Fall 2013 NAIC National Meeting

The National Association of Insurance Commissioners (“NAIC”) held its Fall 2013 national meeting in Washington, D.C., from December 15–18, 2013. The year-long theme of protecting the state-based insurance regulatory system from federal encroachment took on new meaning at these meetings in light of the fact that they commenced just three days following the publication of the long-awaited report of the Federal Insurance Office on how to modernize and improve the system of insurance regulation in the United States (the “FIO Report”). Indeed, the NAIC’s own corporate governance was raised as a topic for debate by the Executive (EX) Committee in connection with a letter, dated December 11, 2013, from Commissioner Thomas B. Leonardi, Insurance Commissioner of the State of Connecticut, to other NAIC members recommending that the NAIC hire an outside consultant to conduct a “thorough evaluation” of the NAIC’s governance structure, as discussed further below. In this context, regulators continued their normal-course work on ongoing initiatives, including the states’ role in implementing federal healthcare reform, implementation of principle-based reserving (“PBR”), establishing corporate governance standards for insurance companies, regulation of insurer investments and financial solvency and achieving consistency with international regulatory standards. The new Private Equity Issues Working Group also held its first public meeting. These and other important topics are discussed in more detail below.

I. Executive (EX) Committee

To begin its meeting on December 16, 2013, the Executive (EX) Committee adopted several items, including 2014 Proposed Charges Related to Contingent Deferred Annuities and a Model Law Development Request for Amendments to the Actuarial Opinion and Memorandum Regulation (#822). The discussion then turned to other matters, specifically, a motion by Commissioner Leonardi of Connecticut to request that the Ad Hoc NAIC Governance Review Group (the “Review Group”) be authorized to hire an outside consultant to review the NAIC’s corporate governance procedures. Commissioner Leonardi’s proposal and rationale were set forth in a letter he wrote on December 11, 2013 addressed to fellow Commissioners, Directors and Superintendents of Insurance in which Commissioner Leonardi questioned certain corporate governance decisions recently made by the NAIC.

Commissioner Robertson of Indiana opposed the motion and suggested instead that the Review Group review the governance issues and make a recommendation. He expressed concern that the motion would in essence “handcuff” the Review Group. Superintendent Lawsky of New York spoke in favor of the motion and indicated that the New York State Department of Financial Services (the “NY DFS”) routinely relies on outside consultants
to provide a fresh perspective. Commissioner Consedine of Pennsylvania, like Commissioner Robertson, deferred to the Review Group.

Following the discussion, Commissioner Leonardi’s motion failed on a 12 to 5 vote. Commissioner Robertson then made a motion to send Commissioner Leonardi’s suggestions to the Review Group and charge it with making an evaluation by the NAIC 2014 Commissioners Conference in February. This motion passed. After the vote, Director Boron of Illinois (who is not a member of the Executive (EX) Committee) stated that he supports additional transparency regarding NAIC corporate governance and Commissioner Leonardi’s proposal.

A. Principle-Based Reserving Implementation Task Force

Despite a full agenda, the only topic discussed at the meeting of the Principle-Based Reserving Implementation Task Force (the “PBR Task Force”) was the proper use of captive reinsurance transactions pending implementation of PBR. The discussion stemmed from a September 13, 2013 report authored by Rector & Associates, Inc. (the “Rector Report”), a consultant to the PBR Task Force. Rector & Associates, Inc. is assisting the PBR Task Force with its charge to consider the recommendations in the NAIC’s Captive and Special Purpose Vehicles White Paper, which was adopted by the NAIC in July 2013.

The Rector Report analyzes captive reinsurance transactions in order to assist regulators in determining whether such transactions should be permitted for XXX and AXXX reserve relief. The Rector Report sets forth a “framework” of concepts for regulators to consider, followed by two alternatives for implementing the concepts. The Rector Report assumes that regulators accept the “general logic” behind the transactions (allowing lower-quality non-admitted assets to back certain portions of a life insurer’s reserves) and that regulators want to make changes to promote consistency and to ensure transactions are “appropriately conservative.”

The Rector Report lists the following as the conceptual underpinnings of the framework:

- XXX and AXXX reserves to pay policyholder claims should be established in full, using applicable reserving guidance (currently, the “formulaic” approach).
- To the extent there is a reasonable probability that they may be needed to pay policyholder claims, those reserves should be conservatively backed by high-quality assets.
- Lower-quality assets (including those not normally allowed as admitted assets under statutory accounting) should be allowed to support such reserves, to a limited extent, if an insurer receives regulatory approval to use them, if the assets meet certain criteria, and if the probability that they will be needed to pay policyholder claims is low.
- To provide consistency and a level playing field, all insurers and regulators should use the same actuarial standard to determine what portion of the reserves must be backed by high-quality assets and what portion may be backed by lower-quality assets.
- There should be appropriate disclosure so that regulators and others (such as rating agencies) can verify that insurers are following the rules and can more effectively measure the levels of risk presented by approved transactions.

The Rector Report sets out two alternatives for applying these concepts in practice. The first alternative would allow the use of reinsurance (including the use of captives). With respect to this alternative, the Rector Report suggests applying a “primary asset requirement” concept, under which a specified level of reserves on business
ceded to a captive would be backed by traditional admitted assets in order for the ceding insurer to receive credit for reinsurance (and the balance of assets could be non-admitted other assets). An “actuarial standard” would be developed to designate the required level of admitted assets, perhaps using Actuarial Guideline 38 as a guide or the NAIC’s amended Standard Valuation Manual (e.g., VM-20—Requirements for Principle-Based Reserves for Life Products). The second alternative involves keeping assets and liabilities on the balance sheet of the primary insurer, an approach that would require legislative and/or statutory accounting changes.

At the PBR Task Force’s meeting, industry representatives and PBR Task Force members discussed their reactions to the Rector Report. The American Council of Life Insurers (the “ACLI”) had previously developed two proposals to address captive reinsurance concerns—one proposing enhanced information and disclosures to enable regulators to better understand captive transactions, and another involving the use of uniform guidelines by regulators when approving and monitoring transactions and for granting credit for reinsurance. However, at the meeting, the ACLI conceded that these proposals do not appear to be satisfying the concerns of some regulators, and it acknowledged that additional regulation is likely. If so, the ACLI expressed its preference for the first alternative set forth in the Rector Report. However, the ACLI commented that it does not believe the approaches for determining an appropriate actuarial standard in the Rector Report adequately take into account the following important elements concerning captive reinsurance transactions: (1) separate from reserving requirements, a captive insurer must also satisfy an additional capitalization requirement generally met with traditional (admitted) assets and (2) all assets of a captive reinsurer are available to respond to reinsurance claims, not just assets backing reserves.

At the meeting, some participants questioned whether industry and regulators could ever reach agreement on an actuarial standard. The PBR Task Force’s Co-Chair, Superintendent Joseph Torti III of Rhode Island, also expressed concern with setting an interim standard, only to have a different standard set when VM-20 is implemented in the future. Superintendent Torti argued that if the interim standard turns out to be a more favorable one for industry, then industry would likely seek to continue using it. The parties expect to continue to discuss interim relief pending PBR implementation and it is possible that the PBR Task Force will create a subgroup to focus exclusively on affiliated captive transactions.

### B. Financial Stability Task Force

At its meeting on December 15, 2013, the Financial Stability Task Force heard a number of presentations relating to U.S. and international efforts to promote financial stability following the 2008 financial crisis. Roy Woodall, the independent member of the Financial Stability Oversight Council (“FSOC”) with insurance expertise, discussed three areas of concern that were noted in his dissent from the FSOC’s designation of Prudential Financial, Inc. (“Prudential”) as a non-bank systemically important financial institution:

- that the FSOC should be focusing more on activities and less on material distress during the designation process;
- the impact and potential unintended consequences resulting from the higher capital requirements under Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (popularly known as the Collins Amendment); and
- whether the U.S. has the right people participating in international regulatory efforts, particularly those of the International Association of Insurance Supervisors (“IAIS”) and the Financial Stability Board.
Mark Grier, Vice Chairman of Prudential, gave a presentation on group capital concepts for insurance companies and echoed Mr. Woodall’s concern with respect to the Collins Amendment.

C. Producer Licensing Task Force

For most of its meeting on December 16, 2013, the Producer Licensing Task Force took comments on the white paper on the role of navigators under the Patient Protection and Affordable Care Act. The Producer Licensing Task Force is drafting Part I of the white paper, titled “Navigator, Non-Navigator Assistance Personnel, Certified Application Counselors, Insurance Producers Certification and Training Standards.” A revised draft of Part I will be circulated for comment in early 2014. As discussed in additional detail in Section III below, Parts II and III of the white paper are being drafted by other NAIC groups.

In federal activity, the National Association of Registered Agents and Brokers Reform Act of 2013 ("NARAB II") passed the United States House of Representatives in September 2013, but the bill was pulled from the United States Senate calendar and will likely not reappear. If passed, NARAB II would have authorized the National Association of Registered Agents and Brokers to issue multi-state licenses to producers in accordance with standards established by state regulators, thus creating a centralized licensing process. The FIO Report recommends that the United States Congress adopt NARAB II and that the Federal Insurance Office monitor its implementation.

II. Life Insurance and Annuities (A) Committee

At its in-person meeting on December 16, 2013, the Life Insurance and Annuities (A) Committee (the “(A) Committee”) formed and requested volunteers for the new Unclaimed Property and Death Master File Working Group. During the meeting, no party volunteered or was assigned to the new working group, which is open to interested parties as well as regulators. The new working group will carry out the following 2014 charge of the (A) Committee: “The Life Insurance and Annuities (A) Committee should undertake a study to determine if recommendations should be made to address unclaimed death benefits.” On December 18, 2013, the Executive (EX) Committee approved the (A) Committee’s 2014 proposed charges.

That charge was adopted by the (A) Committee during a December 4, 2013 conference call. Discussion during the conference call centered on whether the charge should include the phrase “the consistent handling of” such that the charge would have read, “The Life Insurance and Annuities (A) Committee should undertake a study to determine if recommendations should be made to address the consistent handling of unclaimed death benefits” (emphasis added). The Chair of the (A) Committee emphasized that the key word in the charge is “study,” and the (A) Committee agreed to delete the phrase “the consistent handling of,” with only Florida objecting to adoption of the charge in its revised form.

The (A) Committee also discussed its plans to track the issue of longevity risk (the risk of paying out on pensions and annuities for longer than anticipated). The (A) Committee suggested that in 2014, it may refer the issue to the Life Risk-Based Capital Working Group (the “Life RBC Working Group”) to consider whether a factor for longevity risk should be developed. On December 20, 2013, the Joint Forum issued its final paper on longevity risk transfer markets, titled, “Longevity Risk Transfer Markets: Market Structure, Growth Drivers and Impediments, and Potential Risks,” which makes a number of recommendations to policymakers and regulators with respect to transactions used to transfer longevity risk. Those recommendations may influence the course of the (A) Committee’s activities with respect to longevity risk in 2014.
A. Contingent Deferred Annuity Working Group

The Contingent Deferred Annuity Working Group (the “CDA Working Group”) met on December 15, 2013 to discuss its charges from the (A) Committee. Contingent deferred annuities ("CDAs") guarantee lifetime withdrawal benefits to a mutual fund investor where funds are neither owned nor maintained by the insurer. CDAs attracted regulatory attention in late 2011 due to their unique structure and related risks. Some insurance regulators expressed concerns about CDAs from both an actuarial and regulatory perspective, including an insurer’s lack of ownership or control of underlying invested assets and whether the product should be characterized as “financial guaranty” insurance. To address such concerns, the NAIC created the CDA Working Group to examine actuarial issues, potential consumer issues, reserving and capital considerations associated with CDAs.

The (A) Committee has charged a number of NAIC groups with reviewing various regulatory, reporting and accounting issues associated with CDAs. The CDA Working Group will serve as the coordinating body for all CDA-related work being conducted by the various NAIC groups. The CDA Working Group also will be developing NAIC guidelines and/or a model bulletin to assist states interested in modifying their annuity laws to clarify their applicability to CDAs and reviewing existing NAIC model laws and regulations applicable to consumer protection issues associated with CDAs. The CDA Working Group also will be considering how certain existing model laws and regulations might apply to CDAs (or whether CDAs should be expressly exempted from the scope of the same), including the following:

- Annuity Disclosure Model Regulation (#245), to exempt contingent deferred annuities ("CDAs") that are registered with the U.S. Securities and Exchange Commission or offered through retirement plans qualified under the Employee Retirement Income Security Act of 1974 ("ERISA"); and
- Suitability in Annuity Transactions Model Regulation (#275), Advertisements of Life Insurance and Annuities Model Regulation (#570) and Life Insurance and Annuities Replacement Model Regulation (#613), in each case, to specifically reference its applicability to the sale of CDAs (including, with respect to Model #275, the applicability of the one-time, four-hour training and product-specific training requirements).

III. Health Insurance and Managed Care (B) Committee

More than two months following the commencement of open enrollment on the new state, federal and partnership exchanges, discussion regarding federal healthcare reform implementation at the Health Insurance and Managed Care (B) Committee (the “(B) Committee”) meeting focused on problems and concerns of regulators, insurers and consumers in light of the well-publicized difficulties that have affected enrollment on the exchanges. Representatives of the federal Center for Consumer Information and Insurance Oversight ("CCIIO") updated the (B) Committee on CCIIO’s efforts to facilitate federal healthcare reform implementation in 2014, as well as timelines applicable to open enrollment for the 2015 health benefit year. Regulators challenged the CCIIO representatives regarding, among other things, operational problems with the federally facilitated exchange, the role of navigators in the enrollment process and the impact of federal healthcare reform implementation in the U.S. territories (where adverse selection is a threat because certain market reforms, such as guaranteed issue, apply but the individual mandate does not apply). Regulators also discussed the issue of the limited provider networks available through qualified health plans on the health insurance exchanges and the legislation and regulations that some regulators are initiating, including in California and New York, to address...
consumer concerns regarding provider access in the wake of federal healthcare reform. The (B) Committee also heard a presentation from the Georgetown Health Policy Institute, Center on Health Insurance Reforms, regarding resources available to state insurance regulators to assist their consumer services staff in responding to new health insurance inquiries, issues and problems that consumers may raise in 2014 as a result of federal healthcare reform implementation.

The (B) Committee also continued its work on the white paper addressing the certification and oversight of the licensed and non-licensed personnel that assist consumers in using the exchanges. The (B) Committee is preparing Part III of the white paper, titled “Navigator, Non-Navigator Assistance Personnel and Certified Application Counselor Outreach Functions,” and has exposed its November 25, 2013 draft of that section for comments. Other NAIC groups are drafting the remaining portions of the white paper; specifically, the Producer Licensing Task Force is drafting “Part I—Navigator, Non-Navigator Assistance Personnel, Certified Application Counselors, Insurance Producers Certification and Training Standards,” and the Antifraud Task Force is drafting “Part II—Navigator, Producer, Non-Navigator Assistance Personnel and Issuer Fraud.”

The (B) Committee also received reports from several of its working groups. In particular, in response to the report of the Health Actuarial Task Force, the (B) Committee adopted the 2012 Group Long-Term Disability Valuation Table, the actuarial guideline to implement the 2012 Group Long-Term Disability Valuation Table and the revisions made to the Health Insurance Model Regulation (#10) to refer to the 2012 Group Long-Term Disability Valuation Table.

A. Regulatory Framework Task Force

The continuing work of the Regulatory Framework Task Force (the “RF Task Force”) is to update state law in light of impending changes under the Patient Protection and Affordable Care Act and its companion, the Health Care and Education Reconciliation Act of 2010 (together, the “Affordable Care Act”), including (1) drafting an Individual Market Health Insurance Model Regulation (the “Individual Model Regulation”) and Small Group Market Health Insurance Coverage Model Regulation (the “Small Group Model Regulation”), in each case, to accompany the related model acts that were adopted at the Fall 2012 NAIC national meeting, and (2) developing model review recommendations with respect to a list of 31 model laws affected by the Affordable Care Act.

At its meeting in Washington, D.C., the RF Task Force discussed a revised draft of the Individual Model Regulation, which incorporated comments from the Summer 2013 NAIC national meeting, and an initial draft of the Small Group Model Regulation. The RF Task Force exposed each model regulation for a 30-day comment period. In particular, the RF Task Force requested comments on two changes appearing in the revised draft of the Individual Model Regulation: (a) in Section 10 of the Individual Model Regulation, the deletion of a provision that clarified that a health carrier may offer a health benefit plan that does not include the pediatric dental essential health benefit if the health carrier is reasonably assured that an individual has obtained stand-alone pediatric dental coverage through an exchange-certified stand-alone dental plan (the current draft instead includes a drafting note to address what may be permitted in this situation) and (b) in Section 11 of the Individual Model Regulation, the addition of a new section regarding parity in mental health and substance use disorder benefits.

The RF Task Force also adopted the report of the Affordable Care Act Model Review Working Group, which includes that working group’s model review recommendations for the 31 model laws affected by the Affordable
Care Act. Because other work related to some of those model laws is ongoing, the RF Task Force decided to wait to send the recommendations to the (B) Committee for consideration and adoption until after that work is completed. However, the RF Task Force did expose for a 30-day comment period the list of model laws identified by the working group as requiring revision. Specifically, the RF Task Force requested comments regarding which model laws to prioritize for revision.

1. **ERISA Working Group**

A subgroup of the ERISA Working Group is drafting a white paper that will consider issues surrounding the potential impact of small employer self-insurance on the small group market. The subgroup plans to have a draft prepared for the ERISA Working Group to consider at the Spring 2014 NAIC national meeting, with the goal of having the (B) Committee adopt the final white paper at the Summer 2014 NAIC national meeting. During its in-person meeting on December 15, 2013, the ERISA Working Group discussed a draft outline for the white paper. As discussed by the ERISA Working Group and/or set forth in the outline, the white paper will address, among other things, the following:

- the impact of the Affordable Care Act on small employers and self-funding, including the applicability to stop-loss insurance of Section 9010 of the Affordable Care Act (imposing new annual fees on health insurance companies);
- differences between self-funding options offered to small and large employers;
- the nature of stop-loss insurance, including how states regulate the product;
- the use of captives as a vehicle for taking on risk; and
- consumer protection issues, such as disclosure notices and small employers’ fiduciary duties under ERISA.

During its November 6, 2013 conference call, the RF Task Force discussed the ERISA Working Group’s charge to develop the above-referenced white paper. An Ohio regulator expressed concern that it is likely premature to dedicate NAIC resources to a project that seeks to evaluate the impact of the Affordable Care Act on the small employer self-insurance market because the majority of the Affordable Care Act’s operative provisions do not take effect until 2014; therefore, it may be years before any impact of the Affordable Care Act’s market reforms on the small employer market can be evaluated. However, that concern was overruled by other regulators’ desire to proceed with the project to establish a baseline from which the impact of the Affordable Care Act might be measured.

IV. **Property and Casualty Insurance (C) Committee**

At its December 17, 2013 meeting, the Property and Casualty Insurance (C) Committee (the “(C) Committee”) adopted the reports of its task forces and working groups and heard a number of topical presentations. With respect to a “data call” relating to lender-placed insurance initially proposed to be issued on January 1, 2014, the (C) Committee voted to re-expose for 30 days (until January 17, 2014) a revised data call to go solely to Assurant and QBE, the two largest writers of lender-placed insurance who together account for approximately 90% of the market in all states.

A. **Crop Insurance Working Group**

The Crop Insurance Working Group again agreed to request that the Blanks Working Group add a line for private crop insurance to the 2015 blanks. The 2014 proposal was not adopted because the Blanks Working
Group felt that private crop insurance was not a significant line of business and suggested that it be tracked in a supplemental exhibit. Currently, the NAIC cannot assess how many private crop hail writers exist because there is no separate line for it under allied lines. Members of the Crop Insurance Working Group plan to participate on a conference call with the Blanks Working Group in order to better explain the need for the additional information.

B. Terrorism Insurance Implementation Working Group

With the federal Terrorism Risk Insurance Act of 2002 ("TRIA") set to expire on December 31, 2014, the Terrorism Insurance Implementation Working Group (the "TII Working Group") heard a presentation from the American Bankers Association (the "ABA") on the need for its reauthorization. The ABA commented that commercial policies would not cover multi-year construction projects without the reauthorization of TRIA. The ABA asked the TII Working Group to adopt a policy statement, as the National Conference of Insurance Legislators and the National Conference of State Legislatures have done, urging the United States Congress to act quickly to reauthorize TRIA before TRIA expires. In August 2013, the Government Relations Leadership Council adopted a resolution in support of the reauthorization of TRIA, and in September 2013, the NAIC sent a comment letter to the Federal Insurance Office regarding the NAIC's support for the reauthorization of TRIA.

Paula Pallozzi, Chief Property and Casualty Analyst for the Rhode Island Department of Business Regulation, Division of Insurance (the "Rhode Island Department"), reminded the TII Working Group members of the need for expedited filing review. The Rhode Island Department issued bulletins in 2002 and 2008 regarding voluntary expedited filing procedures for exclusions related to acts of terrorism. Insurance departments will need to update their bulletins if and when TRIA is reauthorized.

C. Catastrophe Insurance Working Group

The Catastrophe Insurance Working group received an update regarding state initiatives relating to flood insurance. Certain Lloyds syndicates are writing at the same rates as the prior National Flood Insurance Program ("NFIP") rates and using the same NFIP adjusters. It appears that four parishes in Louisiana are most affected by the NFIP rate adjustments, but the rest of the market is adjusting reasonably well. The Catastrophe Insurance Working Group wants to be sure that lenders will accept private insurance in lieu of NFIP policies. The federal Biggert-Waters Flood Insurance Reform and Modernization Act of 2012 (the "Biggert-Waters Act") does require federal agency lenders to accept private flood insurance in satisfaction of the federal flood insurance requirement if certain conditions are satisfied, including, but not limited to, policy form approval by state regulators.

More than a dozen bills have been filed in the United States Congress to delay the rate changes in the Biggert-Waters Act until the Federal Emergency Management Agency completes an affordability study. One bill, The Homeowner Flood Affordability Act (HR3370/S1610), has 168 sponsors.

V. Market Regulation and Consumer Affairs (D) Committee

At its meeting, the Market Regulation and Consumer Affairs (D) Committee (the "(D) Committee") adopted several items, including the following:

- preexisting conditions examination standards for health insurance;
- summary of benefits and coverage/uniform glossary examination standards for health insurance;
• health insurance complaint coding revisions and definitions for the reporting of state complaint information to the NAIC Complaint Database System;

• updates to the confidential Market Action Working Group’s policies and procedures;

• revisions to the life and annuity, homeowners, and private passenger auto market conduct annual statement data call and definitions; and

• recommendations, as further described below, in response to the NAIC Model Law Review Initiative with respect to the below-referenced model laws and regulations.

In accordance with a request by the Executive (EX) Committee for each NAIC parent committee to assist with the NAIC Model Law Review Initiative, Commissioner Rothman of Minnesota chaired the review of the following three model laws and regulations, and the (D) Committee adopted the following recommendations related thereto:

• that the Military Sales Practices Model Regulation (#568) be retained because the provisions of the model are still relevant to the current regulatory environment, which requires uniformity among all states because of a federal law directive;

• that the Authorization for Criminal History Record Check Model Act (#222) be converted to a guideline because it was adopted before the 2007 model law criteria became effective and currently does not meet the criteria of a majority of states uniformly enacting the model within three years after its adoption by the NAIC membership; and

• that the Unauthorized Transaction of Insurance Criminal Model Act (#890) be converted to a guideline and archived because currently no states have adopted that model.

VI. Financial Condition (E) Committee

At its December 17, 2013 meeting, the Financial Condition (E) Committee (the “(E) Committee”) adopted an additional charge as follows: “Review the Model Insurance Holding Company Act (#440) and Regulation (#450) and consider amendments to address issues that have arisen subsequent to the adoption of the Act and Regulation by the NAIC in 2010.” While the charge is worded in a slightly cryptic fashion, it is intended to address amendments that may be needed in light of international group supervision efforts.

The (E) Committee also adopted the reports of its working groups and task forces as submitted, with the exception of the report of the Accounting Practices and Procedures Task Force, as discussed in additional detail below.

A. Private Equity Issues Working Group

The newly constituted Private Equity Issues Working Group (the “PE Working Group”) held its first public meeting on December 16, 2013. The PE Working Group is chaired by Virginia, and its members also include Iowa, Delaware, Indiana, Kansas, New Jersey, New York, Ohio and Oklahoma. After discussing its charge, the PE Working Group heard a presentation by Apollo Global Management, LLC and Athene Holding Ltd. regarding the history and rationale for its and other alternative asset managers’ interest in annuity writers, as well as feedback on the potential best practices identified by the Financial Analysis Working Group. Following discussion, the PE Working Group voted to re-expose the May 2013 referral memo from the Financial Analysis...
Working Group to the (E) Committee for an additional 45-day comment period to seek additional feedback from interested parties on the potential best practices discussed in the memo.

**B. Reinsurance Task Force**

The highlight of the meeting of the Reinsurance Task Force (the “RTF”) on December 17, 2013, was the RTF’s approval of the insurance regulatory authorities in Bermuda, Germany, Switzerland and the United Kingdom as Conditional Qualified Jurisdictions for inclusion on the NAIC list of Qualified Jurisdictions. Those decisions were also approved by the Executive/Plenary Committees on December 18, 2013. Conditional Qualified Jurisdiction status was granted to these supervisory authorities after evaluating them on an “expedited” basis. The process was expedited because states such as New York, Florida, Connecticut and New Jersey had already granted Certified Reinsurer status to reinsurers domiciled in such countries. The Conditional Qualified Jurisdiction status may be changed to Qualified Jurisdiction status following the completion of a full evaluation of each jurisdiction’s supervisory authority in 2014. The RTF now is reviewing the regulatory supervisory systems of Ireland and France, which have requested approval as Qualified Jurisdictions.

The NAIC’s amended Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) allow for a reduction in posted collateral from unauthorized reinsurers that are approved by states as “certified reinsurers.” In deciding whether to certify a reinsurer, state insurance regulators evaluate (among other things), whether a reinsurer is domiciled in a “Qualified Jurisdiction” (i.e., one that is deemed to “effectively” regulate reinsurers domiciled in the jurisdiction). At the Fall 2013 NAIC national meeting, the NAIC adopted the “Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions” to assist states in determining which countries should be considered a “Qualified Jurisdiction.”

**C. Valuation of Securities Task Force**

At its meeting on December 16, 2013, the Valuation of Securities Task Force (“VOS”) discussed and adopted the following items:

1. **Recalibration Project**

VOS received two reports from the Securities Valuation Office (the “SVO”) concerning the impact of the NAIC’s Recalibration Project on NAIC processes and state investment laws.

The first report sets forth a preliminary itemization of impacted activity, including at the SVO, with respect to financial reporting as well as affected documents and products, such as the SVO Purposes and Procedures Manual (the “P&P Manual”), Accounting Practices and Procedures Manual, financial statement blanks, annual statement instructions, risk-based capital (“RBC”) formulas, and informational systems. The second report considers the impact on state investment laws of a change in the number of NAIC designations and concludes that the impact would depend largely on how a state uses securities designations and characterizations in its statutes.

The Recalibration Project involves changes to the NAIC designation framework to reflect more recent (and more accurate) default rate statistics. Default rates for corporate, municipal and asset-backed securities have been found to differ significantly and, therefore, the Recalibration Project is an attempt to break out the current single NAIC designation framework into three separate frameworks (corporate, municipal and asset-backed securities) and to recalibrate the new NAIC designations to reflect updated default performance data.
2. **Freddie Mac Structured Security**

VOS adopted the recommendations of its Invested Assets Working Group with respect to the treatment of an insurer’s potential investment in certain structured securities recently issued by Freddie Mac (the “STACR Notes”). Specifically, under the adopted recommendations, (a) insurers investing in the STACR Notes must file the STACR Notes transaction with the Structured Securities Group (the “SSG”) of the SVO, (b) the SSG will generate an NAIC designation for the STACR Notes using financial modeling and (c) the securities will be accounted for pursuant to SSAP No. 26—Bonds, Excluding Loan-Backed and Structured Securities. The Invested Assets Working Group also recommended that STACR Notes be treated as residential mortgage-backed securities (“RMBS”) “from an analytical perspective” and assigned an NAIC designation based on guidelines used for non-agency RMBS.

VOS also adopted definitions for “structured note” and “mortgage referenced security” for inclusion in the December 31, 2013 publication of the P&P Manual. Accordingly, effective December 31, 2013, a “mortgage referenced security” (defined as a “structured note” whose “coupon and/or principal payments are linked, in whole or in part, to prices of, or payment streams from real estate, index or indices related to real estate, or assets deriving their value from instruments related to real estate, including but not limited to mortgage loans”) is not a “bond” that is eligible for a filing exemption.

VOS has been considering the proper regulatory treatment of the STACR Notes, including the NAIC designations that should be applied by insurers that invest in STACR Notes for purposes of year-end reporting. At prior VOS meetings, the SSG had suggested that the STACR Notes should be characterized as RMBS, whereas others considered them properly classified (under current regulatory guidance in the P&P Manual) as a filing-exempt bond (i.e., exempt from filing with the SVO pursuant to the filing-exempt status for direct U.S. government obligations). Ultimately, the Invested Assets Working Group determined that although the STACR Notes would be, under existing guidance, technically reportable as a filing-exempt bond, such treatment would be “inappropriate” due to the “inherent risks in the transaction.” Therefore, the Invested Assets Working Group referred to VOS the new definitions of “structured note” and “mortgage referenced security” to exclude such transactions from any filing exemption.

3. **Working Capital Finance Investments**

VOS adopted amendments to the P&P Manual concerning working capital finance investments (“WCFIs”), which are described as short-term obligations to pay a specified amount by one party (the obligor) to another (typically a supplier of goods) generated as part of a WCFI program designated by the SVO and meeting certain specified criteria. After considerable discussion among state insurance regulators, insurer investments in WCFIs will be permitted subject to certain RBC, statutory accounting and reporting requirements. Various NAIC groups have been developing such requirements, including the SVO, VOS, Capital Adequacy Task Force, Blanks Working Group and Statutory Accounting Principles Working Group (the “SAP Working Group”). On December 2, 2013, VOS exposed the proposed amendments to the P&P Manual for a two-week comment period to accommodate a new SSAP governing WCFIs that ultimately was adopted by the SAP Working Group at its December 15, 2013 meeting. SSAP No. 105—Working Capital Finance Investments, sets forth the statutory accounting principles that will apply to WCFIs held by insurers and amends SSAP No. 20—Non-admitted Assets to allow WCFIs as admitted assets to the extent they conform to the requirements of SSAP No. 105.
4. **P&P Manual Amendments—Reclassifications**

VOS is working with the SVO to amend those sections in the P&P Manual that reference reclassification by the SVO of a security by assigning it a reporting category different than that indicated by its name. VOS’s current policy is that the SVO should no longer be reclassifying the reporting categories of assets and, therefore, instructions in the P&P Manual that still reference such reclassifications need to be removed or amended. To that end, VOS directed the SVO to take action on the following instructions which still reference reclassifications: (a) delete an instruction concerning short-dated non-principal protected securities, requiring the SVO to treat as equity any instrument where repayment of principal is uncertain and (b) propose alternatives for current instructions requiring the SVO to treat a principal-protected note as equity or notch it for credit risk and directing insurers to report a catastrophe bond as equity if the rating methodology used by the credit rating provider is inconsistent with the NAIC’s methodology. VOS is separately addressing an instruction requiring the SVO to treat a residual tranche of asset-backed securities, RMBS, collateralized loan obligations and collateralized debt obligations as equity or to notch it for credit risk.

5. **Securitizations—Residual Tranche Designations**

VOS continues to discuss appropriate reporting for residual tranches of securitizations. Tranches are subject to bond reporting requirements pursuant to SSAP No. 43R—Loan-Backed and Structured Securities. The P&P Manual currently addresses residual tranches of RMBS and commercial mortgage-backed securities (“CMBS”) but is unclear on reporting of residual tranches of securitizations involving asset-backed securities, collateralized loan obligations or collateralized debt obligations. During its conference call in November 2013, VOS considered a proposal by the SVO to adopt a rule requiring that residual tranches be reported as equity instruments on Schedule D, except that an insurer could request that the SVO assess a security for possible treatment as a bond. However, at the meeting the SVO and VOS decided that further research is needed and asked the SAP Working Group to further evaluate the issue.

6. **Treatment of Fund Investments**

VOS is considering a recommendation from the SVO to reevaluate current guidance concerning fund investments. Currently, shares of a mutual fund must be treated as common stock regardless of the type or mix of assets held in the fund’s portfolio, pursuant to SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled or affiliated entities). SSAP No. 30 provides an exception for certain mutual funds. According to the SVO, NAIC staff must nevertheless advise insurers that an investment in a fund structurally identical to the exceptions must be reported as common stock, which seems inconsistent with the regulatory intent of the exceptions. The SVO therefore recommended amendments to SSAP No. 30 so that only investments in funds owning equity and “equity like” investments would be deemed investments in “common stock” and investment in a fund owning bonds would no longer be investment in “common stock.” The SVO also recommends a corresponding amendment to SSAP No. 26—Bonds, Excluding Loan-Backed and Structured Securities to specifically identify funds that are limited to bond portfolios as “bonds,” subject to further criteria in the P&P Manual. At its meeting, VOS referred the issue to the SAP Working Group for further consideration.

7. **Schedule BA Assets (Other Long-Term Invested Assets)**

VOS is working with the SVO to better integrate into NAIC guidance a 2004 P&P Manual instruction concerning Schedule BA assets (bond or preferred stock-like) that have fixed income characteristics. The 2004 instruction
relates to filings with the SVO by life insurers and fraternal benefit societies seeking a determination that a Schedule BA asset meets criteria to be reported as a fixed-income investment. According to the SVO, the filing process has not been fully integrated into NAIC guidance (including SSAPs). At its meeting, VOS referred the issue to the SAP Working Group.

D. Capital Adequacy Task Force

The highlight of the meeting of the Capital Adequacy Task Force on December 16, 2013 was a lively discussion concerning a December 5, 2013 letter to the Capital Adequacy Task Force from the Connecticut Insurance Department’s chief actuary broadly questioning whether RBC is useful or effective. The letter suggests that if RBC thresholds are capturing too many companies (through Company Action Level or more severe events), regulators should question if they are using an overly conservative system. The letter characterizes as a “Type 1” error the identification of an otherwise strong company as “weakly capitalized.” The letter suggests that regulators also consider “Type 2” errors, characterized as involving troubled companies where RBC was not effective as a leading indicator. A representative from the Pennsylvania Insurance Department strongly objected to the Connecticut letter and argued that RBC has “saved the industry,” and RBC triggers are a good way to “wake up management.” After considerable discussion, Capital Adequacy Task Force members agreed that RBC initiatives should focus on important issues and the Capital Adequacy Task Force should not spend as much time considering small, piecemeal proposals.

At the meeting, the Capital Adequacy Task Force also voted to expose for a 45-day comment period the Operational Risk RBC Proposal developed by the Solvency Modernization Initiative RBC Subgroup (the “SMI RBC Subgroup”). By way of background, the Capital Adequacy Task Force has been charged with examining whether and how an operational risk charge can be incorporated into RBC formulas. In developing its proposal, the SMI RBC Subgroup examined how regulators in other jurisdictions, such as Bermuda and Canada, incorporate operational risk into their regulatory capital formulas. Operational risk is currently addressed through other NAIC-led initiatives, such as the requirement that insurers prepare Own Risk and Solvency Assessment (“ORSA”) reports and enhanced corporate governance standards, which require analysis of risks that include underwriting, credit, market, liquidity as well as operational risk. At the meeting, a representative of the ACLI stated that although the ACLI will provide specific comments on the proposal, it does not view the proposal as providing a good measure of operational risk and it believes operational risk is better addressed in ORSA reports. ORSA reports provide a qualitative measure of operational risk, rather than quantitative.

The Capital Adequacy Task Force also heard from its Title Insurance Risk-Based Capital Subgroup (the “Title Insurance RBC Subgroup”), which recommended that the Capital Adequacy Task Force not further pursue the development of RBC for title insurers. RBC for title insurers would require uniform statutory accounting requirements among states and, according to the Title Insurance RBC Subgroup, accounting standards vary considerably by state. Further, development of an RBC methodology for title insurers would likely take many years and considerable resources. The Title Insurance RBC Subgroup will most likely be disbanded in the near term.

Finally, a representative from the Pennsylvania Insurance Department asked that the ACLI’s broker receivables proposal be considered on the Capital Adequacy Task Force’s next call. By way of background, the proposal was first brought by the ACLI in October 2012 to change RBC treatment of assets involving sales through a broker/custodian. While at first the proposal seemed to be a fairly noncontroversial measure, on the Capital
Adequacy Task Force’s April 30, 2013 conference call, a surprisingly heated debate took place concerning the proposal, and the Capital Adequacy Task Force declined to vote on the proposal. In August 2013, the Capital Adequacy Task Force voted to put the proposal back onto its agenda for further discussion but, to date, the Capital Adequacy Task Force has not had time during its conference calls to discuss the proposal.

**E. Life Risk-Based Capital Working Group**

At the meeting of the Life RBC Working Group, the following items were discussed:

1. **C-3 Phase 1 Modifications**

   The Life RBC Working Group continues to discuss C-3 Phase 1 modifications to prepare for implementation of PBR. C-3 (relating to interest rate risk) is one of the four categories of risk within the RBC formula used for life insurers. Phase 1 addresses RBC for liabilities of general accounts. Phase 2 relates to RBC for guaranteed benefits and focuses on the effects of separate account performance. The Life RBC Working Group is coordinating with the American Academy of Actuaries (the “AAA”) for these modifications, and the AAA has formed a subgroup to specifically address C-3 Phase 1 modifications.

   The Life RBC Working Group’s chair distributed a list of four possible modifications that may result from the Life RBC Working Group’s efforts. The first proposal is to leave the current C-3 Phase 1 structure in place (which is not a likely result). The second proposal involves creation of a new economic scenarios generator to implement VM-20—Requirements for Principle-Based Reserves for Life Products, as set forth in the NAIC’s amended Standard Valuation Manual. The third and fourth proposals relate to inclusion of equity-indexed annuities and making the use of asset valuation reserve and interest maintenance reserve consistent for all C-3 Phases.

   Nancy Bennett, a representative of the AAA, was asked which of the four proposals the AAA will likely recommend. Ms. Bennett noted that the third and fourth proposals are issue-specific and the AAA is focused more on structural changes. According to Ms. Bennett, the AAA will most likely recommend the second proposal because the current scenario generator is out of date, partly because it uses sets of 12–50 scenarios established in 2000 based on representative (at the time) asset portfolios and annuities and corresponding weighting for each. Ms. Bennett stated that the AAA will likely recommend that insurers use a new, proprietary interest rate generator. Ms. Bennett noted that insurers could utilize AAA’s generator, but the data underlying that generator is not updated frequently.

2. **New York Proposal—RBC Charge for Cessions to Unauthorized Reinsurers**

   The Life RBC Working Group briefly addressed the status of the proposal of the NY DFS concerning an RBC charge for cessions to unauthorized reinsurers. The proposal relates to focusing on risk underlying reinsurance cessions, whether made to an unaffiliated unauthorized reinsurer or an affiliated unauthorized reinsurer (such as a captive) where the unauthorized reinsurer is not providing qualifying reinsurance collateral. The NY DFS has suggested that only where there is qualifying collateral should an absolute reduction in RBC be permitted.

   In February 2013, the NY DFS submitted the following recommendation to the Life RBC Working Group: “Consider the proper treatment for business ceded to unauthorized reinsurers. Currently, in most cases some type of security is required for reserves that are ceded to unauthorized reinsurers but there is no similar handling of RBC. Another option could be a factor applied to the RBC released or some other base.” On August 25, 2013, the Life RBC Working Group voted to expose the recommendation for public comment and, so far, it
has received comment letters from, among others, the ACLI, the AAA and the Bermuda International Long-Term Insurers and Reinsurers Association.

At the meeting, a representative of the NY DFS noted that the NY DFS is still working on the details of its proposal and that it plans to meet with regulators from Canada’s Office of the Superintendent of Financial Institutions (“OSFI”) to discuss insurance regulations in Canada which require collateral for ceded liabilities and as well as an associated capital requirement for cessions to unauthorized insurers.

3. AAA Presentation on Asset Valuation Reserves

The AAA gave a presentation concerning asset valuation reserves (“AVR”), which is a statutory reserve designed to reflect the potential volatility/value fluctuations resulting from credit-related (default) and equity risks inherent in an insurer’s invested asset portfolio. The AVR presentation was meant to assist the Life RBC Working Group’s discussions regarding whether and how AVR should be adjusted as part of the recalibration of C-1 factors in life RBC calculations (i.e., relating to the risk of an asset’s default in terms of principal and interest). Thus far, the Life RBC Working Group has focused on evaluating C-1 factors generated by a bond model developed by the AAA.

4. Life RBC for CDAs

The Life RBC Working Group continues its work (pursuant to a referral from the (A) Committee) to develop guidance that applies current regulations governing RBC requirements, including C-3 Phase 2, to CDAs. The Life RBC Working Group will need to know the corresponding recommendation concerning reserves applicable to CDAs, so it is coordinating with the Life Actuarial Task Force (“LATF”) on this issue. LATF has formed a subgroup to address CDAs in the context of Actuarial Guideline 38 (addressing reserves for universal life products with secondary guarantees).

F. Investment Risk-Based Capital Working Group

At the meeting of the Investment Risk-Based Capital Working Group (the “Investment RBC Working Group”) on December 15, 2013, a representative from the AAA reported on the methodology for calculating C-1 factors for corporate bond assets. C-1 is one of the four categories of risk within the RBC formula and reflects the risk of an asset’s default in terms of principal and interest or fluctuation in fair value. The Investment RBC Working Group has been evaluating C-1 factors generated by a bond model developed by the AAA. The AAA’s report described key modeling assumptions in the corporate bond model and addressed preliminary results generated by the model.

The Investment RBC Working Group also received an addendum to a proposal submitted by the ACLI in March 2013 concerning life insurer RBC for derivatives. The March 2013 proposal had recommended a change to the potential exposure formula for written credit default swaps to reflect recovery experience consistent with the RBC formula for bonds, so that the RBC approach would be as consistent as the fundamental credit risk inherent in both circumstances. Following a public comment period, the ACLI decided to include an addendum to its proposal that, among other things, addresses two comments received on the proposal. The first comment suggested that risks inherent in replications be reexamined, particularly the RBC treatment of the C-1 capital charge applied to the cash instrument component. In response, the ACLI supplemented its proposal to address that current RBC instructions allow the reporting entity to apply a C-1 RBC credit for the cash instrument only when the replication transaction eliminates the C-1 risk. The second comment requested an expansion of the proposal
to address updated treatment of derivative collateral for over-the-counter ("OTC") centrally cleared derivatives in light of changes arising from the Dodd-Frank Wall Street Reform and Consumer Protection Act (requiring standardization of terms and use of central clearing to reduce the transactional risk in the OTC derivative market). In response, the ACLI included recommendations that generally parallel treatment of exchange-traded derivatives that benefit from similar risk-reduction requirements. The Investment RBC Working Group exposed the addendum for a 45-day public comment period.

The Investment RBC Working Group also exposed for a 45-day public comment period a proposal submitted by the Connecticut Insurance Department concerning life insurer and fraternal benefit society C-1 asset RBC requirements for real estate, which is meant to ensure that RBC methodology and rates for the real estate sector accurately reflect underlying risks and to promote consistency in methodology across other asset sectors. The proposal makes the following recommendations:

- Revise the C-1 factor for real estate with a base factor of 8%, including all categories of real estate.
- Consider refinements to the base factor to adjust for specific characteristics of the insurer’s holdings.
- Implement an adjustment within RBC for unrealized gains/losses (consistent with the recently adopted commercial mortgage RBC framework).
- Revise the RBC charge on encumbrances to 6.25% (consistent with the recently adopted commercial mortgage RBC framework).

**G. Solvency Modernization Initiative Task Force**

The Solvency Modernization Initiative Task Force (the “SMI Task Force”) held its last meeting on December 16, 2013, where it adopted the reports of its working groups, including the Corporate Governance Working Group and the International Solvency and Accounting Standards Working Group (the activities of which are discussed in further detail below). Additionally, the SMI Task Force received a report from the SMI RBC Subgroup regarding plans to modify the RBC formula for operational risk in 2014, as further described in Section VI.D above. In light of the disbanding of the SMI Task Force, its current subgroups now will report directly to the (E) Committee (or another group of the (E) Committee).

1. **Corporate Governance Working Group**

At its December 16, 2013 meeting, the Corporate Governance Working Group continued its work on proposed revisions to the Annual Financial Reporting Model Regulation (#205) (commonly referred to as the Model Audit Rule) that would require large insurers to maintain an internal audit function. After a thorough discussion of comments received from interested parties, the working group agreed to integrate the comments received and to re-expose the draft for 45 days (until the end of January 2014), with the goal of adopting the revised regulation at the Spring 2014 NAIC national meeting in Orlando.

The Corporate Governance Working Group also continued its efforts to adopt a Corporate Governance Annual Filing Model Act and related Guidance Manual on an expedited basis. The inclusion of a Guidance Manual permitting modifications through a less fulsome process than an amendment to the model act was the subject of considerable objection by interested parties. After discussion, the working group voted to expose the current drafts for a 45-day period ending on January 31, 2014.
2. International Solvency and Accounting Standards Working Group

At its December 16, 2013 meeting, the International Solvency and Accounting Standards Working Group heard a presentation from the NAIC’s Ramon Calderon on IAIS activities, including the October 2013 draft of the Common Framework for the Supervision of Internationally Active Insurance Groups (“ComFrame”); an update regarding the development of global insurance capital standards; and IAIS field testing efforts.

H. Receivership and Insolvency Task Force

During a December 6, 2013 conference call that preceded its in-person meeting at the Fall 2013 NAIC national meeting, the Receivership and Insolvency Task Force (the “RITF”) adopted (a) without comment from regulators or interested parties, a memorandum to the (E) Committee and (b) without any changes, a report of the Federal Home Loan Bank Legislation Subgroup (the “FHLB Subgroup”), each regarding the FHLB Subgroup’s study of the Federal Home Loan Banks’ proposed receivership legislation. Such legislation proposes amendments to states’ receivership laws to request blanket exemptions from (a) a stay in an insurance company insolvency proceeding and (b) voidable preference provisions.

Through its study, the FHLB Subgroup “observed that the [Federal Home Loan Banks’] proposed legislation has no perceived benefit to the receivership process.” Although one of the stated goals of the FHLB Subgroup’s study was state uniformity in addressing the Federal Home Loan Banks’ legislative request, uniform legislation was not achieved. Instead, in its report, the FHLB Subgroup recommends that “each state make its own determination regarding the proposed exemption based on that state’s existing receivership law and any other factors the state feels appropriate.”

In its memorandum to the (E) Committee regarding the FHLB Subgroup’s report, the RITF noted that each state insurance department should consider the following aspects of a broader review of Federal Home Loan Bank transactions within the state’s domestic insurance industry:

- the need for, and impact of, amendments to the state’s receivership laws to create exemptions that apply exclusively to a Federal Home Loan Bank;
- engaging in discussions or adopting a memorandum of understanding with the state’s Federal Home Loan Bank to clarify expectations for a potential insurance receivership or troubled insurance company situation;
- where an exemption in adopted into law in a state, the state engaging in prospective solvency assessment, particularly in situations with high potential for future receivership; and
- in evaluating the impact of incorporating the proposed exemptions into the state’s receivership laws, considering the benefits of low-cost liquidity and increased operating leverage available to an insurer through Federal Home Loan Bank membership.

The FHLB Subgroup did not meet at the Fall 2013 NAIC national meeting but expects to begin meeting again in 2014 to address its next charge, drafting updates to the Receivers Handbook for Insurance Company Insolvencies to include information for dealing with an insolvency where Federal Home Loan Bank agreements may be involved.

During its in-person meeting in Washington, D.C. on December 16, 2013, the RITF continued its work on a referral from the (E) Committee regarding whether and what type of guaranty fund coverage there is or should be for structured settlements that are sold to factoring companies and life settlements sold to investors or
securitized. Specifically, the RITF heard presentations on the topic from the National Structured Settlement Trade Association (generally supporting guaranty association coverage for non-factored benefits but not factored benefits, but recognizing that guaranty associations should have flexibility to cover factored benefits where they are difficult to distinguish from non-factored benefits), the Life Insurance Settlement Association (supporting guaranty association coverage for factored benefits in the context of life settlements), the National Organization of Life and Health Guaranty Associations (opposing guaranty association coverage for factored benefits) and the American Council of Life Insurers (supporting the model law as written without taking an official position regarding guaranty association coverage for third-party investors). During a conference call in 2014, the RITF plans to consider the issues and make a recommendation based on the information provided.

I. Mortgage Guaranty Insurance Working Group

The Mortgage Guaranty Insurance Working Group (the “MGI Working Group”) discussed proposed extensive modifications to the Mortgage Guaranty Insurance Model Act (#630, originally adopted in 1976). The proposed changes would prohibit captive reinsurance, make extensive changes to mortgage guaranty insurance underwriting standards and add quality assurance standards intended to complement the new underwriting guidelines. The capital standards section develops a two-tiered capital adequacy measurement system using an RBC methodology similar to that applicable to property and casualty insurers and a loan-level capital model. The MGI Working Group received a nine-page comment letter from the industry, and regulators from Pennsylvania and North Carolina expressed disappointment in the tone of the comment letter.

At the meeting, the same industry group suggested that Model #630 should not be too prescriptive and should have risk limits that make sense. As support for its position, the industry group stated that some high-loan-to-value loans do perform well, and investment in government-guaranteed loans should not be a problem. The industry group asserted that any Mortgage Guaranty Insurance Standards Manual authorized under Model #630 needs to be flexible. Industry representatives agreed to prepare a “workable” markup and requested an extension to the exposure period. The MGI Working Group extended the deadline for the exposure period from January 9, 2014 to February 15, 2014.

A representative from Radian Guaranty also commented that it was filing new rewritten master policies in all 50 states and asked the MGI Working Group for assistance with the process.

J. Risk Retention Group Task Force

At its meeting on December 15, 2013 in Washington, D.C., the Risk Retention Group Task Force (the “RRG Task Force”) adopted a referral to the Financial Regulation Standards and Accreditation (F) Committee regarding revisions to the grandfathering provision included in the Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers (the “RRG Reinsurance Guidelines”). The RRG Reinsurance Guidelines, which were developed by the RRG Task Force, impose new requirements for a risk retention group licensed as a captive insurer to take credit for reinsurance in connection with business ceded to reinsurers after January 1, 2011. The RRG Reinsurance Guidelines include a grandfathering provision that allows risk retention groups licensed as captive insurers to continue to take credit for reinsurance for business ceded to an RRG’s reinsurers as of January 1, 2011 without meeting the requirements in the RRG Reinsurance Guidelines. The revision to the RRG Reinsurance Guidelines is intended to clarify that the grandfathering provision applies to reinsurance contracts entered into after January 1, 2011 with reinsurers to which the applicable risk retention group had ceded business as of January 1, 2011. However, during discussion the RRG Task Force agreed that the domiciliary
regulator for the applicable risk retention group may, in its discretion, revoke the applicability of the grandfathering provision to a grandfathered reinsurer that continues (for an unspecified time period after January 1, 2011) to fail to meet the requirements in the RRG Reinsurance Guidelines.

K. Accounting Practices and Procedures Task Force

The proper accounting treatment of the fee payable under Section 9010 of the Affordable Care Act continued to be the subject of considerable disagreement at the Fall 2013 NAIC national meeting. In adopting the reports of its working groups at its December 16, 2013 meeting, the Accounting Practices and Procedures Task Force (the “APP Task Force”) rejected the SAP Working Group’s adopted guidance prescribing the recognition of a liability and expense for the fee payable on January 1 of the fee year, beginning in 2014, with a reclassification in special surplus in the data year. Instead, the APP Task Force voted to re-draft the guidance to require a liability at year-end in the data year with a non-admitted deferred asset. The fee would then be expensed on January 1 of the fee year. The APP Task Force’s actions were reversed at the (E) Committee meeting on December 17, 2013.

VII. Financial Regulation Standards and Accreditation (F) Committee

The Financial Regulation Standards and Accreditation (F) Committee (the “(F) Committee”) met on December 15, 2013. The more significant items addressed by the (F) Committee included a response to a referral from the RRG Task Force clarifying that the amendments to the Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) are intended to apply to both traditional insurance companies and risk retention groups, effective January 1, 2016. The (F) Committee and interested parties also spent a considerable amount of time discussing the definition of “multi-state insurer” for purposes of accreditation; specifically, whether life insurer-owned captives should be considered multi-state insurers and therefore subject to Regulations XXX and AXXX, as compared to traditional captive insurers owned by non-insurance entities for purposes of managing their own risk. Noting some inconsistencies in existing guidance, the (F) Committee asked NAIC staff to draft proposed clarifying language regarding the definition and treatment of multi-state insurers for the committee’s review, following which such language would be exposed for one year.

VIII. International Insurance Relations (G) Committee

The focus of the meeting of the International Insurance Relations (G) Committee (the “(G) Committee”) was on the activities of the IAIS, and a presentation from the Chair of the European Insurance and Occupational Pensions Authority (“EIOPA”) concerning the U.S./E.U. Dialogue Project. The IAIS, which consists of insurance regulators from the majority of international jurisdictions, has been developing ComFrame in response to its charge from the Financial Stability Board to develop a comprehensive, group-wide regulatory framework. The U.S./E.U. Dialogue Project consists of work among the NAIC, the FIO, the E.U., EIOPA and the European Commission to better understand the design and functions of insurance regulatory regimes in the U.S. and the E.U. Below is a summary of the IAIS-related matters that were discussed during the (G) Committee meeting:

- **Financial Stability Committee.** Commissioner Leonardi of Connecticut provided an update on the IAIS’s Financial Stability Committee (the “FSC”), a committee that assists in the identification of global systemically important insurers (“G-SIIs”) and outlines appropriate supervisory measures to be applied to those firms. The FSC has distributed a position paper outlining the views (and concerns) of U.S. insurance regulators regarding international capital proposals. The IAIS is in the process of developing a global RBC standard for internationally active insurance groups (“IAIGs”) and certain basic capital and higher loss
absorbency requirements for G-SIIs; the global RBC standard will be included within ComFrame. State regulators, the NAIC and insurance industry trade groups have questioned the need for, and timing of, global capital standards due to key differences among regulatory regimes in various jurisdictions. However, all have agreed to remain involved in the process to develop such standards.

- **ComFrame.** Commissioner McCarty of Florida provided an update on ComFrame. In October 2013, the IAIS released a third draft of ComFrame for public consultation, which is the last consultation before the document will enter the field testing phase, during which the practicality and feasibility of ComFrame’s procedures will be examined before it is finalized in 2018. Additional comments added to ComFrame include the importance of distinguishing between the IAIS’s work targeted toward IAIGs as opposed to GSIIIs, clarification on group actuarial opinions and reports, capital adequacy assessments in light of developing insurance capital standards and recognizing other supervisory measures in determining criteria for core (as opposed to additional) capital.

- **Reorganization and Restructuring of the IAIS.** Throughout the meeting, there were several debates concerning the level of participation allowed by the IAIS to observers. U.S. regulators and insurance industry groups have been pushing for more open meetings of the IAIS and its committees, particularly the IAIS’s Technical Committee. On the other hand, to improve “efficiency,” the IAIS has been restructuring its operations and in some cases limiting the point at which third parties may observe and comment on actions of the IAIS. Some regulators, including Commissioner McCarty, view the changes as a step in the wrong direction and believe that transparency is important—especially if potential issues with the IAIS’s work cannot be caught earlier due to late participation by observers. Industry representatives who spoke at the meeting in favor of enhanced transparency included CNA, the Global Federation of Insurance Associations, Property Casualty Insurers Association of America and Barnert Global, Ltd. Sensitivities concerning IAIS participation intensified when the meeting closed with a presentation by a representative of EIOPA that referred to full-participation IAIS meetings as having a “circus-like” atmosphere.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

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