NATIONAL COUNCIL OF INSURANCE LEGISLATORS
LIFE INSURANCE & FINANCIAL PLANNING COMMITTEE
BOSTON, MASSACHUSETTS
JULY 15, 2021
DRAFT MINUTES

The National Council of Insurance Legislators (NCOIL) Life Insurance & Financial Planning Committee met at the Westin Boston Waterfront Hotel on Thursday, July 15, 2021 at 3:00 P.M. (EST)

Representative Wendi Thomas (PA), Vice Chair of the Committee, presided.

Other members of the Committee present were (* indicates virtual attendance via Zoom):

Rep. Deborah Ferguson (AR)
Asm. Ken Cooley (CA)*
Rep. Jim Gooch (KY)*
Rep. George Keiser (ND)*
Sen. Jerry Klein (ND)
Sen. Shawn Vedaa (ND)
Asm. Ken Blankenbush (NY)

Other legislators present were:

Rep. Tammy Nuccio (CT)
Rep. Roy Takumi (HI)
Sen. Paul Utke (MN)
Sen. Randy Burckhard (ND)
Sen. Ronnie Cromer (SC)

Also in attendance were:

Commissioner Tom Considine, NCOIL CEO
Will Melofchik, NCOIL General Counsel
Tess Badenhausen, Assistant Director of Administration, NCOIL Support Services, LLC

QUORUM

Upon a motion made by Asm. Ken Cooley (CA), NCOIL Vice President, and seconded by Sen. Jerry Klein (ND), the Committee voted without objection by way of a voice vote to waive the quorum requirement.

MINUTES

Upon a motion made by Asm. Ken Cooley and seconded by Sen. Klein, the Committee voted without objection by way of a voice vote to adopt the minutes of the Committee's April 16, 2021 meeting.

DISCUSSION ON INTERSTATE INSURANCE PRODUCT REGULATION COMMISSION (IIPRC) DEVELOPMENTS

a.) Colorado Supreme Court Decision <u>Amica Life Insurance Company v. Wertz</u>

The Hon. Mary Jo Hudson, Partner at Squire, Patton, Boggs and Former Director of the Ohio Insurance Department, thanked the Committee for the opportunity to speak and stated she is an NCOIL veteran as a former Director of the Ohio Department of Insurance and having served as an officer of the IIPRC for all four of those years and having served with NCOIL CEO Cmsr. Tom Considine. I would first like to provide some background on compacts and here we are talking about the IIPRC. I know you hear a lot about it just to give you some background – you all deal with compacts I'm sure in your states and it is a contract among states, a very important governance tool used by the states to get work done without relying on the federal gov't and letting states do it by themselves. There is a clause in the Constitution regarding compacts but you don't have to have federal consent to have a compact. If there is federal consent for the compact whether its express through a specific bill or implied which means Congress has recognized the compact but didn't do anything to change it those terms in the compact can preempt conflicting state constitutional terms.

With that in mind, we go to our compact – the insurance compact commission (ICC). It has been around for 15 years with 46 states involved and I'll say as a commissioner we were just starting with about 26 states when I started in 2007 and it's great to see this success which is due in large part to the efforts of NCOIL who helped get it up and running so its a great legacy. Upon the formation, the ICC became what's referred to as a joint public agency among those member states – it's a separate body and not part of the National Association of Insurance Commissioners (NAIC). Its staffed and supported separately form the NAIC - there is some support and some office sharing but it's not part of the NAIC and each state commissioner represents that compact as the state representative of that compact. The staff at the ICC is Karen Schutter and they are the staff of that compact so the compact as you may know regulates the product terms for life insurance, annuities, disability and long term care (LTC) products that are sold in the states.

Life insurance companies don't have to file with the compact but many choose to as its incredibly successful and many life insurance companies use it regularly as it improves speed to market and helps have uniformity in their product across the country which helps streamline compliance and helps make sure sales are streamlined as well. I'm here to talk about there was a court case that came out last year around the end of 2019 <u>Amica v. Wertz</u> out of the Colorado Supreme Court and that decision challenged some of the terms of the compact. My firm was retained by the ICC to do a review of the compact's governance and the decision. In <u>Amica</u>, the CO SC ruled that the CO constitution prevented the inter state compact's uniform standard on life insurance based on the assumption that the inter state compact does not have any congressional consent and the issue there was in the CO insurance code they have a one year suicide exclusion and only one other state has that, MO – all other states are two years and the compact standard was two years. Someone brought an action saying they should be paid for a claim of one year and the insurance company challenged it saying no it should be per the uniform standards. The issue was handled in our opinion improperly as it was in a federal court which is sort of beside the point for our purposes today but the bottom line is the CO SC issued a decision that said our CO statute controls rathe than the compact uniforms standards which is quite contrary to the terms of the compact that CO adopted as well as all of the other members states.

Part of our analysis found that the ICC has received congressional consent through what's called the doctrine of implied consent so when congress approved D.C. becoming a member back in 2006 congress consented to the compact and that consent is sufficient to support a congressional consent. The court in <u>Amica</u> did not discuss that and didn't look into it and nobody really briefed congressional consent so they sort of went out on their own side analysis to make their findings. This implied congressional consent is a very strong argument that the ICC and states up to this point have not really had to pursue.

So what's next – this decision in our opinion as we did this analysis for the compact should have a narrow impact so long as the states and the compact going forward stand up for itself in effect and educate regulators and the states and the public about the body of law that supports the compact and about the importance of maintaining compacts and the way legislatures adopt them and acknowledging that implied congressional consent so that other litigants can't go out and try to use this I think poorly decided decision from the CO SC to erode certainty and uniformity that comes right now from the ICC's wildly successful program. We made several recommendations to the compact to try and help shore this up and really there is no silver bullet to stop challenges in the future but what can happen is it's about providing information that can be cited in other court cases to educate state regulators and legislators so that you all now can talk about it as if those uniform standards do apply rather than one off state requirements and then also recommend that the ICC begin to offer in its uniform standards that if there is litigation like that the compact is required to be brought in as party.

b.) Amendments to NAIC Model Standard Nonforfeiture Law for Individual Deferred Annuities

Ms. Schutter, Executive Director of the IIPRC, thanked the Committee for the opportunity to speak and thanked Dir. Hudson who was retained as a consultant to do our governance review and a lot of the recommendations that have come out of the report are very important. We have worked very closely with NCOIL and have provided updates on the compact at a number of meetings as well as we've done even more education for those legislators that are new to the compact and want to understand why the states came together to collaborate and agree upon uniform standards that really are developed through a comprehensive process involving the legislators as we have a legislative committee and we adopt uniform standards that will apply to products that really cross state borders you could have a consumer buy a product in one state and then move into another state so it makes sense that the standards are uniform across states and they also compete on the federal basis with securities and banking products and there has been a long call by the industry and it was a very serious threat for 15 years we don't hear as much now for federal preemption in these areas. And a lot of the reason why you don't hear about it now is because states and regulators and legislators have worked together through the compact to make product approval more seamless through uniformity.

I would like to recognize those state legislators who have been very engaged and active with the compact – Rep. Matt Lehman (IN), NCOIL President; Asw. Maggie Carlton (NV), the Chair of this Committee; as well as Rep. Joe Fischer (KY), NCOIL Secretary. You also probably know RI Rep. Brian Kennedy, UT Rep. Jim Dunnigan, GA Rep. Matt Dollar and IL Sen. Laura Fine as they are all members of the legislative committee and are very active as we have regular calls with them and they attend meetings and you see they sit with the commissioners in all of our deliberations. OH Sen. Bob Hackett, AR Sen. Jason Rapert, NCOIL Immediate Past President, IN Sen. Travis Holdman, NCOIL Immediate Past President, have also been members of the legislative committee. Dir Hudson gave a very concise compressive overview of the first case that got to an opinion and it had a lot of twists and turns with a lower court ruling that the compact was constitutional as state legislators understood what they were doing and could enter into an agreement. With the CO opinion we appreciate the recommendations that came out from Squire and we are looking at them. Implied congressional consent obviously has a meaning in terms of the dialogue and what our regulators are doing we have a governance committee of our officers along with others they are looking at the opinion and to the recommendations from Squire and putting in a plan of action and working with the members of NCOIL and other organizations such as the National Conference of State Legislatures (NCSL) and the National Association of Attorneys Generals (NAAG) and the Council of State

Governments (CSG) who has a national center of interstate compacts. It's going to be akin to what all the stakeholders did back in the early 2000s when the compact was first developed in terms of raising awareness of what the compact was and what the achievements have been and those have been that right now the industry is using the compact. Over the last 10 years most products that are being used right now are industry approved products for 46 compacting states and soon to be 47 as I'm happy to let you know Delaware recently enacted the compact and is waiting the Governor's signature. So for 47 states you can have a uniform product that comes through the compact and we have actuaries and former regulators review that look at the product under detailed standards and everything is transparent to regulators and they are involved in the standards and what we're doing.

I was asked to bring to you attention an issue we have been dealing with this past year. It is a little bit of an outgrowth of the CO case where it made our regulators really pause and the issue is that last year through working with industry the regulators opened up a model law – the NAIC Model Standard Nonforfeiture Law for Individual Deferred Annuities. What they did was amended a minimum nonforfeiture rate because of the exceptionally low interest rate environment not just historically over the last several years but because of the pandemic and how its plummeted. So they amended the model law – it was 1% and it went down .15%. There were a lot of good reasons for it so there could be product offering in these areas. What we did is that our uniform standards that requirement is actually incorporated by reference (IBR) and I understand that it has a meaning at NCOIL but what's happens in our standards is that we incorporated a lot of the technical models of the NAIC and because this is substantive and on its face although there are a lot of good consumer benefits from lowering this we decided to pause and not incorporate that immediately into the standards.

We wanted to wait because that standard nonforfeiture law is actually a statute in the states so we wanted to see how states were going to enact that change and so far there are some discussions still going on but of the 46 compacting states 10 of them have enacted the change so that means the majority of them have not yet enacted them so we paused bringing that standard automatically into our standards and what we did was we indicated in our standards that a company must follow the minimum nonforfeiture rate in state law. So this does take step back from uniformity and the benefit that everyone bargained for but because it was something that was IBR we wanted to and this was probably the first time it happened in the 20 years, we created an emergency rule and took a pause and we said that provision is following state law and we'll probably look at it in a couple of years as more states embrace the change and the normal program will come back but there are some examples in our uniform standards where we go back to state law maybe because it a public policy that one half are one side and one half are on another or maybe it's a public policy that is outside of the compact that companies want to put into their policies.

This looks a little bit like we are stepping away form uniformity but many of our members were deferential to our legislators and wanted to make sure that this change was one that states would embrace on the state level before it made its way back into the standards. I would also say that we are likely to look at our standards one of the main one's being the suicide exclusion and we find that our standards are widely accepted and based on NAIC and NCOIL models and there are some states that might have a one off requirement and some of it might be meaningful. In CO it has a one year suicide exclusion statue and only two compacting states have that but that's a meaningful conflict so we will be looking at those types of provisions and seeing if we can minimize the conflict so that first of all whether its beneficiaries or policyholders don't feel like they have to go to litigation.

UPDATE ON THE SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT (SECURE) ACT 2.0 AND OTHER FEDERAL RETIREMENT INITIATIVES

Bradford Campbell, Partner at Faegre, Drinker, Biddle & Reath, LLP, thanked the Committee and noted that from 2006-2009 he served as the assistant secretary of labor for the employee benefits administration which administers the Employee Retirement Income Security Act of 1974 (ERISA) the fiduciary and reporting provisions governing retirement and other private sector employee benefits plans. In my work there I spent a lot of time dealing with clients dealing with the overlap and the issues created by federal law and the intersection with the work that you all do in regulating state insurance products. I'll address three topics that are relevant in both congress and the executive branch currently in an area that will affect you all – the Secure Act 2.0 and annuity provisions that are in it; and two other regulations from the Department of Labor (DOL) that are affecting conduct standards and some other annuity related issues for participants and insurance producers and others related to those plans.

Starting with Secure 2.0 as you will recall we're talking 2.0 because the first version was two years sago and what we've seen on a bipartisan basis in congress was that there is a consent that there is not enough take up of guaranteed income products of various sorts in retirement plans governed by ERISA and that there needs to be encouragement to have those products be made available to provide certain guarantees to participants particularly in defined contribution plans like 401ks. In the first version they provided greater rules for portability, so that a 401k participant who found the 401k plan, stopped offering an annuity from one provider and then switched to another would for example be able to roll that annuity they purchased over into an IRA and be able to have that portability and not be at a disadvantage because the plans had a change the investment options. There was also established a safe harbor for the selection process of the annuity provider so that if the fiduciaries of the 401k plan, the person charged with making those decisions on behalf of the plans, if they followed the list of elements listed in the federal statute they would have a reduced civil liability in the event the annuity provider is unable to make payments - the idea is to reduce concerns about potential liability as a barrier to adopting those. The third provision was to require that on an annual basis 401k plans and other similar defined contribution plans would provide to participants a projection of the retirement income that could be provided by something like an annuity based on the amount they have accumulated in their 401k plans. That last provision passed and it is something I'll talk about because with passing that into law it then comes into the labor dept. to implement that into regulation.

Because the Secure Act was successful and bipartisan it had only three no votes in the entire congress which is quite a feat for a substantive piece of legislation they decided to take another run at changes to retirement plans. Secure Act 2.0 was passed by voice vote by the House Ways and Means Committee and it's a package of 20/25 different provisions and there are three of them related to annuity providers and trying to make them more available. These are a little more technical but they address some of the tax code issues that have also contributed to limited availability of annuities in retirement plans. The first and probably most significant is facilitating qualifying longevity annuity contracts. Because of the required minimum distribution rules under the tax code which means that once you achieve a certain age you are required to start taking distributions from your 401k plan, the way those rules were originally structured no more than 25% of the assets in a plan could be devoted to a Qualified Matching Contributions (QMAC) and that was presumably to prevent over benefiting from the tax benefits. Congress at least in the House has decided that is limiting the availability of what are useful products for retirees and so they would remove in the Secure act 2.0 the 25% limit so that would effectively allow for amounts over $500,000 to be put into a QMAC so that would facilitate that.

Another change of course in general is increasing the required minimum distribution commencement age from 72 to 75 phased in over 10 years which would provide more time and less mandatory draw down on some of those assets which indirectly facilitates annuities. They would also permit because exchange traded funds didn't exist when these provisions were written in the code they would permit now a class of exchange traded funds to be used in annuities by changing the way the taxation of those is. In other words there wouldn't be internal capital gains these would now be eligible to be taxed as ordinary income when distributed just as other types of retirement savings in that space are. Lastly they were going to change the actuarial rules for calculating retired minimum distributions that have made it difficult for certain what are otherwise common and popular annuity features like return of premiums on death and being able to provide non leveled annuity payments. By facilitating those changes the Secure Act 2.0 would make annuities somewhat more attractive and useful in this context. That bill passed the House Ways and Means Committee by voice vote and there is similar legislation in the Senate. It's not clear yet when the Sente is going to act on this legislation what is pretty clear is that there is a lot of support when you speak to folks on capitol hill about it they all think it or some variation of it incorporating the Senate's views will pass what no one can commit to is when. So we're all pretty optimistic that some variation of these proposals will come through but whether it happens later this year in sort of the end of the year must pass legislation that we always seem to find with funding or defunding the gov't and increasing the debt limit or whether it comes earlier next year we'll see but the prospects for the legislation look good.

As I mentioned before the labor dept is charged with implementing the lifetime income disclosure rule and the reason I think it's going to be significant is that it will give participants sort of real estimations about how well they are doing in retirement savings and the value potential about having the annuity form of payment. The reality is that if you tell me I have $350,000 in my 401k ill say that's great I'm doing really well but I have no idea what that actually means for my retirement but if you say based on the $350,000 you have $600 a month or whatever the number is in retirement income that I can process immediately so I think it's a very useful and significant way to explain to participants their retirement savings. What's not simple is how you calculate that number. What's the methodology that you use and that's what the labor dept was tasked with doing by Congress. The Trump admin issued an interim final regulation last September. An interim final reg is a reg where if they don't change it it will apply as written but they are taking comments or took comments on it and would consider changing it so unless the Biden admin acts the Trump rule will go into effect this September and likely will apply to most plans in the first part of next year.

Just recently a few weeks ago the Biden admin announced that it does intend to change that rule and will be scheduled at least to propose a new final rule for the disclosure requirements and the methodology and is scheduled to do so in July. I have to say they are unlikely to make that deadline given that they have not yet sent anything to the White House for review. We know publicly what's in rules when they go for review but we don't' know what's in them until they go out but its not yet gone for review and that review can take up to nine days so it seems unlikely they are going to meet their July deadline and that in turn raises a question of whether they will change the September deadline we'll have to wait and see but what's at issue there are some questions about what's the right methodology and whether this will be helpful or cause confusion in particular should you take the current account balance - if I'm a worker with an account balance of $5,000 are you going to pretend that I'm 67 and give me a disclosure that says I get $18 a month in retirement income or are you going to project that $5,000 balance forward to retirement age assuming certain contributions and growth and then calculate the annuity number. Those are the kinds of issues the Biden admin is presumably going to address. The Trump admin shows these simplistic numbers of using what do you have in your account today and this is what you will get if you retired today. A lot of folks including Chair Neal of the Ways and Means Committee suggested that they should use the more complex but potentially more confusing calculation. So we will see. When they proposed the rule and what's in it due to the nature of an interim final rule we wont see what's in the final rule until its published because comments were already taken on the proposal so its an unusual wrinkle in the process.

The last issue deals with DOL's fiduciary regulation. The issue there is when is someone who is giving advice to a participant in a retirement plan subject not only to their normal conduct in the case of an insurance producer's rule and regulations about recommending an annuity and when are they also subject to the federal gov't ERISA fiduciary standard. What the Trump admin did and what the Biden admin agreed with and ratified this February was that they have expanded the interpretation of the siting rule to mean that most rollover recommendations would now be subject to ERISA's fiduciary duty. The difference is if its truly a one time recommendation that can still be viewed as a sales event and is not a ERISA fiduciary advice but if I'm recommending an annuity where I'm intending to give you additional recommendations as we go along in the relationship then it would be subject to ERISA's fiduciary advice.

The reality is that ERISA and the concept of commissions and standards for insurance compensation don't play well together. Under ERISA a commission is a prohibited transaction and not a permitted form of payment unless there is a special rule that says it is so there are new special rules that have also gone into effect in February that were intended by the dept to let these two issues coexist to let insurance producers, broker dealers, registered investment advisors, the full range of different financial professionals to be able to make these recommendations and still get paid even if it's a commission subject to additional conditions. There has been quite a bit of debate particularly in the insurance industry that says that the new exemption in the special rules which is called prohibited transaction exemption 2020-02 there has been a lot of concern that it doesn't properly take into account the realities of independent distribution that assumes a level of control b/w the financial institution and the financial professional that works in the securities setting but doesn't work in an independent distribution setting where the carrier doesn't have control over the independent producer which is by design as a consumer protection at the state level so there is a disconnect of where the labor dept is going and where state insurance regulation is and DOL has announced that those rules that apply in February there is an existing exemption for insurance that can be used but by this December DOL is going to propose a new fiduciary rule that will change this existing interpretation that just came out and may change exemptions as well so to sum that up what we have is a new DOL interpretation that's capturing more insurance producers as ERISA fiduciaries, new exemptions that may or may not adequately cover the needs of those products in making those recommendations and on the horizon an entirely new regulation and a new start to the entire process. So if you enjoyed 2016 when the Obama admin changed the fiduciary rule and that was eventually vacated by the federal courts in 2018 you'll enjoy the next two years because we are going to have many of the same debates again.

Rep. Thomas asked if there is within the requirements an explanation of how they are doing this that's going to go out to people who live in our states that explains this is our projection – no matter which way they do it. To me it's more important that they explain what they are doing and how they calculated it for people as much as the actual number. Mr. Campbell stated that the exact details would depend on how they are going to change it in the final rule. We just this June learned they actually were going to change it so that was an open question. In terms of what it says currently there would be a disclosure that explains generally how it was calculated.

How useful that would be to the average participant to read the fine print is an open question but the benefit of the path the Trump admin chose is that it is simple to calculate and it doesn't have a lot of variables. The disadvantage and this is my personal opinion is that it doesn't help me if I'm a younger worker with a small balance to get a projection based on where I am today when that's not where I'll be if I retire. In some ways this is modeled after the fed govt's thrift savings plan for 401ks which provides an annual annuity projection and having been a participant in that as a former federal employee I've found that projection to be of no help at all. When I was 30 I wasn't near retirement when I was 40 I wasn't near retirement and it appears when I'm 50 I wont be near retirement so telling me what that annuity will be based on the balance today when it has changed radically over that period I think has very limited value and I think it needs to be projected forward using more assumptions but as you point that would also take a lot more explanation.

LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS: WHAT ARE THEY? HOW HAVE THEY RESPONDED TO COVID? HOW DO THEY INTERACT WITH CAPTIVE INSURANCE LAWS?

Peter Gallanis, President of the National Organization of Life & Health Guaranty Associations (NOLHGA), stated that I was asked to give a report today basically at a high level on the nature of operations, concerns and prospects for the life and health insurance guaranty system to talk specifically about the effect of the pandemic on the system and to address any special issues that might exist between the insurance guaranty system on the one hand and captive insurers on the other. To begin, I just wanted to make the point that at a very high level the system of providing a financial safety net for consumers in the rare cases where a life or health insurance company fails has been established by the state legislatures working with the regulators and industry and consumer reps it has been refined repeatedly over the last four decades and I think we're in the position right now where the system has proven again and again that it does a good job of protecting consumers and I think its in large part because of the hard work that NCOIL members and other important leaders and stakeholders have taken. If current trends continue absent unexpected extraordinary special problems I think we can look forward to more decades of success of providing a safety net for insurance consumers.

Turning to slide three I was sked to report on the effect of the COVID pandemic and I'm very happy to report that although operationally behind the scenes we had to begin doing a lot of things differently to make sure we were able to provide through our state insurance guaranty association the same type of levels and protections that we have historically when we've been called upon to perform the pandemic itself really resulted in no material increase in the number of insolvencies of life and health insurers. The industry stood up very well. Second, the pandemic did not result in increased costs of the guaranty association providing protections to policyholders. Finally, because I think we did a lot of scrambling increased reliance on technology and did a lot of things that you folks and others had to do to be able to continue doing business over the last 16 months there really was no net effect at least from a consumer perspective of the pandemic on guaranty system operations which is a good thing.

Going to slide four I'd like to talk about the question I was asked to give any available insights on how captive insurers and the guaranty system related to each other and I think the short answer is that guaranty associations protect consumers who have policies with member insurance companies that fail. First of all there aren't a lot of them that fail but second by and large captive insurers are not guaranty association member companies so it really has never been the intent and it is not the outcome that when a captive fails policyholders of the captive are protected by the guaranty associations. The interest in captives because a lot of captives are for example reinsurers and they have an indirect sort of financial implication for companies that would be protected by the guaranty system but so far in our experience in 100 or so insolvencies where NOLHGA members have been involved we really have not had material challenges that have been posed by any captive insurer or reinsurer being part of the picture so from our standpoint its really been an issue that's been pretty remote to our concerns and operations.

That said I'd like to talk a little bit about the current state of the guaranty system and how we got to where we are and what we're doing and how we're doing it and what we're concerned about. Looking at slide six some background points I think you know that we have basically two separate systems reflected by guaranty associations of two different types in every state – in every state there is a life and health guaranty association and a property & casualty guaranty association. In each system there is a national organization that has been formed by the individual guaranty associations to provide support and services for those individual guaranty associations. In the case of the life and health system that support mechanism is NOLHGA the entity for which I work but the guaranty associations and guaranty systems basically developed in the late 1960s early 1970s we worked closely with receivers and insurance regulators to make sure that when a company fails consumers are protected and that's our focus – protecting consumers not bailing out companies that for whatever reason have not been able to make it.

The elements of the guaranty system basically, on the life and health side anyway, are that we have guaranty associations in the 50 states and D.C. and Puerto Rico. Each one of them is a separate legal entity established by a state law that your legislatures have passed. Those laws are basically drawn from at least on the life and health side an NAIC model and there are some differences state to state tailoring to specific state preferences but broadly speaking there is a great deal of similarity across the country. NOLHGA serves our member guaranty associations and was created by them to support and deliver efficiencies and cost effective solutions that benefit consumers and keep the cost of the system down. The way we go about this basically is when the guaranty association systems obligations under their statutes are triggered usually by a liquidation of an insolvent company the guaranty associations continue the coverage that is to say they honor the commitments of the failed company so that they are not taking someone who is 20 years into a life policy or an annuity and throwing them back in the marketplace where they have to replace that. In that regard we are a little different than the P&C system where for most lines of business coverage is cancelled and the policyholders are able to go back out and get replacement coverage on business that is typically repriced and rewritten on an annual basis anyway. It doesn't work that way with life contracts and annuity contracts and some types of health contracts so if you are going to honor the commitment you have to continue the contract. Our preferred way of doing that is by supporting a transfer of the business that's in force when a company fails to another healthy company and that's done basically by giving the healthy company that takes on the liabilities assets that are usually made up by assets in the estate of the failed company plus topping up payments that cover a deficiency that are provided by the guaranty associations.

The guaranty associations cover people who are residents of their states – its residency based and each state determines the level of protection that's provided but the levels for protection are generally pretty consistent across the country on the life and health side. Moving to the next slide, how does the system get paid for? Well the largest chunk of funding for the performance of the guaranty system is from assets that remain within the estate of the failed company – they have failed which basically means that their liabilities exceed their assets but they usually have a significant amount of assets that provide depending on the type of company 50 cents on the dollar 70 cents or 90 cents and essentially the guaranty associations provide most of the rest necessary to protect consumers. Guaranty associations also benefit from receiving premiums on policies that pay premiums there are some statutory deposits that legislatures provide for that also support the activities of the guaranty system but the bulk of what we think of in terms of guaranty association funds comes from assessments that are made to member companies and in some cases those assessments are subject to tax offsets over a period of time reducing the amount of otherwise due and owing premium taxes.

For people who don't know a lot about the guaranty system and how it has performed historically this slide talks about some of the facts that not everyone knows. First, there are very few cases historically of life and health insurers of any significant size that have failed. I'm going to point to the 2008 financial crisis and the worst of the pandemic last year - there were no life and health companies of major significance that failed because of either the crisis or the pandemic. Second, unlike banks, insurance companies are really not subject to run on the bank behavior and that's because the liabilities usually come due over a very long period of time which means that our cash needs are a lot lower than the FDIC for example needs to fund when a bank fails. We do have operational resources to keep the benefits going to policyholders and historically the performance of the system has been really solid over the years I don't think there has ever been a case where a guaranty association has failed to pay for what your statutes call to pay when a consumer's company fails.

Slide 12 shows the number of cases that we've had to respond to over the course of the last 30 years and as you've seen the number of multi state cases is pretty small. Slide 13 answers the question that people often ask – do you have the financial capacity within the guaranty system to respond to failures by companies and this chart really captures the answer to that question. The bottom shows green and that reflects the amount of money that guaranty associations have had to spend to protect consumers on a year to year basis and the blue reflects the amount of funding capacity that we have and although the chart is simplified and if you drill down there are a lot of different ways to talk about it this gives you a sense that the total capacity of the guaranty system nationally historically has always been much greater than the cost to run the system. Moving to the next slide I list some of the recent cases we have been confronted by and we actually have to spend money protecting consumers when there is a liquidation and there have been a few cases in recent years and ill talk about them in a few minutes. Rehabilitation often leads to a liquidation so we often monitor rehabilitations but guaranty associations typically do not pay money out in a rehabilitation.

Ill go now to slide 16 which is where we're talking about challenges to the guaranty system as we move forward. And I would say that our biggest challenge over the last 10 years and likely our biggest challenge over the next 10 years have been in the area of LTC. Some of the reasons particularly for the problems with older LTC are spelled out in the top half of the slide and some of the challenges to try and rehabilitate these blocks are spelled out on the bottom. We literally could spend five hours talking about LTC but we have seen some cases recently and we are likely to see more and it is an area of concern and I'd be happy to help and discuss this with you anytime. The next slide mentions some of the recent LTC cases we've seen the biggest one we've seen liquidation with has been Penn Treaty in PA; there is a much smaller company called Senior American that has been in liquidation; there is a case in PA right now called SHIP that is in rehabilitation and may or may not at some point end up in liquidation; there is another rehabilitation in WI that is largely a LTC company and I think we are going to avoid having a liquidation there although I'm just talking about what's been public and the signs seem to be pretty good.

There have also been some work streams at the NAIC and my guess is at NCOIL too that have been focused on LTC issues and if we had more time we could discuss. We are worried about some other things and there has been some mention of them today. NCOIL members are looking very closely at insurance company restructuring mechanisms and how to be able to do that in a way that accomplishes good but doesn't saddle the society with a risk of increased numbers of insolvencies. We're also somewhat concerned and have been historically with related party transactions within the insurance space. As we move forward what we are really hoping to do as we have been doing for a long time is to use the experience we've gained to work with legislators, regulators, industry and other stakeholders to make sure we are prepared for whatever happens to come down the pipe in the future and I think this is the fifth time I've been asked to testify before NCOIL over the last 30 years or so historically we've had a great relationship with NCOIL as we have had with regulators and I think having that relationship and maintaining it is going to be important for all of us as we seek to protect consumers with anything that may confront us in the coming years. Thank you and I welcome any inquiries now or in the future from you and your members.

ADJOURNMENT

Hearing no further business, upon a motion made by Asm. Cooley and seconded by Asm. Kevin Cahill (NY), NCOIL Treasurer, the Committee adjourned at 5:30 p.m.