by a life insurance company for certain universal life policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee policy.

“CARES Act” means the Coronavirus Aid, Relief, and Economic Security Act that was signed into law by President Donald Trump on March 27, 2020.

“Certified Reinsurer” means a U.S. or a non-U.S. reinsurer domiciled in a Qualified Jurisdiction that satisfies certain financial rating standards set forth in the NAIC Credit for Reinsurance Model Law and Regulation pursuant to the November 6, 2011 amendments.

“ComFrame” means the Common Framework for the Supervision of Internationally Active Insurance Groups being developed by the IAIS.

“Covered Agreements” means the U.S./E.U. Covered Agreement and the U.S./U.K. Covered Agreement, both as defined below.

“Credit for Reinsurance Model Law” means the NAIC Credit for Reinsurance Model Act (#785).

“Credit for Reinsurance Model Regulation” means the NAIC Credit for Reinsurance Model Regulation (#786).

“Executive and Plenary” means all of the U.S. state insurance commissioners in plenary session along with the NAIC’s Executive (EX) Committee.

“Federal Reserve” means the Board of Governors of the Federal Reserve System.

“FIO” means the Federal Insurance Office of the United States Department of the Treasury.

“FSB” means the Financial Stability Board, a nonprofit international body, currently composed of 59 representatives from 25 jurisdictions, as well as representatives from international financial institutions and international standard-setting, regulatory, supervisory and central bank bodies, that monitors and makes recommendations about the global financial system.

“Holistic Framework” means the framework developed by the IAIS to assess and mitigate systemic risk in the global insurance sector.

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“IAIG” means an internationally active insurance group.

“IAIS” means the International Association of Insurance Supervisors.

“ICP” means the Insurance Core Principles developed by the IAIS to apply to IAIGs.

“ICS” means the Insurance Capital Standard being developed by the IAIS to apply to IAIGs.

“Macroprudential Initiative” means the NAIC’s initiative to enhance risk identification efforts in the insurance sector by building on the state-based regulation system.

“NAIC” means the National Association of Insurance Commissioners.

“ORSA Model Act” means the NAIC Risk Management and Own Risk and Solvency Assessment Model Act (#505).

“Qualified Jurisdiction” means a non-U.S. jurisdiction listed on the NAIC list of “Qualified Jurisdictions” established pursuant to the NAIC Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions.

“RBC” means risk-based capital.

“Reciprocal Jurisdiction” means a jurisdiction in which an eligible reinsurer is required to be domiciled in order to qualify for zero reinsurance collateral pursuant to the 2019 Amended Credit for Reinsurance Models (as defined herein).

“U.S./E.U. Covered Agreement” means the Bilateral Agreement Between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance entered into by such parties on September 22, 2017.

“U.S./U.K. Covered Agreement” means the Bilateral Agreement Between the United States and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance entered into by such parties on December 11, 2018.

“XXX Reserves” means statutory reserves recorded by a life insurance company for certain term life insurance policies with guaranteed nonlevel gross premium or guaranteed nonlevel benefits.

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I. Topics of General Interest

A. NAIC Responds Swiftly to the Pandemic

At the Opening Session, President Farmer referred to the COVID-19 pandemic as the “health crisis of our lifetime,” and highlighted the NAIC’s actions to provide resources, data and guidance to state regulators and industry members. For example, in the spring, the NAIC evaluated insurance company exposures to COVID-19-related risks and provided information on this topic to the states. The states, working through the NAIC, have developed a national information request template that gathers data from insurers on their exposure to COVID-19-related claims and the impact of the economic downturn on their assets. The NAIC also completed a resource and guidance document of COVID-19 assumptions that state regulators can use in reviewing insurers’ rate submissions for 2021.

President Farmer also summarized the NAIC’s opposition concerning retroactive amendments to insurance policies in connection with COVID-19 losses, specifically with respect to business interruption coverage. The NAIC does not endorse applying insurance coverage retroactively and it issued a statement and submitted written testimony to Congress this spring in support of this position. President Farmer explained that retroactively altering insurance contracts could jeopardize the financial health of insurers and impact their ability to pay other claims. As of July 8, 2020, according to the NAIC’s data call regarding business interruption insurance and the COVID-19 pandemic, 83% of policies issued to small businesses and 78% of policies issued to large businesses exclude losses from a pandemic, and 98% of policies issued to small businesses and 85% of policies issued to large businesses require physical loss to trigger business interruption coverage. President Farmer also noted that most state insurance regulators acted to protect policyholders affected by COVID-19 by issuing requests, suggestions or requirements concerning early prescription drug refills, suspending prior authorizations and expanding coverage of telemedicine.

At the NAIC’s special session on the COVID-19 pandemic, Jon Godfread, North Dakota Insurance Commissioner and Chair of the Innovation and Technology (EX) Task Force, expressed optimism that a “silver lining” of the pandemic may be that certain regulatory changes that were required by the pandemic streamlined the regulatory process, and if they were implemented on a permanent basis, the result could contribute to the modernization of insurance regulation.

i. NAIC Issues Guidance on Accounting Treatment for COVID-19 Pandemic Premium Refunds

During the Summer National Meeting, the Financial Condition (E) Committee (the “Financial Condition Committee”) adopted INT 20-08, *COVID-19 Premium Refunds, Limited-Time Exceptions, Rate Reductions and Policyholder Dividends* (“INT 20-08”) which provides insurance reporting entities with guidance on the treatment in their statutory accounting reports of premium refunds resulting from decreased commercial and noncommercial activities due to the COVID-19 pandemic. INT 20-08, as adopted by the Financial Condition Committee at the Summer National Meeting, grants a limited-time exception which allows for these premium refunds to be treated as an “underwriting expense” as opposed to a

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“return of premium” (the “Limited-time Exception”). The Limited-time Exception applies only to property and casualty insurers that prior to June 15, 2020 made premium refunds to policyholders via rate filings or policy endorsements and disclosed to their regulators their intent to treat these payments as an underwriting expense. Further, property and casualty insurers who utilize the Limited-time Exception must make additional disclosures in their annual statements similar to those made for permitted practices. For instance, insurers must disclose the impact of this treatment on operating ratios and percentages and whether accounting for the payments as a reduction of premium as opposed to an underwriting expense would otherwise have triggered an RBC action level. The Limited-time Exception is effective as of the second quarter of 2020 and expires on January 1, 2021. Other than the Limited-time Exception, all voluntary refunds due to the COVID-19 pandemic and refunds that are not required by policy terms but required by a jurisdiction are to be treated as premium refunds.

B. NAIC Establishes Special Committee on Race and Insurance

The NAIC announced in late July that the Executive (EX) Committee had formed a special committee devoted to race and insurance co-chaired by President Farmer and the NAIC’s President-Elect David Altmaier, Florida’s Insurance Commissioner. Fifty of the NAIC’s 56 jurisdictions had joined the committee as of the Summer National Meeting. The committee expects to hold its first open meeting in September and, by year-end, intends to report its findings and develop steps that insurance regulators and the insurance industry can take to increase diversity and inclusion in the industry and to address practices that potentially disadvantage minorities. In addition, in order to ensure the ongoing engagement of the NAIC, the new committee will charge existing NAIC committees, task forces and working groups with supporting the NAIC’s initiative to increase diversity and inclusion in the insurance industry.

As part of the Summer National Meeting, the NAIC held a special session on “Race & Insurance” consisting of three panels. The three panels addressed (i) the historical context of racial discrimination in the insurance sector, (ii) current racially based challenges within the insurance sector and (iii) plans to increase diversity and inclusion in the insurance industry. The panel on racially based challenges, moderated by Connecticut Insurance Commissioner Andrew N. Mais, discussed insurance practices that can potentially disadvantage minority communities. Sonja Larkin-Thorne, a panel participant and a consumer advocate who submitted testimony in March 2020 to the Subcommittee on Housing, Community Development and Insurance of the U.S. House Committee on Financial Services, addressed the unregulated use of big data which may contain personal information, and the unintentional biases that may occur from the use of this personal information.

C. Group Capital

The Group Capital Calculation (E) Working Group (the “Group Capital Working Group”) continues to oversee several work streams related to the development of a group capital calculation tool (“GCC”) for insurance groups. As more fully described in our report for the 2019 Fall National Meeting [here](#), the GCC uses a “bottom up” aggregation method that

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requires an accounting of available capital/financial resources and the required regulatory capital of corporate group members on a per entity basis and it builds on the U.S. legal entity RBC assessment.

i. Work Continues on the Design of the GCC Template

At the Summer National Meeting and during a follow-up conference call on September 2, the Group Capital Working Group discussed the core issues raised by stakeholders' extensive comments on the revised draft of the GCC template and instructions that were exposed in May 2020. The topics were broad in scope and included the following: (i) use of the GCC as a regulatory tool; (ii) calibration level, which is proposed to be set at 300% of Authorized Control Level RBC; (iii) scope of application and the related issue of defining financial entities to be included in the group for purposes of the GCC; (iv) the exclusion of certain non-financial entities and the process for making this determination; (v) allowance for debt as additional capital; and (vi) the development of scalars to account for potential differences in jurisdictions' capital requirements. With respect to the first topic, an interested party remarked that the GCC should be a regulatory tool for a group's lead state commissioner, and not a standard and cited concern over language in the draft instructions that a state might take regulatory action based on the results of a group's GCC filing. In response, Kathy Belfi, Director of Financial Regulation at the Connecticut Insurance Department and Vice Chair of the Group Capital Working Group, reassured interested parties that after she had reviewed the proposed GCC guidance to be included in the NAIC's Financial Analysis Handbook, as discussed below, it was clear to her that the GCC is intended to be a tool. She also emphasized that "we're going to make sure the [GCC] instructions and [regulator] guidance sync up on that."

ii. Developing Amendments to the Model Holding Company Act

The Group Capital Working Group held interim conference calls this spring and summer to discuss proposed amendments to the NAIC Insurance Holding Company System Regulatory Act (#440) (the "Model HCA") that will establish an annual filing requirement for the GCC to be given confidentiality protection pursuant to state laws and regulations. The intention is for an insurance holding company system to submit the annual filing with its lead state commissioner, unless an exemption for such group is met.

In June 2020, the Group Capital Working Group dedicated an entire call to the topic of which insurance groups should be exempt from the GCC filing. The amendments to the Model HCA that had been exposed did not include the concept of a size threshold, although President-Elect Altmaier, Chair of the Group Capital Work Group, stated that interested parties' comment letters were generally supportive of adding an exemption with an ORSA-like threshold (i.e., insurance groups whose direct written premium is less than the \$1 billion threshold in the ORSA Model Act). President-Elect Altmaier believes that "groups that do not meet the size exemptions of the [ORSA] or have international business are the types [of groups] where state insurance regulators would want the GCC to be completed," but he is open to giving discretion to regulators for groups that do not meet such a threshold. The proposed amendments contained an exemption for groups that are required to complete the Building Block Approach and file with the Federal Reserve, provided that the lead state

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insurance commissioner is given a copy of the filing. This exemption appeared to be well supported by interested parties and is also consistent with the Group Capital Working Group's goal of avoiding duplicative regulatory requirements.

In addition, there was a proposed exemption for an insurance holding company whose group-wide supervisor is located within a non-U.S. "qualified jurisdiction" or a "reciprocal jurisdiction" (as such terms are defined in the relevant state's credit for reinsurance laws or regulations). Several interested parties expressed their support for the view that these insurance groups should be exempt from the GCC filing under the theory that an insurance group should only be subject to one group capital measurement. Insurance groups that are supervised outside the U.S. would generally be exempt from the GCC. However, interested parties are concerned about the GCC's applicability to subgroup operations (i.e., whether a GCC filing should be required for the U.S. operations of a non-U.S. insurance group).

Additional topics of discussion related to the exposed revisions to the Model HCA included: (i) whether to move certain GCC exemptions that may be adjusted in the future from the Model HCA to the NAIC Insurance Holding Company System Model Regulation (#450) to avoid the necessity of adoptions by state legislatures for any amendments to GCC exemption matters; (ii) having the NAIC create and maintain a list of international jurisdictions that recognize and accept the GCC and assigning responsibility for this task to an NAIC group; and (iii) in terms of confidentiality, whether to allow a lead state regulator to share information from the GCC with the domestic regulators of companies that are part of that group and whose states have existing confidentiality statutes to protect such information. The Group Capital Working Group exposed a further revised draft of proposed amendments following the interim conference calls and comments were due on August 24, 2020.

iii. GCC Guidance Is Being Developed for Regulators

In the spring, a drafting group was formed consisting of state insurance regulators and interested parties to develop guidance for the Financial Analysis Handbook that will address how the GCC should be used by state insurance regulators. The proposed guidance will be exposed for comment at a later date either by the Group Capital Working Group or the Financial Analysis Solvency Tools (E) Working Group.

iv. Group Solvency Issues (E) Working Group to Address Referral Regarding the GCC and XXX/AXXX Reserves

The Group Capital Working Group has expressed concern that once implemented the GCC may understate a group's capital when applied to groups that hold XXX Reserves and AXXX Reserves (collectively, "XXX/AXXX Reserves") for life insurance business placed before January 1, 2015, when Actuarial Guidance XLVIII ("AG48") became effective. Prior to AG48's promulgation, in situations where life insurers viewed XXX/AXXX Reserves as excessive or redundant, they often turned to captive reinsurers or special purpose vehicles ("XXX/AXXX grandfathered captives") to finance, through reinsurance agreements, the redundant statutory reserves. Due to these concerns, the Group Capital Working Group has decided to provisionally exclude from the GCC adjustments for XXX/AXXX Reserves. However, the Group Capital

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Working Group requested assistance from the Group Solvency Issues (E) Working Group (the “Group Solvency Working Group”) to identify insurance groups that utilize XXX/AXXX grandfathered captives and to ask the lead state regulator for such a group to evaluate whether its XXX/AXXX Reserves have a material negative impact on the insurance group’s capital. The Group Capital Working Group’s suggested approach is that once the GCC is implemented, the lead state regulator may, in its discretion, require the group to disclose to the lead state the ongoing impact of the GCC on the group’s capital until that impact is no longer negative or material. At the Summer National Meeting, the Group Solvency Working Group formed a drafting group to address the request.

v. Next Steps

The Group Capital Working Group intends to circulate a further revised draft of the GCC template and instructions this fall so that progress can be made ahead of the 2020 Fall National Meeting to be held in mid-November. Discussions regarding proposed amendments to the Model HCA and guidance for the Financial Analysis Handbook will also continue.

D. International Developments

i. IAIS Begins to Assess the Global Framework for Supervision of IAIGs as it Responds to the COVID-19 Pandemic

As discussed in our report for the 2019 Fall National Meeting [here](#), in November 2019, the IAIS adopted a comprehensive set of reforms related to cross-border supervision of IAIGs, which includes ComFrame, the ICS and the Holistic Framework. At the Summer National Meeting, the International Insurance Relations (G) Committee (the “International Relations Committee”) received an update from the IAIS on its progress in implementing these reforms.

The IAIS Macroprudential Monitoring Working Group oversees several holistic initiatives, including the Global Monitoring Exercise (“GME”), which allows data from individual insurer monitoring and sector-wide monitoring to be used to track global market trends and identify the potential build-up of systemic risk in the global insurance sector. Due to the COVID-19 pandemic, the IAIS’s reporting to the FSB on the outcomes of the 2020 GME will be postponed until 2021, and the GME has instead been primarily focused, at least for the first two quarters of 2020, on gathering pandemic-related information. The IAIS’s data collection exercise related to the pandemic revealed several common themes, including the potential material realization of credit risk in insurers’ investment portfolios, the impact of the low interest rate environment on insurers and the insurance sector’s interconnectedness.

From a prudential perspective, the IAIS is concerned about the pandemic’s impact on insurers’ capital and solvency preservation and several of the supervisory responses have had the effect of curbing the payment of dividends by insurers. Going forward, the IAIS anticipates that it will have to take a “deeper dive” into certain issues related to the COVID-19 pandemic, such as the insurance supervisory perspective on products that attempt to bridge the pandemic risk protection gap revealed by the pandemic.

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In general, the IAIS views the pandemic as a global crisis that requires a global, coordinated response by insurance supervisors. The IAIS also recognizes that it must balance competing priorities, since its stakeholders need operational relief due to the pandemic and at the same time, the IAIS must preserve the momentum gained in 2019 with the adoption of ComFrame, the ICS and the Holistic Framework as it proceeds with the GME.

a. ComFrame Is Analyzed by U.S. Insurance Regulators

ComFrame is intended to support the coordination of supervisory activities between an IAIG's group-wide supervisor and other involved supervisors, provide global regulators with a common language for the supervision of IAIGs, and help supervisors address group-wide risk. In response to ComFrame's adoption, the Group Solvency Working Group was charged with assessing ComFrame and recommending steps to implement it in a manner appropriate for the U.S. insurance regulatory scheme. Toward that end, the Group Solvency Working Group completed and exposed for comment in February 2020, its analysis of the significant elements of ComFrame that are not incorporated into the existing U.S. state-based insurance laws and regulations (the "Gap Analysis").

The Gap Analysis concluded that (i) many key elements of ComFrame are already included in the U.S. state-based insurance regulatory system, whether partially or fully, through recent amendments to the Model HCA and (ii) certain ComFrame elements, some of which are prescriptive, are not appropriate for the U.S. insurance regulatory system. The Gap Analysis also recommended certain revisions or additions for the U.S. insurance regulatory system including that:

1. Corporate Governance Annual Disclosures be filed at the head of the IAIG level to ensure that processes are evaluated at an appropriate level for the full group.
2. The Financial Analysis Handbook be updated to provide additional guidance for use in completing holding company analysis of IAIGs and that the Financial Condition Examiners Handbook be updated to provide additional guidance for use in conducting coordinated examinations of IAIGs. These updates would also consider the development of certain guidelines or procedures to allow the assessment of group-wide governance framework and reporting and group-wide investment strategy and oversight.
3. ORSA be conducted and filed at the head of the IAIG level to ensure risk exposures and control functions are evaluated at the appropriate level for the full group.

Certain insurance industry commentators found these recommendations unnecessary or misguided. For instance, commentators were concerned with the recommendation that additional guidance or procedures be developed for inclusion into the Financial Analysis Handbook concerning the assessment of group-wide control functions and investment strategy, claiming it was difficult to reconcile this recommendation with ComFrame's overarching express provision that it does not favor any particular governance model whether centralized or decentralized. Another area of concern voiced by commentators was the recommendation in the Gap Analysis that Corporate Governance Annual Disclosures and ORSAs

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be conducted and filed at the head of the IAIG level to ensure that risk exposures and control functions are evaluated at the appropriate level for the full group. According to commentators, this recommendation could be interpreted as requiring a single ORSA for both an IAIG's insurance and non-insurance operations, thereby resulting in a filing not required by the NAIC Corporate Governance Annual Disclosure Model Act or the ORSA Model Act.

In order to address the Gap Analysis's recommendations and commentators' objections to these recommendations, the Group Solvency Working Group formed drafting groups at the Summer National Meeting to develop targeted enhancements to the Financial Analysis Handbook, the Financial Condition Examiners Handbook and the ORSA Guidance Manual for further consideration by the Working Group. The Working Group will also develop overarching principles to guide the work of the drafting groups (e.g., any revision should aim to effect the desired outcome and not be prescriptive).

b. Comparability of Group Capital Standards

The IAIS is also using the GME to assess whether the aggregation method which has been proposed to be used as part of the GCC and which leverages the legal entity approach inherent in the state-based insurance regulatory scheme (the "AM") produces comparable (i.e., substantially the same) outcomes to the ICS. Due to the COVID-19 pandemic, the deadline for insurers voluntarily participating in the IAIS's assessment to submit data was moved from August to October 2020. The NAIC is also developing criteria to determine whether the AM produces comparable outcomes to those of the ICS.

E. Systemic Risk

i. Update on the NAIC's Macroprudential Initiative

a. Liquidity Assessment (EX) Subgroup Shifts its Focus Due to the Pandemic

At the Financial Stability (EX) Task Force meeting, Justin Schrader, Chief Financial Examiner at the Nebraska Department of Insurance and Chair of the Liquidity Assessment (EX) Subgroup, reported that the Subgroup had adopted a motion, effective as of April 17, 2020, to pause its work on the development of the 2019 NAIC Liquidity Stress Test Framework for certain large U.S. life insurers due to the COVID-19 pandemic. In its place, the Subgroup was directed to address a proposal from the American Council of Life Insurers looking at macroprudential information as an indicator of how the insurance sector is navigating current market conditions. A study group was formed to establish a data collection plan focused on liquidity for the 23 life insurance groups that were in scope for the liquidity stress test framework. The first phase of the data collection plan asked for qualitative data based on an insurance group's first quarter of 2020 financial information, and the second phase requested qualitative and quantitative data based on second-quarter financial information. The phase one and phase two data were due on July 15, 2020 and August 31, 2020, respectively. The NAIC intends to compile the findings for presentation to the study group and lead state regulators.

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Mr. Schrader explained that the macroprudential information produced by this data collection exercise will help the Subgroup refine its work on the 2019 NAIC Liquidity Stress Test Framework when the project resumes. For instance, a pandemic in conjunction with economic stress will be considered for use as a stress scenario.

ii. U.S. Federal Developments

a. Third Financial Sector Assessment Program Completed

The Financial Sector Assessment Program (“FSAP”) of the United States is an evaluation conducted every five years by the International Monetary Fund (“IMF”) which analyzes the strength and scope of the insurance regulatory scheme under the standards of the ICPs. The 2020 FSAP was released just prior to the International Relations Committee’s meeting at the Summer National Meeting, and it includes a Financial System Stability Assessment (“FSSA”) with an overall evaluation of the U.S. financial sector, including banking, securities and insurance. The 2020 FSSA has an appendix related to the COVID-19 pandemic, although the assessment was largely completed prior to the outbreak.

According to Mr. Schrader, who served as the lead U.S. insurance regulator for the third FSAP, the IMF’s view is that the U.S. insurance system is in line with the ICPs, and key recommendations from the 2015 FSSA have been addressed or implemented in the U.S. insurance regulatory system. The 2020 FSSA highlights what the IMF views as the strengths and enhancements of the U.S. system, such as the implementation of principle-based reserving for life insurers, as recommended in the 2015 FSSA. The 2020 FSSA also notes several areas of U.S. regulation that require improvement, including:

1. A regulatory response to natural catastrophes that is strategically focused on medium- to long-term goals, as opposed to short-term responses, to ensure that risks are appropriately priced, insurers are incentivized to remain in a market and mitigation measures are developed which will increase resiliency.
2. More frequent, focused and thematic examinations of insurance groups.

The 2020 FSSA also recommends the development of a GAAP Plus version of the ICS (at least for IAIGs) which would be implemented in parallel with an insurance group’s own AM as a way to address the perceived gap between the group capital standard in the U.S. which upon adoption will use the AM, and the ICS. Mr. Schrader took exception with this recommendation as being inconsistent with the current discussions between the IAIS and the NAIC regarding the potential comparability of the ICS and the AM. Mr. Schrader also challenged the IMF’s recommendation that if the NAIC adopts the GCC, it should be a regulatory requirement as opposed to a tool for evaluation purposes.

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F. Innovation and Technology

i. Data and Privacy and Consumer Rights

a. Privacy Protections (D) Working Group Begins Process to Update Privacy of Consumer Financial and Health Information Regulation

The Privacy Protections (D) Working Group (the “Privacy Protections Working Group”) is charged with reviewing state insurance privacy protections regarding the collection, use and disclosure of information gathered in connection with insurance transactions, and making recommended changes, as needed, to the Insurance Information and Privacy Protection Model Act (#670), which addresses data security, and the Privacy of Consumer Financial and Health Information Regulation (#672) (the “Privacy of Consumer Information Regulation”), which addresses data privacy. At the Summer National Meeting, the Privacy Protections Working Group agreed to begin discussions with state insurance regulators and interested parties in order to compare the Privacy of Consumer Information Regulation with recently enacted state, federal and international privacy laws to identify potential “gaps” in such regulation.

b. Casualty Actuarial and Statistical (C) Task Force Exposes White Paper on the Use of Predictive Models

The Casualty Actuarial and Statistical (C) Task Force (“CASTF”) of the Property and Casualty (C) Committee (the “P&C Committee”) exposed for comment the Regulatory Review of Predictive Models White Paper (the “White Paper”) which addresses best practices for an insurance regulator when reviewing predictive models and analytics justifying an insurer’s rate filing. According to Richard Piazza, Chief Actuary for the Louisiana Department of Insurance and a member of CASTF, regulators are increasingly challenged with evaluating complex predictive models and techniques, thereby necessitating the White Paper, the substance of which will be included in the Product Review Handbook for insurance regulators. The White Paper does not impose new requirements on state insurance regulators or impinge upon the states’ current rate-making regulatory authority and autonomy, but rather guides regulators on the use of predictive models by insurers and their assessment that the predictive models comply with state laws and regulations. The exposure period for the White Paper ended on July 27, 2020 but due to the length and complexity of the comments received, CASTF will likely not complete its review and potential incorporation of these comments into the White Paper until the end of September at the earliest.

ii. Artificial Intelligence in Insurance

a. NAIC Adopts Artificial Intelligence Principles

During the Summer National Meeting, the NAIC adopted Artificial Intelligence (AI) Guiding Principles (the “NAIC AI Principles”). As background, at the 2019 Summer National Meeting, the NAIC formed the Artificial Intelligence (EX)

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Working Group (the “AI Working Group”) to develop guidance for the insurance industry with respect to AI and the increased availability of vast amounts of data due to ever-expanding computing power. Over the past year, the AI Working Group developed the NAIC AI Principles after receiving input from various industry groups, including the American Council of Life Insurers, the American Property and Casualty Insurance Association and the Center for Economic Justice (“CEJ”). The NAIC AI Principles are based on the Organisation for Economic Co-operation and Development’s Principles on Artificial Intelligence that have been adopted by 42 countries (including the United States). The NAIC AI Principles represent “guideposts” that do not carry the weight of law and are to be used to assist regulators and NAIC committees addressing insurance-specific AI applications. This guidance is intended to establish general expectations for insurance companies and other members of the insurance industry that use AI, emphasizing the importance of accountability, compliance, transparency, and safe, secure and robust outputs.

The drafting process included extensive discussion regarding the principle that AI actors should avoid “discrimination by proxy” which was a suggestion introduced by the CEJ contending that potential unfair discrimination may result from the use of data that reflects historical discrimination against “protected classes,” described by the CEJ as consumer characteristics that may not be the basis for discrimination (i.e., race, religion and national origin). At the Summer National Meeting, the NAIC AI Principles, as adopted, include the principle that AI actors should avoid discrimination by proxy against protected classes and that the insurance industry should be encouraged to take proactive steps to avoid discrimination by proxy against protected classes when using AI platforms. President Farmer noted this is part of the NAIC’s broader effort to address racial equity issues.

b. NAIC Moves to the Next Phase on Accelerated Underwriting in Life Insurance

Since its inception in the fall of 2019, the Accelerated Underwriting (A) Working Group (the “AUWG”) has been charged with considering the use of external data and data analytics in accelerated life underwriting, including consideration of the ongoing work of the Life Actuarial (A) Task Force (the “Life Actuarial Task Force”) on the issue and, if appropriate, drafting guidance for the states. Accelerated life underwriting programs allow some applicants for life insurance to forgo medical examinations if they meet certain pre-determined thresholds generally by using new data together with algorithmic tools and modeling to assess applicants’ risks.

The AUWG will carry out its charge, as previously described, over three phases: an initial information gathering phase, a second phase during which the AUWG will identify key issues and decide on an appropriate work product, and a final phase dedicated to preparing the final work product. As of the Summer National Meeting, the AUWG has nearly completed its first phase of information gathering, during which it heard presentations about accelerated underwriting and related issues from presenters including insurance companies, consulting firms, law firms, and consumer advocates. The consensus of these commentators is that while traditional underwriting remains the norm currently, accelerated underwriting is attractive to companies for a number of reasons and is expected to expand in scope over the next decade.

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The AUWG is forming two subgroups as it moves into its second phase. As various working groups and task forces within the NAIC have considered or are considering issues associated with accelerated life underwriting, during the second phase, an ad hoc liaison group will coordinate with other NAIC groups exploring issues related to accelerated underwriting, and an ad hoc drafting group will synthesize information received during the phase one presentations and recommend a form of final work product to the AUWG. The AUWG intends to complete this second phase by December 2020, and to prepare a first draft of its work product to expose for comment by the end of December 2020, with the goal of presenting a final work product to the Life Insurance and Annuities (A) Committee by the 2021 Summer National Meeting.

G. Reinsurance

i. Amended Credit for Reinsurance Models Become State Accreditation Standards

The NAIC adopted amendments to the NAIC Credit for Reinsurance Model Law and the Credit for Reinsurance Model Regulation in June 2019 to incorporate applicable requirements of the Covered Agreements (together the “2019 Amended Credit for Reinsurance Models”). The 2019 Amended Credit for Reinsurance Models will become an NAIC accreditation standard as of September 1, 2022, with enforcement beginning on January 1, 2023. The September 1, 2022 date coincides with the date on which FIO is required under the Covered Agreements to complete its preemption analysis which would allow FIO to preempt the implementation of a state’s credit for reinsurance law and regulations if FIO determines that such state’s law and regulations are inconsistent with the Covered Agreements and treat a qualified non-U.S. reinsurer less favorably than a U.S. insurer licensed in that state.

As of July 2020, 11 jurisdictions had adopted the amendments and 17 jurisdictions were considering adopting revisions to their state credit for reinsurance laws to conform with the 2019 Amended Credit for Reinsurance Models. COVID-19 has resulted in several state legislatures taking a “pandemic recess,” thus potentially hampering the NAIC’s goal to have all NAIC accredited jurisdictions enact the 2019 Amended Credit for Reinsurance Models into their laws and regulations by September 1, 2022. While the NAIC had been updating FIO on the progress of the states’ adoption process, no discussions have been held with FIO or the European Union regarding a potential extension of the September 1, 2022 deadline. The Reinsurance Association of America has urged states to consider the “pandemic recesses” when undertaking efforts to amend their credit for reinsurance laws and regulations.

At the Summer National Meeting, the Reinsurance Financial Analysis (E) Working Group (“ReFAWG”) of the Reinsurance (E) Task Force reported that in recognition of the newly created class of reinsurers from “Reciprocal Jurisdictions,” created by the 2019 Amended Credit for Reinsurance Models, it will implement a passporting process for these reinsurers similar to that used for Certified Reinsurers from Qualified Jurisdictions. The NAIC has charged ReFAWG with providing advisory support and assistance to states in their review of reinsurance collateral applications by reinsurers from Qualified Jurisdictions and Reciprocal Jurisdictions. ReFAWG is currently determining the best way to monitor and effect surveillance of the financial solvency of reinsurers domiciled in Reciprocal Jurisdictions, and ReFAWG anticipates

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assisting states in the process of approving zero collateral for reinsurers from Reciprocal Jurisdictions as it has done in the past in assisting states with the process for approving reduced collateral for Certified Reinsurers from Qualified Jurisdictions. ReFAWG is also developing other financial assessment processes to assist states with respect to changes necessitated by the Covered Agreements.

II. Topics of Interest to the Life Insurance Industry

A. States Begin to Adopt the Revisions to Suitability in Annuity Transactions Model Regulation

The Executive and Plenary adopted amendments to the Suitability in Annuity Transactions Model Regulation (#275) (the “Annuity Suitability Model Regulation”) on February 13, 2020 that add a “best interest” standard when a producer recommends an annuity. This standard is less than a fiduciary standard, but more than a suitability standard, and the Annuity Suitability Model Regulation provides that a producer has acted in the best interest of a consumer if he or she has satisfied certain obligations regarding care, disclosure, conflict of interest and documentation. As of the Summer National Meeting, only Iowa and Arizona had adopted the amendments.

B. LIBOR Cessation

London Interbank Offered Rate (“LIBOR”), the most widely used benchmark for short-term rates, is not expected to be available as a financial reference rate after 2021, at which time it will be replaced by the Secured Overnight Funding Rate (“SOFR”). The Financial Stability (EX) Task Force has been monitoring three issues to assess whether the LIBOR transition could significantly impact financial stability: (i) derivatives cutover to SOFR, (ii) the life reserving/valuation impact and (iii) the GAAP/statutory accounting impact. On October 16, 2020, when U.S. central clearing counterparties (“CCPs”) shift their discounting rate to SOFR, CCPs will revalue existing cleared swaps and issue basis swaps on a mandatory basis to all parties that clear swaps with them. As a result, life insurers are looking for a temporary safe harbor from state insurance departments in order to hold these basis swaps, since they would be an unauthorized holding of derivatives under most state investment laws. On June 12, 2020, the Financial Condition Committee sent a memorandum to all state insurance commissioners in support of life insurers, requesting that basis swaps be deemed a permissible derivative investment for up to one year after the cutover to SOFR. Each individual insurance commissioner must now decide how to handle the issue. The life reserving and accounting issues will be addressed by the Life Actuarial Task Force and the Statutory Accounting Principles (E) Working Group, respectively.

III. Topics of Interest to the P/C Insurance Industry

A. Catastrophes

At the Summer National Meeting, the Catastrophe Insurance (C) Working Group of the P&C Committee received a proposal by Milliman, Inc., a consulting and actuarial firm, for a Catastrophe Modelling Clearinghouse which would include

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a multidisciplinary panel to develop standards, select expert reviewers and manage the catastrophe model review process with the aim of eventually approving or certifying qualifying catastrophe models for use by insurers in rate-making. Industry commentators noted that catastrophe risk is no longer immaterial and historical experience, particularly with respect to wildfires and floods, is not sufficient to inform rate-making. In addition, the value of historical data is limited as demographics and climate change. Currently, there is a patchwork of state laws and regulations regarding the use of catastrophe models in the rate-making process with states either allowing, prohibiting or not addressing their use in rate-making. The proposed clearinghouse would be a resource for insurance regulators who may be challenged by a lack of the appropriate expertise and/or resources when asked to approve a rate based on the results of a catastrophe model.

IV. Briefly Noted

A. Insurance Business Transfer and Division Laws

During an interim conference call in January 2020, the Restructuring Mechanisms (E) Subgroup (“the Subgroup”) directed NAIC staff to begin drafting best practices for review of restructuring transactions and for monitoring of companies in voluntary or involuntary runoff. NAIC staff was directed to use the NAIC’s 2009 white paper on this topic, comments received in meetings of the Subgroup and the Restructuring Mechanisms (E) Working Group, policyholder protections required under UK Part VII transfers and the results of the state survey conducted by the Subgroup to determine how states currently monitor companies in runoff. The key issues to be addressed in the best practices document will include: (i) whether a court should be involved, (ii) communications with policyholders and beneficiaries, (iii) guaranty fund protection, (iv) other regulators impacted by a transaction, (v) use of independent experts and actuaries, (vi) reserving, and (vii) monitoring procedures. The Subgroup noted that the process will result in multiple calls and drafts of best practices. Although the Subgroup’s charge was to complete the best practices by the Summer National Meeting, the Subgroup and the Working Group did not meet at the Summer National Meeting and their work is expected to continue.

B. Comment Period Extended for the Real Property-Lender Placed Insurance Model Act

At the Summer National Meeting, the P&C Committee extended the comment period for the proposed Real Property-Lender Placed Insurance Model Act (the “Lender Placed Insurance Model Law”) until the Fall National Meeting in November. Policyholder advocates predict that the COVID-19 pandemic and its related economic dislocations will increase lender-placed insurance rates once mortgage forbearance protections required by the CARES Act end. In light of this potential, policyholder advocates urged the NAIC to complete and enact the Lender Placed Insurance Model Law, noting that it has been in development for the last five years.

C. Update on National Flood Insurance

The National Flood Insurance Program (“NFIP”), which is set to expire on September 30, 2020, is currently operating under its 15th short-term funding extension. The NAIC continues to promote long-term funding for the NFIP, but

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congressional action to pass long-term authorizing legislation is expected to stall due to the COVID-19 pandemic. The NAIC believes the NFIP should incentivize mitigation efforts, and it continues to encourage the development of a private flood insurance market.

D. Potential Amendments to the Nonadmitted Insurance Model Act

The Nonadmitted and Reinsurance Reform Act (the “NRRA”) was enacted in 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act and its provisions impact the placement of nonadmitted insurance. At the Summer National Meeting, the Surplus Lines (C) Task Force agreed to establish a drafting group to produce a summary document that outlines amendments to the Nonadmitted Insurance Model Act (#870) which are needed to update certain provisions so they conform with those portions of the NRRA that govern the placement of nonadmitted insurance. The model law was last revised in 2002 and it has been adopted in 31 states.

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