CLIENT ALERT

NAIC Report: 2018 Spring National Meeting

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AUTHORS

Leah Campbell | Donald B. Henderson, Jr. | Allison J. Tam

The 2018 Spring National Meeting of the National Association of Insurance Commissioners was held in Milwaukee, Wisconsin on March 24-28, 2018.

Discussions regarding the Covered Agreement developments were a highlight of the meeting, including the manner in which the NAIC will implement its provisions. Other highlights included discussions on the insurance industry's use of new and innovative technologies and discussions on the impact on the insurance industry of federal tax reform passed in late 2017.

In her inaugural National Meeting as NAIC President, Tennessee Insurance Commissioner Julie Mix McPeak introduced the NAIC's three-year strategic plan, known as "State Ahead." The three themes of State Ahead are: (i) safe, solvent and stable markets; (ii) consumer protection and education; and (iii) superior member services and resources. State Ahead's priorities for 2018 include big data, cybersecurity, international regulation, operationalizing provisions of the Covered Agreement through state-based insurance laws and regulations, and the NAIC's Macroprudential Policy Initiative, which is aimed at identifying and calculating how risks from the broader financial markets and economies impact the insurance sector.

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

Definitions used in this Report include:

- “Academy” means The American Academy of Actuaries.
- “Accreditation Committee” means the NAIC’s Financial Regulation Standards and Accreditation (F) Committee.
- “ACLI” means The American Council of Life Insurers.
- “AIA” means The American Insurance Association.
- “Certified Reinsurer” means a reinsurer that is domiciled in a Qualified Jurisdiction and that has been certified as a reinsurer in an NAIC accredited jurisdiction after having undergone a “passporting” process developed by the Reinsurance Financial Analysis (E) Working Group.
- “ComFrame” means the Common Framework for the Supervision of the Internationally Active Insurance Groups being developed by the IAIS.
- “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.
- “DOL” means the United States Department of Labor.
- “Executive and Plenary” means all of the U.S. state insurance commissioners in plenary session along with the NAIC’s Executive (EX) Committee.
- “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-SII” means Global Systemically Important Insurer, 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.
- “Qualified Jurisdiction” means a non-U.S. jurisdiction that, based upon evaluation of the jurisdiction’s reinsurance supervisory system, the NAIC recommends be recognized by the U.S. states as a “Qualified Jurisdiction” under the revised Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786), which require an assuming insurer to be licensed and domiciled in a “Qualified Jurisdiction” in order to be eligible for certification by a state as a Certified Reinsurer for reinsurance collateral reduction purposes.
- “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.
- “USTR” means the Office of the U.S. Trade Representative.

COVERED AGREEMENT AND REINSURANCE

Dodd-Frank authorized the USTR and Treasury to negotiate bilateral or multilateral agreements regarding prudential measures affecting insurance or reinsurance. The U.S. commenced negotiations with the EU in February 2016, submitted the text of the Covered Agreement to certain congressional committees on January 13, 2017, and signed the agreement on September 22, 2017. The Covered Agreement became provisionally effective on November 7, 2017. It addresses reinsurance collateral and "local presence" requirements, group supervision and group capital standards. Several transition periods are set forth in the Covered Agreement, and the execution of measures required under the agreement rests with the states. In particular, a U.S. ceding insurer's ability to take credit for reinsurance ceded to an EU reinsurer is a central and time-sensitive issue for the states; state laws that result in less favorable treatment of an EU reinsurer than a U.S. reinsurer are subject to federal preemption and the NAIC's timeline is driven by such preemption deliberations.

The substantive reinsurance requirements of the Covered Agreement are the elimination of collateral and "local presence" requirements for U.S. reinsurers operating in the EU and for EU reinsurers operating in the U.S. as a condition for ceding insurers obtaining credit for reinsurance ceded to such reinsurers. The Covered Agreement establishes financial strength and market conduct conditions that EU and U.S. reinsurers must meet to receive the benefits of the Covered Agreement.

Recognizing that each state must promulgate appropriate amendments to laws and regulations within the next few years to avoid preemption deliberations by FIO, the NAIC is working under an accelerated timeline to adopt amendments to the NAIC Credit for Reinsurance Model Law and Regulation (the "Reinsurance Models"). The Reinsurance (E) Task Force held a public hearing in New York City on February 20th, which NAIC President Julie McPeak referred to as "the hottest ticket this winter, at least in the insurance space." During the hearing, 18 speakers testified, including U.S. domestic insurer trade associations, international reinsurers and international trade associations, and a Treasury representative. The majority of those testifying recommended that the Reinsurance Models be amended not only to comply with the Covered Agreement but also to afford the credit for reinsurance standards set forth in the Covered Agreement to reinsurers domiciled in non-EU Qualified Jurisdictions. Currently, non-EU Qualified Jurisdictions include Bermuda, Japan, and Switzerland, and EU Qualified Jurisdictions include France, Germany, Ireland and the United Kingdom.

On April 17, 2018, on an interim conference call, the NAIC's Executive (EX) Committee adopted the recommendation of the Financial Condition (E) Committee to amend the Reinsurance Models. Specifically, the purpose of the revisions to the Reinsurance Models is to (1) conform to the requirements of the Covered Agreement with respect to EU reinsurers; (2) provide to reinsurers domiciled in Qualified Jurisdictions outside the EU the same collateral reduction benefits as those provided to EU reinsurers under the Covered Agreement, provided that the Qualified Jurisdiction agrees to adhere to all other standards imposed upon the EU in the Covered Agreement, including agreeing to recognize the states' approach to group supervision, including group capital; and (3) address a breach of the Covered Agreement (or a Qualified Jurisdiction's agreement to adhere to Covered Agreement standards) and/or the Reinsurance Models. The proposed timeline for adoption of revisions to the Reinsurance Models is aggressive, calling for a working draft of the revisions to be available by the 2018 Summer National Meeting with adoption at the 2018 Fall National Meeting. The number of countries applying to become Qualified Jurisdictions will likely increase significantly as a result of the proposed changes to the Reinsurance Models.

In practice, under the amended Reinsurance Models, reinsurers domiciled in Qualified Jurisdictions would likely benefit from the zero collateral requirement of the Covered Agreement and would not be subject to the current provisions of the Reinsurance Models that require a Certified Reinsurer domiciled in a Qualified Jurisdiction to post graduated amounts of collateral depending on the reinsurer's credit rating. It also means that the 44 states that have incorporated the current Reinsurance Models' reduced collateral for Qualified Jurisdictions into their reinsurance laws and regulations would have to again approach their legislators/insurance commissioners with the Covered Agreement required revisions to the Reinsurance Models to account for the elimination of collateral for Qualified Jurisdiction reinsurers.

Based on the Financial Condition (E) Committee's recommendation, on the April 17th conference call, the NAIC's Executive (EX) Committee adopted a charge requiring the Qualified Jurisdiction (E) Committee Working Group to consider changes to the Qualified Jurisdiction qualification process to incorporate elements of the Covered Agreement as follows: (i) require that Qualified Jurisdictions recognize key NAIC solvency initiatives, including group supervision and group capital standards; (ii) require the strengthening of the information-sharing requirements between the states and Qualified Jurisdictions; and (iii) incorporate processes of removal of Qualified Jurisdiction status in the event of a breach. The NAIC's goal is for the Working Group's work to be completed by the 2018 Fall National Meeting.

The NAIC's Executive (EX) Committee, on its interim conference call, also adopted a charge to the Reinsurance Financial Analysis (E) Working Group ("REFAWG") to consider changes in its current methods of monitoring Certified Reinsurers to incorporate changes to state reinsurance collateral requirements resulting from the Covered Agreement and from adoption by the states of the revised Reinsurance Models. The NAIC's goal is for REFAWG's work to be completed by the 2019 Fall National Meeting.

Also, the Reinsurance (E) Task Force recognized during the Spring National Meeting that the majority of the domestic insurers testifying at the Task Force's February 20th hearing objected to the imposition of "guardrails" on domestic insurers placing reinsurance with EU and Qualified Jurisdiction reinsurers. Despite this fact, the Task Force did not rule out the imposition of such guardrails. There was discussion of the fact that the 2018 P&C RBC formula assigns a charge to a cedent's reinsurance recoverable based on the financial strength ratings of that cedent's reinsurer; this charge is intended to recognize the potential loss to the cedent's surplus because of the absence of reinsurance collateral. Currently, if an unrated reinsurer is authorized, then uncollateralized reinsurance recoverables receive a 10% charge. If an unrated reinsurer is unauthorized, then uncollateralized reinsurance recoverables are treated as though the reinsurer has the lowest financial strength rating. A similar charge is not included in the Life and Health RBC calculation. As such, on its April 17th conference call, the NAIC's Executive (EX) Committee adopted the Capital Adequacy (E) Task Force's charge to review and possibly modify the Life and Health RBC formulas specific to reinsurance credit risk charges to be based on the financial strength of the reinsurer consistent with the P&C RBC formula, giving due consideration to public default experience and current factors used by credit rating agencies. The charge also requires the Task Force to consider whether adjustments are needed to the P&C RBC formula to consider such information relative to non-rated reinsurers. The Task Force expects this work to be accomplished by the 2020 Fall National Meeting.

TOPICS OF GENERAL INTEREST

International Developments on Group Capital and Group Supervision

1. IAIS Returns to Committee Structure and Macroprudential Committee Focuses on Systemic Risk

At the Spring National Meeting, the (G) Committee heard several reports, including a report from IAIS Deputy Secretary General & Head of Capital and Solvency, Romain Paserot, that the IAIS adopted a new committee structure, effective January 1, 2018. The IAIS has divided its work into three separate committees: (1) the Policy Development Committee, (2) the Macroprudential Committee, and (3) the Implementation and Assessment Committee.

The Macroprudential Committee, tasked with IAIS financial stability work, has two subcommittees: (1) the G-SII Analysts Working Group and (2) the Macroprudential Policy and Surveillance Working Group. The IAIS has been taking a holistic approach to systemic risk in insurance, which includes three work streams: (i) developing an activities-based approach ("ABA") to assessing systemic risk; (ii) addressing cross-sectoral aspects in systemic risk assessment; and (iii) revising the entities-based approach, mainly the G-SII assessment methodology. With respect to development of an ABA, the IAIS released an interim consultation at the end of 2017, which the IAIS is currently reviewing, and plans to release a second public consultation on systemic risk assessment by the end of 2018.

Due to the FSB's decision not to publish a new list of G-SIIs for 2017, the IAIS will provide a recommendation to FSB shortly for the 2018 G-SII assessment methodology process. Additionally, the IAIS Global Insurance Market Report was released at the end of February and discusses the global insurance and reinsurance market from a supervisory perspective. The IAIS Implementation and Assessment Committee is also continuing to develop a revised Coordination Implementation Framework setting out the IAIS's strategic approach to the implementation of IAIS supervisory material and cooperation with insurance supervisors.

2. IAIS Development of Global ICS Continues

As background, the IAIS has been developing a risk-based global ICS since 2013 pursuant to a directive by the FSB to develop a risk-based global insurance capital standard for IAIGs. The IAIS released Version 1.0 of its proposed ICS on July 21, 2017 for volunteer field testing, public consultations and input from stakeholders. This feedback, which included input from U.S. companies, was used in developing ICS Version 2.0. In November 2017, the IAIS announced a unified path to convergence of group capital standards and agreed that ICS Version 2.0 would be conducted in two phases: a five-year monitoring phase, beginning in 2020, followed by an implementation phase, beginning in 2025.

The IAIS has been working on resolving issues related to the technical aspects of ICS Version 2.0, including valuation and capital resources, and the (G) Committee reported that field testing for 2018 will be getting underway shortly. The IAIS will release ICS Version 2.0 for consultation in August 2018 at the same time it releases the specifications used for field testing the revised standards. According to Paserot, ICS Version 2.0 will have less optionality than ICS Version 1.0 and provide greater clarity as to the ultimate goal of the IAIS standards. ICS Version 2.0 will be field tested during the remainder of this year and throughout 2019.

3. ComFrame Development Continues

Several subcommittees of the IAIS Policy Development Committee have also been working on revisions to ICPs based on comments received on ComFrame material that was out for public consultation in 2017. Certain ICPs will be released for a second public consultation in June. The next public consultation on overall ComFrame, including ICS Version 2.0, will be released in August of 2018. The IAIS plans on adopting revised ICPs and ComFrame, including ICS Version 2.0, by year-end 2019.

The NAIC Group Capital Calculation Tool

The Group Capital Calculation (E) Working Group continues to develop 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. The NAIC has been working with volunteer insurance groups on a "baseline exercise" that will result in a proposed group capital calculation tool to be used in field testing. At the Spring National Meeting, the Working Group Chairman, Florida Insurance Commissioner David Altmaier, noted that the Working Group must focus on three significant issues before field testing can begin: (i) treatment of non-regulated entities, (ii) scope of the group, and (iii) treatment of XXX/AXXX captive insurers. Commissioner Altmaier would like to resolve these issues by the 2018 Summer National Meeting so that the second half of the year can focus on field testing.

At the Spring National Meeting, the Working Group and interested parties also discussed a memorandum on the treatment of non-regulated entities in a group. The NAIC had initially proposed a flat charge of 22.5% to the equity of all non-regulated entities, but additional approaches were considered following the 2017 Spring National Meeting. The approach discussed in Milwaukee would require the group capital calculation to identify all legal entities within a group. Certain entities would be individually identified, such as insurers, banks, asset managers, registered investment advisors, and other entities material from a risk perspective, while the remaining entities would be inventoried, but would not be subject to individual capital calculations. Comments from interested parties at the Spring National Meeting focused on whether the treatment of non-regulated entities should strictly follow the existing RBC framework. On the one hand, certain interested parties believe that the group capital calculation should directly follow state legal entity rules without adjustment. On the other hand, other interested parties believe that the group capital calculation is an additional analytical tool and its possible deviations from the existing RBC framework would not alter legal entity requirements. The Working Group Chairman directed NAIC staff to revise the memorandum based on the feedback from interested parties.

The Working Group also discussed a memorandum that proposes an approach for determining the scope of the group for purposes of applying the group capital calculation, which is the first document produced by the NAIC on this issue. Currently, state insurance department financial analysis staff use the ultimate controlling person as the starting point for the scope of the group based on the Insurance Holding Company System Regulatory Act. The memorandum recommends that the scope of the group should be determined by the lead state based upon the lead state's understanding of the group while considering the input of other regulators that have an interest in regulating an entity within the group. In response, certain interested parties proposed uniform criteria for the lead state to consider when determining whether an entity other than the ultimate controlling person should be used as the starting point for the scope of the group (*e.g.*, evaluation of the lead insurer's Schedule Y and applicable Holding Company Act Regulatory Filings). The memorandum, which includes a request for suggested criteria to be considered by the lead state, was exposed for comment until May 8.

Federal Developments Affecting Insurance Groups

Following the 2017 NAIC Fall National Meeting, FSOC published its 2017 annual report, which describes significant financial market and regulatory developments, analyzes potential emerging threats and makes certain recommendations. Among other things, the annual report recommends that regulators and the NAIC continue their ongoing work to improve transparency of captive reinsurance transactions, increase visibility with respect to cybersecurity, and ensure that large financial institutions have sufficient capital and liquidity to reduce their vulnerability to economic and financial shocks. FSOC also recognized the Financial Stability (EX) Task Force and its Macroprudential Initiative and liquidity work. FSOC noted that there is only one SIFI remaining that is subject to a final determination by FSOC.

The Senate confirmed Thomas Workman's nomination as the independent insurance industry's voting member of FSOC in March. We also note that a permanent director of FIO, who, among other things, serves as a non-voting member of FSOC, has not been named since Michael McRaith stepped down in January 2017. Steven Seitz is still performing the role of Director, including serving as Vice Chair of the IAIS's Macroprudential Committee.

Innovation and Technology

1. Cybersecurity

During the Spring National Meeting, the Innovation and Technology (EX) Task Force received an update regarding the state-by-state enactment of the Insurance Data Security Model Law (the "Data Security Model Law"), which was adopted by the NAIC on October 24, 2017. In addition, at the Spring National Meeting, the Task Force disbanded the Cybersecurity (EX) Working Group, which had developed the Data Security Model Law, since its work was complete and the Task Force took over its remaining charges.

The Data Security Model Law governs cybersecurity and data protection practices of insurers, insurance agents, insurance brokers and other licensed entities registered under state insurance laws and is similar to the NYDFS cybersecurity regulation that became effective in March of 2017. In fact, according to a drafting note to the Data Security Model Law, the NAIC's intent is that a licensee that is in compliance with the NYDFS cybersecurity regulation is also in compliance with the Model Law.

At the 2017 Fall National Meeting, Treasury recommended prompt adoption of the Data Security Model Law by the states within the next five years and warned that if adoption did not occur states may risk federal preemption in the form of Congress enacting legislation setting uniform requirements for insurance data security. Legislation enacting the Data Security Model Law, without any amendments, is currently pending in South Carolina and Rhode Island, and there is some interest in introducing the Data Security Model Law during Nevada's and Vermont's 2018 legislative sessions. Recognizing the potential of federal preemption in the next five years, NAIC President McPeak in her Spring National Meeting opening remarks urged states to work toward adoption of the Data Security Model Law, adding that "we must act or face the real potential of federal preemption." Despite this urging, the Data Security Model Law is currently not an NAIC accreditation standard and the Accreditation Committee did not consider adding the Data Security Model Law to its accreditation standards during the 2018 Spring National Meeting.

2. Big Data Discussion Continues

The Big Data (EX) Working Group adopted at the Spring National Meeting a proposal to aid state regulatory review of complex models used in support of personal lines auto and homeowners insurance rate filings. Pursuant to the adopted proposal, the Task Force is requesting that the Casualty Actuarial and Statistical (C) Task Force ("CASTF") appoint a Predictive Analytics (C) Task Force to do the following:

- Draft additions to the Product Filing Examiners Handbook addressing best practices for the review of predictive analytics and models used by insurers to justify rates.

- Recommend filing requirements for rate filings that are based on complex predictive models.
- Facilitate discussion among state regulators regarding rate filing issues of common interest and seek legal assistance to ensure that states can share confidential information during these discussions.
- Facilitate the training and sharing of expertise through predictive analytics webinars.
- Work with the NAIC technical staff to identify software, databases, and other technology that could be proposed to be purchased or developed to assist analysis of predictive models.

Prior to the proposal's adoption, an interested party questioned why the Big Data (EX) Working Group's focus was limited to property and casualty lines and did not include best practices for all lines of insurance, including small business coverage. The Working Group responded that its initial efforts are confined to property and casualty lines in order to realistically deliver on its current charges. A representative from a property and casualty trade group also expressed concern that the proposal injected the NAIC into rate-making and model review, both of which are within the purview of state regulators. A Working Group member from Utah responded that certain states do not have the resources, including a staff property and casualty actuary, to review the accuracy and the appropriateness of the assumptions and data that support complex pricing models. As such, states must turn to the NAIC to furnish this expertise. The adopted proposal also included a request to NAIC management to conduct research into the appropriate skills and the potential number of resources required for the organization to address the needs of the NAIC membership in reviewing models and to make appropriate recommendations to the NAIC's Executive (EX) Committee and the Internal Administration (EXI) Subcommittee.

The proposal was then adopted by the Working Group's parent committee, the Innovation and Technology (EX) Task Force. The next step is for the Property and Casualty (C) Committee to adopt these charges so that the CASTF can begin its work on the charges described above.

In addition to the above, the Innovation and Technology (EX) Task Force requested that the NAIC's Executive (EX) Committee direct NAIC staff to conduct research with respect to the skills and resources necessary for the NAIC to address the needs of its members in reviewing predictive models. The Task Force also requested that the NAIC Legal Division prepare a memorandum analyzing methods and procedures to be followed in sharing predictive modeling information in order to maintain applicable statutory confidentiality protections.

3. Innovation and Technology

The Innovation and Technology (EX) Task Force heard a presentation by the AIA trade association on the potential enactment of state legislation allowing for insurance providers to test innovative new products, services and technologies in a "regulatory sandbox" environment. According to the AIA, Arizona, Hawaii, Illinois and Massachusetts have introduced regulatory sandbox bills in 2018, and Florida, Iowa and Missouri arguably have existing laws that allow for a regulatory sandbox. The AIA has also proposed a model law entitled Insurance Innovation Regulatory Variance or Waiver Act with the stated aim of amending "the insurance law to promote innovative insurance technologies, products and services by permitting the insurance commissioner, subject to legislative reporting, to grant targeted variances, waivers and no action letters."

Task Force members expressed concern about defining the scope of a transaction that would be eligible for sandbox treatment and how to transition from a sandbox environment once a product or start-up is established. Task Force members also questioned whether the current regulatory framework already allows the flexibility necessary to launch innovative insurance products. The NAIC's Executive (EX) Committee met by conference call on April 17, 2018 and adopted the Task Force's revised charges to (1) continue to monitor the area of cybersecurity, including the implementation of the Cybersecurity Model Law and representing the NAIC and communicating with other entities/groups, including appropriate information-sharing; and (2) consider whether additional consumer disclosures related to cybersecurity might be necessary and effective, and, if appropriate, develop model consumer disclosure guidance by December 2018.

Form F Updates

At the Spring National Meeting, the Group Solvency Issues (E) Working Group adopted the Form F Implementation Guide. As background, in the Spring of 2016, the Working Group sponsored a state survey on the effectiveness of the Form F. Many of the 34 states that participated in the survey evidenced disappointment with the process. The Working Group subsequently agreed to develop a non-authoritative implementation guide. This Implementation Guide is intended to assist insurers and regulators by proposing best practices for consideration in preparing and reviewing Form F filings. While the guidance is not authoritative, the Implementation Guide suggests that all filers should consult it for best practices when preparing enterprise risk reports to facilitate a more efficient process. The Implementation Guide is also intended to provide consistency and uniformity across the states in obtaining and utilizing information in the Form F. The Working Group noted that states should become familiar with the Implementation Guide and encouraged each state to notify its regulators of the Implementation Guide's existence and encourage its use.

Valuation of Securities (E) Task Force Updates

The Valuation of Securities (E) Task Force adopted amendments to the *Purposes and Procedures Manual* of the NAIC Investment Analysis Office ("P&P Manual") to clarify the credit assessment procedures of the Securities Valuation Office ("SVO") when assessing investments in debt instruments and preferred stock issued by a subsidiary, controlled and affiliated ("SCA") entity. The Task Force noted that the population of filed SCA investments of this type is relatively small with most having characteristics very similar to those of unaffiliated transactions. The SVO is concerned, however, that its standard procedures used to assign an NAIC Designation to an unaffiliated transaction may not be well suited to assessing the creditworthiness of large, custom and complex SCA transactions. The Task Force's revisions to the P&P Manual clarify that an NAIC Designation will consider only credit risk of the SCA investment, and that the SVO will review only those SCA investments that have terms, structure complexity and purpose that resemble the terms, structure complexity and purpose of transactions between unaffiliated parties filed with the SVO.

Under the amended procedures, the SVO has the sole discretion to determine if the characteristics of an SCA transaction are dissimilar from those of an unaffiliated transaction or that the SVO could not apply its analytical methodologies to assess the creditworthiness of the transaction. An insurer apprised of the SVO's determination may request a conference call with the SVO to evaluate whether focused disclosures and documentation pertaining to the terms, structure, complexity and purpose of the transaction may enable the SVO to develop a credit assessment methodology specific to the transaction.

Alternatively, the insurer may file a submission with the Regulatory Treatment Analysis Service of the SVO to solicit an opinion and rationale as to whether the SCA transaction would be considered to be like those between unaffiliated entities or the insurer may ask its domiciliary state regulator to consider requesting that the SVO assist the domiciliary insurance department in the determination of an NAIC Designation for the transaction.

Liquidity Risk Assessment Updates

The Financial Stability (EX) Task Force met at the Spring National Meeting. The Task Force adopted the Baseline Blanks Proposal and Note Blanks Proposal of the Liquidity Assessment (EX) Subgroup, part of the NAIC's Macroprudential Initiative, to identify insurance product categories with greater particularity in the statutory statement blanks. The blanks proposals will be submitted to the Blanks (E) Working Group for consideration. The Task Force also heard an update from the Liquidity Assessment (EX) Subgroup related to liquidity stress testing. The Subgroup has been participating in regulator-only sessions to discuss specific companies' stress testing methodologies. The Subgroup plans to move to open calls regarding a stress testing framework. The Subgroup noted that it was behind schedule as its work had been focused on the blanks proposals, but anticipates having a draft stress testing framework to be discussed at the Summer National Meeting.

Briefly Noted

1. Update on Adoption of Other Accreditation Standards

Following adoption by the Accreditation Committee at the 2017 Fall National Meeting, Executive and Plenary adopted at the Spring National Meeting the Corporate Governance Annual Disclosure Model Act (#305) and Model Regulation (#306) as accreditation standards effective January 1, 2020.

The Accreditation Committee adopted the 2014 revisions to the Insurance Holding Company System Regulatory Act (Model #440) that provide authority to a designated state to act as a group-wide supervisor for an IAIG. South Dakota, Texas and Wyoming voted against the adoption; Virginia abstained from the vote. Holding companies must meet certain criteria as outlined in Model #440 to be considered IAIGs. If adopted by Executive and Plenary, the revisions will be effective as an accreditation standard January 1, 2020 and will be applicable to all states, including states that have a risk-retention group in a holding company that meets the definition of an IAIG.

The Accreditation Committee also discussed at the Spring National Meeting 2017 amendments to the Life and Health Insurance Guaranty Association Model Act (#520), which ensures the payment of policyholder obligations when a company is deemed insolvent. The revisions were to (i) broaden the assessment base for long-term care insurance ("LTCI") insolvencies to include both life and health insurers, (ii) clarify that LTCI is included in guaranty associations, and (iii) include HMOs as members of the guaranty association. This model law is currently included in the Part A accreditation standards and requires a "regulatory framework" as opposed to specific elements within the model. The Accreditation Committee stated that the revisions are acceptable for maintaining the appropriate regulatory framework as required by accreditation, but the revisions are not specifically required for accreditation.

2. Pre-Dispute Mandatory Arbitration Clauses Update

The Pre-Dispute Mandatory Arbitration Clauses (D) Working Group met at the Spring National Meeting to consider adoption of a bulletin for states to use to advise companies that pre-dispute arbitration clauses and choice-of-venue and choice-of-law provisions are not permitted in personal lines coverage. In September 2017, the Working Group decided to develop a draft bulletin, which was discussed on an interim conference call on March 8, 2018. On that call and at the Spring National Meeting, comments from regulators and interested stakeholders were received. There was a consensus to remove Section 5 of the bulletin, which provides guidance to insurers that file forms with post-dispute arbitration clauses, as it falls outside the scope of the Working Group's charges. Concern was also expressed about the manner in which certain venue selection provisions may be mutually agreed upon by the policyholder and the insurer in Section 6 of the bulletin. The bulletin will be revised to address these concerns and another draft bulletin will be exposed for comment once the revisions have been made.

3. Revisions to Bond Structure

The Investment Risk-Based Capital (E) Working Group has been focused on the increase of RBC bond categories from 6 to 20. The Working Group noted that increasing the bond group granularity will require significant resources to be implemented by year-end 2019, which is the target implementation date. As such, at the Spring National Meeting, the Financial Condition (E) Committee approved of the Valuation of Securities (E) Task Force and NAIC staff beginning the necessary information technology work needed to implement various changes to facilitate the expansion to 20 bond designation categories.

TOPICS OF INTEREST TO THE LIFE INSURANCE INDUSTRY

Impact of Federal Tax Reform on RBC

The focus of the Life Risk-Based Capital (E) Working Group at the Spring National Meeting was the impact of the recently enacted decrease in the U.S. corporate tax rate from 35% to 21% on the NAIC's Life Risk-Based Capital ("Life RBC"). Unlike property and casualty RBC, the Life RBC is calculated on an after-tax basis, and the 2017 tax law changes will therefore affect many items involved in the calculation of Life RBC. For instance, the reduction in the tax rate will generally decrease tax expense for a life insurance company. Tax reserves will be reduced, however, which in turn will increase a life insurer's taxable income and tax expense for the tax years 2018 to 2025. Also, deferred acquisition cost tax provisions will generally increase taxable income and tax expenses for a life insurance company.

At the Working Group's meeting, the ACLI expressed concern with attempting to implement changes required by the tax reform without factoring in how these changes may impact other aspects of the Life RBC formula. For instance, the C-1 and C-2 RBC factors may be materially impacted by lowering the tax rate from 35% to 21%. As such, the ACLI proposed that revisions aimed at addressing the tax reform be delayed until 2019, providing the NAIC with sufficient time to revise all aspects of the Life RBC calculation which may be impacted by the tax reform.

At the meeting, the Academy provided a suggested modification to certain tax-related aspects of the Life RBC formula which address the tax reform's revisions. The ACLI advocated for delaying adoption of these modifications until their appropriateness could be fully studied and also expressed concern with amending the Life RBC "piecemeal." According to the ACLI, a piecemeal application could potentially reduce a life insurance company's minimum RBC level to an RBC regulatory action level even though a company was in no more danger of insolvency after the tax reform than it was before the tax reform.

The Working Group agreed that it would endeavor to enact changes to the calculation of Life RBC necessitated by the 2017 tax reform by year-end 2018 with recommended changes exposed by the end of April 2018 and with adoption of the changes by the end of June 2018. When reporting to the Capital Adequacy (E) Task Force the day after its meeting, the Working Group emphasized that it would be a "heavy lift" to implement all the required changes in the Life RBC calculation by year-end 2018 and recommended against piecemeal changes. When presented with this proposed timeline for the implementation of the changes, the Task Force instructed the Working Group to "start working" and report back with its progress. The Working Group is holding a series of conference calls this month to finalize its recommendations with respect to this item.

Finally, the Working Group agreed to remove from its Working Agenda consideration of the proper treatment for Life RBC purposes of business ceded to unauthorized reinsurers. While security is often required to be posted by an unauthorized reinsurer in order for the cedent to obtain reserve credit for business ceded to that unauthorized reinsurer, there is no similar handling of these cessions when determining Life RBC. In light of the Group's current 2018 work load and expected changes to be made to the Reinsurance Models to address the Covered Agreement, this agenda item was tabled until 2019.

Annuity Suitability Working Group Discusses Fifth Circuit's Decision on DOL Fiduciary Rule

At the 2017 Fall National Meeting, the Annuity Suitability (A) Working Group discussed and exposed draft revisions to the Suitability in Annuity Transactions Model Regulation (Model #275), which incorporates a best interest standard of care into its existing suitability standards. On an interim conference call, the Working Group discussed comments received on the proposed revisions to Model #275. As we previously reported, the Working Group's intention of the "best interest" standard in Model #275 is to create uniformity of approach among FINRA, the DOL and the SEC. Immediately prior to the Spring National Meeting, the United States Court of Appeals for the Fifth Circuit struck down the fiduciary rule and related exemptions that were issued by the DOL ("DOL Fiduciary Rule"). As such, at the Spring National Meeting, the Working Group heard analysis of the Fifth Circuit's decision on the DOL Fiduciary Rule, a rule that the Chairman of the Working Group believed the DOL did not have the authority to create, and comments from stakeholders. The Working Group noted that the Fifth Circuit decision allows the Working Group to work on a new, more appropriate standard. The Working Group reopened the comment period on Model #275 for 30 days ending April 27, 2018. The Chair encouraged comments to focus on the current Model Regulation as opposed to the draft revisions to the Model Regulation. There will also be an in-person meeting in May, during which the Working Group anticipates having a new draft of revisions to the Model Regulation to be used in future discussions with the SEC.

TOPICS OF INTEREST TO THE P/C INSURANCE INDUSTRY

Flood Insurance Market Discussion Continues

The NAIC's Senior Financial Policy and Legislative Advisor updated the Catastrophe Insurance (C) Committee on Congress's efforts to enact reforms to the NFIP whose statutory authority to operate expired in September of 2017 and was reauthorized until July 31, 2018. The Committee's discussion centered on the NAIC's current and proposed efforts to construct a regulatory framework aimed at stimulating the purchase of private flood insurance. Toward that end, the Transparency and Readability of Consumer Information (C) Working Group previewed graphics developed by the Working Group for posting on state insurance department websites advising consumers of the need for flood insurance even for those homes located outside a flood zone.

Substantively, the Committee continues to endorse the following NFIP's reforms:

- Reauthorization of the NFIP for at least five years as short-term extensions create uncertainty in both NFIP and the private market;

- Clarify the definition of private flood insurance in the reauthorization legislation;
- Stop penalizing former NFIP consumers who procure insurance from the private market and opt to return to the NFIP;
- Require the NFIP to share its data with the private insurance market to allow for the pricing of flood risk; and
- Reward consumers for mitigation efforts with rate reductions.

Representatives from consumer groups agreed that the NAIC should encourage homeowners to purchase flood insurance even when not required by their home loan lender. The consumer groups also claimed that when purchasing a home, consumers are loathe to purchase yet another insurance policy in addition to a homeowners policy, seemingly suggesting that flood insurance should be part of the standard homeowners policy. The consumer groups also indicated that NFIP participants should be rewarded for mitigation efforts via rate reductions.

A representative from a property and casualty trade group emphasized that the private insurance market needed better access to NFIP data in order to price private flood insurance coverage and also needed prompt approval of private market flood insurance policy forms. A reinsurance trade group claimed that the NFIP allowed the federal government to subsidize flood insurance, resulting in very few ceding insurers underwriting private flood insurance.

The Insurance Commissioner from Louisiana recommended that the NAIC approach federal bank regulators with a proposal requiring that homeowners obtaining a mortgage backed by the federal government procure flood insurance. The Committee took this recommendation under consideration and requested that the Catastrophe Working Group of the Property and Casualty Committee be tasked with looking at potential recommendations to increase the purchase of private flood insurance.

The Chairperson of the Property and Casualty Committee advised at the meeting that the NAIC had received a request from FEMA for information as to the amount of flood premiums currently written by surplus lines carriers.

Travel Insurance

At the Spring National Meeting, the Travel Insurance (C) Working Group of the Property and Casualty Insurance (C) Committee continued its section-by-section review of the NAIC Travel Insurance Model Act, which uses the NCOIL travel insurance model law as a template. The Working Group completed its review of Section 7.C.3 of the NAIC Model Law. This section allows a free look period during which a policy can be canceled within 10 or 15 days of purchase, depending on the method by which the travel insurance policy fulfillment material is sent.

The Working Group also completed its review of Section 7E. The intent of this provision is to prohibit the imposition of a charge for a blanket travel insurance policy when the policy is advertised as free. The Working Group revised this Section to affirmatively state that it is "an unfair trade practice to include Blanket Travel Insurance coverage with the purchase of a trip with a separate charge for such coverage." Because Blanket Travel Insurance coverage is a policy of Travel Insurance issued to an eligible group, covering all members of the group, persons offering travel insurance may not charge separately for the policy.

The Working Group also completed its review of a newly added Section 7F that was proposed by a trade group. That section provides:

> Where a consumer's destination jurisdiction requires insurance coverage, it shall not be an unfair trade practice for the travel retailer to require that a consumer choose between the following options as a condition of purchasing a trip or travel package: (1) purchasing the coverage required by the destination jurisdiction through the travel retailer supplying the trip or travel package; or (2) agreeing to obtain and provide proof of coverage that meets the destination jurisdiction's requirements prior to departure.

The Working Group agreed to include the trade group's proposed Section 7F in the Model Law, reasoning that it provides needed information to the consumer.

Finally, the Working Group completed its discussion of Section 8A, which allows MGAs, TPAs and producers, within the activities permitted under their state licenses, to adjust travel insurance claims. The consumer representative from the trade group questioned why a person adjusting a travel insurance policy loss should not be licensed as a claims adjustor. The Working Group responded that most states already exempt producers from procuring a separate claims adjustment license and states do not want to establish separate licenses for the adjustment of travel insurance. Finally, the adjustor licensing exam does not include travel insurance policies.

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

Leah Campbell
212 728 8217
lcampbell@willkie.com

Donald B. Henderson, Jr.
212 728 8262
dhenderson@willkie.com

Allison J. Tam
212 728 8282
atam@willkie.com