NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
LIFE INSURANCE & FINANCIAL PLANNING COMMITTEE
NEW ORLEANS, LOUISIANA
NOVEMBER 20, 2009
MINUTES

The National Conference of Insurance Legislators (NCOIL) Life Insurance & Financial Planning Committee met at the Royal Sonesta Hotel in New Orleans, Louisiana, on Friday, November 20, 2009, at 8:00 a.m.

Sen. Ralph Hudgens of Georgia, chair of the Committee, presided.

Other members of the Committee present were:

Rep. Greg Wren, AL	Sen. Carroll Leavell, NM
Sen. Ruth Teichman, KS	Assem. Nancy Calhoun, NY
Rep. Ronald Crimm, KY	Sen. Keith Faber, OH
Rep. Robert Damron, KY	Rep. Charles Curtiss, TN
Rep. Tommy Thompson, KY	Del. Harvey Morgan, VA
Rep. Barb Byrum, MI	Rep. Gini Milkey, VT
Rep. George Keiser, ND	Sen. Mike Hall, WV

Other legislators present were:

Sen. Travis Holdman, IN
Sen. Vi Simpson, IN
Rep. Ed Legg, ME
Rep. Bruce Goforth, NC
Rep. Don Flanders, NH
Sen. James Seward, NY
Rep. Brian Kennedy, RI

Also in attendance were:

Susan Nolan, NCOIL Executive Director
Candace Thorson, NCOIL Deputy Executive Director
Michael Humphreys, NCOIL Director of State-Federal Relations
Jordan Estey, NCOIL Director of Legislative Affairs & Education

MINUTES

Upon a motion made and seconded, the Committee voted unanimously to approve the minutes of its July 9, 2009, meeting in Philadelphia, Pennsylvania.

PRINCIPLES-BASED RESERVING

Kansas Insurance Department Chief Actuary, Larry Bruning, updated Committee members on National Association of Insurance Commissioner (NAIC) efforts to develop a new system of principles-based standards for setting company life insurance and annuity reserves. He said that the new standards would measure all of a company's assets, liabilities, and risks and require a reserve level based on that calculation. He said NAIC efforts would shift reserve rules from a 150-year-old conservative formula-based structure to a flexible principles-based one where companies estimate and maintain reserves. He said the company estimates would need to be credible, that new reinsurance programs would help mitigate risk, and that insurance regulators would still make final determinations on a company's experience.

Mr. Bruning stressed to legislators that the new reserves would still have to maintain prudent solvency regulation and accurately reflect a company's underlying risk. He said companies that sell risky products and make dicey investments would hold higher reserves. He said this "right-sizing" of individual company risks would allow the sale of stable products.

Mr. Bruning said a principles-based framework would eliminate the flaws of the current formula-based approach. He said sales of increasingly complex products, for example, had caused regulators to be reactive instead of proactive, adopting rules to fit new products on an ad hoc basis that didn't address all pricing and reserve risks for financial solvency. He said things like expenses, lapse rates, and other policyholder behaviors were not being utilized, but would be, under a new principles-based approach.

Mr. Bruning described the steps each company would need to take to set reserves for life insurance and annuity products. He said company actuaries would have to:

- identify the company's "material" risks on their products and assets to set reserves
- generate a thousand economic scenarios a company could experience over 30 years
- build and run financial models that include both formula-based—such as interest rates and equity-market returns—and principles-based—such as mortality, lapse rates, and anticipated company expenses—to test asset flows and liabilities for all scenarios
- add "experience margins" to each principles-based assumption
- average the worst 30 percent of these levels for scenarios to determine deficiencies and reserves
- conduct sensitivity testing to examine how reserves change with shifts in variables, such as lapse or mortality rates
- disclose formulas, assumptions, and processes to insurance regulators for final review

Rep. Keiser said the 2008 financial crisis presented regulators with a unique opportunity to test the strengths and weaknesses of a principles-based system against a formula-based one and he asked if such a review had been conducted. Mr. Bruning said that the Society of Actuaries (SOA) had completed a study and that some principles-based standards for variable annuities had been in place since 2005. He warned that formula-based standards for variable annuities were "woefully inadequate" when the credit crisis hit. He repeated his earlier comments and said that requiring a thousand tests of economic scenarios would predict such a situation.

Rep. Keiser asked how differing regulatory opinions among states would impact the implementation of principles-based approach. Mr. Bruning said regulators and individual states could voice concerns before new rules were enacted and would have final authority on any domiciled-company's reserves once the system is in place.

Mr. Bruning said that adopting the principles-based approach would be a good public policy that would benefit consumers and markets by strengthening solvency regulation, impacting product price, increasing product availability, heightening competition, and strengthening oversight. He said the principles-based framework could spur innovation, pointing out that the current framework forced insurance companies to operate in "silos," and sell individual products that aren't convertible when consumer situations change. He said a principles-based approach could encourage, for example, sellers of universal life products to allow conversion into long-term care or retirement products.

Nancy Bennett of the American Academy of Actuaries (AAA) voiced strong support for the new principles-based approach. She said the AAA felt strong governance and professional responsibility standards would ensure company and actuary responsibility when assessing risk and maintaining reserves. She said changes to the NAIC *Standard Valuation Law* and *Valuation Manual* would codify these governance standards for company management, actuaries, and regulators.

LIFE INSURER CAPITAL & SURPLUS RELIEF

Mr. Bruning said the NAIC had approved six of nine capital and surplus relief measures proposed by the life insurance industry in a November 2008 letter to the regulators requesting assistance during the credit crisis. He reminded Committee members that the NAIC had originally formed a working group in December 2008 to review the nine proposals, ultimately rejecting their use on an emergency basis. He said the NAIC had then directed several working groups to examine the proposals on an individual basis under a normal 2009 timeline.

Birny Birnbaum of the Center for Economic Justice (CEJ) said NAIC inaction on an emergency basis prompted several states to approve changes for individual companies anyway, which provided them billion dollars in capital relief. He said the most controversial life insurer proposal—which related to the amount of deferred tax assets a company could apply to its surplus estimates—was almost complete.

Mr. Birnbaum explained how statutory accounting and standard accounting rules differed for life insurance companies. He said the NAIC was changing tax rules to allow greater company use of deferred tax assets in their surplus estimates. He said companies would be able to count fifteen percent of their surplus as deferred tax assets, realized over a three-year period, instead of long-standing requirements of ten percent and a one-year period. He said consumers were concerned this change would allow companies to decrease liquidity by allowing greater levels of “non-liquid” assets in surplus estimates, which would weaken insurer cash reserves.

New York State Insurance Superintendent James Wrynn said the 2008 credit crisis had stressed life insurers, who depended on long-term capital markets. He said that regulators recognized consumers’ concerns and had established safeguards against company abuse, including a two-year sunset clause on the deferred tax asset rule so regulators could review the rule’s impact before a long-term change was made. He said this would ensure that only the healthiest companies could take advantage of the new rules.

In response to a question from Rep. Keiser, Superintendent Wrynn said that the NAIC didn’t weaken financial solvency requirements nor help insurers with lax standards. He said the changes would help consumers and companies during the down economy.

Mr. Birnbaum said regulators were also reconsidering new capital relief requirements on residential mortgage-backed securities (RMBS). He said life insurers had urged regulators to stop using rating agencies for investment ratings and subsequent capital requirements and that the NAIC had quickly responded and assigned RMBS ratings to a private company, which had raised several conflict of interest concerns.

Mr. Birnbaum said that the industry had originally pushed the NAIC to rely on the rating agencies for financial solvency requirements and it was ironic for companies to seek changes when their ratings became stressed. While he didn’t disagree with the industry arguments against the use of rating agencies, he questioned the logic of not using such a new entity to rate all insurer financials, instead of just one security. Superintendent Wrynn responded that regulators' options were limited and they had responded as swiftly as possible during a dynamic credit crisis.

SEC RULE 151A

Jim Poolman, on behalf of the Coalition for Indexed Products updated legislators on industry efforts to block U.S. Securities and Exchange Commission (SEC) Rule 151A, which would classify new indexed annuity products as securities instead of insurance. He said that a federal court had ruled in favor of SEC authority to regulate the products over state insurance commissioners, but told federal securities regulators they hadn't properly analyzed the rule's impacts on competition, efficiency, and capital formation. He said SEC next steps could include one of the following: conducting the proper analyses and implementing the rule, ignoring the court's ruling and implementing the rule, or abandoning the rule.

He said the industry was concerned about SEC next steps because the indexed annuity distribution system would need an overhaul to accommodate the rule, if implemented. He said two federal bills to overturn Rule 151A had also gained increasing bipartisan support in both the House and Senate, with 59 and ten cosponsors, respectively.

In response to a question from Sen. Hall, Mr. Poolman said agent commissions for equity indexed annuities varied, but averaged around eight percent. He said these were higher commissions than paid on other products, such as mutual funds, but that equity indexed annuity sales featured front-end commissions without continued fees like other products.

NAIC ANNUITY SUITABILITY EFFORTS

Mr. Bruning reported on NAIC efforts to update suitability model regulations, which he said where jumpstarted when U.S. Sen. Herb Kohl (WI) in Fall 2007 requested a thorough review of state suitability rules. He said the NAIC, as a result, was reviewing its suitability model regulations and was near completion of model language regarding annuity transactions, information disclosure, guidelines for annuity illustrations, guaranty fund disclosures, and consumer guides for annuity products.

John Gerni with the American Council of Life Insurers (ACLI) said that life insurers were concerned with NAIC attempts to parallel federal Financial Industry Regulatory Authority (FINRA) requirements in a revised *Suitability in Annuity Transactions Model Regulation.* He said that applying broker-dealer standards to insurance agents would be like "fitting a square peg into a round hole." He said that 40 states had already implemented some form of NAIC suitability laws, and that maintaining uniformity across the states once changes were complete would be important. He noted that state deviations from a uniform standard would increase costs for insurers and consumers.

STATE/FEDERAL LIFE SETTLEMENTS ACTIVITY

Mr. Estey reported that California, Rhode Island, Tennessee, and Illinois had enacted new life settlements laws since the 2009 Philadelphia Summer Meeting. He said the California, Rhode Island, and Illinois laws were based on the NCOIL *Life Settlements Model Act* and that twenty-seven states had passed life settlements legislation since the Life Insurance & Financial Planning Committee had amended the NCOIL model in 2007. He said that New York had also passed life settlements legislation based on the NCOIL model, but that the Governor had yet to sign it.

Mr. Estey also reported on federal life settlements activity, saying that Congress held a September 24, 2009, hearing entitled *Recent Innovations in Securitization* to focus on the systemic risks, if any, of life settlements securitization and the need for more federal oversight. He said regulators, industry, and investment bank representatives had testified.

Mr. Estey said the SEC and the U.S. Government Accountability Office (GAO) were also reviewing the life settlements industry. He said the SEC was focused on the investment side of the industry and available consumer protections for buyers of variable life insurance policies. He noted that the GAO had contacted NCOIL staff about consumer protections in the NCOIL model act.

2010 COMMITTEE CHARGES

Mr. Estey said that proposed 2010 Committee Charges were as follows:

- continue to examine a principles-based approach for life insurance reserves and develop a position as appropriate
- continue to examine capital and surplus relief efforts and input as appropriate
- examine life insurance suitability efforts
- monitor and report on emerging state and federal life settlement activity
- monitor and report on regulatory issues related to annuities

Sen. Hudgens entertained a motion to amend the fourth proposed charge to add language "and review the state of life settlements regulation in the United States."

Upon a motion made and seconded, the Committee unanimously adopted the charges, as amended.

ADJOURNMENT

There being no other business, the Life Insurance & Financial Planning Issues Committee adjourned at 9:15 a.m.

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