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Global Corporate Insurance and Regulatory Bulletin

INSURANCE & REINSURANCE INDUSTRY GROUP

First Quarter 2014

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Global

RESPONSES TO IAIS CONSULTATION ON BASIC CAPITAL REQUIREMENTS FOR GLOBAL SYSTEMICALLY IMPORTANT INSURERS

As reported in our prior bulletins, on 18 July 2013 the International Association of Insurance Supervisors ("IAIS") published a methodology for identifying global systemically important insurers ("GSIIs") together with a set of policy measures that will apply to such insurers. In December 2013 the IAIS launched a consultation on basic capital requirements ("BCR") for GSIIs.

On 6 February 2014, the IAIS published a compilation of responses, dated 5 February 2014, received in respect of its consultation. Among the key issues that commentators addressed were: (1) the extent to which insurers will have to publicly disclose their BCR; (2) potential conflicts between BCR and Solvency II; (3) the legitimacy of a market-consistent approach to asset valuation; and (4) the capital classifications that will satisfy BCR requirements. The feedback will be used as a basis to inform the upcoming field testing phase and further support the design and development of BCR. The IAIS expects to approve the final BCR proposal in September 2014, to secure approval for the BCR from the Financial Stability Board ("FSB") in October-November 2014, and from the G20 in November 2014.

A link to the full compilation of responses can be found **here**.

Asia

CHINA – NEW MEASURES ON ADMINISTRATION OF ACQUISITIONS AND MERGERS OF INSURANCE COMPANIES

Under new rules issued by the China Insurance Regulatory Commission ("CIRC"), insurance companies in China, both domestic and foreign, will be allowed to acquire and merge with each other for the first time, and acquirers will be able to control two insurance companies that are in the same business. The Measures on Administration of Acquisitions and Mergers of Insurance Companies ("Measures"), effective from 1 June 2014, apply to any acquisition as a result of which the acquirer obtains more than a one-third equity interest in and becomes the largest shareholder of an insurance company target, or as a result of which the acquirer becomes the largest shareholder and controls the insurance company target even if the acquirer holds less than a one-third equity interest in that target insurance company.

An "acquirer" under the Measures includes certain affiliates of the acquirer and persons acting in concert with the acquirer. A person which was affiliated with the acquirer within a period of 12 months prior to the execution of the acquisition agreement will be deemed to be an affiliate. Two or more investors who have invested in the same insurance company within a three-month period will be deemed to be persons acting in concert.

The Measures amount to a relaxation of the current regime in the following respects:

1. Under the current regime, two or more insurance companies that are under common control or have a controlling relationship with each other are not permitted to carry on insurance businesses of the same category which can result in conflict of interests or competition between/among each other. In view of the developing maturity of China's anti-monopoly law and the efficiency that could be achieved by the acquisition of distressed insurance companies by other insurance companies operating in the same category of insurance business, the Measures will allow insurance companies to acquire and merge with each other and carry on insurance businesses of the same category.

2. Under the current regime, an investor in an insurance company must make capital contributions in cash with its own funds – it may not fund its investment through debt financing. In view of the large-scale capital involved in acquisitions and mergers of insurance companies and the difficulty in raising equity capital within a short period of time even for acquirers in sound financial position, the Measures will allow acquisition or merger transactions to be funded partly through debt financing, provided that the debt portion does not exceed 50% of the total cash consideration involved in the transaction.

3. The current regime requires a shareholder to have been invested in the insurance company for a period of more than three years before holding or acquiring more than 20% of the registered capital of an insurance company. The Measures will no longer require compliance with this qualification requirement.

Notwithstanding the above, acquisitions and mergers of insurance companies remain subject to CIRC's approval and a three-year lock-up period during which the acquirer undertakes not to transfer the equity or shares it holds in the insurance company. There continues to be a restriction on owning both a life and property business unless, otherwise permitted by law.

Foreign investors will otherwise remain subject to requirements with respect to foreign-invested insurance companies and other applicable foreign investment rules.

CHINA – INSURERS ALLOWED WIDER INVESTMENT CHANNELS

The CIRC has begun allowing insurers in China to invest in the country's Growth Enterprise Board based in Shenzhen, also known as the ChiNext board. Created in 2009, ChiNext serves as an alternative market for smaller Chinese companies looking to raise capital and has fewer listing requirements than China's main boards in Shanghai and Shenzhen.

However, insurers are prohibited from investing in companies that are under investigation by regulators, have been punished or censured within the last year, or for which the auditors have not endorsed the accounts. There will also be an obligation to report to CIRC if shareholdings reach 5 percent.

Separately, CIRC is running a pilot program to allow certain insurers to invest in blue-chip stocks, with funds from premiums collected before 1999.

It remains to be seen what the take-up will be for these new investment opportunities.

CHINA – NEW *BANCASSURANCE* RULES

The CBRC and CIRC have jointly introduced new *bancassurance* rules to help safeguard the interests of customers to whom banks sell insurance products.

The new bancassurance rules came into effect on 1 April 2014. Under the new rules, banks must focus on customer needs. Banks will be required to carry out risk assessments with respect to the capability of the buyers to tolerate risk and suggest insurance products based on such assessments.

The rules appear to have been introduced to counter suggestions by commentators that China's bancassurance market needs tighter regulation to avoid banks ignoring the interests of buyers in favour of commissions.

The new rules require banks to suggest low-risk insurance products with stable returns for low-income households and customers aged over 65. Insurers will have a duty to verify whether an insurance product is suitable to a customer before selling them the policy. If the policies have a non-guaranteed value then, where the premiums are high relative to the customer's income, the customer must sign an acknowledgement.

The consequences of non-compliance are currently uncertain at this time.

CHINA – REGULATIONS REGARDING BITCOIN

On 5 December 2013, the *Notice Concerning the Prevention of Risk Related to Bitcoin* was jointly issued by the People's Bank of China ("PBOC"), the China Insurance Regulatory Commission ("CIRC"), the China Banking Regulatory Commission ("CBRC"), the China Securities Regulatory Commission ("CSRC"), and the Ministry of Industry and Information Technology ("MIIT"). Bitcoin is a digital or virtual currency and a peer-to-peer payment system.

In summary, the notice prohibits financial institutions (including insurers) from:

- insuring Bitcoin-linked products;
- pricing goods and services in Bitcoin or accepting Bitcoin as payment;
- buying, selling, and direct or indirect trading of Bitcoin;
- investing in Bitcoin trusts, investment funds or other financial products; and
- providing Bitcoin exchange, settlement, storage, hosting, mortgage or other services.

The PBOC has commented that the rationale behind the ban is to prevent money laundering, and noted a concern regarding the speculative nature of Bitcoin.

The notice does not ban use of Bitcoin by private individuals, although such individuals would need to comply with existing legal requirements such as China's exchange control regime. The PBOC has also indicated that companies serving as trading platforms must ask clients to register their personal details including name and identity card number.

CHINA – TAX TO BE DEFERRED ON PENSION CONTRIBUTIONS FROM 1 JAN 2014

On 6 December 2013, the Ministry of Finance, together with the Ministry of Human Resources and Social Security and the State Administration of Taxation issued a "Circular on Issues Concerning the Individual Income Tax on Corporate Annuities and Occupational Annuities" (the "Circular"). The Circular introduced a tax incentive that came into effect on 1 January 2014 to encourage participation of individuals in China in pension insurance products.

The tax incentive defers personal income tax on contributions to employer pension plans and any investment returns arising out of such contributions until withdrawal of the annuity at retirement. However, the tax-exempt pension contribution is not without limitations. The cap is currently set at 4% of monthly salary of the previous year (and at three times the average salary of the relevant city).

This measure has been swiftly introduced following the Communist Party third plenum to quicken old-age pension reforms in view of the low penetration/coverage of state social pension fund.

CHINA – FURTHER REFORMS TO THE INSURANCE BUSINESS IN 2014

At the China Wealth Management 50 Forum held on 10 January 2014, Mr. Chen Wenhui, the deputy chairman of the CIRC, outlined four reforms that will be undertaken:

(1) establishment of a new system of ratio monitoring of capital operation on the basis of the existing mandatory capital monitoring ratio requirements;

(2) further broadening of area and scope for investments by improving existing policies on shareholding and real properties as well as offshore investments;

(3) establishing a central registry-cum-exchange to centralize registration for asset management products and to provide a platform to allow investors to buy and sell asset management products through the central registry-cum-exchange; and

(4) setting up an asset management association for insurance companies to promote solving of registration problems and other problems in the industry.

Additionally, CIRC has been actively seeking to open up further investment opportunities (see prior article regarding wider investments permitted for insurers).

When compared with last year where CIRC had only focused on two areas for reforms in their use of insurance funds, namely, reform in registration system and expansion in types of insurance asset management products, CIRC has evidently stepped up the reforms in the insurance sector for 2014.

HONG KONG – MEASURES TO ATTRACT CAPTIVE INSURERS TO BE ESTABLISHED IN HONG KONG

Following the proposal set out by the Financial Secretary of Hong Kong in the 2013-2014 Budget speech to diversify Hong Kong's risk management services, the Government, on 27 December 2013, gazetted the Inland Revenue (Amendment) (No.3) Bill 2013 (the "Bill") to effect, inter alia, certain measures to attract offshore insurance companies to set up their captive insurance business in Hong Kong. The Bill passed on 19 March 2014.

It is intended to promote associated areas of the insurance industry and help to expand and develop Hong Kong's insurance business. Qualifying captive insurance companies will enjoy the same concessions as those of a qualifying reinsurance business. The concession in that profits tax will be assessed at one-half of the standard rate of profits tax in respect of a corporation.

In order to qualify for the profits tax break, the captive insurance company must be an authorized captive insurer as defined under the Insurance Companies Ordinance (Cap. 41) and authorized by the Insurance Authority. It will then need to elect in writing to have the profits tax break applied to it pursuant to s.14B(2)(a) of the Inland Revenue Ordinance.

HONG KONG – ESTABLISHMENT OF A NEW INDEPENDENT INSURANCE AUTHORITY

In the near future, Hong Kong will have a new insurance regulator which will be financially and operationally independent from the government – the Independent Insurance Authority ("IIA"). The IIA will replace the current insurance regulator, the Office of the Commissioner of Insurance, which is a government department headed by the Insurance Authority.

In October 2012, the Financial Services and Treasury Bureau ("FSTB") undertook a three-month consultation on key legislative proposals for the new IIA. A Mayer Brown summary of the Consultation Conclusions can be found **here**.

The **Insurance Companies (Amendment) Bill 2014** was introduced on April 16, 2014. It provides provide for, *inter alia*, the establishment of the IIA and a statutory licensing regime for insurance intermediaries that will replace the existing self-regulatory system.

SINGAPORE – TAX TREATMENT OF INSURANCE INVESTMENTS

On 4 January 2014, Singapore's Court of Appeal issued a landmark decision in *Comptroller of Income Tax v BBO [2014] SGCA 10*, in relation to the income tax treatment of investment gains made by insurance companies. The Court of Appeal rejected the Comptroller's appeal and agreed with the finding of the High Court that gains arising from the disposal of investments in the insurance industry could, under certain circumstances, be treated as non-taxable capital gains and not as taxable income.

The Court of Appeal made it clear that the holding of assets in statutorily mandated insurance funds does not automatically determine the tax treatment of such an asset (here the Insurance Act required certain funds to be maintained). Instead, the issue to be determined on a case by case basis is the reason for which the assets are held, according to ordinary principles of revenue law. If the assets are held for the purposes of trade, it is likely that the gains would be considered taxable income; if the assets are held as a capital asset, the assets are likely to be considered capital, the gains of which are not taxable.

In this case, the assets in question were long-held shares of three companies. The Court of Appeal determined these were a capital asset and income tax was therefore not payable upon their disposal.

VIETNAM – AN OVERVIEW OF VIETNAM'S INSURANCE MARKET

Vietnam started liberalising its insurance market by allowing foreign insurers to participate in the domestic market almost 20 years ago. Since then, its insurance market has grown exponentially. Before the 1990s, Vietnam's insurance market was dominated by state-owned insurance enterprises. As of the end of 2013, there were a total of 57 players from the state and the private sector, the latter including both domestic and foreign-invested companies.

According to the figures in Vietnam's Insurance Market report issued by the Ministry of Finance annually, in the period 2005 to 2012, insurance business revenue increased by an average annualised rate of 13 percent to 15 percent a year, totalling approximately US$2 billion by the end of 2012. Growth is likely to continue for the years to come.

An overview of Vietnam's insurance market can be found in Mayer Brown's report "**Vietnam's Insurance Market: An Overview – January 2014**".

UK/Europe

UK – LLOYD'S 2014 GUIDANCE NOTES ON SOLVENCY II

Lloyd's of London published guidance notes on Solvency II and risk assurance on 6 February 2014. The guidance is intended to provide information on the steps and actions Lloyd's, together with its managing agents, intends to take with regards to the implementation of Solvency II.

The guidance contains the following points of specific interest:

1. Review of EIOPA guidelines and PRA statement

   Lloyd's has carried out a review of the European Insurance and Occupational Pensions Authority ("EIOPA") guidelines together with the Prudential Regulatory Authority ("PRA") supervisory statement on preparing for Solvency II in order to assess the impact of Solvency II for managing agents. Following the review, Lloyd's has confirmed it is comfortable that the guidelines do not impose any requirements on managing agents which were not previously covered by the Lloyd's Solvency II programme.

2. Pillar 3 "dry run"

   In order to assist managing agents to prepare for the Pillar 3 reporting requirements, which will come into effect in 2015, Lloyd's will be carrying out a Pillar 3 "dry run" exercise during the third quarter of 2014 and the deadline for submission to Lloyd's will be 25 September 2014.

3. Mapping exercise of EIOPA interim measures

   In order to ensure its ability to demonstrate to the PRA that managing agents are able to meet the requirements of the EIOPA guidelines, Lloyd's proposes to carry out a mapping exercise of the guidelines against its own Solvency II programme. Whilst Lloyd's believes it complies with the guidance on the whole and no additional requirements are imposed, it does consider there to be areas where more explicit evidence would be expected in order to demonstrate how the guidance is being met. The mapping exercise and its impact on managing agents will be discussed by Lloyd's in more detail in early 2014.

4. Review of minimum standards

   Lloyd's is reviewing its minimum standards to ensure they are up to date and incorporate new Solvency II requirements. Lloyd's will continue to issue re-drafted standards for market consultation and feedback before they are finalised. Agents are expected to be fully compliant with the standards by January 2015. Agents will be expected to carry out self assessments against all the minimum standards over the next two to three years and Lloyd's is developing an internal process aimed to ensure the consistent review of self-assessments.

5. PRA review and interaction

   Lloyd's expects the level of PRA review and interaction with both Lloyd's and the market on Solvency II to increase in 2014.

A link to the Lloyd's guidance notes can be found **here**.

GERMANY – PROPOSED AMENDMENTS TO THE REGULATION ON THE INVESTMENT OF RESTRICTED ASSETS OF INSURANCE UNDERTAKINGS

German insurance companies and pensions funds must comply with various legal restrictions when they invest their restricted assets. The cornerstones of the investment policies are laid down in the German Insurance Supervisory Act ("Versicherungsaufsichtsgesetz" – "VAG" in connection with the Regulation on the Investment of Restricted Assets of Insurance Undertakings ("Anlageverordnung" – "AnlV")).

As a general rule, the restricted assets must be invested with the requisite care and expertise. Compliance with the general investment principles set out in the VAG and the specific provisions of the AnlV must be ensured by qualified investment management, appropriate internal capital investment principles and control procedures, a strategic and tactical investment policy and other organizational measures. The AnlV stipulates the forms of eligible investments. Currently discussions are under way to amend and expand the eligible forms of investments, inter alia, to include additional investment opportunities in infrastructure projects.

Under the current regime loans – in a nutshell – are eligible investments if the borrower is domiciled in a member state of the European Economic Area ("EEA") or in a full member state of the OECD excluding credit institutions; if on the basis of the past and expected future development of the net assets and results of operations of the undertaking the contractual interest payment and repayment appear to be guaranteed; and if the loans are adequately secured (i) by first-ranking land charges, (ii) by receivables which are pledged or transferred as collateral or by securities admitted to trading on a stock exchange or admitted to another organized market, (iii) or in a similar manner; provided that a formal commitment issued by the borrower to the insurance undertaking (negative pledge) may serve as collateral instead only if and for as long as the status of the borrower alone is guarantee for interest payment and repayment of the loan.

The proposed amendment to the AnlV will expand the scope of eligible loans to corporate loans, for such borrowers who provide an undertaking and the borrower is rated as "Speculative Grade Ratings" or a comparable own assessment. The implementation of the amended AnlV can not yet be foreseen but it is expected that this will take place in first half of 2014.

Details of the amendments are not yet finalized or published so far. Nevertheless, it is expected that the new eligible asset class will lead to additional investments of German insurance companies and pensions funds in infrastructure projects.

US/Americas

US – NAIC'S SPRING NATIONAL MEETING

The National Association of Insurance Commissioners ("NAIC") held its 2014 Spring National Meeting in Orlando, Florida from March 27 - April 1, 2014. Set forth below are highlights from the meetings of some of the NAIC groups.

Reinsurance Task Force

The Reinsurance (E) Task Force (the "RTF") held a meeting on March 30, 2014, in which the RTF discussed its priorities for 2014, received a status report on the implementation by the states of the NAIC's revised Credit for Reinsurance Model Law and Regulation (the "NAIC Reinsurance Model Law and Regulation"), considered adoption of the "Uniform Application Checklist for Certified Reinsurers" as well as work of the Reinsurance Financial Analysis (E) Working Group ("ReFAWG") with respect to "passporting" of "certified reinsurers", discussed the potential development of Part B accreditation standards regarding the states' certification of reinsurers and determination of qualified jurisdictions, and received updates regarding insurers' use of captive reinsurers and international developments regarding reinsurance.

The Revised NAIC Reinsurance Models and Certified Reinsurers

Nineteen states, with insurers domiciled in such states representing more than 50% of US direct insurance premiums written, have adopted the revised NAIC Reinsurance Model Law and Regulation. Nine additional states have introduced or expect to introduce legislation in 2014 or 2015 to adopt the revised NAIC models; assuming the legislation is passed in those states, the total number of states that will have adopted the revised NAIC models will represent approximately 80% of US direct insurance premiums written.

The most significant change under the revised NAIC Reinsurance Model Law and Regulation is the possibility of a non-US reinsurer becoming "certified" and therefore eligible to post less than 100% collateral for credit for reinsurance based on the reinsurer's financial strength ratings and other factors. According to the RTF, 30 non-US reinsurers have already become certified and at least 8 states have certified reinsurers.

Only reinsurers from "qualified jurisdictions" are eligible to become certified. The NAIC granted conditional qualified jurisdiction status to four jurisdictions for 2014: Bermuda, Germany, Switzerland and the United Kingdom. Those four jurisdictions are now undergoing fuller review by the NAIC, which review is expected to be completed in 2014. In addition, the NAIC is considering France and Ireland for inclusion in the qualified jurisdictions list.

Another issue being considered by RTF is the potential "passporting" of certified reinsurer status – i.e., the ability of a reinsurer that becomes certified in one state to use that certification to become certified in other states that allow for certified reinsurers. The Qualified Jurisdiction (E) Working Group is considering the concept of a "lead state" that would be responsible for being the initial certifying state; in that role, the lead state would have primary responsibility for reviewing the certified reinsurer and liaising with the qualified jurisdiction in which the certified reinsurer is domiciled.

Also with respect to passporting, ReFAWG has cleared 24 certified reinsurers (20 of which are domiciled in Bermuda) as being eligible for passporting at this time. In addition, ReFAWG is developing the "**Uniform Application Checklist for Certified Reinsurers**", which is intended to be used by a state for an initial application by a reinsurer to become certified as well as in the passporting application process after a reinsurer becomes certified in one state. The draft Uniform Application Checklist for Certified Reinsurers has been exposed for comment until May 2, 2014.

In connection with the reduced collateral levels for certified reinsurers, the RTF will be reexamining the collateral levels under the NAIC Reinsurance Model Law and Regulation. This is because the Reinsurance Regulatory Modernization Framework Proposal, which the NAIC adopted in 2008 and which led to the passage of the revised NAIC models, requires the RTF to monitor and consider changes, if any, to the reinsurance collateral levels. The NAIC staff will distribute surveys in the near future to regulators and interested parties to obtain quantitative and qualitative information regarding reinsurance collateral requirements with the aim of being in a position to share analysis of the survey findings by the NAIC's 2014 Summer National Meeting.

Finally, the RTF will consider the development of standards under the Financial Regulation Standards and Accreditation Program, Part B: Administrative Practices and Procedures with respect to the states' processes for certifying reinsurers and approving qualified jurisdictions. The NAIC staff will work with ReFAWG and the Qualified Jurisdiction (E) Working Group to develop initial recommendations for the Part B standards.

Use of Captive Reinsurers

The RTF discussed the issues surrounding the use of captive reinsurers by the life insurance industry. After the Financial Condition (E) Committee adopted the "Captives and Special Purpose Vehicles" white paper in July 2013, it referred to the RTF the task of considering three recommendations in the white paper, specifically with respect to access to alternative markets, IAIS principles, standards and guidance, and credit for reinsurance model enhancements. The RTF has not begun its consideration of the issues pending the developments from the Principle-Based Reserving Implementation (EX) Task Force (the "PBR Task Force") regarding the use of captives and special purpose vehicles in the life insurance industry.

The RTF discussed the ongoing consideration by the PBR Task Force of the use of captives and special purpose vehicles including the Rector Report, which is discussed in further detail below. In addition, the RTF discussed the consideration being given by the Financial Regulation Standards and Accreditation (F) Committee (the "FRSA Committee") to potentially classifying reinsurers organized under captive laws and reinsuring business written in other states as "multi-state insurers" for purposes of NAIC accreditation standards, which proposal is also discussed below.

International Issues

Finally, the RTF also discussed international developments with respect to reinsurance, including the EU-US Dialogue Project and the IAIS's reinsurance-related work.

Principle-Based Reserving Implementation (EX) Task Force

At its meeting on March 31, 2014, the PBR Task Force discussed various matters, including a progress report on states that have passed legislation adopting principle-based reserving ("PBR") and continuing consideration of the use of captives and special purpose vehicles by the life insurance industry. In order for PBR to become effective, the legislatures in 42 NAIC member jurisdictions representing 75% or more of US direct life insurance written premiums need to pass PBR legislation. At the meeting, it was reported that thus far nine states have passed PBR legislation, representing 9.2% of US direct insurance written premiums. Significantly, Benjamin Lawsky, the New York Superintendent of Financial Services, has declared his public opposition to the adoption of PBR.

Regarding the use of captives, the PBR Task Force received on February 17, 2014 the **Report of Rector & Associates, Inc.** (the "Rector Report") regarding reserve financing transactions for the so-called XXX reserves and AXXX reserves for level premium term life insurance policies and universal life insurance policies with secondary guarantees, respectively. Rector & Associates, Inc. had previously issued an initial report in September 2013.

The heart of the Rector Report is a proposed new framework for allowing credit for reinsurance of XXX and AXXX reserves. Under that framework, a ceding insurer would only get reinsurance credit if it retains (on a funds withheld or trust basis) "primary assets" equal to what statutory reserves would be under PBR (using a modified version of the VM20 valuation manual that was developed for PBR). The remainder of the statutory reserves could be supported by any assets approved by both the ceding insurer's regulator and the reinsurer's regulator, subject to certain regulatory protections. The Rector Report expressly states that the proposed new framework is not contingent on PBR becoming effective. Rather, the actuarial standard of PBR is being used to define the level of statutory reserves that would need to be supported by "primary assets" under the proposed new framework. That means that if PBR is adopted by the requisite number of state legislatures and becomes effective, then the need for the proposed new framework would fall away. However, even if PBR never becomes effective, the PBR actuarial standard would still be used to define the level of statutory reserves that would need to be supported by "primary assets" under the proposed new framework. Other important aspects of the proposed framework in the Rector Report include disclosure regarding such financing transactions and assets used to support them as well as full risk-based calculations to be performed by the ceding insurer and/or the reinsurer.

The Rector Report proposes a demanding timetable for implementation of the framework: that any new XXX/AXXX reinsurance transactions be subject to the new framework after July 1, 2014; that the new annual statement disclosure requirements regarding such transactions become effective on December 31, 2014; that all existing XXX/AXXX reinsurance transactions be subject to the new framework on January 1, 2015; and that the new risk-based capital requirements become effective on December 31, 2015.

At its March 31st meeting, the PBR Task Force discussed the Rector Report, including the comments received from interested parties. Several regulators and interested parties expressed concern about various aspects of the Rector Report, including the proposed implementation timeline, the proposed new XXX and AXXX Model Reinsurance Regulation, and the appropriateness of using a modified version of VM-20. Insurance regulatory authorities in California and New York, among others, continue to express concerns about XXX/AXXX reserve financing transactions. As discussed in prior bulletins, New York Superintendent Lawsky has repeatedly called for a moratorium on such transactions, in connection with which position New York issued its March 27, 2014 letter to the NAIC (discussed below).

Following the March 31st meeting, the PBR Task Force continued discussions regarding the comments received on the Rector Report in a conference call on April 14, 2014.

Financial Regulation Standards and Accreditation (F) Committee

The FRSA Committee met on March 29, 2014. As noted above, a key issue discussed by the FRSA Committee was the incorporation in the definition of "multi-state insurer" for Part A and Part B of the accreditation standards captive reinsurers that reinsure business written in other states. The FRSA Committee has exposed for a 45-day period **proposed revisions** to the Part A and Part B preambles to the NAIC accreditation standards. The revisions would add a definition for "Multi-State Reinsurer" and would clarify when such a reinsurer would be subject to the accreditation standards. Comments on the proposed revisions are due by May 19, 2014. The proposal received substantial criticism at the March 29 meeting, not only from interested parties but even from some state insurance commissioners. Critics of the proposed revisions argue that including captive reinsurers in the accreditation standards would essentially eliminate the distinction between captive reinsurers and other reinsurers and would be an indirect way of precluding the use of captive reinsurers for XXX and AXXX transactions.

Private Equity Issues (E) Working Group

At its meeting on March 30, 2014, the Private Equity Issues (E) Working Group (the "PE Working Group") continued discussions regarding developing procedures for regulating investment by private equity firms in the insurance industry. Most regulators on the PE Working Group expressed the view that investors and acquirers should not be treated differently solely based on their type or ownership – e.g., private equity or hedge funds – but that instead regulators should focus on identifying and addressing specific risks and concerns that apply to acquisitions of insurance companies regardless of the type of investor or acquirer. The PE Working Group has tasked the NAIC staff with analyzing private equity-owned insurers versus the industry, including a review of past approval orders for acquisitions by private equity firms or private equity-backed acquirers, with an eye towards the goal of developing regulatory procedures and best practices. The PE Working Group hopes to complete its work by the end of this year.

Mortgage Guaranty Insurance (E) Working Group

The Mortgage Guaranty Insurance (E) Working Group (the "MI Group") met on March 29, 2014. The discussion focused on comments received by the group on its draft Mortgage Guaranty Insurance Model Act (the "MI Model Act") as well as comments and a draft model act received from the Private Mortgage Guaranty Industry ("PMGI"). The PMGI comments on the draft Model MI Act as well as PMGI's draft model act identified significant areas in which the industry remains concerned about the draft MI Model Act. However, several regulators who are MI Group members emphasized that the new model act will need to take into account concerns such as capital adequacy for mortgage insurers that came to the forefront following the 2008 financial crisis. In addition to discussing the MI Model Act, the MI Group received an update on federal developments with respect to the mortgage industry, including the legislative proposals in Congress regarding Fannie Mae and Freddie Mac as well as the proposed Federal Mortgage Insurance Corporation.

International Insurance Relations (G) Committee

The International Insurance Relations (G) Committee (the "International Committee") met on March 29, 2014. Among other matters, the International Committee discussed the work of the IAIS, including the Common Framework for the Supervision of Internationally Active Insurance Groups ("ComFrame") and the Multilateral Memorandum of Understanding as well as the US-EU Insurance Dialogue Project. With respect to ComFrame, the IAIS concluded its third consultation at the end of 2013 and received hundreds of comments; field testing is ongoing. The NAIC's new ComFrame Development and Analysis (G) Working Group will consider and provide input with respect to ComFrame; that working group reported to the International Committee that field testing should help with the development of the BCR and a new BCR proposal is expected from the IAIS later this year with qualitative field testing also to take place this year.

US – NEW YORK PROPOSES ALTERNATIVE TO XXX/AXXX RESERVE FINANCING TRANSACTIONS

On March 27, 2014, the New York Department of Financial Services ("NY DFS") sent a letter informing the NAIC that NY DFS intends to issue a regulation to update the reserving formulas for term life insurance policies (which are backed by so-called XXX reserves) for new business written after January 1, 2015. According to the letter, the proposed regulation "will reflect actuarially sound and evidence-based adjustments regarding mortality data and expenses in acquiring and retaining business for that product." In addition, the proposed regulation will introduce a 2-year "full preliminary term" (in place of the current 1-year) to address higher upfront expenses for acquiring and retaining term life business a proportion of premiums paid compared to other types of business. NY DFS expects that the changes made by the proposed regulation will lead to a 30-35% reduction in reserves for level term life products. Following up on the proposed regulation to address XXX reserves, NY DFS also expects to update formulas for universal life insurance policies with secondary guarantees (which are backed by so-called AXXX reserves).

US – NEW YORK ADOPTS REGULATION 203 RELATING TO ENTERPRISE RISK MANAGEMENT AND OWN RISK AND SOLVENCY ASSESSMENT

In January 2014, NY DFS published for comment a proposed new regulation on insurance company enterprise risk management ("ERM") and own risk solvency assessment ("ORSA") requirements ("**Regulation 203**"). On April 11, 2014, NY DFS issued a Notice of Emergency Adoption and Revised Rule Making to adopt Regulation 203 (in slightly revised form) immediately on an emergency basis.

Regulation 203 incorporates many of the concepts from the NAIC ORSA Model Act, which to date has been adopted by seven other states: California, Iowa, Maine (portions of the Model Act), New Hampshire, Pennsylvania, Rhode Island, and Vermont. Subject to certain limited exemptions, New York domestic insurers will be required to conduct an ORSA consistent with the process set forth in the Own Risk and Solvency Assessment Guidance Manual developed and adopted by the NAIC, and to file an annual ORSA summary report by December 1 of each year beginning in 2015.

Regulation 203 also requires the ultimate holding company of any insurer that is authorized in New York to adopt a formal enterprise risk management function and file an enterprise risk report with the NY DFS by April 30 of each year, beginning in 2014. The enterprise risk report is required to identify, to the best of the holding company's knowledge and belief, the material risks within the holding company system that could pose enterprise risk to the insurer.

The items that are required to be addressed in the enterprise risk report replicate the elements of the "Form F" as it appears in the NAIC Insurance Holding Company System Model Regulation.

However, in contrast to the NAIC framework (which requires enterprise risk reports to be filed with the "lead state" commissioner of an insurance holding company system, as determined by the procedures within the NAIC Financial Analysis Handbook), Regulation 203 requires the ultimate holding company of any New York-licensed insurer (not just New York-domiciled insurers) to adopt a formal risk management function and file an enterprise risk report with the NY DFS. In addition, Regulation 203 requires an enterprise risk report to include a signature of the ultimate holding company's chief risk officer, attesting to the best of his or her knowledge and belief that the report identifies any material risks within the holding company system that could pose enterprise risk to any insurer within the system, and that a copy of the report has been provided to the holding company's board of directors or the appropriate committee of the board.

The requirement to file an enterprise risk report apply not only to insurers subject to the New York holding company law, but also to New York-domiciled insurers that control one or more subsidiaries and other New York-domiciled insurers, even if not part of an affiliated group, of a certain size (annual direct written premium and unaffiliated assumed premium, including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, equal to or greater than $500 million).

The adopted version of Regulation 203 (in contrast to the proposed version) includes a reference to the provisions of New York's Freedom of Information Law ("FOIL") that will allow the filer of an enterprise risk report to request that the report be exempted from disclosure pursuant to the provisions of the FOIL that exempt trade secrets from public disclosure.

US – VERMONT'S NEW LEGACY INSURANCE MANAGEMENT ACT

On February 19, 2014, Vermont enacted a new law called the **Legacy Insurance Management Act** ("VT LIMA"). It allows for the licensing and regulation of specialized Vermont insurance companies that will be established specifically to assume closed blocks of legacy commercial insurance policies and reinsurance agreements. Prior to the enactment of VT LIMA, the United States has had few alternatives for the transfer of legacy blocks of business compared to other jurisdictions. For instance, as recognized in the NAIC's 2010 white paper titled "Alternative Mechanisms for Troubled Insurance Companies", other jurisdictions have allowed alternatives such as the solvent schemes of arrangement and Part VII portfolio transfers in the United Kingdom, which have not been available in the United States.

VT LIMA will allow the creation of specialized Vermont-domiciled insurance companies that will be able to aggregate legacy blocks of business. As noted above, such companies will only be permitted to assume commercial business and not any workers' compensation, health, life, or any other personal lines. Only "closed blocks" of business – which is defined in VT LIMA as "a block, line, or group of commercial non-admitted insurance policies or reinsurance agreements" that the transferring insurer is no longer writing with the policies having expired for more than 60 months and no new premiums being paid – will be allowed to be transferred under VT LIMA.

An assuming company seeking to assume a legacy block of business will need to file a proposed plan with the Vermont regulator. As part of the plan, the assuming company will need to provide details regarding the business to be assumed, an actuarial study or opinion, three years of pro forma financial statements showing solvency of the assuming company, a letter from the transferring insurer's domiciliary regulator that such regulator does not object to the transfer, and other required documents and information.

A significant policyholder protection that is included in VT LIMA is the requirement for the assuming company to provide notice to all affected commercial policyholders and reinsurance agreement counterparties and such policyholders' and counterparties' right to opt out of the transfer. There is a requirement for notice and hearing by the regulator prior to approval of the proposed plan of the assuming insurer with respect to a block of policies or reinsurance agreements. After such a hearing, an approval order will be issued. Such an approval order will effect a legal novation of the transferred policies or reinsurance agreements. Under VT LIMA, "any policyholder or inward reinsurance counterparty that, prior to the expiration of the comment period [for the plan], has not provided express written notice objecting to the plan shall be deemed to have accepted the plan and the transfer shall have the full force and effect of a statutory novation of his or her respective policy or inward reinsurance agreement, as applicable". However, if a policy or reinsurance agreement prohibits its transfer without specific consent of the policyholder or counterparty, then such a policy or reinsurance agreement will not transfer without written consent.

The specialized companies' financial solvency and the implementation of the assumption of business by such companies will be subject to ongoing review by the Vermont Department of Financial Regulation. VT LIMA provides for certain fees and a transfer tax (in the amount of 1% of the first $100 million of liabilities transferred and 0.5% of the amounts of liabilities above the $100 million) for such transfers.

The Vermont Department of Financial Regulation will develop regulations based on VT LIMA to allow for establishment of the specialized companies.

US – NAIC PROVIDES ORSA GUIDANCE IN NEW FEEDBACK TO INDUSTRY

On January 30, 2014, the NAIC's Own Risk and Solvency Assessment ("ORSA") (E) Subgroup issued a "feedback to industry" summary in connection with its ORSA Feedback Pilot Project. The summary, which can be found **here**, included observations and suggestions based on 2012 and 2013 ORSA Summary Reports received from insurers as part of the pilot project and outlined various ways in which insurers might improve the quality of reports developed and submitted as part of the regulatory process. Under the ORSA Model Act, insurers and their affiliate groups must perform and report the results of self-examinations on their risk profile and capital adequacy. The pilot project was instituted to provide guidance to both insurers and state regulators on how the ORSA Model Act should be implemented.

US – CONGRESSIONAL HEARING ON THE FIO'S MODERNIZATION REPORT

On February 4, 2014, the House of Representatives' Subcommittee on Housing and Insurance held a hearing to discuss the Federal Insurance Office's report entitled "How to Modernize and Improve the System of Insurance Regulation in the United States" (the "FIO Report"). The hearing included a discussion of the differing roles federal and state institutions should play in regulating the insurance industry, with testimony provided by FIO Director Michael McRaith and Connecticut Insurance Commissioner Thomas Leonardi, as well as an examination of the recommendations of the FIO Report.

Members of Congress and panelists engaged in a fact-gathering analysis of the FIO Report, including inquiries about future costs of changing the current regulatory system, the US's role in the regulation of insurance internationally, and whether there is a need for change in how insurance has been regulated in the United States historically. There has been ongoing debate in the United States over what role, if any the US federal government should play in the regulation of insurance in the United States. The FIO Report asserted that there are inefficiencies in the current regulatory scheme. The hearing provided an opportunity for US Congress to review the FIO Report's conclusions on this and other issues.

US – DELAWARE AMENDS INSURANCE CODE WITH RESPECT TO INSURANCE COMPANIES' BORROWINGS FROM FEDERAL HOME LOAN BANKS

On April 8, 2014, Delaware's governor signed into law amendments to the Delaware Insurance Code's sections regarding insolvency proceedings of Delaware-domiciled insurance companies with respect to borrowings by such insurance companies from Federal Home Loan Banks ("FHLBs"). The amendments can be found **here**.

The amendments are intended to address rights of FHLBs when a Delaware-domiciled insurance company that is a member of an FHLB borrows from such FHLB on a fully secured basis. Under federal banking law and regulation, an FHLB as a secured creditor is not subject to stays or voidable transfer provisions if a federally insured depository institution becomes insolvent. The amendments to the Delaware Insurance Code alter the Code's provisions to exempt FHLBs from stays upon commencement of insolvency proceedings and voidable transfer rules with respect to secured loans given by FHLBs to Delaware-domiciled insurance companies. The goal of such amendments is to enable Delaware-domiciled insurance companies that are FHLB members to receive loans on similar terms as are offered by FHLBs to federally insured depository institutions.

Delaware is the first state to grant this special status to FHLBs with respect to loans made to insurance companies. In that regard it is both building on and going beyond the work done by the NAIC's Federal Home Loan Bank Legislation (E) Subgroup regarding proposed amendments to the Insurer Receivership Model Act to provide certain exemptions for security agreements between insurance companies and FHLBs, a summary of which can be found in **Mayer Brown's April 2013 bulletin**.

Have you seen our Year in Review?

We recently published our Global Insurance Industry 2013 Year in Review, which discusses some of the more noteworthy developments and trends in insurance industry transactions in 2013 in the US, Europe, Asia and Latin America, with particular focus on mergers and acquisitions, corporate finance, and the insurance-linked securities and convergence markets. A request for the 2013 Year in Review can be made here.

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