NATIONAL COUNCIL OF INSURANCE LEGISLATORS
LIFE INSURANCE & FINANCIAL PLANNING COMMITTEE
2023 NCOIL ANNUAL MEETING – COLUMBUS, OHIO
NOVEMBER 16, 2023
DRAFT MINUTES

The National Council of Insurance Legislators (NCOIL) Life Insurance & Financial Planning Committee met at The Renaissance Columbus Downtown Hotel in Columbus, Ohio on Thursday, November 16, 2023 at 3:15 p.m.

Representative Carl Anderson (SC), Chair of the Committee, presided.

Other members of the Committee present were:

Rep. Deborah Ferguson, DDS (AR)
Sen. Walter Michel (MS)
Sen. Joseph Thomas (MS)
Sen. Jerry Klein (ND)
Sen. Shawn Vedaa (ND)
Asm. Ken Blankenbush (NY)
Asw. Pam Hunter (NY)
Rep. Tim Barhorst (OH)
Sen. Bob Hackett (OH)
Sen. George Lang (OH)
Rep. Ellyn Hefner (OK)
Rep. Tom Oliverson, M.D. (TX)
Del. Steve Westfall (WV)

Other legislators present were:

Sen. Larry Walker (GA)
Rep. Brian Lohse (IA)
Rep. Chad Aull (KY)
Rep. Jane Pringle (ME)
Rep. Helena Scott (MI)
Sen. Lana Theis (MI)
Rep. Stephanie Young (MI)
Sen. Paul Utke (MN)
Rep. Bob Titus (MO)
Sen. Pam Helming (NY)
Asm. David Weprin (NY)

Also in attendance were:

Commissioner Tom Considine, NCOIL CEO
Will Melofchik, NCOIL General Counsel
Pat Gilbert, Director, Administration & Member Services, NCOIL Support Services, LLC

QUORUM

Upon a Motion made by Sen. Jerry Klein (ND) and seconded by Sen. Bob Hackett (OH), the Committee voted without objection by way of a voice vote to waive the quorum requirement.

MINUTES

Upon a Motion made by Sen. Klein and seconded by Del. Steve Westfall (WV), the Committee voted without objection by way of a voice vote to adopt the minutes of the Committee's July 21, 2023 meeting.

UPDATE ON NCOIL LIFE INSURANCE IS A PROMISE FOR LIFE MODEL ACT

Rep. Anderson stated that we will start today with an update on the NCOIL Life Insurance is a Promise for Life Model Act. This will be a very brief update as the sponsor of the model, Sen. Travis Holdman (IN), NCOIL Immediate Past President, wasn't able to be here today. You can view the model on page 114 in your binders and on the website and app. Sen. Holdman did ask me to report to everyone that since he was not able to be here today and since there has still been significant regulatory developments on this issue among the states, he would like the Model to be held at this meeting and he would like to see how things develop over the next few months before deciding what's the next step to take with this model. It may end up being that such regulatory activity reaches a level that makes the model unnecessary and states that are interested in responding to this issue can utilize the resolution that NCOIL adopted on this issue as a guidance. We did have a couple of speakers scheduled to make brief comments but in light of some last minute scheduling changes and the model being held they have withdrawn requests to speak. So, if there are any questions on this issue, please reach out to Sen. Holdman, myself or the NCOIL staff.

DISCUSSION ON THE RETURN OF THE U.S. DEPARTMENT OF LABOR (DOL) FIDUCIARY RULE

Rep. Anderson stated that next on our agenda is a discussion on the return of the U.S. DOL fiduciary rule. As many of you know, the DOL has been working on this rule for nearly a decade and despite a prior version being vacated by the courts the DOL is back at it again with a second bite at the apple. In your binder on page 117, is a resolution I sponsored that was adopted at our last meeting which opposes the return of this rule. And on page 119 is a similar resolution that was adopted back in 2016. Lastly, on page 121 is a statement from NCOIL CEO, Cmsr. Tom Considine, regarding the DOL's latest action. As you can see from both resolutions and the statement the main issue here is that there simply isn't a need for federal involvement in this area of revising professional responsibilities for financial professionals providing investment advice. That area is reserved for the states. And under the proven state based insurance legislative and regulatory structure, tens of millions of Americans have been able to receive sound retirement assistance, products and services from financial professionals who have consistently served the best interests of the consumers.

Allison Itami, Principal at Groom Law Group, thanked the Committee for the opportunity to speak and stated that the DOL is racing through a rulemaking effort in the next weeks that will shape the behavior of insurance companies and insurance agents that's currently under your regulation in a profound way. The DOL is reviving its 2016 rulemaking to capture more sales activity both providing itself with the ability to prevent a company from doing business for a full 10 years. The activity that was highlighted in the rollout was the sale of annuities portrayed as containing junk fees. This rulemaking explicitly rejects your efforts to regulate using a suitability best interest standard for annuities sold to retirement investors as falling short of the protection that DOL wishes to provide. I'm a principal at Groom Law Group. It's a boutique law firm focusing on employee benefits including health and retirement plans that are often covered by federal law, the Employee Retirement Income Security Act of 1974 (ERISA). Groom attorneys have been focused on ERISA for as long as ERISA has been around and that's coming up on 50 years. For much of that time, the provision of investment advice with respect to retirement plans has been governed by the five part test regulation. The proposed rulemaking at issue today is another attempt to redesign the regulation and its implementing exemptions. This is the third such attempt since 2010. I personally devoted thousands of hours on advocacy and compliance, worked back in 2015 through 2018 during the last DOL proposal and finalization. This was the proposal that was vacated by the Fifth Circuit Court of Appeals in 2018. Why is this rulemaking so important? This rulemaking is so important because ERISA is a statute of prohibitions. It

starts from a place of no, no actions can be taken without permission. That means no services can be provided and very few sales can occur without complying with the conditions of a prohibited transaction exemption. Failure to comply with an exemption can result in having to part with profits and it might impose penalties and it will also impose excise taxation. These are all very serious consequences.

Why is this rule so important to you? Although it is framed as protection from junk fees and regulatory arbitrage, the proposal, in my opinion, is at heart the DOL's inability to take a win. The 2016 rulemaking truly did shift the retirement industry and the financial professionals that work in it. The rulemaking kicked off, or at least preceded consumer protection efforts from others like the Securities and Exchange (SEC) and from states. These consumer protection efforts have included Regulation Best Interest and the adoption by the states of the National Association of Insurance Commissioners (NAIC) Model 275. Several states have also imposed fiduciary standards on state regulated financial professionals. The disclosures that retirement investors now receive have become more fulsome. The efforts to mitigate conflicts have also increased. Under these consumer protection efforts, the standards of care require some formulation of providing a recommendation that takes into account the recipients needs without placing the financial interests of the financial professional first. For a rulemaking that was vacated before it truly took hold it's pretty remarkable the impact that it has had. Rather than allowing these new efforts to establish and flourish the DOL has taken direct aim at the states. The DOL is of the belief that regulatory arbitrage occurs where investment advice providers can use more favorable rules in one market to circumvent less favorable rules elsewhere. When they use elsewhere here they mean avoiding the DOL regulation to be regulated at the state level. The DOL states that state regulated annuities are covered by state regulations that potentially hold those selling such insurance products to a lower standard. The DOL views Model 275 as lacking because they view it as a suitability standard rather than a fiduciary one. Because the DOL does not believe that the state adopted standards of insurance regulation are good enough they feel it justifies federal regulation in this area.

The regulation first broadens the definition of fiduciary investment advice to capture most activities by financial professionals when the recipient is a retirement plan participant or individual retirement account (IRA). Next, the DOL once again uses its exemptions to impose standards of care upon entities and transaction types that Congress did not. Further, if stating that state standards were too low and imposing standards upon IRAs that Congress admitted wasn't enough, the exemption also reserves an unbelievable amount of discretion to the DOL in a manner that could be business ending. The DOL has proposed to condition exemptive relief upon remaining eligible. Ineligibility is found based upon affiliate convictions, including when a foreign affiliate is convicted in areas that are completely unrelated to providing investment advice or management. DOL has also reserved for itself the ability to discretionarily revoke eligibility based upon a pattern of behavior such as the failure to file excise tax returns. Given DOL's stated goal of forcing everybody to use a single exemption, the loss of that single exemption could result in the inability to conduct business with retirement investors for a full ten years for both small shops and multinational institutions. The fewer providers that are in this space, the less likely it is for consumers to have access to the provider of their choice and the growing possibility that prices will increase as compliance becomes more complex. In my opinion providers are willing and able to comply with an appropriate standard of care but the DOL's vision for an appropriate standard of care tramples upon where other regulators have already recently acted. It imposes compliance costs in the form of disclosures that DOL itself does not believe enhanced protection.

Confusion over the ability to tout your own services as a sales effort rather than being fiduciary advice has caused many to shy away from advising upon retirement assets even while advising or managing that same person's non retirement assets. The rulemaking's scant nod to ERISA's savings clause, which is meant to carve out from federal preemption state laws that regulate insurance, banking and securities is inadequate because this rulemaking is intended to push state regulators out of the field because they elected to impose a standard of care that the DOL does not approve of. DOL's bid to "level the playing field" has been to set the field beyond the reach of state regulators based on unconvincing worries that no other regulator is able to protect retirement consumers as well as it can. It states that it uniquely among regulators can impose uniform standards for the provision of investment advice to retirement investors. As mentioned in your resolutions that the Chair just referenced from earlier this year, that protection goes to such an extreme that it limited services in the 2016 go round and it may well do so again. Given ERISA's starting point of prohibition, providing a recommendation that is indeed in the consumer's best interest is not good enough. You still need to comply with all the bells and whistles of the exemption conditions. Meeting all those add-ons is costly and failure with respect to those add-ons can result in the inability to conduct business even while meeting a best interest standard of care. Forcing so many relationships into DOL's regulatory field is not necessary given the efforts of other regulatory bodies to act in these spaces including your efforts with Model 275. Usurping your regulatory authority based on no evidence or experience with the newly adopted and implemented model 275 appears unjustified and like regulation for the sake of regulation given all the widespread changes that have occurred in the financial services industry in the past decade.

Brian Graff, CEO of the American Retirement Association (ARA), thanked the Committee for the opportunity to speak and stated that let me start by agreeing with Ms. Itami with respect to what we felt was an absolutely outrageous and inappropriate attack on one particular insurance product by the White House when the regulation was issued, namely fixed index annuities. We published an editorial several days after that attack criticizing quite vociferously the unfair and frankly flawed attack on fixed index annuities because they are perfectly appropriate and sound products and investment options for retiring investors frankly benefiting millions of those investors throughout the country. And so I want to make sure that's on the record and we've been consistent with this that we want everyone to understand how we feel about the way that the regulation was rolled out, that it was inappropriate. And certainly, we believe and support the idea that products like fixed index annuities have an important role to play in the retirement investor marketplace. That being said, there is one aspect of the current regulatory regime that we as an organization have concern about and that has to do with retirement plans that are sponsored by employers. Let me explain. For 140 million American workers, the gateway to investing in the first place is in the workplace. That's how most Americans save, invest in the market, build wealth and hopefully generational wealth. As an organization, we have been continuously working to expand coverage of workplace retirement plans because they are the gateway to building that equity and starting to save. American workers are 15 times more likely to save when they're covered by a workplace plan then on their own in an IRA. Retirement plans in the workplace work. Problem is, there's still 40% of the American workforce, roughly 65 million American workers, who don't have access to a plan at work and it's particularly acute and problematic for communities of color where predominantly many of them work for smaller businesses, family owned businesses. And the racial wealth gap when it comes to retirement savings remains significant. 50% of black Americans, 62% of Hispanic Americans, have no retirement savings. Compared to about 35% of white Americans. We believe that gap is absolutely unacceptable.

So, expanding coverage to workplace plans is critically important. You might be asking yourself why am I talking about this and what does this have to do with the fiduciary rule? Well, the one thing that the NAIC model rule doesn't apply to, the one thing that the SEC best interest rule doesn't apply to is the advice given to an employer with respect to their workplace retirement plan that they're offering to their employees. And that is why we have a concern with the current regulatory regime and that is the element of this rule that we think is worth considering. The reason this is so important is because the person and by the way this rule with respect to the fact that Regulation best interest doesn't apply to workplace retirement plans or the NAIC model is because advice given to a small business owner is considered institutional advice even if that small business owner has two employees and has no sophistication when it comes to investments. So, basically what we're saying is that there is no current regulatory regime when it comes to workplace retirement plans in many cases and in particular, when it comes to the selling of a retirement plan to a small business owner. We, along with many of you in states, have been working very hard to address this coverage problem. There are now 14 states that require employers above a certain size to have some type of workplace plan. We've worked with many of you on that legislation. We just recently worked with Congress to enact numerous provisions to incentivize and make it easier for small businesses to have workplace retirement plans. I think we all share the goal of having some coverage in the workplace so that working Americans can save. The problem is there are no investor protections in many cases for those small business owners and that's the focus of our emphasis with respect to this rule.

Leah Walters, Senior Vice President of State Relations at the American Council of Life Insurers (ACLI), thanked the Committee for the opportunity to speak and stated that first, I want to thank Cmsr. Considine for the statement on the DOL's proposal. And we agree with you. The proposed rule is unnecessary and burdensome to the many consumers it seeks to protect. And we also agree that it 100% undermines the state based regulatory system of insurance. And this encroachment by the federal government should not go unnoticed. As you just heard, a lot has happened since 2016. The SEC has a best interest regulation. The NAIC has adopted amendments to model 275 and 40 states have adopted the NAIC best interest language. And for those who know about NAIC models, that's not an easy feat in two to three years - 40 states and its growing. We also have six states with pending activity and we think Utah will be number 41 on December 3rd. So, we want to thank all of you for the work in your states that you've done getting this accomplished. But this federal trend of staff completely ignoring the state based insurance regulation system should not go unnoticed. This is the second such encroachment in one year. In July, there was a tri-agency action of the Department of Health and Human Services, DOL and Treasury, they proposed a rule preempting state authority on short term limited duration insurance (STLDI) and supplemental products. Both NCOIL and the NAIC issued letters of opposition on such encroachment and we agree with you as we think the state based system is where the regulation of insurance products should continue. We heard a lot from Ms. Itami about what the rule itself does and we believe it's a significant setback for retirement savers. We believe that public policy should provide all Americans with the option for financial security and that should happen through choices, not limitations on their financial security. Conflating legitimate retiring costs with junk fees we believe was the scare tactic to push regulation that will hurt Americans. The other thing is traditional pensions are no longer the norm. So, guaranteed income through annuities let's people create their own pensions and that's why annuity ownership is up. And just a couple more facts - the median household income among annuity owners is $76,000 a year. The median household income is $63,000 a year. So, you see who's buying annuities, middle income. And fiduciaries generally typically charge ongoing fees and impose account minimums that moderate income savers just cannot afford so we think this would be a huge hit to the middle market. So again, we want to thank NCOIL and the NAIC for leadership on this. We think you're already protecting consumers against conflicts

of interest. These 40 states represent 76% of U.S. consumers with this enhanced best interest of care. and we think that's exactly where it belongs, in the states.

HOLD THAT RATING: DISCUSSION ON ACTIVITIES OF NAIC'S SECURITIES VALUATION OFFICE (SVO)

Last on the agenda is a discussion on the activities of the NAIC'S SVO. This discussion deals with a proposal from the NAIC'S SVO that generally speaking, would provide them with the authority to overrule the determination of rating agencies that rate certain types of securities. The proposal has generated a significant amount of controversy. There are a slew of questions about potential issues with the proposal that can be said to fall into three buckets. Number one, due process. Number two, unintended consequences. Number three, misguided financial incentives for the SVO. So that is just for your background. This has also garnered attention at the federal level. A letter was sent to the NAIC by several U.S. House Members raising concerns. You can see that letter on the website and the app along with NAIC's response.

The Honorable Beth Dwyer, Director of the Rhode Island Department of Business Regulation, thanked the Committee for the opportunity to speak and stated that I will try to get through this pretty quickly although it is a very complicated subject. So, what is the issue? The issue is that insurers are investing in newer products, not your typical bonds. They're not as easily understood as we have seen in the past. So, the NAIC had a number of working groups under the financial condition committee looking at various issues with these type of investments. As you know, one of our main focuses, if not our main focus as state insurance regulators is the solvency of companies and we have to understand what they are investing in in order to have an understanding of whether or not the companies are solvent. So, we started hearing comments as I believe you did as well from various people involved in investments and insurers that it seemed like our approach was scattershot, maybe not coordinated. And so, what we did was we put out what we are calling the framework for insurer investments which you have on the screen here. What we did was draft a framework that I'm going to go through the seven points of our initial draft and we hope that each of these points shows that these issues are being coordinated at the Commissioner level. They are not being directed by NAIC staff.   The comments that we are hearing are being addressed. For instance, due process - I think you're going to see even more when we come to our next version of the draft on various ways to give due process to insurers who have these investments.

But let me run through if I could what that framework is going to look like. The purpose is not an intent to compete with credit rating providers or to become a credit rating provider. Our intent is to understand the ratings and establish a clear procedure on how we would adjust a rating on a particular investment if we believe that that rating was not properly assessing risk. So, what we're trying to get to is the appropriate financial charge based on the risk of the investment. We are committed to a clear procedure with levels of appeals and we are committed to adding levels of appeal that are not currently in our process. Our intent is to continue to rely on credit rating providers but to make sure that reliance is well informed. A number of people within state insurance departments have called our current reliance on credit rating providers blind reliance and from a financial regulator point of view that is scary. We want to understand what the investment is and we want to have the appropriate charge for that investment. So, the first proposal is to reduce or eliminate blind reliance on credit rating providers but retain overall utilization of those providers with the implementation of a due diligence framework. That framework has yet to be drafted. We do have some investment professionals within the states that are going to draft procedures and that will be out for public comment. I actually included at the very end here the last bullet, a quote from the framework which says, "inefficient and

impractical for the SVO to effectively replicate the capabilities of credit rating providers on a large scale and would not provide incremental benefit if the output substantially similar. Rather, the SVO should focus primarily on holistic due diligence around credit rating provider usage." What that means is we intend to continue to rely on credit rating providers, unless we see some indicia that that particular investment is getting an inappropriate charge in our financial framework.

The second proposal is to retain the ability within the SVO to provide individual credit assessment and utilize regulatory discretion when needed under well documented and governed parameters. This is a backstop. Most credit ratings are going to be accepted. The newer and more exotic ones, if that's the right word, and probably isn't the right word, those are the ones that we're going to be focusing on. The ones that we feel like we're not getting the right charge for. We're not going to be focusing on all of them. I've also heard some criticism that the SVO in and of itself wants to create itself as a competitor to credit rating providers and I do want all of you to know the SVO is part of the NAIC. The people that work there are NAIC employees. What they do and how they do it is directed by the Commissioners so it doesn't matter how much money comes in, they don't have the free discretion to spend whatever they want or add employees or anything like that. That all has to be approved by the Commissioners. There is no intent by the Commissioners to compete with credit rating providers. What we use the SVO for is to inform Commissioners on very complicated investments and how we should look at those investments in evaluating the financial solvency of an insurance company. The third proposal is to enhance the SVO risk analysis capabilities. So, this is to assist Commissioners on understanding risk analysis. It's not directly associated with any credit rating provider. But this would cost money and the NAIC would have to approve the money in order for us to do this. But it's something that we think could be very valuable to individual states in doing their own analysis. The fourth proposal is to enhance the structured asset modeling capabilities focusing less on individual designation production and more on credit rating provider due diligence and validation. Again, we're going to have to draft procedures on this but what we're trying to do is set up procedures for credit rating providers so that we can have more faith in the ratings that we receive from them. The fifth proposal is to build out a broad policy advisory function at the SVO that can consider and recommend future policy changes to regulators. So, we are not investment experts, we are insurance regulators. But we do need to understand and be able to take into account the securities that our insurers are investing in. The sixth proposal is an investment working group under the E Committee. We currently have something called the Valuation of Securities Task Force. The proposal is to make a smaller group, very specifically focused on investments to advise the Commissioners on various policies.

And the final proposal is to rename the SVO and the Valuation of Securities Task Force to better recognize the responsibilities of the groups. We also have an issue with the Valuation of Securities Task force in that there's just too many members. I'm sure you've all been members of committees when there's so many people you can't get anything done. So, we're looking at the committees and the task force we have in this area to see if reduction in size might assist us in getting more done. So, the conclusion is that these proposals are designed to provide regulators with the tools that we need to properly value investments. The goal is equal capital for equal risk. As financial regulators were attempting to assess the appropriate capital and avoid regulatory arbitrage. There is no attempt to compete with credit rating providers. We are the recipients of the ratings and we're evaluating them for our own use, not putting them out for somebody else's use. The NAIC has established a public process to consider this so the framework is out for comment. We've received comments from I believe 17 different carriers. I would, by the way, strongly suggest that anybody who is interested in this file comments either orally or written. It makes it very difficult when we hear comments outside of what we have in the process. It's very difficult to address those comments if the people who are interested don't file

comments. We will have a meeting at the NAIC meeting in Orlando where each of the 17 that have filed written comments will be allowed to supplement those comments orally. We will then take back all of the comments and come up with a second version of the framework hopefully addressing most of the issues that commenters bring up.

Caitlin Colvin, Senior Managing Director, Business Development at Kroll Bond Rating Agency (KBRA), thanked the Committee for the opportunity to speak and stated that I'm happy to give the credit rating agency perspective on some of the work streams going on within the NAIC. For those of you that aren't familiar, KBRA was founded in 2010. We have over 500 employees, over 68,000 ratings representing over $3.3 trillion in debt issuance. We are the largest post crisis founded rating agency. And we rate all asset classes. We are a nationally recognized statistical rating organization (NRSRO) in all asset class and we'll talk about that in a little bit but what I want to start off by saying is we were very happy to see the E Committee's framework that was released before the summer national meeting. We think there's a lot of really interesting and helpful guideposts in that framework. And most importantly, I think it's important to say we are very supportive of additional rating agency diligence. We're happy to talk about our process and speaking from KBRA's perspective, of course, we're happy to talk about our process, our methodologies, how our teams arrive at certain ratings. We're happy to do case studies on certain transactions and talk about asset classes. We think rating agencies broadly actually are very well positioned to opine on credit given that is our sole reason for existing. And we as rating agencies, and again speaking specifically for KBRA, we work really hard at cultivating sector expertise and we really believe we are the experts in particular in certain classes that may potentially be more challenging and take a little bit longer to understand. But we think it's really important to staff our credit analysts with the right people to dive into those credits and we don't take that lightly. It can take us months to turn around a rating and come to a rating that we think is the appropriate rating for that security. I'm just speaking from experience. I'm an aircraft finance lawyer by trade. I was initially hired by KBRA to actually rate aircraft finance transactions and I was able to build a team and pass along knowledge that we think is really helpful in the ratings that we have outstanding in that asset class.

We really understand collateral. We really understand structure and we think it's really helpful to the market and the write ups we provide to insurance companies that are purchasing that kind of paper. That's just one example. We also believe that you don't really want your podiatrist doing brain surgery. So we have a subject matter expertise in each asset class that we do. I think in contrast to the SVO, and I think in what Dir. Dwyer was saying they are a very helpful organization and they're helpful staff to the Valuation of Securities Task Force but they are tasked with reviewing a great many securities. We have the staff and expertise we think to sort of be best in class in credit ratings. So, we're happy to shed light on how we do that and we look forward to engaging in further dialogue and in fact the Valuation of Securities Task Force passed along a list of questions to each credit rating provider about our processes, about our regulations, about our methodologies. And we did provide responses to those and very much look forward to dialoguing with regulators on those. We think that's going to shed a lot of light on how diligent these processes are and how much the insurance companies actually rely on the write ups that we do. And in contrast, not only do we provide the write up in conjunction with the rating itself, we also do extensive research across asset classes where we believe, banks in particular, there's a void. So, sector expertise is helpful. I do just want to take a minute or two to focus on the federal regulation over NRSRO's. We are an approved rating agency. We are regulated by the SEC. We are also regulated in Europe by European Securities and Markets Authority (ESMA), and the Financial Conduct Authority (FCA) and in particular U.S. federal regulation require us to be extremely transparent in what we're doing. It requires us to have published methodologies. It requires us to back test when we're changing methodologies. It

requires us to say how many ratings would be impacted when we make those changes. I think things like that are really helpful, particularly when it comes to the NAIC. I think Standard & Poor’s (S&P) for example just produced its insurance rating risk based capital (RBC) rating methodology today. It was required to list which companies would be impacted by or potentially impacted by that methodology. That kind of transparency is really helpful.

And I think as we start working through the discretionary proposal that Rep. Anderson spoke about at the beginning, we think it's really important that that transparency exists because it is required by rating agencies and we think that can be very helpful in that process. And as Dir. Dwyer said the discretionary proposal it was re-released and it'll be seemingly on the agenda at the national meeting. And as was alluded to at the beginning by Rep. Anderson as well, it garnered a significant amount of attention, the initial draft. My reading of the second draft and some comments I received is that there are certain additional transparencies built in but I very much look forward to understanding a little bit better what the SVO is required to bring in front of regulators, particularly state regulators, where you have insurance companies across states. How's that going to be worked out? And I’m very much looking forward to understanding the controls that the Commissioners are looking to put in place in light of the E Committee framework but I think we'll be hearing a lot more of that after the national meeting in December.

Ms. Walters stated that the ACLI and its member companies appreciate and support this new holistic approach that the NAIC is looking at. As we know, the regulation of insurer investments continues to evolve daily so it makes sense for this coordinated approach. While each of the projects are led by knowledgeable subject matters and there's some overlap in membership between the working groups, we think it might also make sense to maybe create a more smaller group of knowledgeable regulators that have a clear sight into all of the groups so that they can see the big picture and the interconnected projects and perhaps could provide an additional layer of leadership and guidance if necessary.

Sen. Lana Theis (MI) stated that this is an extraordinarily important issue. I have some generalized questions regarding the statements that there was a blind reliance and they weren't appropriately assessing risk and wanting people to be well informed. Who considers the risk inappropriate and based on what factor? What are you looking at to consider it appropriate? Because they have measurable quantifiable success rates and you weren’t referring to those. Dir. Dwyer stated that this is only on some by the way. So the vast majority of ratings are accepted by the NAIC and the charge is given. There’s various indicia on some and it's usually private credit. It won't be something that you'd use, it's not something you or I would buy. This is private credit. One of the things we're going to put into our procedures is what indicia it would be that would lead us to consider whether to take one step further and look closer at the investment. So some of the things I've heard and I do not obviously day-to-day look at investments myself, but some of the things I've heard are a credit rated at A where the underlying assets might be C and you wonder why the A is given. So, you look a little further into whether that was the appropriate valuation. That's the kind of thing we're talking about.

Sen. Theis asked are you seeing insolvency such that you feel like you need to do this? Dir. Dwyer stated we're not seeing insolvency but our job is to make sure that the insolvencies don't occur. Newer investments are starting to come into the market. They are not a huge percentage of the market yet but we don't usually wait until there is an insolvency to do something that we're concerned about. Sen. Theis stated that I understand what you're saying, but it sounds like you have a regulator overseeing something that's saying we're going to agree with you as long as we agree with you and then we're going to tell you it's not correct and you're going to have to go back and then that's going to be a pretty chilling effect on our rating agencies in how they're

going to be able to approach the rating and what they're going to consider and what remedies they might have. So, I have concerns about the NAIC here and the regulator organization being the one that makes the determination as to whether or not these rating factors are accurate. It doesn't seem like it's going to be an independent approach. It's basically as long as you say what we think, then we agree and you're good. But if we disagree there's going to be a major problem. Dir. Dwyer stated that's kind of what we do every day. So, you might have an insurer file a reserve with you, and this doesn't have anything to do with investments, but you'll file a reserve with us, our domestic companies, and we will take a look at it with a consulting actuary or an actuary that's on staff and say, "we don't agree with you." And we go back and forth with the insurer. That would kind of be the same thing here, except that you have the involvement of credit rating providers which you wouldn't in the reserve type situation.

Sen. Theis stated that it is an expansion of what it is that you do. It's not what you do every day. This is an expansion, correct? Dir. Dwyer stated no, it's not an expansion. Every day we do look at the investments of insurers and give them an appropriate charge. The issue is the investments are changing. These are newer investments, they're not, buying a corporate bond. If you buy a corporate bond, it's pretty easy. You bought the bond, the bond is rated A or B, we give an appropriate charge for this. These are newer investments. They're not corporate bonds. They are more complicated and we feel we need to understand the rating that's given and why it's given to give the appropriate charge. We also have an issue between companies. So, if there are certain companies investing in these newer investments and they're getting an inappropriate charge for that, there's a competitive advantage over companies that are still investing in bonds. So, we're also looking at that. We look to make sure that whatever financial charge we're giving is the appropriate charge for that investment.

Rep. Tom Oliverson, M.D. (TX) stated that my understanding is that you have these NRSRO's which are all regulated by the SEC. The private sector is essentially already fulfilling this responsibility but now we have the organization that is not regulated by the SEC which is responsible for taking those recommendations and basically taking action with the insurance companies doing business in their states and sort of I'm going to take your business from you and I'm going to do it myself. My question is, are you going to charge for this? Does the SVO charge for these services that they're providing? Dir. Dwyer stated that they do charge for some services and we are going to look at what they're charging and how they charge but we are the customer. So, when a bond is rated by an NRSRO, we are the customer of that. So we're looking at the solvency of the insurance company. The rating organization is rating that bond and then we're looking at that rating and making sure that we agree with it. Right now, a lot of what we do is simply blind reliance on that SEC regulated provider. The problem is the SEC is not responsible for the solvency of insurance companies. If we see an investment that we do not feel is getting the appropriate charge, that can affect the solvency of the insurance company which is what our responsibility is.

Rep. Oliverson stated that it just seems to me like this is an unmitigated terrible conflict of interest for the NAIC to get into this business. And then I could see in a very short period of time that essentially this becomes the only company doing this business cause the NAIC stops using everybody else and essentially says, "we're just going to do this in house. And by the way, we're making a lot of money by doing it." I really have a bad feeling about this and I hope that you all will go back to the drawing board on multiple proposals here. I have serious questions about the appeals process and the lack of transparency. And if you're an insurance company and you disagree with the SVO, you're essentially appealing to the umpire that threw you out of the game. There is no alternative mechanism for dispute resolution. And if you come in heavy-handed as an insurance company because you object to the ratings now you're not only picking a fight with

the SVO, you're picking a fight with the NAIC who essentially holds all the cards in your future ability to do business. I think this is an unbelievably bad conflict of interest and I can assure you that we are going to continue to stay very aggressively engaged with you on this if you all continue down this path to make sure that we're not doing irreparable damage to the free market in this process by essentially reducing the number of NSRSO's down to one which is the SVO. Dir. Dwyer stated that I can tell you that is absolutely not the intent of the Commissioners at all. We have absolutely no intent to replace credit rating providers. In fact, in order for us to do our own ratings of all of the investments and insurance companies we'd have to be larger than S&P and we have no intent to do that.

Sen. Bob Hackett (OH) stated to Rep. Oliverson that we rarely disagree but I disagree with you profusely here. I like the rating agencies but the rating agencies aren't perfect and I'll give you an example. Look at mortgage-backed bonds – in 2008 and 2009 they were rated a lot better than they should have been rated but they were rated based on the details and the data of risk that they were given. And so, I don't mind this because our Department of Insurance has to make sure that companies are strong and we have to look at them even stronger than in addition to the ratings alone. So, they're going to listen to the rating agencies, but they're going to make the rating agencies really back things up if there are questions. Sen. Hackett asked Ms. Colvin how KBRA rated the mortgage-backed bonds in 2009 because I know how Moody's rated them and how S&P rated them. Ms. Colvin stated that KBRA was founded in 2010 so we didn't rate them. Sen. Hackett stated that's probably why KBRA was started, because of the criticism of Moody's and other rating agencies. Ms. Colvin stated that's exactly right. Rep. Oliverson stated then it should be done at cost - don't turn it into a profit center. If you're turning it into a profit center, then it becomes a monopoly.

ADJOURNMENT

Hearing no further business, upon a motion made by Sen. Hackett and seconded by Rep. Oliverson, the Committee adjourned at 4:45 p.m.