

CLIENT ALERT

# NAIC Report: 2017 Fall National Meeting

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The 2017 Fall National Meeting of the National Association of Insurance Commissioners was held in Honolulu, Hawaii on December 2-4, 2017. While not all NAIC committees held onsite meetings, attendance was solid and regulators who could not attend in person joined by conference call.

Much has occurred since the Summer National Meeting, including U.S./EU Covered Agreement developments and IAIS actions concerning the group capital standards for IAIGs. Discussions regarding these global developments were a highlight of the Fall National Meeting. Other highlights included discussions on the insurance industry's use of new and innovative technologies. The NAIC membership and attendees also received reports and expressions of gratitude from leaders of U.S. territories that suffered severe natural disasters in recent months.

The election of NAIC 2018 officers also took place at the meeting.

**President:** Tennessee Insurance Commissioner Julie Mix McPeak

**President-Elect:** Maine Insurance Superintendent Eric Cioppa

**Vice President:** South Carolina Insurance Director Raymond Farmer

**Secretary-Treasurer:** Hawaii Insurance Commissioner Gordon Ito

This report summarizes some of the key activities at the Fall National Meeting and, as indicated, NAIC interim meetings and conference calls and other developments 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:

- “Accreditation Committee” means the NAIC’s Financial Regulation Standards and Accreditation (F) Committee.
- “ACLI” means The American Council of Life Insurers.
- “Covered Agreement” means the Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance entered into by such parties on September 22, 2017.
- “Dodd-Frank” means the Dodd-Frank Wall Street Reform and Consumer Protection Act.
- “Executive and Plenary” means all of the U.S. state insurance commissioners in plenary session along with the Executive (EX) Committee.
- “Federal Reserve” means the Board of Governors of the Federal Reserve System.
- “FIO” means the Federal Insurance Office of the U.S. Department of the Treasury.
- “FSB” means the Financial Stability Board, an international organization.
- “FSOC” means the Financial Stability Oversight Council of the U.S. Department of the Treasury.
- “(G) Committee” means the NAIC’s International Insurance Relations (G) Committee.
- “G-SIIs” means Global Systemically Important Insurers, as designated by the FSB.
- “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.
- “NCOIL” means the National Council of Insurance Legislators.
- “NFIP” means The National Flood Insurance Program.
- “NYDFS” means the New York State Department of Financial Services.

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- “ORSA” means Own Risk and Solvency Assessment.
- “PBR” means Principle-Based Reserving.
- “RBC” means risk-based capital.
- “SIFI” means a systemically important financial institution, as designated by FSOC.
- “Treasury” means the U.S. Department of the Treasury.

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### TOPICS OF GENERAL INTEREST

#### IAIS Discussions on International Group Capital Standards

The (G) Committee received several reports during its December 2 meeting. Among the topics covered was the FSB's decision (announced in a November 21 statement) not to publish a new list of G-SIIs for 2017 (maintaining however the nine G-SIIs identified in 2016). The FSB encouraged the IAIS to continue work on an activities-based approach to systemic risk assessment for G-SIIs which may ultimately affect the global insurance groups identified as G-SIIs. Reports were also received on the NAIC's submission of comments on several ICPs and the IAIS's adoption of ICPs regarding Reinsurance and Other Forms of Risk Transfer. But the most dramatic and significant report concerned Team USA's achievements on ICS during the IAIS's Annual Conference on November 2 in Kuala Lumpur, Malaysia.

As background, the IAIS began development of a risk-based global ICS in 2013. In 2017, the IAIS published ICS Version 1.0 for extended field testing and had committed to deliver an ICS Version 2.0 for implementation as a group-wide prescribed capital requirement (PCR) by the end of 2019. The ICS uses a single reference method based on a consolidated Market Adjustment Valuation approach (MAV). Team USA has objected to using the single methodology as the basis for creating an international capital standard. The United States also objected to the estimated 2019 timing for ICS Version 2.0 because the United States (including both the Federal Reserve and the NAIC) are developing a risk-based aggregation approach to assessing group capital. The United States sought IAIS agreement to (i) include the aggregation approach in the ICS testing and assessment of group capital and (ii) extend the overall ICS testing period to permit appropriate time for completing and testing this approach.

At the Kuala Lumpur meeting, the IAIS agreed to collect data from interested jurisdictions (both U.S. and non-U.S.) to determine whether the aggregation method favored by the United States creates data that is comparable to the MAV approach currently being tested for use in developing an ICS. U.S. insurance regulators and interested parties view the incorporation of two methods for assessing group capital as extremely positive, and because the IAIS had not agreed to consider the U.S. capital approach six months ago, the IAIS decision in Kuala Lumpur was viewed as a U.S. victory. If the data supports comparability between the approaches, U.S. regulators hope that the aggregation method will be incorporated into the ICS. Additionally, in order to permit adequate time for testing and comparing these methods, the IAIS has agreed to develop ICS Version 2.0 in two phases which will push out its effective date past the originally planned 2019 time frame. The first phase, which will start in 2020, involves confidential reporting of data to supervisory colleges and will permit monitoring for a five-year period. The ICS will not be used to trigger supervisory action during this time period. The second phase begins in 2025 and involves the implementation of ICS Version 2.0. The development of the ICS is further discussed below.

Speaking to attendees of the NAIC, Jonathan Dixon, the new Secretary General of the IAIS, reported on the IAIS's announcement last month of a "unified path to convergence" of group capital standards, setting the course for a single ICS that "achieves comparable outcomes across jurisdictions."

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### The NAIC Group Capital Calculation Tool

The delayed timing accorded the ICS process also benefits both the NAIC and the Federal Reserve, each of which is working toward completion of an aggregation method for measuring group capital. NAIC CEO Michael Consedine stated in an August interview that the Federal Reserve and NAIC will work together to develop aligned standards in order to achieve great marketplace efficiency. As we have previously reported, the NAIC's Group Capital Calculation (E) Working Group is developing an RBC aggregation methodology which includes (i) creating an inventory of the group's insurance and non-insurance members, (ii) determining whether an entity should be included in the group capital calculation, and (iii) if so, determining the appropriate method for calculating the entity's capital.

Although the Working Group did not meet at the Fall National Meeting, it has discussed several topics during its interim conference calls as briefly described below. Treatment of XXX/AXXX captive insurers as members of an insurance group continues to receive attention from the Working Group. On one hand, regulators do not want to incentivize insurance groups to create new XXX/AXXX captives but, on the other, regulators wish to avoid penalizing groups that already use such captives. Discussions regarding a "look through" approach are taking place during the Working Group's meetings.

Interested parties had previously proposed excluding from the group capital calculation tool all non-financial entities and immaterial entities that do not create demonstrable recourse to the group. However, several regulators found this approach inconsistent with the defined scope of a group under the Insurance Holding Company System Regulatory Act (Model #440), which applies to the ultimate controlling person and includes all insurer and non-insurer affiliates.

Following its October calls, the Working Group exposed a second memorandum, which would require the group capital calculation to identify all legal entities within the group. The following entities would be individually identified: insurers, banks, asset managers and registered investment advisors, all other financially regulated entities, and other entities material to the group from a risk perspective. All remaining entities would be inventoried, but would not be subject to individual capital calculations. Rather, similar entities would be grouped together and be reported in total for the calculation. For the individually identified entities and the entities that are grouped together, the NAIC proposes factors for purposes of initial field testing of a beta version group capital tool. The Working Group has explained that this proposal is an attempt to capture contagion risk in a group structure, and the goal is to come up with a modified version of capturing all the entities that have to be inventoried in the group. Comments on this memorandum are due by January 15, 2018.

Since April, NAIC staff has been working with volunteer insurance groups to perform a "baseline exercise" to help inform the Working Group's decisions with respect to components of the group capital calculation tool. The baseline exercise is primarily a data collection effort; a more formal field testing process will be established once there is a proposed calculation tool to test.

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NAIC staff has reported that they are ready for “Round 2” of the exercise. In order to proceed in a timely manner, the NAIC asked the volunteer insurance groups to submit their information by year-end. Following completion of Round 2, the NAIC will create an initial version of the group capital calculation tool. The Working Group expects an initial version of the capital tool to be available by late March or early April 2018.

### Federal Developments Affecting Insurance Groups

#### 1. FSOC

Director Hartt, who also serves as the state insurance commissioner representative on FSOC, reported that FSOC met three times since the Summer National Meeting, including on September 29 when FSOC voted to rescind the designation of AIG as a non-bank SIFI. On November 17, the Treasury issued a report reviewing FSOC’s process for non-bank SIFI designations pursuant to President Trump’s memorandum ordering the Secretary of the Treasury to conduct a “thorough review of FSOC process including non-bank SIFI designations.” The Treasury recommended that FSOC focus on an activities-based approach and work with regulators to address systemic concerns. The Treasury report made several recommendations, including increasing “analytical rigor,” improving the engagement between FSOC and primary regulators, increasing the public transparency of FSOC’s basis for SIFI designations and providing a clear “off-ramp” for designated non-bank financial companies.

The Trump administration recently nominated Thomas Workman, former longtime President and Chief Executive Officer of the Life Insurance Council of New York (LICONY), to replace S. Roy Woodall Jr. as the independent insurance industry’s voting member of FSOC for a term of six years. Workman’s nomination is subject to Senate confirmation. Woodall was appointed by former President Barack Obama in 2011 to serve as the initial person holding the independent insurance expert position under Dodd-Frank. Woodall’s six-year term was set to expire in late September 2017, but in September, Congress passed a bill to permit the independent insurance expert to remain on FSOC until 18 months after the end of his term or when a successor is appointed or confirmed, whichever is earlier.

#### 2. FIO

The Director of FIO has a number of roles, including serving as a non-voting member of FSOC. Since Michael McRaith stepped down as the Director of FIO in January, a permanent replacement has not been named, but Steven Seitz, Deputy Director of FIO, is performing the role of Director. A Treasury report released in October on the insurance and asset management industries contained several suggested reforms of FIO. The report noted that the Treasury is “committed to realigning FIO’s operations through five pillars of focus” to “help promote the state-based insurance regulatory system in the United States, and make FIO’s work more effective.” The five pillars Treasury has crafted to guide FIO’s mission are:

- Promote the U.S. state-based insurance regulatory system and advocate for the U.S. insurance sector in international forums and negotiations, and in foreign markets.

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- Provide insurance policy expertise and advice to the federal government, state insurance regulators, and industry through the publication of comprehensive research and analysis, consultation on emerging issues, and evaluation of federal insurance programs.
- Provide coordinated and collaborative leadership on insurance issues that engage the federal government and state insurance regulators, including through enhanced coordination between the federal government and state insurance regulators.
- Protect the U.S. financial system and economy by advising the Secretary of the Treasury and the FSOC on insurance-related matters that may pose a threat to U.S. financial stability.
- Protect America's financial security by promoting access to insurance products and administering the Terrorism Risk Insurance Program.

To effectuate these pillars of focus, the Treasury made several recommendations to FIO, including increased transparency and stakeholder engagement. Treasury and FIO plan to achieve these objectives by committing to more regular and consistent engagement between state insurance regulators and stakeholders with regard to important issues in the insurance industry.

### **Innovation and Technology**

#### 1. Cybersecurity

##### a. NAIC Cyber Model Adopted on Interim Calls

On an interim call on October 24, the Executive and Plenary adopted the Insurance Data Security Model Law, commonly referred to as the NAIC Cybersecurity Model Law. The Model had been adopted by the underlying NAIC working group and task force at the Summer National Meeting, and no further changes were made prior to adoption by the Executive and Plenary. This adoption was the culmination of a major NAIC initiative and has been commended by the Trump administration. The adopted Model now goes on to the states for adoption into state law, and the NAIC will presumably begin the process of considering the Cybersecurity Model Law as a part of the NAIC Part A Accreditation Standards at the appropriate time.

##### b. Federal Initiatives

At the Fall National Meeting, the Cybersecurity (EX) Working Group received an update on federal cybersecurity initiatives. It was noted that Congress is very concerned about large-scale data breaches such as at Equifax. Such incidents have reportedly renewed Congress' interest in significant federal legislation addressing data breaches, and NAIC staff speculated that outrage may push them to act this time. There have been numerous hearings in both houses over the past months, and the NAIC has been working hard to connect with key committees. On the other hand, the



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report that Treasury released in October reported favorably on the adoption of the NAIC Cybersecurity Model Law, recommended that all states adopt it promptly, and recommended that if there has not been uniform adoption within five years the federal government should enact federal legislation setting standards for insurer data security. NAIC staff did not highlight the additional recommendation in the Treasury report that the NAIC work to adopt a Model as an NAIC Accreditation Standard which requires insurer data breach notifications to consumers.

### 2. Big Data Discussion Continues

The Big Data (EX) Working Group met at the Fall National Meeting and continued discussion of its following charges:

(i) review current regulatory frameworks used to oversee insurers' use of consumer and non-insurance data, (ii) assess data needs and required tools for regulators to appropriately monitor the marketplace and evaluate underwriting, rating, claims, and marketing practices, and (iii) propose a mechanism to provide resources and allow states to share resources related to their review of complex models.

First, the Working Group discussed current regulatory frameworks for oversight of insurers' use of consumer data. The Working Group noted that they want to understand gaps in such framework but also conflicts, and that they must balance consumer protection with industry innovation. They considered whether it was plausible to try to harmonize state laws on this subject, leading to the determination that the Working Group will survey state regulators on whether their state laws include specific prohibitions on the use of consumer data in underwriting and rating. The Working Group also re-affirmed that they are interested in considering these issues with regard to other lines of business, but that they are beginning by analyzing personal lines auto and homeowner business. They will accept comments through January 12, 2018 on this subject and a related NAIC paper titled "Regulatory Framework - Proposed Structure and Issues for Discussion."

Second, the Working Group discussed data needs and tools for state insurance regulators to monitor the marketplace. The Working Group determined it would consult with subject matter experts and relevant NAIC groups, and would accept comments through January 12, 2018 on the topic and a related discussion paper prepared by NAIC staff this summer titled "Background Information for Assessment of Regulatory Data Needs."

Third, the Working Group discussed the proposal for the NAIC to assist with the analysis of complex models. The Working Group discussed a proposal to form a Predictive Analysis (C) Working Group, charged with drafting potential changes to the Product Filing Examiners Handbook to "address best practices for review of predictive analytics and models used by insurers to justify rates," recommending filing requirements, facilitating multistate regulator discussions and sharing of training and expertise between states, and working with NAIC staff on identifying IT resources that could assist with analysis of predictive models. It was determined that proposed charges for such a working group should be prepared for the Working Group's consideration, and also that NAIC staff should be tasked with researching the skills and number of personnel that the NAIC might need to employ in order to form an analytics team to assist state regulators with their review of complex models. The proposal to form such a working group, and to ask NAIC staff to perform such

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research, was subsequently exposed for comment through January 12, 2018 in a document titled “To Aid State Regulatory Review of Complex Models Used in Support of Personal Auto and Homeowner Insurance Rate Filings.”

### 3. Innovation and Technology

At the Fall National Meeting, the Innovation and Technology (EX) Task Force continued to hear presentations from the industry on initiatives related to innovation. There was further discussion of regulator “sandbox” concepts (*i.e.*, the practice of relaxing regulatory requirements on a trial basis in order to promote innovation), including hearing presentations from industry representatives on sandbox activity in jurisdictions outside of the United States. In particular, the American Insurance Association (AIA) has proposed draft legislation related to giving insurance commissioners more flexibility in working with startups and existing insurers in getting innovative products and services to market, which they believe would create the foundation necessary to promote insurance innovation.

IAIS Secretary General Dixon also discussed how the IAIS is becoming increasingly focused on emerging risks and trends in the insurance marketplace as these issues are important to all of the IAIS’s members, in both the developing and developed markets. These emerging issues include FinTech (*i.e.*, technological innovation in the financial sector), cybersecurity and climate risk. Earlier this year, the IAIS published a foundational paper showing the profound effect that FinTech may have on regulatory oversight. In 2018, the IAIS plans to launch a FinTech forum for supervisors to exchange perspectives on supervisory practices and to address the supervisory challenges posed by the use of algorithms and artificial intelligence in underwriting. Also in 2018, the IAIS intends to publish an application paper on good supervisory practices for cybersecurity. With respect to natural disasters and climate risk, the IAIS’s aim will be to support members as they increasingly engage in discussions on the importance of insurance in addressing climate-related risks.

## Reinsurance

### 1. Covered Agreement

On September 22, the EU and U.S. signed the Covered Agreement. Among other terms, U.S. states have five years from the date of signature to remove collateral requirements for EU reinsurers that meet certain standards, or face federal preemption determinations by FIO, while EU member states have two years to revise their “local presence” laws. The Trump administration also issued a U.S. policy statement providing guidance on implementation which “encourages” each state to “promptly” adopt credit for reinsurance laws and regulations consistent with the Covered Agreement, and to implement the required phase-out of collateral requirements. The policy statement notes that the Covered Agreement “affirms the U.S. system of insurance regulation, including the role of state insurance regulators as the primary supervisors of the business of insurance.”

At the Fall National Meeting, Task Force Chair NYDFS Superintendent Maria Vullo spoke about beginning the process of implementing the Covered Agreement at the state level and noted that, under Dodd-Frank, FIO has the authority to take action where it finds that EU domiciled (re)insurers are treated less favorably than U.S (re)insurers. She noted that

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insurance commissioners have already started to hold discussions about passing the necessary reforms, and that a public hearing will be held on the subject, on February 20, 2018 in New York City. Written comments are requested by February 6, 2018 from regulators and interested parties.

### 2. XXX/AXXX Regulation and Law

At the Fall National Meeting, the Accreditation Committee discussed whether to adopt a proposed Part A Accreditation Standard relating to the XXX/AXXX Model Regulation, the proposal having been adopted by the Reinsurance Task Force at the Summer National Meeting. The Accreditation Committee decided to defer a decision as the implementation of the Covered Agreement may affect this Model. Since the Fall National Meeting at least two states have adopted the Model Regulation.

### 3. Qualified Jurisdictions

The Reinsurance Task Force also heard a report from the Qualified Jurisdiction (E) Working Group, which noted that the Working Group had been instructed to stop working on matters related to Solvency II while the Covered Agreement was being finalized, and that they have done so but stand ready to proceed with such matters or with the evaluation of any new candidate Qualified Jurisdiction as needed. It was also noted again that the reevaluation of current Qualified Jurisdictions is approaching, as all seven of the currently qualified jurisdictions were approved through 2019, and that work will begin on those reevaluations at the end of next year. This work is still relevant as the Covered Agreement as executed would only apply upon effectiveness to certain international jurisdictions and, within such jurisdictions, only to reinsurers which meet certain standards.

### ORSA and Form F Updates

The Group Solvency Issues (E) Working Group did not meet at the Fall National Meeting, but on an interim conference call had continued the discussion of potential overlap in the regulatory roles of the ORSA report and the Form F enterprise risk management report. The Working Group has exposed through January 12, 2018 a draft NAIC Enterprise Risk Report (Form F) Implementation Guide (available [here](#)) and a Comparison of Form F and ORSA Reporting Requirements (available [here](#)). The Working Group stated that the Implementation Guide is intended to create more certainty on regulators' expectations by helping companies understand the intent of the Form F, that it recommends good or best practices while not overreaching its statutory scope, and that it will help companies avoid repetitive filing of the same information.

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### Briefly Noted

#### 1. Update on Adoption of Other Accreditation Standards

##### a. Corporate Governance Models

At the Fall National Meeting, the Accreditation Committee again considered the adoption of the Corporate Governance Annual Disclosure Model Act (#305) and the Corporate Governance Annual Disclosure Model Regulation (#306) as additions to the NAIC Part A Accreditation Standards. These Models require the annual filing by insurers or groups of insurers of a confidential disclosure of corporate governance practices. The Models had been discussed at the Spring National Meeting and considered for adoption at the Summer National Meeting, but a decision had been deferred due to the possibility that the terms of the Covered Agreement might require further changes to the Models, as the Covered Agreement was anticipated to affect requirements related to group supervision.

At the Fall National Meeting Kay Noonan, General Counsel to the NAIC, advised that in light of the guidance issued by Treasury with respect to the Covered Agreement, she does not believe that there will be any impact on these Models. After some discussion, the Models were adopted as an addition to the Part A Accreditation Standards (not applicable to risk retention groups), to become effective as of January 1, 2020, with dissenting votes from Texas and Michigan. It was noted that 19 states have already adopted the Model Law.

##### b. Model Audit Rule Revisions

At the Fall National Meeting, the Executive and Plenary adopted as an addition to the NAIC Part A Accreditation Standards the amendments to the Annual Financial Reporting Model Regulation (#205) (the “Model Audit Rule”) made in 2014 (the “MAR 2014 Amendments”). The MAR 2014 Amendments require individual insurers writing more than \$500 million and insurance groups writing more than \$1 billion in annual premium to maintain an internal audit function providing independent, objective, and reasonable assurance to the audit committee and insurer management regarding the insurer’s governance, risk management, and internal controls. The function is required to be organizationally independent from management and required to report at least annually to the audit committee on the results of internal audit activities. The NAIC advocated for the ultimate adoption by every jurisdiction of these revisions to the Model Audit Rule to ensure uniformity and consistency in requirements for U.S. insurers, particularly as uniform adoption across jurisdictions will assist the United States in meeting international standards and ensure a standard level of protection to policyholders of large insurers across the United States. The revisions to the Model Audit Rule would become effective as an accreditation standard January 1, 2020.

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### c. Disagreements over Scope of Applicability Complicate Adoption of HCA Model Revisions as Accreditation Standard

At the Fall National Meeting, the Accreditation Committee ran into what seemed to be an unexpected amount of resistance to adopting as an NAIC Part A Accreditation Standard the 2014 revisions to the Holding Company Model Act, which authorize a U.S. state insurance regulator to act as group-wide supervisor for an IAIG which includes a domestic insurer. Although Ms. Noonan advised that the Covered Agreement would not affect this Model, committee members sparred over whether it makes sense to adopt, as an accreditation standard, group-wide supervision requirements that affect only those states that are the domicile of a U.S. insurer that is a member of an IAIG and would likely be identified as group-wide supervisor for such an IAIG. At Ms. Noonan's suggestion the decision was deferred to an interim call but during such call the Accreditation Committee decided without objection to defer the decision to the 2018 Spring National Meeting. The intent of this deferral is reportedly to provide all regulators with the chance to fully review the proposal.

## 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 ("Annuity Model Regulation"), as well as considering how to promote greater uniformity across NAIC member jurisdictions regarding annuity suitability regulation. At the Summer National Meeting, the Working Group heard suggestions from trade associations regarding adopting a "best interest" standard instead of the current undefined "suitability" standard of the Model Regulation. At the Fall National Meeting, the Working Group discussed an initial draft of proposed revisions to the Annuity Model Regulation, which incorporates a best interest standard of care into its existing suitability standards. The Working Group noted that the intention of the "best interest" standard in the Annuity Model Regulation is to create uniformity of approach among FINRA, the DOL and the SEC.

The Working Group received comments from stakeholders regarding the initial draft. Stakeholder concerns related to the "best interest" and "material conflict of interest" definitions and the notion that disclosure of compensation may lead to unwanted consumer focus on compensation as opposed to consumer "best interest."

The Working Group exposed the draft revisions to the Annuity Model Regulation for comment until January 22, 2018. Following the end of the comment period, the Working Group will schedule a call before the 2018 Spring National Meeting to discuss the comments received, in order to present a draft of the proposed revisions to the Life Insurance and Annuities (A) Committee at the 2018 Spring National Meeting.

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### **Long-Term Care Insurance Initiatives**

At the 2016 Fall National Meeting in Florida, the Receivership Model Law (E) Working Group (the “Receivership Working Group”) was given two new charges related to long-term care. One of those charges was to consider changes to the Life and Health Insurance Guaranty Association Model Act (#520) (the “L&H Model Law”) to determine whether any changes were needed. In furtherance of this, the Receivership Working Group after much effort on this initiative in 2017 has also exposed proposed changes to the L&H Model Law which provide for the following, among other items: (i) adding health maintenance organizations as members of the guaranty fund; (ii) splitting guaranty fund assessments between health insurers and life insurers; and (iii) allowing guaranty associations to request rate increases if they are actuarially justified. The proposed changes to the L&H Model Law were (i) approved on a November 29 joint conference call between the Receivership Working Group and the Receivership and Insolvency (E) Task Force, (ii) approved at the Fall National Meeting by the Financial Condition (E) Committee, and (iii) subsequently adopted by Executive and Plenary on a December 21 interim phone call. The adopted model now goes on to the states for adoption into state law.

### **Liquidity Risk Assessment Proposals Dominate Financial Stability Task Force Meeting**

The Financial Stability (EX) Task Force met at the Fall National Meeting. As background, this Task Force was created to consider issues concerning domestic or global financial stability as it pertains to the role of state insurance regulators and make recommendations for improvements. One area of focus is improving insurance regulators’ ability to assess liquidity risk. The Liquidity Assessment (EX) Subgroup, part of the NAIC’s new Macro-Prudential Initiative, introduced a proposal to identify insurance product categories with greater particularity in the statutory statement blanks. For example, currently the lines of business identified in the blank’s “analysis of operations” has one column for “life insurance” and under the new proposal, this would be broken down into numerous new columns, such as whole life insurance, term life insurance, universal life insurance, variable life insurance, etc. The Task Force intended to approve this proposal at the Fall National Meeting and refer it to the Blanks (E) Working Group for review, approval and implementation for the 2018 financial statements. The ACLI expressed concern that this proposal was moving too rapidly and that the additional disclosure would be costly and burdensome for the industry to implement, and suggested to the Task Force that more time was needed to evaluate why the proposal is needed and how difficult it would be to implement. The regulators from Texas agreed with the ACLI’s concerns. After a lengthy discussion by its members, the Task Force decided they would expose the proposal for 45 days in light of concerns from Texas and interested parties, but noted that this should still provide enough time for the initiative to be approved by the Blanks (E) Working Group for year-end implementation.

### **Updated Reserving and RBC Framework for Variable Annuities Finally Exposed for Comment, but Much Work Remains Ahead**

At the Fall National Meeting, the Variable Annuities Issues (E) Working Group exposed for comment until March 2, 2018 the recommendations of the Working Group’s outside consultant with respect to potential modifications to the regulatory framework governing variable annuity products. This first exposure follows the completion of two quantitative impact

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studies by the outside consultant, which were conducted over a two-year period. The Working Group noted that the outside consultant's recommendations reflect extensive input from the industry, but only limited input from regulators—and that the regulators would be reviewing and potentially modifying the recommendations following the end of the comment period.

As expected, the outside consultant's recommendations are mainly focused on revisions to Actuarial Guideline 43 (including in particular revisions to the calculation of the Conditional Tail Expectation (CTE) amount and the Standard Scenario amount) and revisions to the calculation of the C3 charge in the risk-based capital framework. In addition, the proposed recommendations include increased disclosure requirements, increasing admissibility limits for variable annuity hedges and variable annuity-related deferred tax assets, changes to statutory accounting rules applicable to interest rate derivatives that are part of variable annuity hedge programs, and certain revisions to the reserve allocation methodology. These changes are designed to: (i) decrease balance sheet volatility for companies with economically-focused hedges, which is expected to reduce disincentives for companies to hedge their variable annuity exposures; (ii) result in greater comparability across companies writing variable annuity business and the variable annuity products they offer; (iii) provide for enhanced oversight of company assumptions via the revised Standard Scenario; and (iv) simplify the interpretation and calculation of variable annuity reserves and risk-based capital. The outside consultant has suggested that a three-year phase-in period be implemented with respect to the adopted recommendations, with additional extensions permitted for qualifying companies, so as to enable companies to better comply with the proposed changes.

Along with the outside consultant's initial recommendations, the Working Group also exposed proposed revisions to Actuarial Guideline 43 and the "Interest Rate Risk and Market Risk" sub-part of the risk-based capital calculation. Following the end of the comment period on March 2, 2018, the Working Group will schedule calls to discuss the various sub-components of the outside consultant's recommendations. In addition, the Working Group will meet for a full day before or at the 2018 Spring National Meeting to further discuss these recommendations.

### **Principle-Based Reserving**

At the Fall National Meeting, the Principle-Based Reserving Implementation (EX) Task Force observed that its work is pretty much complete. PBR went live in most states on January 1, 2017 (the Task Force reported that 47 states, representing approximately 86% of premium, have adopted it), and 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. It was noted that (E) Committee and the Life Actuarial (A) Task Force will be taking on oversight functions of certain related workstreams. The proposal to disband the Task Force and all its subgroups was unanimously approved by the Task Force.

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## NAIC Report: 2017 Fall National Meeting

### TOPICS OF INTEREST TO THE P/C INSURANCE INDUSTRY

#### Flood Insurance Market Discussion Continues

At the Fall National Meeting, Roy Wright of FEMA gave a presentation regarding the NFIP. The NFIP was set to expire on September 30, but has been extended – so far through January 19, 2018 – as part of the stopgap funding for the U.S. government. In the wake of summer and autumn hurricanes and other storms, there were hopes that Congress would act on a reauthorization of the NFIP before adjourning for the year. Although the House passed its bill to do so in November, the Senate has not and it seems the Senate will not do so. Congress plans to enact another “continuing appropriations” bill, which may include an NFIP temporary extension. Mr. Wright observed that there will be renewed promises to enact a long-term reauthorization in 2018, and that election-year pressures for Senators and Representatives will be greater than in 2017, but that this still may not be enough to spur full reauthorization of NFIP.

#### Travel Insurance

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 Working Group began by considering a related NCOIL model law. Following the Summer National Meeting, the Working Group has held a series of interim calls for the purpose of determining, section by section, the revisions required to draft the NAIC Travel Model. These interim calls are scheduled to continue, and it was reported at the Fall National Meeting that the Working Group will probably complete their drafting work on the NAIC Travel Model during the first quarter of 2018, with the goal of having it fully adopted by the NAIC in 2018.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

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