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Global Corporate Insurance and Regulatory Bulletin

INSURANCE & REINSURANCE INDUSTRY GROUP

December 2013

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Contents

Global

CAPITAL REQUIREMENTS FOR GLOBAL SYSTEMICALLY IMPORTANT INSURERS

As reported in our July 2013 bulletin, on July 18, 2013, the International Association of Insurance Supervisors (the "IAIS") published a methodology for identifying global systemically important insurers ("GSII") together with a set of policy measures that will apply to such insurers. These measures have been endorsed by the Financial Stability Board ("FSB"). Also on July 18, 2013, FSB released its list of nine GSIIs: Allianz SE, American International Group Inc., Assicurazioni Generali SpA, Aviva plc, AXA S.A., MetLife Inc., Prudential Financial Inc., Prudential plc and Ping An Insurance (Group) Company of China, Ltd. FSB plans to perform an assessment process for determining globally systemically important reinsurers with the aim of creating a list of "systemically important" reinsurers before the end of 2014.

On December 16, 2013, the IAIS released proposals for a public consultation for the development of basic capital requirements ("BCR") for GSIIs. A link to the IAIS press release can be found here. The consultation is designed to receive feedback on the proposal, inform upcoming field testing that is due to start in March 2014, and support the development of BCR. BCR will apply to all group activities, including non-insurance subsidiaries, and is the first step towards developing risk-based, group wide global capital standards. The second step will be the development of high loss absorption ("HLA") requirements to apply to GSIIs, which is supposed to be completed by the end of 2015. The HLA will build on the BCR and will reflect the need for different capital requirements for GSIIs due to their systemic importance in the international financial system.

Responses to the IAIS' initial consultation on BCR are due by February 3, 2014. A second consultation period is expected to commence in July 2014, following the field testing and further development of BCR, which will provide the opportunity for comments on more specific BCR proposals. BCR is expected to be approved by the FSB by November 2014 at the latest in order to allow for its endorsement at the G20 meeting in the same month.

In addition, the IAIS will develop global insurance capital standard for Internationally Active Insurance Groups ("IAIGs") as part of the Common Framework for the Supervision of Internationally Active Insurance Groups ("ComFrame"). The IAIS expects to finish developing the global insurance capital standard for IAIGs under ComFrame by the end of 2016 with an eye towards implementation in 2019.

Although the proposed BCR will only apply to GSIIs and the global insurance capital standards will only directly apply to IAIGs, it is likely that the changed capital standards will eventually have an effect on the standards applicable to all insurance companies.

UK/EUROPE

UK – BRITISH REGULATORS TO CUT RED TAPE FOR INSURERS MOVING TO UK

In a bid to boost growth in the City of London, the UK government, together with financial regulators, has pledged to cut the red tape that currently affects foreign insurers attempting to move to the UK.

According to the British finance ministry, the Prudential Regulation Authority (the "PRA") and the Financial Conduct Authority (the "FCA") are committed to ensuring that the authorisation process for prospective insurers wishing to establish themselves in the UK is as streamlined as possible. This commitment has been driven largely by the success of the relocation of the world's biggest broker, Aon Corp, from Chicago to London in 2012 and the resulting increase in London's status in the insurance industry.

The government has also declared it will promote the UK insurance industry in economies key for their fast growth, such as China and Brazil, with the intention of putting the UK at the centre of trade negotiations.

In addition to the proposed streamlined authorisation process, it is hoped that planned cuts to corporation tax and London's already well established links with emerging markets in Africa, the Middle East and Asia, will help entice firms to the UK.

In line with the British government's support of the insurance industry generally, in May 2012 Prime Minister David Cameron helped Lloyd's launch a new strategy for the development of its market, Vision 2025. Vision 2025 targets profitable growth from developed and developing economies and its aim is to ensure that the Lloyd's market remains the global centre for specialist insurance and reinsurance.

Alongside the pledges from the regulators and the government, the UK's biggest insurers have announced that over the course of the next five years they will invest 25 billion pounds in transport and energy projects, backing a government drive to shore up infrastructure investment.

US/AMERICAS

US – SEC'S INQUIRIES AND OTHER DEVELOPMENTS REGARDING CAPTIVES

According to public filings by large publicly traded life insurance companies, the United States Securities and Exchange Commission ("SEC") has requested information from such companies regarding their use and funding of captive entities and the potential financial impact for such companies if state insurance regulators prohibit the use of captives.

As reported in our prior bulletins (see, for instance, here and here), the use of captives by life insurance companies has been under scrutiny by various US regulators. The Captives and Special Purpose Vehicle Use (E) Subgroup of the National Association of Insurance Commissioners (the "NAIC") issued the Captive and Special Purpose Vehicle White Paper in 2013. The NAIC's Principle-Based Reserving Implementation (EX) Task Force ("PBR Task Force"), which is coordinating all of the NAIC's technical groups involved with projects related to the NAIC's principles based reserving initiative for life and health insurance and is also charged with assessing the solvency implications of life insurer-owned captive insurers and alternative mechanisms, is tasked with considering the white paper's recommendations in the context of the proposed principles based reserving system and with making further recommendations, if any, to the NAIC's Executive (EX) Committee. A brief note regarding the issues being considered by the PBR Task Force appears later in this bulletin.

Separately, the New York Department of Financial Services (the "NY DFS") issued a report titled "Shining a Light on Shadow Insurance: A Little-known Loophole That Puts Insurance Policyholders and Taxpayers at Greater Risk" in June 2013; the NY DFS has called for greater disclosure and transparency about the use of captives and an immediate national moratorium on such transactions (see here). The 2013 New York Supplement to the Annual Statement blank includes a new exhibit that requires information regarding captive reinsurance transactions. Specifically, the exhibit requires a schedule of reinsurance transactions with captives and affiliated offshore insurance companies where parental or affiliated guarantees are involved.

The Federal Insurance Office ("FIO") also raised questions regarding the use of captives in its report issued on December 12, 2013 (and described in the following article). In addition, the use of captives by the life insurance industry is being considered by the Federal Advisory Committee on Insurance (see here).

US - FIO RELEASES ITS LONG-AWAITED REPORT MANDATED BY THE DODD-FRANK ACT

On December 12, 2013, FIO submitted to Congress and released a report entitled, "How to Modernize and Improve the System of Insurance Regulation in the United States." The report was mandated by Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In its preparation of the report, FIO reviewed nearly 150 written comments and consulted with nearly 40 different insurance sector participants and stakeholders, including insurance regulators, insurance companies and consumer advocates.

In its report, FIO recognizes the importance of the state-based system of insurance regulation, but also notes that "[a]ny system with 56 independent jurisdictions is inherently limited in its ability to regulate uniformly and efficiently." The report therefore takes a two-pronged approach: specifying reforms FIO believes are needed in the state-based system of insurance regulation and also identifying new areas for direct federal involvement.

FIO's recommendations for state based reforms focus on three areas: (1) capital adequacy and safety/soundness; (2) reform of insurer resolution practices and (3) marketplace regulation.

The FIO report also identifies areas for direct federal involvement, which include, among other topics: (1) development and implementation of federal standards and oversight for mortgage insurers, (2) uniform reinsurance collateral requirements based on the NAIC models, (3) a national registration system for insurance agents and brokers, and (4) FIO participation in supervisory colleges that will oversee large national and internationally active insurers.

A complete list of the FIO recommendations for modernizing and improving insurance regulation in the United States is found under Section I of the report.

In its report, FIO states that it intends to work with all aspects of the insurance sector and promises to "recommend additional improvements to the U.S. system of insurance regulation that best integrate the interests of U.S. insurers and consumers."

The FIO report sets forth issues and challenges but does not present specific solutions. FIO will explore solutions in the next phase, including in discussions with the US Congress and the state insurance regulators. The NAIC's statements regarding the FIO report can be found here.

US - NAIC FALL 2013 NATIONAL MEETING

The NAIC held its Fall 2013 National Meeting from December 15-18, 2013, in Washington, D.C. Set forth below are highlights from some of the sessions.

Principle-Based Reserving Implementation (EX) Task Force

On December 15, 2013, the PBR Task Force met during the NAIC Fall 2013 National Meeting. The stated mission of the PBR Task Force is to coordinate the NAIC's implementation plan for principle-based reserving and to formulate recommendations to the NAIC Executive Committee regarding the use of captive insurers by life insurers for financing life insurance reserves.

The primary agenda item for the December 15, 2013 meeting was a discussion of the September 2013 Initial Report of Rector & Associates (the "Rector Report"), along with comments on the Rector Report that had been submitted by interested parties. The Rector Report posed the threshold question of whether "lower quality non-admitted assets should be allowed to back portions of the reserve that have a low probability of being needed to pay claims—or whether, instead, to seek to prohibit transactions that result in an economic effect different than the current statutory accounting requirement that admitted assets be used to back 100% of statutory reserves."

The Rector Report went on to propose two potential alternatives if the decision was to permit two tiers of assets to be used to back reserves: (1) reinsurance to a captive (the approach currently used by some insurers) or (2) modifying statutory accounting principles to allow the lower quality assets to be maintained in some fashion on the insurer's own balance sheet. The Rector Report also identified key issues that would need to be addressed under either alternative, such as adopting a uniform actuarial standard to define the boundary between the two tiers, deciding what kinds of assets could be used to back the lower probability tier, and establishing uniform guidelines for regulatory oversight, including enhanced disclosure standards.

In the discussion at the PBR Task Force meeting on December 15, the Co-Chair, Rhode Island Superintendent Joseph Torti, expressed the view that the alternatives outlined by the Rector Report were interim measures to be used until principle-based reserving is ratified by the states and is implemented. He added that, although he does not think regulators should go back and make changes to previously approved transactions, he would expect that once principle-based reserving is implemented, such transactions should stop and no new business should be added to open-ended transactions.

The time available for discussion at the PBR Task Force meeting was quite limited, as the meeting had been scheduled for only one hour. However, the primary viewpoint expressed by most of the regulators who spoke was the need for uniformity and transparency in reserve financing transactions. Significantly, a similar concern appeared as one of the Federal Insurance Office's recommendations for short-term action by the states in its December 2013 report on how to modernize and improve the system of insurance regulation in the United States. Rector & Associates is expected to issue a further report in February.

On a related note, the Financial Regulation Standards and Accreditation (F) Committee (the "Accreditation Committee") discussed the definition of a "multi-state insurer" for accreditation purposes with respect to those reinsurers that reinsure business in accordance with the Valuation of Life Insurance Policies Model Regulation (#830) (Regulation XXX) and Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation (AG 38) (Regulation AXXX). Rhode Island Superintendent Joseph Torti stated that NAIC had not intended to exclude captives from the definition of multi-state insurer. The NAIC staff has been tasked with developing clarifying language on this point for consideration by the Accreditation Committee.

Financial Condition (E) Committee Private Equity Issues (E) Working Group

On December 16, 2013, the Private Equity Issues (E) Working Group ("Private Equity Working Group") of the NAIC's E Committee met at the NAIC Fall 2013 National Meeting. During the meeting, the Private Equity Working Group received a presentation by representatives from Apollo Global Management ("Apollo"), an investment management firm, and its affiliate, Athene Life Re Ltd ("Athene").

Representatives from Apollo described the nature of the company's business and the key drivers that have sustained the company over the years. They explained that Apollo became an insurance holding company in 2012, but that private equity investment in the insurance sector has a long history. They also discussed what they described as general misconceptions about the private equity industry. In response to questions about the motivation for a private equity firm to participate in the insurance sector, the Apollo representatives described private equity as a source of capital for the insurance industry and noted how Apollo had acted as a source of credit for the industry after the financial crisis.

Representatives from Athene discussed, among other things, that while they support regulatory oversight, they believe that any increased regulation should be applied equally across insurance industry participants, rather than singling out insurance companies based on the existence of private equity investment in their capital structure.

Reinsurance (E) Task Force: Qualified Jurisdictions and Credit for Reinsurance Model Law and Regulation

On December 17, 2013, the Reinsurance (E) Task Force (the "Reinsurance Task Force") held a meeting at the NAIC Fall 2013 Meeting. The meeting covered, among other items, the following matters: 1) a status report on state implementation of the revised *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786); 2) consideration of a report issued by the Qualified Jurisdiction (E) Working Group; 3) consideration of the report of the Reinsurance Financial Analysis (E) Working Group; 4) discussion of the Reinsurance Financial Analysis (E) Working Group (the "R-FAWG") report; 5) a status report regarding referrals from other NAIC groups; 6) a short discussion of the EU-US Dialogue; and 7) an update on the *2013 Report on the Impact of Part II of the Nonadmitted and Reinsurance Reform Act.*

With respect to the implementation of the revised *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786), 18 states have adopted revisions to date. The discussion of the Qualified Jurisdiction (E) Working Group report focused on the inclusion of supervisory authorities in Bermuda, Germany, Switzerland and the United Kingdom on the NAIC List of Qualified Jurisdictions (the "NAIC List") as Conditional Qualified Jurisdictions. The Task Force voted to adopt the report and to approve the four jurisdictions as conditionally qualified jurisdictions for the NAIC List; the Reinsurance Task Force expects to complete its final review of these four jurisdictions in 2014 and will also consider other jurisdictions for qualification (including France and Ireland, which have already expressed an interest in being considered). The Reinsurance Task Force also considered adoption of the report of the R-FAWG, which included a discussion of developments related to passporting. The Reinsurance Task Force voted to adopt the R-FAWG report. The meeting concluded with a discussion of international developments and a brief summary of the EU-US forum held on December 14, 2013.

Mortgage Guaranty Insurance (E) Working Group Discusses Revisions to the Mortgage Guaranty Insurance Model Act

On December 15, 2013, the Mortgage Guarantee Insurance (E) Working Group ("MGIWG") of the E Committee met at the NAIC Fall 2013 National Meeting. The meeting focused on the proposed revisions to the *Mortgage Guaranty Insurance Model Act* (#630) (the "Mortgage Guaranty Model Act"). The draft proposed revisions to the Mortgage Guaranty Model Act were prepared by the Wisconsin Office of the Insurance Commissioner as requested by the MGIWG. During the December 15th meeting, MGIWG heard preliminary comments on the proposed revisions.

The meeting began with a summary of the historical underpinnings of the proposed revisions to the Mortgage Guaranty Model Act, particularly mortgage fraud that contributed to the 2008 financial crisis. MGIWG then discussed the proposed revisions briefly, providing explanations for the proposed changes. In addition, there was discussion regarding the role of regulators in reviving the industry after the financial crisis, with a short debate over the mechanisms needed to prevent such an occurrence in the future.

Interested parties were permitted to address MGIWG after initial written comments received were discussed at length. The period for providing comments on the proposed revisions to the Mortgage Guaranty Model Act was extended from January 9 to February 15, 2014.

Life Insurance and Annuities (A) Committee Developments

On December 16, 2013, the Life Insurance and Annuities (A) Committee (the "Life Committee") met at the NAIC Fall 2013 Meeting. The agenda for the session included updates from working groups and task Forces, as well as a federal legislative update.

The federal legislative update focused primarily on the progress of the Social Security Administration's Death Master File through Congress, as part of the Bipartisan Budget Act of 2013. The working group and task force reports included updates from the Contingent Deferred Annuity (A) Working Group, the ERISA Retirement Income (A) Working Group ("ERISA Working Group") and the Life Actuarial (A) Task Force. The ERISA Working Group, formed after a Department of Labor ("DOL") request for guidance on best practices for annuity providers as relates to DOL safe harbor and fiduciary requirements, has been working to illustrate to the DOL that sound regulatory systems are in place to regulate company solvency. The Life Actuarial (A) Task Force *Valuation Manual* spread tables were exposed for a 45-day period. The Life Committee also discussed a few other matters such as state uniformity of unclaimed property regulations and longevity risks.

Financial Condition (E) Committee

On December 17, 2013, the E Committee met at the NAIC Fall 2013 Meeting. The main issues discussed at the meeting included proposed revisions to the NAIC group code assignment process; the Accounting Practices and Procedures (E) Task Force ("APP Task Force") report; and the Own Risk and Solvency Assessment ("ORSA") Feedback Pilot Project report.

The meeting began with a discussion of proposed changes to the NAIC Group Code Assignment procedures. The proposed revisions were exposed to a 30-day comment period that closed on December 1, 2013. A motion to defer consideration of proposed revisions and comments to a committee conference call, to take place before the NAIC Spring 2014 National Meeting, was approved.

Discussion of the APP Task Force report included a motion to adopt the report with the exclusion of the *Statement of Statutory Accounting Principles (SSAP) No. 35R—Guaranty Fund and Other Assessments* and *Issue Paper No. 148, Affordable Care Act Section 9010 Assessment* to require a liability at year-end and a corresponding nonadmitted deferred asset with respect to the fee payable under Section 9010 of the federal Affordable Care Act. On this issue, the E Committee adopted SSAP No. 35R and Issue Paper No. 148, as adopted by the Statutory Accounting Principles (E) Working Group on December 15 and rejected the APP Task Force's action with respect to this item. Under the adopted revisions to SSAP No. 35R, there is guidance to recognize the liability and expense on January 1 of the fee year. Included in the adopted *Issue Paper No. 148* is an analysis of the adopted guidance under the statutory accounting Statement of Concepts along with dissenting opinions.

The E Committee also discussed adoption of the ORSA Feedback Pilot Project report. The project involved the voluntary submission of confidential ORSA Summary Reports for regulatory review in advance of the ORSA requirement taking effect in 2015. After adopting the report, the E Committee agreed to hold a conference call for the ORSA subgroup in January 2014.

Corporate Governance (E) Working Group

On December 16, 2013, the Corporate Governance (E) Working Group of the SMI Task Force held meetings at the NAIC Fall 2013 National Meeting. The key topics covered in the meeting included: 1) the governance-related activities of the IAIS; 2) comments received on proposed revisions to the *Annual Financial Reporting Model Regulation* (#205) (the "Model Regulation # 205"); and 3) a discussion of updated drafts of the Corporate Governance Annual Filing Model Act ("Corporate Governance Model Act") and Guidance Manual.

The IAIS update included a summary of in-process papers on corporate governance and of the self-assessment peer review process implemented by the IAIS. The working group also noted that the government components of the ComFrame were completed.

Following discussions regarding the Model Regulation # 205 and the Corporate Governance Model Act and Guidance Manual, the working group exposed the documents for comments until January 31, 2014.

International Insurance Relations (G) Committee

On December 15, 2013, the International Insurance Relations (G) Committee met at the NAIC Fall 2013 Meeting. The meeting included a discussion of activities of the IAIS, working group and task force updates, and a summary of the EU-US Dialogue forum held on December 14, 2013.

The IAIS discussion focused on ComFrame, which was developed by IAIS in 2012. Field testing for the ComFrame is expected to begin in the coming year. The Committee reviewed comments received on the IAIS ComFrame 2013 Draft. Finally, the potential reorganization of IAIS was discussed with comments suggesting the reorganization of the subcommittee structure and expressing concern over transparency of IAIS meetings as currently structured.

Among the working group and task force updates, the Solvency Modernization Task Force ("SMI Task Force") provided an update, noting that it is wrapping up its charges and finishing policy proposals. Going forward, the Solvency Modernization Initiative will continue but the SMI Task Force will be disbanded and the Financial Condition (E) Committee ("E Committee") will assume any remaining charges of the SMI Task Force.

The meeting concluded with a debrief from the EU-US Dialogue forum held on

December 14, 2013, in advance of the NAIC Fall 2013 National Meeting, and a discussion of The Way Forward document.

Title Insurance (C) Task Force

On December 16, 2013, the Title Insurance (C) Task Force ("TITF") met at the NAIC Fall 2013 National Meeting. The meeting included consideration of working group reports, a presentation on affiliated business arrangements and a federal legislative update.

Discussion of the working group reports focused primarily on the Title Insurance Risk Based Capital (C/E) Subgroup ("TI RBC Subgroup"). In a December 13, 2013, letter to the Chairs of TITF and the Capital Adequacy (E) Task Force, the TI RBC Subgroup concluded that developing risk-based capital requirements for title insurers was not feasible at this time. At the meeting, the TI RBC Subgroup representatives expanded on the letter, stating that development of risk-based capital requirements would be time intensive and require uniformity of statutory accounting requirements across the states. The TI RBC Subgroup concluded its presentation by requesting permission to disband.

The presentation on affiliated business arrangements was led by a representative from the National Association of Independent Land Title Agents. The presentation included a brief overview of the Real Estate Settlement Procedures Act, which regulates referrals and other practices in the real estate closing process, and a discussion of the public policy implications of affiliated business arrangements.

The federal legislative update included a briefing on the elimination of government-sponsored enterprise bailouts from the Protect Taxpayers & Homeowners Act. The update also included a summary of Section 217 of the Housing Finance Reform and Taxpayer Protection Act of 2013, which would establish the Federal Mortgage Insurance Corporation as an independent agency of the federal government.

US - EU-US DIALOGUE PROJECT FORUM ON BEST PRACTICES FOR SUPERVISORY COLLEGES

On December 14, 2013, the EU-US Dialogue Project (the "Dialogue Project"), which includes representatives from the NAIC, the US Federal Insurance Office, the European Insurance and Occupational Pensions Authority and the European Commission, held a Supervisory Colleges Best Practices Forum in Washington, D.C. The forum was an opportunity to address big picture questions relating to multijurisdictional supervision of insurance companies. Key issues discussed during the forum included: 1) the current state of best practices for supervisory colleges, specifically with respect to confidentiality; 2) the future of supervisory colleges; and 3) the function of the Dialogue Project in a dynamic global setting.

The forum began with a brief discussion of the Dialogue Project's function and the evolution of supervisory colleges. The Dialogue Project began in January 2012 as a means of facilitating international coordination between insurance regulatory regimes in the European Union and the United States. The purpose of supervisory colleges is to enable regulators to better assess risks with respect to insurance companies outside of their borders. In the overview of the current state of supervisory colleges, panelists discussed ideal outcomes of a successful supervisory college, the benefits and risks of developing a "Model Holding Company Act" to fill regulatory gaps between the European Union and the United States, and the challenges of information sharing and confidentiality. With regard to the future of supervisory colleges, the role of trust between participants in the supervisory colleges was discussed at length. Panelists noted that supervisory colleges are meant to serve as a tool for information exchange, coordination, joint analysis and joint decision-making among the jurisdictions.

In a brief forward-looking discussion during the forum, participants described the developments they hope to see with regard to supervisory colleges in the next four years, including a proposed "common language" on international standards. Stephen Johnson, Deputy Commissioner of the Pennsylvania Insurance Department, pointed to governance, risk management and asset management as the three issues on which the EU and US needed to agree. Finally the discussion shifted to The Way Forward report ("The Way Forward"), which was issued in December 2012. To conclude the forum, the Steering Committee of the Dialogue Project, comprised of three US officials and three EU officials, announced its renewed commitment to The Way Forward.

If you have any query in connection with anything in this Bulletin, please do not hesitate to get in touch with your usual Mayer Brown contact or one of the contacts referred to below.

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