STROOCK
SPECIAL BULLETIN

NAIC Updates – June 2018

Model Regulation #275

The Annuity Suitability (A) Working Group of the NAIC Life Insurance and Annuities (A) Committee held an open meeting on Saturday, March 24, 2018 during the NAIC 2018 Spring National Meeting in Milwaukee, Wisconsin. The meeting centered on proposed revisions to the *Suitability in Annuity Transactions Model Regulation #275* ("Model #275") which had been introduced at the NAIC 2017 Fall National Meeting and included a "best interests" standard designed to comport with U.S. Department of Labor's ("DOL") fiduciary rule. Model #275 was adopted to "set standards and procedures for suitable annuity recommendations, and to require insurers to establish a system to supervise recommendations so that the insurance needs and financial objectives of consumers are appropriately addressed." A recent federal circuit court decision has undermined the DOL fiduciary rule raising questions in the Working Group regarding the viability of its proposed revisions to Model #275.

Federal Circuit Court Decisions Affecting DOL Fiduciary Rule

The meeting commenced with a legal analysis provided by Jennifer McAdam of the NAIC of two United States Courts of Appeal decisions impacting the DOL's fiduciary rule (the "Federal Court Decisions"). McAdams explained that the first decision, *Chamber of Commerce of the United States of America, et al. v. United States Department of Labor*, issued by the Fifth Circuit Court of Appeals struck the DOL fiduciary rule in its entirety. According to McAdam, the Fifth Circuit ruled that, (1) the DOL did not possess authority to adopt the new definition of "fiduciary advice" as it was inconsistent with the text of the Employee Retirement Income Security Act of 1974 ("ERISA"); and (2) the DOL had acted arbitrarily and capriciously when enacting the fiduciary rule in violation of the federal Administrative Procedures Act ("APA").

McAdams next discussed the second decision, *Market Synergy Group v. U.S. Dept. of Labor,* issued by the Tenth Circuit Court of Appeals two days before the Fifth Circuit decision. In *Market Synergy*, McAdams explained, the plaintiffs contended that the DOL fiduciary rule violated the APA by: (1) failing to provide sufficient notice of its intention to exclude transactions involving fixed indexed annuities (FIA) from the Prohibited Transaction Exemption (PTE); (2) arbitrarily and capriciously handling FIAs disparately than other fixed annuities by eliminating them from PTE; and (3) failing to sufficiently consider the negative economic effect of its exclusions of FIAs from the PTE. McAdams stated that the Tenth Circuit disagreed with Plaintiffs and upheld part of the DOL fiduciary rule.

McAdams has advised that the DOL was currently considering its options in light of these decisions and was not enforcing the fiduciary rule pending further review.

Stakeholder Comments on the Federal Court Decisions' Effect on Model Regulation #275

The American Council of Life Insurers ("ACLI") has remained committed to developing appropriately tailored rules for annuity sellers to protect consumers. The group is interested in moving forward through a coordinated effort among the NAIC, regulators, state legislators, the DOL and the U.S. Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA"). ACLI seeks a "common sense best interests standard" for annuities, which it believes should be achieved by improving Model Regulation #275 in the following key areas: (1) establishing a process-oriented approach to determining what is in the best interests of the consumers; and (2) identifying and disclosing conflicts of interest regarding cash and non-cash compensation. ACLI has also advised that its president has reached out to the SEC to emphasize the importance of working with state regulators to create a best interests standard of care for annuities. ACLI believes that the NAIC should work with the SEC in connection with the SEC's proposed rule.

The Insured Retirement Institute ("IRI") has expressed its agreement with ACLI's comments and its belief that producers already operate in their clients' best interests. The DOL rule did not recognize this according to the IRI. IRI has suggested that, as the Working Group revises Model #275, it target areas that need enhancement and ensure that there are a wide variety of consumer choices/products. The IRI has implored that the Federal Court Decisions free the Working Group to decide where appropriate changes need to be made.

The American Banks Association ("ABA") has expressed its concerns that the proposed revisions to Model Regulation #275 will unsettle the current annuity marketplace and likely remove banks from offering annuity products, which will negatively affect consumers. According to the ABA, the Model currently incorporates standards that are applied to security sellers, which are too onerous on banks. The ABA has contended that, if the revisions are adopted, Model #275 will create increased litigation and inconsistent compliance requirements for banks across jurisdictions.

The National Association of Insurance and Financial Advisors ("NAIFA") has advised that its representatives have met with the SEC regarding the SEC's proposed rule. NAIFA believes that the NAIC should wait for the SEC so that its model rule can conform to the SEC rule. NAIFA has stated that it supports a best interests standard and has reiterated that NAIFA members have relationships with consumers; thus, annuity sales are driven by that relationship and not by the producer compensation structure. NAIFA has stressed that any approach taken by the NAIC cannot impair the low and middle market consumers' capacity to obtain these products.

Independent Insurance Agents and Brokers of America ("IIABA") has welcomed the Fifth Circuit Decision striking down the DOL fiduciary rule – which the IIABA deems "very troubling" – and has expressed that the Fifth Circuit Decision allows the Working Group to pause and reset. Before the Decision, the Working Group's goal, according to IIABA, was to create a Model that was uniform with the DOL rule. The IIABA has contended that now, the Working Group can reassess this goal. The IIABA believes that the best interests standard is too vague and does not provide sufficient direction to brokers and agents. NAIC has an opportunity to provide more defined guidance.

Reinsurance Provisions of the Covered Agreement Between EU and U.S.

The NAIC Reinsurance (E) Task Force ("RTF") held an open meeting on Sunday, March 25, 2018 during the NAIC 2018 Spring National Meeting in Milwaukee, Wisconsin. During the meeting, the RTF focused on the reinsurance provisions of the Agreement Between the European Union and the United States of America on Prudential Measures

Regarding Insurance and Reinsurance ("Covered Agreement"), which was executed by the United States and the European Union on September 22, 2017. The Covered Agreement will "eliminate reinsurance requirements for EU reinsurers that maintain a minimum amount of own funds equivalent to $250 million and a solvency capital ratio (SCR) of 100% under Solvency II," and allow U.S. reinsurers to do business in the EU without local presence so long as they "maintain capital and surplus equivalent to €226 million with an RBC of 300% of Authorized Control Level." The Covered Agreement requires U.S. states to implement rules that comport with the Covered Agreement within 60 months or risk pre-emption by the federal government.

NAIC To Revise Models To Extend Covered Agreement's Reinsurance Collateral Requirements to Non-EU Qualified Jurisdictions

On February 20, 2018, the NAIC held a public hearing in New York to address the reinsurance collateral provisions of the Covered Agreement. Commissioners McPeak and Altmaier and Superintendent Vullo presided over the meeting, which was attended by approximately 160 people and by another 181 participating by conference call. During the public hearing, 18 speakers – including a representative from the U.S. Department of Treasury, several U.S. domestic insurers and U.S. trade associations, international reinsurers and international trade associations – provided testimony regarding the collateral requirements. The NAIC also received twenty (20) comment letters from various stakeholders and interested parties.

As a result of the hearing, the NAIC has determined that industry consensus favors extending the benefits of the reinsurance collateral requirements of the Covered Agreement to reinsurers in non-EU qualified jurisdictions (Bermuda, Japan, Switzerland and, after Brexit, the UK). However, industry representatives have made it clear that they support this initiative only if the non-EU reinsurers are required to treat the states in the same manner and with the same recognition as do the EU states. This specifically includes a mandate that the non-EU reinsurers recognize the states' approach to group supervision, including group capital.

As such, the commissioner group presiding over the February meeting has drafted a memorandum to the NAIC Financial Condition (E) Committee recommending that it adopt a request for NAIC Model Law Development to amend the *Credit for Reinsurance Model Law (#785)* and the *Credit for Reinsurance Model Regulation* (#786) so that those Models both conform to the Covered Agreement's collateral requirements and bestow reinsurers domiciled in non-EU qualified jurisdictions the same or similar reinsurance collateral requirements. In so doing, the commissioners have recommended that the Committee direct NAIC staff to draft the proposed amendments for the RTF's review.

The commissioner group has also advised the Committee to adopt charges to the RTF to (1) revise Model #785 and Model #786 to conform to the Covered Agreement; and (2) design amendments to those Models that authorize non-EU reinsurers domiciled in Qualified Jurisdictions to follow the same or similar reinsurance collateral requirements as set forth in the Covered Agreement. Based on comments and testimony received during the public hearing, the commissioners have asked that the charge mandate that any changes to Model #785 and Model #786 require these reinsurers to be bound by all other constraints imposed upon the EU in the Covered Agreement, including the mandate that the Qualified Jurisdiction agree to recognize the state's approach to group supervision, including group capital. The RTF will be directed to convene with international regulators, as well as other interested parties, to ensure they will abide by this approach.

The commissioner group has also recommended that Financial Condition (E) Committee adopt

charges to the Qualified Jurisdiction (E) Working Group to require qualified jurisdictions to recognize fundamental NAIC solvency enterprises, including group supervision, group capital standards as well as mandate increased information sharing between the states and Qualified Jurisdictions so that reinsurers domiciled in those jurisdictions are treated no differently than EU reinsurers under the Covered Agreement.

In addition, public hearing attendees emphasized that enforcement mechanisms should be adopted to address the situation where an EU state breached the Covered Agreement or a non-EU jurisdiction failed to meet its obligations. The commissioner group has therefore recommended that the Committee charge the RTF to draft amendments to the models that address these concerns. Finally as a result of testimony received at the hearing, the commissioner group has recommended that the Reinsurance Financial Analysis (E) Working Group be charged to consider changes to its current methods for monitoring certified reinsurers domiciled in Qualified Jurisdictions to reflect changes to the collateral requirements set forth in the Covered Agreement and any revisions to the Model #785 and Model #786.

The Financial Condition (E) Committee met separately on Monday, March 26, 2018 in an open session during the 2018 NAIC Spring Meeting and adopted the model law development request and charges recommended by the commissioner group as immediately set forth.

Update from Qualified Jurisdiction Working Group

At its Spring Meeting on March 25, 2018, the RTF heard the report of the Qualified Jurisdiction (E) Working Group. The Working Group has advised that, in anticipation of the charge that the Working Group consider changes to the *Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions* to require that the Qualified Jurisdictions recognize key NAIC solvency initiatives, including group supervision and group capital standards, as well as require fortification of the information-sharing requisites between the states and Qualified Jurisdictions, the Working Group is expected to complete this charge by the NAIC 2018 Fall National Meeting.

At the 2017 Summer National Meeting, the Working Group was directed to discontinue work on its report on the implementation of Solvency II by the European member-states, given the likelihood that the Covered Agreement would go into effect. The Working Group was also directed to evaluate any new EU member states. The Working Group has not convened since the NAIC 2017 Summer National Meeting; however, it is prepared to evaluate any jurisdiction that desires to obtain qualified jurisdiction status.

The Working Group has advised that it received a request from an EU member state for status, (it could not publicly disclose the name of the EU state) and was waiting to receive confirmation from the sponsor that the state still desired status in light of the execution of the Covered Agreement.

The Working Group also has advised that the seven jurisdictions currently on the NAIC List of Qualified Jurisdictions must be reevaluated in accord with the *Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions*. The Group approved each jurisdiction as of January 1, 2015, however, the qualification lasts five years (thus, expires on December 31, 2019). The Working Group will commence the process at the end of 2018 or beginning of 2019.

Reinsurance Financial Analysis (E) Working Group

During its Spring National Meeting on March 25, 2018 the RTF also heard an update from the Reinsurance Financial Analysis (E) Working Group regarding next steps in the process of the Covered Agreement, including a potential charge to the Working Group to "consider changes in its current methods of monitoring certified reinsurers

domiciled in qualified jurisdictions to incorporate changes to state reinsurance collateral requirements caused by the EU Covered Agreement and any changes to Model #785 and Model #786 to provide similar treatment to reinsurers domiciled in qualified jurisdictions."

The Working Group currently monitors 26 certified reinsurers; however, this number could expand significantly with the increase of EU reinsurers authorized to assume reinsurance under the Covered Agreement without posting collateral, and with similar treatment potentially being extended to other qualified jurisdictions. The Working Group intends to work with the RTF to ascertain the most effective approaches to enhance the financial solvency surveillance capabilities of the group and to determine the most sound approach to working with the states to guard their interests as well as the interests of policyholders.

NAIC's Initiative To Promote Retirement Security

The Life Insurance and Annuities (A) Committee held an open meeting on Sunday, March 25, 2018 during the NAIC 2018 Spring National Meeting in Milwaukee, Wisconsin. The Committee entertained presentations from Allianz and Reinsurance Group of America ("RGA") to assist it in determining how to carry out its retirement security charge. The Committee also heard from the Resource Insurance Consultants ("RIC") which sought a NAIC model bulletin requiring life insurance companies to provide life insurance policy data and in-force illustrations to insureds' designated service providers ("DSPs") so that those providers are able to evaluate policies, as part of their function.

Retirement Security Charge

In 2016, the NAIC launched its Retirement Security Initiative, which is designed to provide consumers with education, pioneering products and safeguard, so that they are financially prepared for retirement. As the Committee discussed during its March 12, 2018 conference call, because consumers are often financially ill-prepared for retirement, a charge enabling the Committee to advance retirement security by addressing retirement instruments, such as life insurance and annuities and the way these products are sold to consumers, is pivotal to the NAIC initiative. The Committee agreed it would further address the charge and the initiative at the NAIC Spring Meeting.

In so doing, the Committee has heard from the Center for Economic Justice ("CEJ"), which implored the Committee to look beyond life insurance and annuities when considering its retirement security charge. Retirement security, according to the CEJ, must include social and other types of insurance that will preserve retirement assets. The CEJ has advocated that Consumers have access to retirement tools that increase their assets, not strip them. CEJ believes that these goals will be fostered if the Committee takes the following initiatives: (i) revise suitability framework to a best interests standard of care; and (ii) conducts a comprehensive review of disclosure regimes, which are currently disjointed and do not empower consumers.

The Committee also entertained comments from Karroll Kitt, a consumer advocate, who advocated that retirement security is a personal state of mind, which is composed of several features including, funding one's lifestyle during retirement and protecting one's assets. Consumers should not think that buying life insurance and annuities alone is security. It is not.

Allianz Generations Ahead Presentation

When it comes to retirement, a 2017 study conducted by Allianz revealed that baby boomers, Gen Xers and millennials share the common fear of running out of money in retirement; in fact, it is something that the majority fear more than death. The good news for baby boomers is that their retirement picture is improving. They identify themselves as savers and can financially plan for their future. As they age, baby boomers are

becoming more fiscally conservative and saving more money than the other generations. Gen Xers, on the other hand, are struggling with retirement savings. Their non-mortgage debt is increasing and vis-à-vis retirement security, they are moving in the wrong direction. Allianz's study revealed that Gen Xers' failure to save for retirement is having a large emotional toll on the generation. The population has grave concerns regarding how they will make money in the future and how they will maintain their lifestyle. As for millennials, they are currently on the right track when it comes to retirement savings. Social media however puts them at risk. It causes millennials to spend more (and save less) because they compare their wealth with contemporaries, which causes FOMO (fear of missing out). While millennials displayed high confidence in their ability to save, whether they will actually do so sufficiently for retirement remains to be seen.

RGA's Innovation in Life Insurance Presentation

According to the RGA, the pace of innovation is reshaping insurance in fundamental ways and incumbents are struggling to keep up. Traditional insurance companies find it difficult to embrace innovation because they see it as a threat to their existing core business and lack the requisite expertise and capital to create new products. Historically, insurers have operated under the belief that insurance was sold, not bought. This dogma is now being challenged by RGA's new company, RGAx which was created to develop solutions to the problems identified in the Generations Ahead Study. RGAx focuses on designing products that people want to buy. How does RGAx make that determination? By observing humans, creating what they appear to need/desire and then validating the creation. RGA advocates that this concept needs to be incorporated into the U.S. insurance industry, as today, insurance product development takes too long and is too costly.

Must Life Insurers Provide Policy Data and In-Force Illustrations To Designated Service Providers (DSPs)?

RIC wants the NAIC to create a model bulletin requiring life insurers to provide in-force illustrations and policy data to management firms directly when asked on behalf of a policyholder, fiduciary or client. DSPs require this information to assist their clients in evaluating life products and perform their obligations as independent managers of assets. DSPs routinely represent banks and other fiduciaries and must have the tools required to assist these organizations in meeting their obligations. In most cases, the banks/fiduciaries lack expertise regarding life products; therefore, they retain a DSP.

NAIC model regulations currently permit policyholders to seek, via telephone, illustrations and policy data annually from their insurers. In recognition of the essential role DSPs provide, NAIC must expand these models to require insurers to provide this same information to third-party service providers upon *written* request, according to RIC.

Recognizing that insurance companies have valid security reasons for requiring that a policyholder seek this information via telephone, the Committee agreed to table a motion to add a charge to develop a bulletin for further discussion at its next meeting.

Form F Implementation Guide and ORSA Comparison Chart Are Adopted

The Group Solvency (E) Working Group of the Financial Condition (E) Committee held an open meeting on Saturday, March 24, 2018 during the NAIC 2018 Spring National Meeting in Milwaukee, Wisconsin. During the meeting, the Working Group discussed and adopted changes to the Form F Implementation Guide and ORSA Comparison Chart.

In 2015, insurance regulators began to receive Form F filings from insurers and quickly became

concerned regarding the value of those forms. Regulators questioned whether Form F provided quality and sufficient information. The Working Group therefore conducted a survey to determine whether the states considered Form F useful. The Working Group's survey was conducted in the Spring of 2016 and it was determined the states did not believe that Form F had much value. To improve the situation, the Working Group agreed to create a non-binding Form F implementation guide to assist insurers in support of the *Insurance Holding Company System Regulatory Act (#440)* and the *Insurance Holding Company System Regulation with Reporting Forms and Instructions (#450)*.

The Working Group developed two versions of the implementation guide by Spring of 2017. However, the NAIC Legal Division and other interested parties advised that the guide needed to be revised because, as drafted, the guide could be seen as creating conflicts with Model #440 and Model #450. Accordingly, a drafting group was appointed to identify and consider various options available to regulators in addressing Form F reporting. The drafting group performed its charge by reviewing Form F and ORSA Summary Reports from several insurance groups in view of the regulatory purpose of each report. The drafting group was asked to determine if the reports were needed and how best they could be used. The result was significant revisions to the Form F/ORSA Comparison Chart as well as the implementation guide.

Both newly revised documents were open for public comments through January 12, 2018. The ACLI comments offered during a February 27, 2018 conference call provoked additional revisions to the implementation guide.

Interested Parties Comments On Form F Implementation Guide

During the February 2018 conference call, the ACLI described the following concerns received by interested parties: 1) minor clarifications; and 2) an exemption for U.S. Securities and Exchange Commission (SEC) filers. Interested parties and the ACLI believe that, because SEC filings require insurers to reveal risk factor information, regulators should exempt those insurers making such filings from filing Form F (to the extent all relevant enterprise risks are set forth in their SEC filings). Opposition to the exemption was expressed, as SEC filings and Form F filings are not identical, Moreover, SEC filings are public and, therefore, contain less information on a particular risk than in the confidential Form F filing. It was also noted that state insurance regulators already have the authority to grant individual exemptions under Section 4J of the *Insurance Holding Company System Model Act* (#440) and that a state could decide to grant an exemption in this circumstance. Finally, the NAIC has advised that all of the proposed ACLI clarifications had been included in the updated draft documents, with the exception of a proposed edit to the Form F/ORSA Comparison Chart regarding the purpose of the Form F filing. The reason this clarification was not incorporated is that the language in this section of the chart was taken directly from the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450).

During the Spring Meeting, the ACLI reiterated its belief that the implementation guide should exempt insurers which file SEC forms from filing Form F reports. The Working Group responded that an exemption is an option for states, but the Working Group will likely not recommend it.

The ACLI then discussed another outstanding concern regarding the examples of information in the implementation guide, which were garnered through information provided by insurers on their Form F reports. The ACLI has stated that those examples could lead to disclosure of an insurer's highly confidential and proprietary information without adequate protection by the Model laws. The interested parties have therefore again requested the removal of those examples from the guide. In response, the Working Group chair has stated that the guide's usefulness would be greatly

undermined by removing the examples, which are a significant benefit to the industry and regulators. The NAIC has refuted the ACLI's confidentiality concerns by responding that the Models included strong confidentiality terms which will protect proprietary information in the examples. The NAIC has also explained that the disclosing of such information across states is governed by the NAIC's Master Information Sharing and Confidentiality Agreement, which provides additional protection. Moreover, the NAIC has advised that it has created a separate information-sharing agreement for the Form F, which was currently under assessment.

A discussion was then held on how the Working Group intends the implementation guide to be utilized by registrants and regulators. The implementation guide sets forth "best practices" for Form F preparation, so that it can be most functional to regulators. If these "best practices" are followed, registrants will be subject to less regulatory follow-up and correspondence necessary to utilize the information provided. This will allow for a more effective and efficient process.

Update from the ORSA Implementation (E) Subgroup

The Working Group heard from the ORSA Implementation (E) Subgroup learning that it had held regulator-to-regulator conference calls on January 30, 2018 and March 1, 2018, respectively. The Group has also advised that it received comments from its members (as well as members of other NAIC actuarial groups) in connection with responding to the second exposure of the Actuarial Standard Practice (ASOP, *Capital Adequacy Assessment* created by Actuarial Standards Board's (ASB) Enterprise Risk Management (ERM) Committee. The Group has submitted those comments in a letter to ASB, which will be published on ASB's website once the ERM Committee finalizes its responses to comments received.

The Subgroup has advised that it desired a comprehensive and practical actuarial standard which will assist actuaries involved in capital adequacy assessment work for insurers. Regulators believe that the ORSA submissions will improve as a result of this standard. The standard will also assist state insurance department actuaries in uncovering issues regarding capital adequacy assessment.

The Subgroup intends to schedule an open call in the next few months to receive comments from industry players and state regulators on the requirements of Sections 2 and 3 of the ORSA Guideline Manual. The Subgroup has stated that it requires comments to develop training and provide guidance to insurers.

Finally, the Subgroup has agreed to address the issue of NAIC accreditation standards on ORSA review procedures in 2018.

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