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# LEGAL ALERT

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## Insurance Regulators Heighten Focus on Life Insurer's Separate Accounts

In the aftermath of the recent financial crisis, insurance regulators are reassessing the tools they have at hand to monitor and regulate the solvency of insurance companies, including life insurance company separate accounts. In addition to proposing new holding company reporting and inspection requirements and heightened corporate governance standards, U.S. insurance regulators at the National Association of Insurance Commissioners (NAIC) are focused on how to improve the regulation and monitoring of separate account products (particularly non-variable products) and minimize their potential negative impacts on insurer solvency.

**FAWG Report on Separate Accounts.** During a conference call of the NAIC's Financial Condition (E) Committee on March 8, 2011, the NAIC made public for the first time the summary of a report on separate accounts prepared by the influential Financial Analysis (E) Working Group (FAWG).[1] A copy of the summary report is here. In presenting the report, Roger Peterson,[2] Chair of FAWG, noted that there is a concern at FAWG about the solvency risks posed by non-variable, non-unit linked products written in separate accounts and how such products would interact with the general account in a troubled company situation. There is also concern about how such products would interact with state guaranty funds.

In a survey of state insurance departments, FAWG identified 300 non-variable products in separate accounts, including market value adjusted annuities, BOLI/COLI, group annuities and modified guaranteed annuities, of which 81 were not legally insulated (although the FAWG report notes that there are "different views on what is defined as legally insulated"). The FAWG report also noted that state insurance departments place widely different limitations on investments that may be held within separate accounts, potentially increasing solvency risks.

The FAWG report recommended, and the (E) Committee agreed, that this issue warrants further attention by:

- the Receivership and Insolvency (E) Task Force, which will take this issue up at next week's NAIC National Meeting in Austin, Texas;
- the Separate Account Risk (E) Working Group (see below);
- the Financial Analysis Handbook (E) Working Group, to consider developing guidance and procedures for inclusion in the 2011 Life edition of the NAIC Financial Analysis Handbook so that analysts can be alerted to potential risks; and
- the Capital Adequacy (E) Task Force, in its consideration of risk-based capital requirements.

**Separate Account Risk (E) Working Group.** During the March 8 conference call, the (E) Committee also received a December 2010 report from the Chair of the Separate Account Risk (E) Working Group (SARWG). A copy of the report is here. The report recommended, and the (E) Committee agreed, that

[1] FAWG is a working group of the NAIC that meets in regulator-only executive sessions. Its role is to analyze nationally significant insurers and groups that exhibit characteristics of being financially troubled to ensure that domiciliary regulators are taking effective action with respect to such insurers. FAWG 2011 charges include increasing information-sharing between state and federal regulators, including through "representation of state regulators in national bodies with responsibilities for system-wide oversight," which would appear to include the Financial Stability Oversight Council created by the Dodd-Frank Act.
[2] Roger Peterson is Director of the Financial Analysis and Examinations Bureau at the Wisconsin State Insurance Department.

during 2011 the SARWG should study the need to modify existing regulatory guidance, and/or develop new guidance, "related to separate accounts where in recent years various products and contract benefits have increased the risk to the general account." At the end of the study, the SARWG will provide a recommendation to the (E) Committee regarding whether to develop a new model law and/or change current model laws.

The Chair noted that when the SARWG was formed in the fall of 2009 (and was called the Separate Account Risk Charge Working Group), the primary concern of the Working Group was the lack of risk charges for certain individual separate account products where a guaranty is provided by the general account for the policy owner's benefits. The lack of such a charge, or an inadequate charge, could create solvency concerns for general account contract owners.

During 2010, the SARWG identified other areas of concern, including "otherwise general account products" that are included in separate accounts for various reasons. Such policy owners have the potential to be considered a preferred class compared to general account policy owners with essentially the same product. According to the Chair, this issue is related to the issue identified in the FAWG Report – the apparent increase in recent years in the type and number of non-variable, non-unitized products within separate accounts, which may or may not be insulated.

The SARWG will study whether the NAIC should modify the Variable Contract Model Law, as well as other related NAIC model laws and regulations, to increase the solvency protection provided to policy owners related to the activities and operations of separate accounts.

We will continue to monitor and report to you on developments in the regulation and monitoring of separate accounts at the NAIC.

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*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*


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