The National Association of Insurance Commissioners (NAIC) held its 2016 Fall National Meeting December 10-13. Despite the glitzy setting at the Fontainebleau Hotel in Miami Beach, there were no splashy new developments—save the announcement of the appointment of Michael Consedine as NAIC Chief Executive Officer (see full report below). Instead, there was steady progress on ongoing NAIC initiatives, mostly technical in nature, and an overhanging sense of uncertainty as regulators, industry and consumers alike await Federal legislation on the Affordable Care Act, and Dodd-Frank and the imminent release of a covered agreement with the European Union—all of which could have any number of consequences for state regulators and state regulation.

The following are some highlights from the Fall National Meeting. We do not cover every meeting in this report; rather, we comment on select noteworthy developments and matters of interest to our clients.

A. Leadership Changes at NAIC and State Departments of Insurance

B. Issues of Particular Interest to Life Insurers

1. State Implementation of PBR

2. Life Insurance and Annuities (A) Committee

3. XXX/AXXX Model Regulation

4. Variable Annuities

5. Possible Changes to RBC Formulas

C. International Issues

1. Group Capital Calculation

2. International Reinsurance

D. Cybersecurity

E. Big Data

F. Travel Insurance Model

G. Briefly Noted

1. National Flood Insurance Program

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2. Requests for Review of Insolvency Regulation in Light of Penn Treaty


4. NAIC Corporate Governance Review

A. Leadership Changes at NAIC and State Departments of Insurance

Former Pennsylvania Insurance Commissioner Michael Consedine was named Chief Executive Officer (CEO) of the NAIC, effective in early 2017. Mr. Consedine succeeds Senator Ben Nelson, whose term as CEO ended on January 31, 2016. Andy Beal, NAIC Chief Operating Officer (COO) and Chief Legal Officer (CLO), has served as acting NAIC CEO in the interim. Mr. Beal will continue in his COO and CLO roles, overseeing the Kansas City and New York offices and managing the day-to-day operations of the organization.

Mr. Consedine is well known and respected among his public and private sector colleagues, having served as an insurance commissioner and officer of the NAIC, and as an attorney and, most recently, as Senior Vice President and Global Head of Government and Policy Affairs for Aegon. He will be based in the NAIC’s Washington, D.C. office with responsibility over state and federal government affairs and international activities. He will work closely with all NAIC staff and members, most especially with the newly elected 2017 officers: President Ted Nickel (WI); President-Elect Julie Mix McPeak (TN); Vice President Eric Cioppa (ME); and Secretary-Treasurer David Mattax (TX).

As a result of the November 2016 elections—in which there were gubernatorial races in 12 states—Republicans increased their majority of governorships to 33, and there was a net gain of 50 Republican seats on the legislative level. Of the 11 states where the insurance commissioner is elected, five were up this year. Two of the five incumbents, Monica Lindeen (MT) and Adam Hamm (ND), did not run for reelection, and two others, Karen Stewart (DE) and Wayne Goodwin (NC), ran and lost their bids for re-election. Incumbent Democratic commissioner Mike Kreidler (WA) won re-election. As a result, four new insurance commissioners (DE, MT, NC, ND) were elected. Current NAIC President John Huff’s appointment as Missouri Insurance Director will likely end in 2017 when the new Republican governor takes office.

B. Issues of Particular Interest to Life Insurers

1. State Implementation of PBR

In June, the NAIC adopted a recommendation from the PBR Implementation (EX) Task Force that will activate principle-based reserving (PBR) beginning on January 1, 2017. In anticipation of the January 1, 2017 effective date, certain technical amendments to the Valuation Manual, which can be changed anytime, are proceeding among various working groups.

By way of background, in 2009, the NAIC adopted a revised Model Standard Valuation Law authorizing PBR and a Valuation Manual that sets forth the minimum reserve and related requirements for certain products under PBR. The Valuation Manual was subsequently adopted by the NAIC in 2012. The effective date for PBR (i.e., the Valuation Manual Operative
Date), however, could not occur until the amended Standard Valuation Law was adopted by 42 states and state adoption reflected 75% of total life insurance premiums written in the United States, which threshold was reached in early 2016.

At the Fall National Meeting, the PBR Review (EX) Working Group discussed the 2016 PBR Company Pilot Project in which 11 companies are participating. Regulators participating in the Pilot Project have reviewed all company responses and scheduled follow-up conference calls to discuss questions. At a high level, Chair of the Working Group Mike Boerner (TX) noted that regulators want to ensure an appropriate level of detail in company valuations, including particularly the exact methodology for setting assumptions such as mortality credibility. Mr. Boerner indicated that some clarifications may need to be included in the Valuation Manual concerning credibility. Next, a survey will be sent to companies participating in the Pilot Project, and a final written report will be drafted for submission to the PBR Implementation (EX) Task Force by the end of January 2017.

The Society of Actuaries (SOA) reported on a survey concerning PBR implementation in which the SOA received responses from 72 companies. The survey is available on the SOA website. Of the 72 companies responding, only 15 indicated they would value at least one product under PBR in 2017. The SOA understands these responses to mean that most companies will make use of the three-year transition period ending 2020 to become more comfortable with PBR valuation. The survey responses also indicated that certain companies may continue to make use of captives. Paul Graham (Chief Actuary, American Council of Life Insurers (ACLI)) noted that one reason for the continued use of captives after the implementation of PBR, at least initially, is uncertainty with regard to the tax deductibility of PBR reserves, and that the industry was still awaiting rulings from the Internal Revenue Service and Treasury on the appropriate tax reserve.

PBR is ultimately expected to become a state accreditation standard in 2020, meaning that states will be required to enact “significant elements” of the amendments to the Standard Valuation Law to maintain accreditation by the NAIC. The Financial Regulation Standards and Accreditation (F) Committee has exposed the Life Actuarial (A) Task Force’s proposed significant elements for a 60-day public comment period ending February 8, 2017.

2. Life Insurance and Annuities (A) Committee

The Life Insurance and Annuities (A) Committee discussed key NAIC initiatives, including the November 18, 2016 launch of the life insurance policy locator service and the extension of the Unclaimed Benefits Model Drafting (A) Subgroup in order to move the Unclaimed Life Insurance and Annuities draft model act forward.

The Life Insurance Illustration Issues (A) Subgroup Working Group report was adopted. The Working Group will continue to work on a one to two page policy overview document to help consumers better understand life insurance policies, beginning with term products followed by whole life and then universal life policies.

The Life Insurance Buyer’s Guide (A) Working Group report was also adopted. This Working Group has a work plan for revising the Buyer’s Guide through every other week conference calls beginning in January 2017.
3. XXX/AXXX Model Regulation

At the joint NAIC Executive (EX) Committee and Plenary meeting, the Committee and Plenary adopted the Term and Universal Life Insurance Reserve Financing Model Regulation (also known as the XXX/AXXX Credit for Reinsurance Model Regulation) that was adopted by the Financial Condition (E) Committee at an interim conference call on September 30, 2016, after having been adopted by the Reinsurance (E) Task Force at the Summer National Meeting. The Committee and Plenary also adopted revised Actuarial Guideline XLVIII (AG 48), which was redrafted for consistency to the Model Regulation.

The Model Regulation is intended to establish uniform national standards governing reserve financing arrangements pertaining to XXX and AXXX policies. Subject to certain exemptions, the Model Regulation and AG 48 prescribe a required actuarial analysis on each non-exempt reinsurance agreement to determine whether: (i) funds consisting of “Primary Security” are held by or on behalf of the ceding insurer as security under the reinsurance contract in an amount at least equal to the “Required Level of Primary Security”; and (ii) funds consisting of “Other Security” are held by or on behalf of the ceding insurer in an amount at least equal to the portion of the statutory reserves in excess of the Required Level of Primary Security.

The only material change to the Model Regulation from that adopted at the Summer National Meeting was the removal, by the Financial Condition (E) Committee, of the drafting note inserted by the Reinsurance (E) Task Force pertaining to commissioner discretion in relation to the Model Regulation’s consequence option and remediation provisions that previously included guidance that commissioner discretion should be captured as a prescribed or permitted practice.

Additionally, the Financial Regulation Standards and Accreditation (F) Committee heard a report from NAIC staff regarding compliance of certain XXX/AXXX policies subject to a XXX/AXXX Reinsurance Framework following revisions by the Committee in 2016 to the accreditation standards, adopted as an interim measure of XXX/AXXX oversight pending finalization of the Model Regulation. The Framework involves, among other things, the filing of a Supplemental XXX/AXXX Reinsurance Exhibit and the taking of certain actions by a ceding insurer if a security shortfall for XXX/AXXX transactions exists in order not to become subject to the general NAIC accreditation standards. NAIC staff reported that there were no transactions reviewed that had either a primary security shortfall or other security shortfall and that, as such, all of the transactions complied with the XXX/AXXX Reinsurance Framework.

Separately, the Reinsurance (E) Task Force sent a referral to the Financial Analysis Handbook (E) Working Group asking for analysts to be advised of the need for additional scrutiny during review of security for reinsurance of “grandfathered policies.” The request originated with comments from the Maine Bureau of Insurance, which expressed concern that existing security supporting grandfathered policies that are not subject to the Primary Security requirements could be switched out for assets of lesser quality and used as Primary Security for new business. The Bureau asked for the Financial Analysis Handbook to advise analysts of the need to review security for reinsurance of grandfathered policies to ensure that any credit for alternative reinsurance arrangements must be dependent on security that meets reserve valuation and asset quality standards that are at least as protective as those in place at the time the arrangement received its grandfathered status. The ACLI reported it was not opposed to the referral, but wants clarification on what is meant by “standards.” Steve Kinion (DE) asked what the Task Force meant by “hard assets.” The Bureau’s actuary who authored
the comments said he meant to refer to asset quality requirements for admissible assets. He said assets can change, but not quality. He emphasized that his request was only for grandfathered policies, “to plug the gap between very clear requirements going forward, and nothing in writing going back.”

4. Variable Annuities

The Executive (EX) Committee and Plenary adopted revisions to Actuarial Guideline 49 (AG 49) with an effective date of March 1, 2017. The revisions apply AG 49’s standards for determining the maximum annual rate of index-based interest that can be used to calculate values in illustrations for indexed universal life (IUL) insurance policies, to all IUL policies, including in-force IUL policies sold prior to September 1, 2015. Currently, the standards apply only to illustrations for IUL policies sold on or after September 1, 2015.

As adopted by the Life Actuarial (A) Task Force in November, the revisions were scheduled to become effective on July 1, 2017. However, at the Life and Annuity (A) Committee meeting, a request was made that the effective date be moved to March 1, 2017. One participant requested that the effective date be adopted as proposed voicing concern that issuers of IUL policies should be given time to implement the changes required by AG 49 for in-force illustrations.

Notwithstanding that request, the Life Insurance and Annuities (A) Committee adopted the revisions to AG 49 as proposed except with a change in the effective date from July 1 to March 1, 2017. As noted above, the NAIC Executive (EX) Committee and Plenary subsequently adopted the revisions to AG 49. The Variable Annuities Issues (E) Working Group did not meet in Miami Beach.

5. Possible Changes to RBC Formulas

Bond Factors. The NAIC Investment Risk-Based Capital (E) Working Group's focus has been on increasing the granularity of the life formula from 6 to 20 different designations with an implementation target date of year-end 2017. At the NAIC Fall National Meeting, the Working Group heard a presentation by the American Academy of Actuaries (Academy) related to portfolio adjustments for the C1 (asset risk) factors for corporate bonds. The Academy stated that the more bonds an insurer has, the less possibility of loss. In the current life risk-based capital (RBC) formula, the “size adjustment factor” is incorporated into the portfolio adjustment (PA) factor. It overstates the diversification benefit for small portfolios and understates for large portfolios. The goal of the PA is to scale the base factor up or down so that the 96th percentile is achieved.

The Academy looked at 677 life companies and developed two variations of potential portfolio adjustments by minimizing the overall differences of the C1 target to individual results. Alternative 1 updates the portfolio factors for the number of issuers (i.e., changes the size factors). Alternative 2 evaluates a new PA measure designed to capture the variations in the invested amount by the issuer in addition to the number of issuers.

The Academy offered that either of these two alternatives is better than the current PA and, acknowledging that Alternative 1 is simpler, the Academy’s preference is Alternative 2. The Chairman of the Working Group, Kevin Fry (IL), agreed that while Alternative 2 may create a bit of added complexity, it is preferable. John Bruins (ACLI) commented that the two-factor approach (Alternative 2) makes intellectual sense but he would like the opportunity to take it
back to ACLI member companies to ask how much work it is to implement. Chairman Fry said that would be helpful and that nothing definitive would be done immediately; rather, the discussion will continue on calls that will be scheduled early next year.

The Working Group then heard a presentation from the ACLI recommending that an alternate set of C1 factors developed by the ACLI be considered for adoption because the Academy’s factors reflect a dramatic change in the capital charges that does not appropriately reflect the underlying risk and results in a shift of incentives from investment grade to below investment grade bonds. Chairman Fry responded by reminding the Working Group that the NAIC asked the Academy to do the modeling and that its model is what the Working Group has been working from for the past three years. He stated that it would not be appropriate to disregard the Academy’s model at this point. However, the Chairman said the Working Group, with the help of the Academy, is willing to look at the points made and try to address some of the concerns that have been raised.

The discussion shifted to whether the bond RBC structure should be consistent across all statement types—Life, Health and Property & Casualty. The Chairman proposed extending the implementation date to year-end 2018 but including all statement types. The Property Casualty Insurers Association of America (PCI), American Insurance Association (AIA) and America’s Health Insurance Plans (AHIP) all stated a preference not to make a change but did recognize that some insurance groups have both Life and P&C companies. They all requested an opportunity to discuss the matter with their members. Chairman Fry agreed that would be helpful. The results of these discussions will be considered on the next call of the Working Group early next year.

Operational Risk. As part of its ongoing focus on operational risk, the NAIC Operational Risk (E) Subgroup of the Capital Adequacy (E) Task Force reported that it is looking at two types of RBC changes—basic and growth operational risk. The Subgroup plans to make structural changes to the 2017 RBC formulas necessary in order to implement an “add-on” methodology for basic operational risk. The subgroup is looking at a percentage of an insurer's RBC before co-variance in order to determine what the “add-on” should be. It was reported, however, that there is not currently much data on operational risk and that the life business risk charge (C-4) is similar to operational risk (C-4a), which would necessitate an offset. The Subgroup intends to expose a draft for consideration in April 2017.

The Subgroup will also be looking at growth operational risk in 2017. The Life RBC currently does not have a growth risk charge.

The American Academy of Actuaries has launched its own Life Operational Risk Subgroup. The Academy will conduct its work in two phases: Phase 1—recommend an alternative to C4a charge; and Phase 2—assist the NAIC Subgroup in determining the appropriate operating risk charges.

Longevity Risk. At the 2016 Spring National Meeting, the Life Actuarial (A) Task Force (LATF) and the Life Risk-Based Capital (E) Working Group (Life RBC Working Group) agreed to form a joint Longevity Risk (A/E) Subgroup, with a charge to “provide recommendations for recognizing longevity risk in statutory reserves and/or RBC, as appropriate.” The joint subgroup is working with a task force of the Academy.

In April, the Chairman of the Subgroup, Felix Schirripa (NJ), gave a presentation on longevity risk issues. He noted that “mortality improvements have been sizable” and pointed out that
there is currently no longevity risk charge under RBC. Given the exposure of current products—including pension risk transfer transactions, income annuities, deferred annuities, LTC products, etc.—to longevity risk, Mr. Schirripa said it is time to consider the imposition of such a charge.

Mr. Schirripa gave an update during the Fall meeting. He proposed reflecting longevity risk in two components:

- Recognize a statutory reserve shortfall from locked-in/outdated valuation tables via asset adequacy testing (i.e., update reserves using tables applicable to new issues), and
- RBC (C2) charge (calibrated based on “stressed” mortality rates).

Mr. Schirripa said that the reserve and capital components are not tied and that the RBC charge component can be implemented faster than the asset adequacy testing component. The earliest the Subgroup intends to begin a review of reserves, therefore, is April 2018.

**FHLB Proposal.** Life RBC currently has a C-0 charge for collateral held for Federal Home Loan Bank (FHLB) advances of 1.30% on LR017. ACLI is proposing that this be changed to -0- for the collateral equal to the amount advanced, and a factor based on the risk of the FHLB for any excess collateral.

John Bruins of the ACLI asked that the Life Risk-Based Capital (E) Working Group schedule an hour-long call so that the ACLI can walk through its proposal in detail. It was described as a fairly simple correction to the formula for 2017. One regulator suggested that if the NAIC were to do away with the charge, advances should be limited to 2% of total assets. It was noted that four states do have limits on restricted collateral (i.e., not more than 5% of assets can be borrowed in New York). Another regulator suggested that the NAIC review the size of the companies taking these advances. It is not yet clear whether the Working Group will respond to the ACLI request for a future scheduled review of its proposal.

**C. International Issues**

1. **Group Capital Calculation**

Both federal and international insurance regulators are proposing group-wide regulatory capital requirements that will have a significant impact on the industry. While engaging with the International Association of Insurance Supervisors (IAIS) on the development of an international capital standard and monitoring the group capital developments by the Federal Reserve Board, the NAIC formed the Group Capital Calculation (E) Working Group (GCCWG) in 2015 to construct a U.S. group capital calculation using an RBC aggregation methodology.

The agenda for the GCCWG meeting, chaired by Florida Commissioner David Altmaier, included a discussion of two staff memos. The first outlines two possible methodologies—“relative ratio” and “distance to intervention” approaches—to developing a scalar (i.e., a factor to equate local requirements to comparable U.S. levels) for use with non-U.S. insurers in a group capital calculation. The second outlines a baseline test for reviewing the inventory approach to the group capital calculation.

Commissioner Altmaier asked NAIC staff to walk through the two memos. Starting with the scalars memo, staff described the “relative ratio” approach as one based on the Aggregation and Calibration (A&C approach) that the ACLI and AIA developed for the Federal Reserve and presented to the Working Group at the Spring National Meeting. A primary objective of
this approach is to address the issue of comparability of accounting systems and capital requirements between jurisdictions. The “distance to intervention” approach, a simpler way to look at scaling based on excess capital held over intervention level, assesses the raw strength of the capital ratio as a buffer to avoid intervention. Some industry members commented that the distance to intervention approach was difficult to analyze because of the lack of any guidelines and that scalars must be risk-sensitive and transparent. They expressed a preference for the relative ratio approach but said that no matter which approach is chosen, field tests will be required.

The Working Group exposed the scalar memo for a 45-day public comment period ending January 24, 2017.

Commissioner Altmaier moved on to the memo regarding the baseline test of the inventory method and stated that it was not intended to be a first version of a group capital calculation. Rather, the industry should think of the test outlined in the memo as a “sandbox” (a term borrowed from the technology start-up world). NAIC staff explained that the main point of this test is to ascertain what data is needed to do such a calculation. In response to the Chairman’s request for real life examples, staff responded that they will require assistance from the regulators on the Working Group to obtain the data that is needed.

The Chairman encouraged everyone to review the potential timeline for developing the group capital calculation that was included in the agenda as that will be discussed on the next call of the Working Group. It includes five different phases and contemplates performing field testing in 2017 and 2018.

2. International Reinsurance

Following on concerns expressed during the Summer meeting regarding EU member state implementation of Solvency II and its impact on U.S. insurance groups, both the International (G) Committee and the Reinsurance (E) Task Force heard updates concerning the ongoing resolution of collateral and waiver requirements imposed by member states including Belgium, Germany, Poland and the United Kingdom due to each country’s transposition or interpretation of the Solvency II Directive into its national legislation.

In particular, the Reinsurance (E) Task Force received a report from the Qualified Jurisdiction (E) Working Group regarding the possible effects of Solvency II on qualified jurisdiction status. As background, under the revised Credit for Reinsurance Model Law and Regulation adopted in some form as law in 35 states, non-U.S. reinsurers domiciled in “qualified jurisdictions” are permitted to post reduced collateral for purposes of the reinsurance credit permitted U.S. insurers. Currently, four EU jurisdictions are approved by the Working Group as “qualified jurisdictions”—France, Germany, Ireland and the U.K. (the list also includes Bermuda, Japan and Switzerland, which are not EU member states). Each designation is valid for five years from January 1, 2015.

The Working Group’s report notes that a jurisdiction’s designation status as a qualified jurisdiction may be re-evaluated due to a material change in circumstances and describes the considerations for making a determination whether there has been such a change. The report then details the implementation of Solvency II by France, Germany, Ireland and the U.K. and describes certain changes not anticipated when the original designations were made. The report did not propose any specific recommendation and was presented as merely
representing the facts to the Task Force.

After hearing the report of the Working Group, the Task Force exposed the Working Group’s report for a 30-day comment period ending January 10, 2017 and requested that the Working Group continue to study EU member state implementation of Solvency II in order to provide a formal recommendation regarding the qualified jurisdiction status of France, Germany, Ireland and the U.K.

Underlying these events are the ongoing negotiations for a “covered agreement” with the EU concerning reinsurance collateral requirements being conducted by Treasury, the Federal Insurance Office and the U.S. Trade Representative. Those negotiations could culminate in a covered agreement that includes recognition of the U.S. regulatory framework as equivalent in the EU, but also preempts state authority with respect to the matters covered by the agreement. NAIC President and Missouri Insurance Director John Huff noted his concerns during the Summer meeting that state insurance commissioners and state and federal legislators had so far been kept mostly in the dark concerning any insight on even high-level expectations, let alone negotiating objectives.

**D. Cybersecurity**

The NAIC’s most visible work on cybersecurity during 2016 has been the development of an Insurance Data Security Model Law (Model Law). The original goal was to finalize the Model Law by year-end 2016, which coincides with when Cybersecurity (EX) Task Force Chair Adam Hamm (ND) leaves office. The initial and first revised drafts of the Model Law met with opposition from all sides, and an ad hoc drafting group was formed to move the drafting process along more expeditiously. The ad hoc group is co-chaired by Illinois Acting Director of Insurance Anne Melissa Dowling (who announced this week she will leave the office) and Rhode Island Insurance Superintendent Elizabeth Kelleher Dwyer. At the Fall meeting, Superintendent Dwyer reported there are six main issues to be resolved: (1) how to address uniformity among states and whether information security program and breach response standards under the Model Law should be exclusive, (2) harmonizing the Model Law with Health Insurance Portability and Accountability Act (HIPAA) and Gramm-Leach-Bliley Act (GLBA) requirements, (3) whether consumer harm should be a prerequisite for breach notices, (4) the definition of “personal information,” (5) scalability of information security requirements for smaller licensees, and (6) oversight of third-party vendors. She reported that work on a third draft will continue into the new year with biweekly calls.

Separately, the Cybersecurity Task Force also received a report on Federal legislative and regulatory activity during the Fall meeting. NAIC staff reported that Federal banking regulators issued a joint advance notice of proposed rulemaking (ANPR) for enhanced cyber risk management standards for federally regulated banks, bank holding companies and non-bank SIFIs with $50 billion or more in assets. (For a summary of the ANPR, see [Legal Alert: Enhanced Cyber Risk Management Standards Announced in Joint Rulemaking Initiative by Treasury, Federal Reserve, and FDIC](#)). NAIC staff also reported that the President’s Commission on Enhancing National Cybersecurity has released its final report on security and the digital economy. Staff also mentioned Federal bills before Congress that would provide tax incentives for businesses to purchase cybersecurity insurance (HB 6032).

The Task Force also received a report from the Financial Condition (E) Committee on its work on assessing cybersecurity threats during examinations. The report noted enhancements to
procedures and guidelines in the *Financial Condition Examiners Handbook* for the assessment of cybersecurity practices and risks, and included a recommendation for the Task Force to continue work on a Model Law provision that sets minimum standards for information security program requirements, urging that such standards be adopted “with minimal exclusions or exemptions.”

**E. Big Data**

NAIC consideration of how insurers collect and use data in marketing, rating, underwriting and claims will continue during 2017, but the issue has been escalated from a working group to a dedicated task force. A Big Data (D) Task Force was formed for 2017 by the Market Regulation and Consumer Affair (D) Committee and charged with: (1) reviewing current regulatory frameworks used to oversee insurers’ use of consumer and non-insurance data and recommending changes to model laws as appropriate; (2) proposing a mechanism to provide resources for states that can be shared to conduct a technical analysis of complex models used by insurers for underwriting, rating and claims; and (3) assessing data needs and required tools for regulators to monitor the marketplace and evaluate underwriting, rating, claims and marketing practices.

No action on Big Data was taken during the Fall meeting, but regulators and consumer and industry advocates elaborated on two themes during discussion about the Task Force’s work plan for 2017. The first theme was whether regulatory changes are needed to address how insurers use consumer data, and the second theme involved finding ways for regulators to have enough resources to understand complex rating models and how data is being used for pricing. The discussions raise basic questions about what insurance is, and how regulators should respond to insurers’ use of data for risk classification and pricing. Birny Birnbaum (Center for Economic Justice) repeated arguments that consumer advocates have made before that Big Data can be used for extreme risk segmentation that does not allow appropriate spreading of risks. Dave Synder (Property Casualty Insurers Association of America) reiterated an appeal that regulation not stifle innovation by limiting how insurers can use information and technology. Mr. Synder added that the *Price Optimization White Paper* adopted by the NAIC in 2016 reaffirmed risk-based pricing and the application of the “not inadequate, excessive or unfairly discriminatory” standard for insurance rates, and that socialized non-risk-based pricing is not the answer. Regulators reiterated they need better tools to understand rating models and to explain rates to consumers who inquire or complain about their premiums.

**F. Travel Insurance Model**

Travel insurance industry representatives urged the Travel Insurance (C) Working Group to consider draft amendments to an existing National Conference of Insurance Legislators (NCOIL) Travel Insurance Model Act. The draft would clarify the rules applicable to various widespread practices in the sale of travel insurance. One spokesman noted there is an ongoing multistate investigation into a number of travel insurers and that the proposed settlements include business reforms, which he described as making new law through enforcement. Another said the industry needs clear rules of the road for the definition of what line of insurance travel insurance is classified, how it can be sold, what filings are required and what part of distribution should be licensed. Another noted a model law is appropriate because travel insurance does not fit neatly into the existing framework. Topics that the draft
addresses include:

- Limited lines producer licenses
- Premium taxes
- Classification of travel insurance as inland marine and clarifying policy form and insurance certificate filing requirements
- A declaration that rates in a competitive market cannot be “excessive” and that rates averaged broadly among persons insured under a single insurance plan cannot be “unfairly discriminatory”
- Defining “eligible groups” for group policies
- Allowing bundling of insurance and non-insurance benefits in a single product
- Sales practices rules, including a ban on opt-outs and declaring it not to be an unfair trade practice to include Blanket Travel Insurance coverage with the purchase of a trip, provided the coverage is not marketed as free
- Licensing and oversight of travel administrators

Birny Birnbaum, on behalf of the Center for Economic Justice, criticized the draft on a number of counts. He was particularly critical of bundling and classifying travel insurance as inland marine and not as a separate line of insurance. He criticized the industry for not disclosing loss data, stating he believes that high premiums are resulting in excessive profits.

Although the meeting ended with no formal action on the draft, the Working Group Chair Anne Melissa Dowling (IL) asked the proponents of the draft a number of questions for follow-up. Presumably, the responses to those questions will guide other discussion.

G. Briefly Noted

1. National Flood Insurance Program

During an interim meeting, the Property and Casualty Insurance (C) Committee approved “Principles for National Flood Insurance Program (NFIP) Reauthorization,” which was referred to the Government Relations (EX) Leadership Council. The principles are intended to serve as guidance for the NAIC as it engages with Congress on reauthorization of NFIP, which expires on September 30, 2017 and has incurred a debt of $23 billion. Shortly before the Fall meeting, the House Financial Services Subcommittee on Housing and Insurance released a draft “Principles for Flood Insurance Reauthorization and Reform” document, which enjoys support from various property and casualty insurance trade associations. The two “principles” documents are aligned insofar as they both urge long-term reauthorization of NFIP and encourage growth of the private flood insurance market. The House Subcommittee “principles” would require the program to use private risk funding mechanisms, such as reinsurance and capital markets alternatives, to protect taxpayer funds from losses under the program. The NAIC “principles” are silent on these sources of risk financing but instead encourage the study of alternative approaches for the program, such as transitioning NFIP to a residual market or reinsurance backstop.
2. Requests for Review of Insolvency Regulation in Light of Penn Treaty

Individual state insurance regulators and the NAIC have been addressing the challenges posed by faulty underwriting and dramatic rate increases related to legacy long-term care (LTC) insurance policies, which have resulted in fewer and fewer companies selling traditional LTC products, despite the obvious need. The NAIC recently established a new LTC Innovation (B) Subgroup focused on the future of the private LTC insurance market. According to Pennsylvania Insurance Commissioner Teresa Miller, who is chairing the NAIC group, Pennsylvania has had some of the largest insolvencies of LTC insurers in the country. One of the most challenging of those is Penn Treaty, which was the subject of closed door, regulator-only discussions at the Fall meeting because a final order of liquidation is expected sometime in the first quarter of 2017.

Penn Treaty has been in rehabilitation since 2009. It is the second largest and one of the most complex insolvencies ever handled by the state guaranty fund system. Adding to the complexity of developing a plan for the guaranty system to protect Penn Treaty policyholders is the fact that LTC is grouped with traditional health insurance in the health insurance account under the NAIC Life and Health Insurance Guaranty Association Model Act. Consequently, health insurers that do not sell LTC would be assessed disproportionately for an LTC company insolvency such as Penn Treaty, despite the fact that LTC policies are sold mostly by life insurers. This has prompted calls for a change in the way LTC claims are assessed, especially from the largest health insurers, which will shoulder the greatest assessments.


The Group Solvency Issues (E) Working Group of the Financial Condition (E) Committee released an Enterprise Risk Report (Form F) Guidance Manual for a public comment period ending December 5, 2016. It was developed by the Chair (NE) and Vice-Chair (TX) of the Working Group, along with NAIC staff, after a Working Group survey of state insurance regulators revealed uncertainly about the effectiveness and value of the Form F. The purpose of the Guidance Manual is to assist insurers and regulators in maximizing the usefulness of the Form F by effectively communicating its intent and related regulator expectations. As currently proposed, the Guidance Manual:

- Includes general guidance on the applicability of the Form F reporting requirement, including the definition of “ultimate controlling person” and “insurance holding company system.”

- Encourages disclosure of the following areas of enterprise risk, even though disclosure of these risks may not be required under a strict reading of the Form F reporting statute:
  - Those risks that are less likely to occur but have the potential to materially impact the insurance holding company system if they do.
  - Those risks that the insurance holding company system is exposed to that would be material if not for the mitigation strategies put in place.

- Reminds insurers that a Form F filing may incorporate by reference information that appears in their Annual Registration Statement (Form B), ORSA Summary Report, SEC filings or public audited financial statements.
• Includes interpretative guidance, including examples, on the types of enterprise risks that should be disclosed in Item 1 of the Form F reporting form.

• Advises insurers that, while the Form F reporting form contemplates that a group may have no enterprise risks to report, regulators generally expect enterprise risks to be disclosed in each Form F, unless all enterprise risks are addressed in the insurer’s Form B or ORSA filings and are cross-referenced in the Form F, or under other limited situations where no enterprise risks have been identified due to the group’s limited operations and exposures.

• Encourages all insurers to include with their Form F filings a signature and certification similar to those which appear in the Form B filing form (even though a certification does not appear in the Form F reporting form).

• Notes the current Form F filing deadline in each state.

California and New York regulators, the American Academy of Actuaries and a joint interested parties group (ACLI, AIA, AHIP, BCBS, NAMIC, PCI and RAA) submitted comments. New York suggested eight revisions, some of which both fellow regulators and industry felt would inappropriately expand the scope of the Form F. The Academy commented that it thought the Guidance Manual was good but some clarification was necessary (i.e., treatment of non-insurance entities in the definition of Insurance Holding Company System, etc.), and some additional items should be included (i.e., guidance for companies to document their determination of the ultimate controlling person for each IHC system, etc.). The joint trade associations expressed concern that the Guidance Manual creates additional requirements for companies that have no basis in law or regulation and objected to using a Guidance Manual to memorialize the additional requirements. The use of a memorandum to provide additional guidance to regulators that are evaluating the Form F was suggested as an alternative to the Guidance Manual.

Christy Neighbors (NE), the Chair of the Working Group, said she would be inclined to have staff change the title “Guidance Manual” to something else like “Implementation Guide” but not “Memorandum.” She said the Working Group will consider all of the suggestions and that there will be another round of staff drafting based on the discussion.

4. NAIC Corporate Governance Review

The NAIC Governance Review (EX) Task Force received an NAIC staff memorandum, including possible recommendations, regarding administrative due process for NAIC work product to be incorporated by reference into state laws. The NAIC staff memorandum was drafted after a review of interested party letters concerning NAIC administrative due process issues.

One recommendation that generated considerable debate was a proposal that NAIC working groups consider, if offered, business impact or fiscal impact statements or cost-benefits analyses but not be required to produce their own cost-benefit analyses. Motions to adopt, reject and table the recommendation all failed for lack of a second, and, failing future affirmative guidance or action by the Task Force, the recommendation in practice will not be adopted.

Recommendations from the staff memorandum (i) that all groups with responsibility for maintaining NAIC work product incorporated by reference into state law prepare a written
procedures document (if one does not currently exist) and post those procedures to the NAIC website and (ii) to incorporate updates to NAIC work product into state legislator briefings during NAIC national meetings and as otherwise requested, were adopted.

If you have any questions about this Legal Alert, please feel free to contact any of the professionals listed under 'Related People/Contributors' or the Sutherland attorney with whom you regularly work.