NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
LIFE INSURANCE AND FINANCIAL PLANNING COMMITTEE
PHILADELPHIA, PENNSYLVANIA
JULY 11, 2013
MINUTES

The National Conference of Insurance Legislators (NCOIL) Life Insurance and Financial Planning Committee met at the Philadelphia Marriott Downtown in Philadelphia, Pennsylvania, on Thursday, July 11, 2013, at 9:45 a.m.

Sen. Mike Hall of West Virginia, chair of the Committee, presided.

Other members of the Committee present were:

Rep. Greg Wren, AL	Sen. Jerry Klein, ND
Sen. Jason Rapert, AR	Rep. Don Flanders, NH
Sen. Travis Holdman, IN	Sen. Caroll Leavell, NM
Rep. Ron Crimm, KY	Sen. William Larkin, NY
Rep. Joseph Fischer, KY	Rep. Marguerite Quinn, PA
Rep. Tommy Thompson, KY	Rep. Charles Curtiss, TN
Sen. Dan Morrish, LA	Rep. Bill Botzow, VT
Rep. George Keiser, ND	

Other legislators present were:

Rep. Lindsey Holmes, AK	Sen. Delores Kelly, MD
Rep. Romy Cachola, HI	Rep. Keith English, MO
Sen. William Haine, IL	Rep. Don Gosen, MO
Sen. Greg Walker, IN	Rep. Anthony DeLuca, PA
Sen. Laura Kelly, KS	Rep. Nick Kotik, PA
Rep. Steve Riggs, KY	Rep. Brian Kennedy, RI
Rep. Jeffrey Roy, MA	Rep. Kathleen Keenan, VT

Also in attendance were:
Susan Nolan, Nolan Associates, NCOIL Executive Director
Candace Thorson, Nolan Associates, NCOIL Deputy Executive Director
Jennifer Webb, Nolan Associates, NCOIL Director of Legislative Affairs–DC
Eric Ewing, Nolan Associates, NCOIL Director of Legislative Affairs

MINUTES
Upon a motion made and seconded, the Committee unanimously approved the minutes of its March 8, 2013, meeting in Washington, D.C.

PRIVATE EQUITY-HELD INSURERS
Robert Easton, Deputy Superintendent of the New York Department of Financial Services (DFS), participating by phone, reported that both DFS and the National Association of Insurance Commissioners (NAIC) have begun to examine the activities of private equity firms in the insurance market. He stated that in recent years, particularly following the financial crisis, a number of private equity firms have taken an interest in annuity products. He said that life insurers, finding their annuity products too capital-intensive, have discovered that they can offload the business to private equity firms for a good price.

Mr. Easton said that when insurers are able to attract capital it is generally a positive development. However, he said that the rapid growth of private equity-held insurers has raised concerns among regulators. He pointed out that over the last five years the percentage of annuity products owned by private equity firms has grown from single digits to approximately thirty percent. He said that the types of investments that private equity investors pursue differ from the traditional investments of life insurance companies. He said that there is concern among regulators that these investors will focus on short-term investment gains rather than the long-term health of the product.

Mr. Easton said that DFS has started gathering data on investor practices as it reviews two proposed acquisitions of insurers by private equity firms. He predicted that there will be an increase in these kinds of acquisitions, pointing to proposed deals in Delaware and Iowa. He noted that New York oversees parts of the businesses involved in the Delaware transaction and that Delaware has indicated that approval hinges on concurrent approval from New York.

In responding to a series of questions from Sen. Hall and Rep. Botzow, Mr. Easton asserted that the solvency of the products is in question. He noted, for example, that a firm could take ownership of an insurer, make a short-term profit, and then sell the company, leaving behind a thinly-capitalized set of products.

Mr. Easton stated that it is not wrong in principle for private equity firms to acquire annuity products, because capital investment can be beneficial to the market. He noted that sometimes capital from private equity investors is all that is available. He said that the real question is whether or not the current regulatory framework properly addresses these types of situations.

PRINCIPLES-BASED RESERVING/CAPTIVES

Commissioner Michael Consedine of Pennsylvania gave an overview of recent NAIC activity on principles-based reserving (PBR). He said that the goal of PBR is to bring reserving methodology in line with more complex, modern products. He stated that since the Valuation Manual for Principles-Based Reserving was adopted in late 2011, seven states have enacted legislation to implement PBR.

Commissioner Consedine argued that while solvency concerns due to low reserves are valid, regulators should also be concerned about high reserves that drain capital which could be used to lower prices and create new products. He said that PBR is designed to strike a balance between the two extremes. He stressed that “right-sizing” reserves is ultimately more important than any relative increase or decrease in reserves may that result from PBR.

Commissioner Consedine acknowledged that questions have been raised regarding PBR implementation. He that the NAIC is taking steps to address concerns, pointing specifically to initiatives designed to improve actuarial expertise among state insurance departments.

Mr. Easton said that New York is not a proponent of PBR at this time because DFS does not consider the proposed valuation manual to be sufficiently protective of policyholders or company solvency.

Turning to the issue of captives, Mr. Easton said that DFS released a report on June 12 of this year examining the use of captives in New York State. He stated that the report identified seventeen instances involving the creation of captives or special-purpose vehicles (SPVs) to address redundant reserve situations, amounting to $48 billion worth of transactions. He stated that these transactions were backed by assets of questionable quality and dubious validity. He said that DFS does not regard the scrutinized transactions as genuine risk transfer, but rather as a means of inflating risk-based capital. He said that the DFS report found that companies were able to report capital increases of approximately 250 percent as a result of such transactions.

Mr. Easton said that the captive transactions were backed by parental guarantees and letters of credit, in some instances with no third-party financing at all. He said that of the seventeen transactions identified, only one involved adequate disclosure to regulators, investors, and others. He said that of the $48 billion transferred, $38 billion were not flagged in statements filed with insurance regulators. He said that DFS is not moving forward with approvals of any additional captive transactions at this time and intends to develop stronger reporting requirements.

Mr. Easton argued that PBR, though it seeks to address concerns about reserve redundancies, will not solve the issue of opaque captive transactions. He said that the industry has stated it will not cease its use of captives even under a PBR regime. He said that DFS also has concerns about the notion of allowing companies to essentially fashion their own reserves under PBR.

David Provost, Deputy Commissioner of the Captive Insurance Division for the Vermont Department of Financial Regulation, stressed that life insurer-owned captives are not representative of the traditional captive market, which is often used by non-insurance entities to self-insure. He said that captive insurers are highly regulated, both in the state where the captive company is domiciled and the state in which the parent company is located. He said that many parties are involved in examining the transactions. He stated that when a license is granted to a captive entity it is not a general order to write insurance, but rather a specific arrangement. He noted that once a captive is licensed it is subject the same regulations that a typical life insurance company must follow, including regular audits and examinations.

Mr. Provost said that the sense among companies in Vermont has been that without the ability to offload reserve redundancies they would be forced to pull out of the market or raise prices on their products. He acknowledged that there are concerns about the use of captives by life insurers. He stated that Vermont does not allow parental guarantees, but his department does believe that letters of credit are an appropriate support for transactions. He said that Vermont is already working with the NAIC to ensure that captive transactions are being properly disclosed.

Mr. Provost stated that he believes PBR will lead to a significant decrease in demand for these types of transactions.

Paul Graham of the American Council of Life Insurers stated that the life insurance industry is supportive of the PBR project. He said that ACLI will work with the NAIC in support of further adoption in the states. He said that the primary concern of those who voted against the valuation manual in 2011 was that some states were not ready for implementation. He said that the NAIC has since put together an implementation task force to develop a resource plan, which includes data collection and training, to ensure uniform regulation across the states. He expected a working version of the plan to be ready by the NAIC meeting in August 2013. He expressed his belief that NAIC efforts would assuage state concerns about PBR implementation.

Referring to Mr. Easton's comment that use of captives will not abate under a PBR regime, Mr. Graham stated that it was accurate for a number of reasons. He said that while captives have been used to reduce redundant reserving, that is not their only use. He said that such vehicles provide capital to the insurance industry. He said that any block of business will have reserves that are higher than premium inflow, and that this must be financed somehow. He stated that the industry has found that captive insurers are one of the least expensive methods of acquiring capital.

Commissioner Consedine stated, regarding use of captives by life insurers, that the issue is of concern to the NAIC. He said that there should be increased disclosure, transparency, and scrutiny regarding these types of vehicles. Mr. Graham added that ACLI supports those efforts and suggested that many of the objections to the use of captives are due to a lack of transparency.

In discussing regulation, Mr. Easton said that there are legitimate uses for captives and that New York's concerns apply specifically to life insurers' activities. He said that improved transparency would go a long way toward addressing many of the concerns DFS has raised. He cautioned, however, that DFS does not agree that the current reserves are redundant, nor is it convinced that the financing behind the risk being ceded is genuine.

Mr. Provost concurred that improving transparency in captive transactions is important from a regulatory perspective. Commissioner Consedine added that captives pose a challenge for regulators, particularly in that they have to rely on fellow regulators in the domiciliary state. He agreed with Mr. Easton and Mr. Provost that improved transparency is an important step toward increasing regulatory cooperation.

UNCLAIMED PROPERTY

Rep. Damron stated that as more states consider the *Model Unclaimed Life Insurance Benefits Act* it has become apparent that a technical amendment, which he was sponsoring, was necessary to clarify the intent of NCOIL legislators.

Ms. Nolan said that it was the intent of the model to exclude from its scope credit life and accidental death insurance, as well as preneed funeral contracts. She said that, as the model is written, it appears that such plans are only exempt if they fall under a federal employee benefit plan or an ERISA plan.

Upon a motion made and seconded, the Committee unanimously approved the amendment and moved it for consideration by the NCOIL Executive Committee.

Rep. Damron reported on recent developments concerning the NCOIL model. He said that he attended a meeting of the Uniform Law Commission (ULC) earlier in the year as they began re-examining their own unclaimed property model. He noted that in Kentucky a group of three life insurers, represented by the Kemper Corporation, had filed suit against the Kentucky legislation, but the court ultimately upheld the law. Rep. Damron said that the model is attracting support from a number of areas, including the National Association of Unclaimed Property Administrators (NAUPA), the National Association of State Treasurers (NAST), and ACLI.

During Committee discussion, Rep. Kennedy noted that he had encountered some resistance to the model in Rhode Island. Sen. Leavell and Rep. Keiser added that there had been some opposition from life insurers in New Mexico and North Dakota, respectively, but both states eventually amended their versions and passed the model.

Vermont State Treasurer Beth Pearce, President of NAUPA, commended NCOIL for its work on unclaimed property. She reported that on the audit side, $1.8 billion in unclaimed benefits have been returned to claimants or the states as of this date, with about $1 billion going directly to beneficiaries. She said that the NCOIL model helps to ensure that benefits are distributed earlier, when they are most needed.

Following up on Rep. Damron's earlier comments regarding the ULC, Treasurer Pearce said that developments in unclaimed property over the course of the last eighteen years led the ULC to revisit its model. She said that this presents an opportunity for NCOIL, NAUPA, ACLI, and the ULC to work together to improve consumer protection.

Bruce Ferguson of ACLI noted that, as a whole, unclaimed property makes up a small percentage of the benefits that the life insurance industry pays out on a regular basis. He said that ACLI has been supportive of the NCOIL model due to changing expectations of insurers, growing use of the DMF, and inconsistencies between state laws. He said that there are legitimate concerns from smaller companies regarding unclaimed property regulation that should be taken into consideration as legislation moves forward. He said that ACLI supports allowing the commissioner of each state to phase in provisions of the model on a company-by-company basis. Mr. Ferguson expressed hope that regulators, state treasurers, and state records agencies would work together to ensure proper regulation.

Scott Cipinko of the Consumer Credit Industry Association voiced support for the technical amendment adopted by the Committee. He noted that the only major issue CCIA had encountered in states where the model was under consideration involved confusion over the model's scope. He expressed concern that multiple versions of the model would create confusion. He urged NCOIL to make clear to the states that the amended model reflects the intent of legislators.

John Camillo of the Kemper Corporation noted that an appeal has been filed in the Kentucky lawsuit discussed by Rep. Damron. Rep. Riggs expressed surprise that small and mid-sized companies are not using the DMF and asked Mr. Camillo what process they have in place to identify unclaimed benefits. Mr. Camillo responded that Kemper's objection is to the retroactive provisions of the model. He said that Kemper believes that any changes to administrative processes should be prospective.

ADJOURNMENT

There being no other business, the Committee adjourned at 11:00 a.m.