

NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS



NAIC 2008 FALL NATIONAL MEETING

The National Association of Insurance Commissioners held their 2008 Fall National Meeting in Washington D.C. September 21-24. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

Executive Summary

- At their Executive and Plenary sessions, the Commissioners adopted AG VACARVM, Reserves for Variable Annuities, with an effective date of December 31, 2009. The Commissioners also approved the formation of four new groups to address international and emerging issues. (page 3)
- The Government Relations Leadership Council heard updates from NAIC staff on congressional bills related to financial products and healthcare; it is generally believed that no pending insurance bills would move forward this year, but that insurance regulatory issues will be a very significant topic in Congress in 2009. (pages 4-5)
- The Statutory Accounting Principles Working adopted changes to SSAP 63 on reporting intercompany pooling and adopted SSAP 99, Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment. After extensive debate, the working group did not adopt SSAP 98, Treatment of Cash Flows When Quantifying Changes in Valuation and Impairment, but noted they expect to adopt it in December with a January 1, 2009 effective date. The working group also exposed for comment SSAP 91R on the accounting for transfers of assets, and re-exposed Issue Paper 131 and Issue Paper 132 on pensions and OPEB. The working group added consideration of FAS 163, Accounting for Financial Guarantee Insurance Contracts to its agenda and directed staff to draft an issue paper. (pages 5-10)
- The International Solvency and Accounting Working Group held a joint meeting September 3 with the Financial Condition Committee to discuss the recently adopted work plan for the Solvency Modernization Initiative and how the recent market events may reshape the future of solvency standards. In addition, the working group recommended that NAIC staff draft additional documents to facilitate the solvency modernization work plan, and that the IAIS Subcommittee reassess the solvency papers based on the new information gained from the recent turbulent market events. The SEC's Roadmap for adoption of IFRS in the United States was also discussed. (pages 10-12)
- The Blanks Working Group adopted six blanks proposals as final and exposed three new issues for comment. Its Premium Survey Subgroup will survey states regarding the method of allocating premiums that are acceptable for the purposes of taxation and guaranty fund assessments, which may result in the reconsideration of the recently adopted Schedule T instructions. (pages 13-14)
- The NAIC/AICPA Working Group updated its survey on the states' progress of adopting the revised Model Audit Rule (MAR) noting that eight jurisdictions have either adopted revised laws or regulations or have

exposed proposed revisions. An additional 18 jurisdictions plan to expose revisions by the end of the year. The working group also reviewed a comment letter from the AICPA on audit procedures that might be performed once principle-based reserving requirements are adopted. The working group will hold a conference call in the fourth quarter to discuss GAAP disclosures that will be considered under generally accepted auditing standards for 2008 audited statutory financial statements. (pages 14-15)

- The Valuation of Securities Task Force adopted new language for the Purposes and Procedures Manual that would make the process for placing securities under regulatory review more transparent by requiring a public declaration by the task force of any security placed under regulatory review. The Invested Assets Working Group continued its work in cataloging and analyzing investment risks inherent in fixed income securities. (pages 15-17)
- The Capital Adequacy Task Force reconvened its LHATF/CADTF Subgroup to consider changes to Life RBC in conjunction with the principles-based reserve initiative. The task force is also considering development of a RBC analysis specific to captive risk retention groups. (pages 17-18)
- The Life RBC Working Group rejected the proposal to raise the trend test in the life RBC formula from 250% to 300%. The P/C RBC Working Group's Catastrophe Risk Subgroup continued its development of a catastrophe risk charge for RBC and made some significant revisions to the discussion draft including a change from a 1-in-250 year event standard to a 1-in-100 year standard. The Health RBC Working Group continued progress on its development of a trend test for the Health RBC formula. (pages 18-19)
- After many more hours of meetings, conference calls and debate, the Reinsurance Task Force adopted its Reinsurance Regulatory Modernization Framework, which proposes two new classes of reinsurers in the U.S.: national reinsurers (U.S. companies) and port of entry (POE) reinsurers (non-U.S. companies). The Framework would also create the Reinsurance Supervision Review Department. The Financial Condition Committee also approved the Framework at its subsequent meeting. (pages 19-20)
- The Life Insurance and Annuities (A) Committee heard a presentation regarding public hearings held in New York on broker compensation arrangements and received an update on the adoption efforts of the Viatical Settlement Model Regulation made by various states. The committee also established a working group to review the Annuity Disclosures Model Regulation. (pages 20-21)
- The Life and Health Actuarial Task Force again spent a significant portion of its two days of meetings on the development of principle-based reserves and appears to be very near completion of a final revised Standard Valuation Law, which could be adopted by its parent committee later this fall. The task force also voted to adopt Actuarial Guideline CCC which addresses the treatment of traditional life products that contain intermediate cash benefits and Actuarial Guideline GWP on the use of the 2005 Group Term Life Waiver Reserve Table for calculating minimum reserves for waiver of premium disabled lives. (pages 22-23)
- The Climate Change and Global Warming Task Force received a report from its Climate Risk Disclosure Working Group regarding the latest draft of the Climate Risk Disclosure Proposal. The working group received and reviewed 14 written comment letters on the proposal and stated that more consensus is needed at the working group level. In addition, the working group will be working on stronger safe harbor language to protect companies' public statements. (page 25-26)

Executive Committee and Plenary

Executive Committee and Plenary

During its Plenary meeting in Washington D.C., the commissioners adopted the following new items, all of which were the subject of extensive public hearings as the proposals were being debated by the various groups of the NAIC:

- Actuarial Guideline VACARVM-CARVM for Variable Annuities Redefined.
- Repeal of Actuarial Guideline XXXIV - Variable Annuity Minimum Guaranteed Death Benefit Reserves
- Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities.
- White Paper on the Oversight of Medicare Private Plans
- Medical Professional Liability Closed Claims Reporting Model Law
- Market Conduct Annual Statement Proposal

At its earlier meeting, Executive Committee determined that the following three models met the criteria for development of a model regulation in accordance with the Model Law Development Framework:

- Amendments to the Annuity Disclosure Model Regulation
- Amendments to Model Regulation to Implement the NAIC Medicare Supplement Minimum Standards Model Act
- Amendments to Long-Term Care Insurance Model Regulation

The committee also ratified the creation of three new groups and adopted their respective charges. The groups, which will report to the Executive Committee, include the following:

- International Insurance Relations Leadership Group which will develop, coordinate, and implement the NAIC's international initiatives;
- Indexed Annuities Working Group which will develop a response to the SEC's proposed Rule 151 A on indexed annuities and certain other insurance contracts; and
- SVO Initiatives Working Group which will review the potential expansion of the SVO credit assessment role.
- AIG Special Task Force (discussed below)

AIG Public Briefing

The NAIC held a public briefing open to all attendees at the Fall National Meeting to provide an update with respect to issues related to AIG. The NAIC officers (Sandy Praeger (KS), Roger Sevigny (NH), Jane Cline (WV) and Susan Voss (IA)) and Eric Dinallo (NY) Joel Ario (PA) and Thomas Sullivan (CT) spoke at the meeting. The briefing started with a summary of the AIG Special Task Force meeting earlier that day (which was for regulators only), during which the NAIC met with the Federal Reserve and Mr. Edward Liddy, AIG Chief Executive Officer. The task force has formed two subgroups, the Form A Subgroup and the AIG Life Working Group. The AIG Special Task Force adopted three charges as follows:

- The task force is charged with overseeing the regulatory activities related to the AIG insurance subsidiaries and coordinating interaction among state regulators, federal government officials, company representatives, and international regulatory interests. Membership consists of every NAIC member, unless a particular member opts to be excluded.
- The task force will use a Form A Subgroup to manage the communication of information and coordination of activities related to the change in ownership approval process for insurers proposed to be sold by AIG holding company. The Form A Subgroup will be composed of the U.S. jurisdictions that have domestic AIG insurers.
- The task force will use an AIG Life Working Group to ensure the specific regulatory concerns regarding the 17 life insurers in the AIG group are adequately addressed in the overall AIG plan and its implementation.

The public briefing focused on two major themes: 1) NAIC leadership and the regulators strongly believe that the 71 legal entity insurance companies of AIG are financially sound and solvent and that the policyholders are protected, and 2) it is their belief that state insurance regulation is responsible for this.

The NAIC has posted an audio download of the entire meeting to its website.

Financial Condition (E) Committee

The committee heard a short presentation from Cathy J. Cole, Associate Chief Accountant of the Securities and Exchange Commission, on the SEC's "Roadmap" for the adoption of International Financial Reporting Standards in the United States. A committee member asked what happens to other U.S. standard setters if the SEC requires IFRS for all filers; Ms. Cole responded that it is not yet known what would happen in that event.

In addition to receipt and adoption of the reports of its various working groups, the committee accomplished the following:

- Adopted unanimously the Reinsurance Regulatory Modernization Framework Proposal dated September 12. This Framework is discussed in detail starting on page 19 of Newsletter.
- Adopted the final report of the Disaster Reporting Working Group which includes the Insurer Disaster Reporting Template produced by the new Disaster Reporting System Application. The working group continued in operation during the implementation phase of the Disaster Reporting System. The committee then approved dissolution of the working group.

Principle-Based Reserving Working Group

The working group has not met since the Summer National Meeting and canceled its meeting in Washington, D.C. due to scheduling conflicts and due to LHATF not completing its efforts on proposed revisions to Standard Valuation Law, which had been anticipated. The timeline to completion continues to slide, but it now appears the SVL will be ready for the working group's review in December; a draft of the Valuation Manual is also expected at the Winter National Meeting. The working group may hold a joint call or meeting with Life Insurance and Annuities (A) Committee after adoption of the revised SVL.

The NAIC did hold a four hour Principles-Based Reserving Education Session in Washington, D.C. to educate commissioners, legislators and others on principles-based reserving and which included speakers from state insurance departments, the American Academy of Actuaries and life insurance trade associations. The session was well attended and the audience included some

commissioners. The PowerPoint presentations for the session are posted to the PBR Working Group's webpage.

Corporate Governance Subgroup

The PBR Working Group's subgroup met via conference call twice this summer to draft and finalize a state survey of existing corporate governance requirements. The subgroup was formed "to consider the type of governance requirements that would be necessary in a more principles-based regulatory environment" and the survey is meant to determine what laws and regulators states currently have in effect with respect to corporate governance, both generally and with respect to life and annuity reserves. The survey is expected to be distributed this fall.

Government Relations Leadership Council

This group is charged with monitoring and analyzing federal and state legislative/regulatory actions regarding financial services. At its meeting in Washington D.C., the council heard an update of various proposals being considered by Congress.

NAIC staff estimated that Congress's focus through the adjournment of the current session would be on legislation to stabilize the financial markets. Although there is a possibility that a lame duck session may convene after the presidential election, it was generally believed that no pending insurance bills would move forward this year. Notwithstanding, NAIC staff predicted that insurance regulatory issues would be a huge topic in 2009. The leadership council affirmed its commitment to be proactive in order to blunt any momentum in favor of an Optional Federal Charter.

NAIC staff provided specific updates to the Council on bills related to financial products and healthcare, including the following:

- Legislation enabling an Office of Insurance Information has not passed to date, although supporters are citing recent market events to justify the need for the collection of insurance industry data on the federal level;
- Legislation to pass the National Association of Registered Agents and Brokers passed in the House. There was no comparable Senate bill;
- Legislation relative to surplus lines and reinsurance passed in the House. The NAIC has renewed its request for the reinsurance

provisions to be omitted from the legislation pending implementation of the NAIC's reinsurance modernization proposal;

- H.R. 6965 was passed to extend the National Flood Insurance Program until March 31, 2009. There are still major obstacles, however, between the House and Senate that are preventing passage of a long-term solution;
- H.R. 6308, the Municipal Bond Fairness act, which would require credit ratings for municipal bonds and authorize the collection of data by the federal government on these instruments, is pending a full vote in the House. To the extent this bill also attempts to regulate reserves, the NAIC opposes it.

Statutory Accounting Principles Working Group

Public Hearing

The working group held its regular quarterly hearing to discuss proposals exposed at its prior National Meeting.

SSAP 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments. An Amendment to SSAP 43—Loan Backed and Structured Securities –At the Summer National Meeting, the working group adopted an interested party suggestion to amend the paragraph 16 guidance in SSAP 43 to require impaired securities to be written down to "fair value" instead of "discounted estimated future cash flows." That proposed change to the SSAP led to very extensive discussion during the public hearing in Washington D.C. A comment letter from a life insurance company raised concerns about the requirement to write impaired loan-back securities down to fair value. Instead, the working group was asked to return to the use of "discounted cash flows" which the life insurer believes better approximates the "economic value to a long-term holder" of the securities. Regulators and CPA firm representatives responded that if the difference is significant between fair value and the value determined by an internal cash flow analysis for a specific security, it calls into the question the appropriateness of the discount rate used in the company analysis.

The life insurance company also asked for additional guidance on the definition of "interest-related impairment" as discussed in INT 06-07.

The working group did not commit one way or the other to providing additional guidance.

The working group ultimately agreed to defer final action on adoption of SSAP 98 and will hold a conference call during the fourth quarter to continue discussion of the issues. To reduce uncertainty caused by not adopting the SSAP at the Fall National Meeting as anticipated, the chair of the working group stated they expect SSAP 98 to be adopted at the Winter National Meeting (December 7) with a January 1, 2009 effective date and to "allow for and encourage" early adoption. Subsequent to the SAP Working Group meeting, interested parties and CPA firms informally discussed the requirement to consider disclosure of the estimated effect of adoption of the new standard in the 2008 audited statutory financial statements.

SSAP 99, Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment – The working group adopted minor wording changes to SSAP 99 as suggested by interested parties. This SSAP adopts the GAAP guidance in paragraph 16 of FSP FAS115-1/ 124-1 on amortization/accretion of a previous premium/discount after impairment occurs, with an effective date is January 1, 2009 with early adoption permitted.

Deferred Premium Asset and Unearned Premium Reserve – The working group voted to defer the issue of the appropriate accounting under SSAP 61 when reinsurance premiums are paid in full upfront and the policyholder pays on an installment basis; the chair asked that interested parties, the ACLI and regulators from California and other states make a "good faith effort" to reach a compromise by year-end.

The most significant issue outstanding is whether the changes to SSAPs 51 and 61 should be prospective only or should apply to all policies, not just those issued January 1, 2009 and later. In addition, some regulators believed that the issues should be referred to LHATF a second time, while other regulators and interested parties believe the issue should stay at the SAP Working Group as the issue relates to guidance in SSAP 61. A conference call of the working group is expected to be scheduled for the fourth quarter to address these issues.

The working group also deferred consideration of a August 2008 Form A on the issue of modal reinsurance premiums from the California

Insurance Department, which was in response to the ACLI Form A exposed at the Summer National Meeting as discussed above.

Goodwill in a Merged Subsidiary – Over the strong objections by the interested parties group, the working group adopted its proposed revisions to paragraph 13 of SSAP 68 to clarify that goodwill related to a previous business combination should be written off when that entity is merged or is dissolved.

EITF 06-5, Accounting for Purchase of Life Insurance—Determining the Amount that Could be Realized in Accordance with FASB Technical Bulletin 85-4 – The working group adopted proposed changes to paragraph 6 of SSAP 21, Other Admitted Assets, to address when amounts may be admitted as assets related to these types of insurance arrangements, i.e. when the reporting entity is the owner and beneficiary or has otherwise obtained rights to control the policy.

SSAP 91R - Accounting for the Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (Revised) – The working group exposed for comment a revised SSAP 91 which proposes adoption of FAS 156, Servicing of Financial Assets, an amendment of FAS 140, with certain modifications. The most significant deviation from FAS 140 is to allow only the use of fair value to account for servicing assets and liabilities while GAAP allows both cost and fair value.

The working group noted that this SSAP is the first substantially revised SSAP done without issuing a new standard; the working group asked for comments on whether users of the SSAPs had a preference for the new or old methodology.

Clarification of SSAP 63 Regarding Intercompany Pooling Arrangements – The working group adopted previously exposed revisions to SSAP 63 to allow the settlement of intercompany pooling transactions to be reported through the Receivable/ Payable from Parent, Subsidiaries and Affiliates financial statement line items and offset against other affiliated transactions if permitted per SSAP 64, *Offsetting and Netting of Assets and Liabilities*, effective for 2008 reporting. The final guidance does require that amounts due to and from the lead entity and all affiliated entities participating in the intercompany pool be disclosed in the annual and audited financial statements.

One change not adopted by the working group was a proposed change to paragraph 5 to require the domiciliary insurance department to evaluate and approve the intercompany agreement since insurers are already required to file material intercompany reinsurance agreements with the domestic state.

SSAP 48 Audit Requirements for Non-SCA Investments – The working group re-exposed for comment a proposed change to SSAP 48 to clarify the timing of the audited financial statements of SSAP 48 entities, i.e. audits of SSAP 48 entities do not need to be completed by the filing of the insurance company investor audited statutory financial statements. The new wording requires that the investee be obligated by written agreement to provide annual audited financial statement to the insurance company investor. The wording exposed for comment also requires domiciliary commissioner approval and the working group asked for comments as to whether such approval would be onerous to companies and/or insurance departments. Since insurance companies regularly make new investments that would be subject to SSAP 48, it would appear that domiciliary approval would be required frequently.

Capital Notes – The working group adopted revisions to SSAP 41 to provide guidance on capital notes for the holders of those notes. The revisions would apply the same accounting to holders of capital notes as that for holders of surplus notes, i.e. at face value if rated by an ARO or a lesser amount if not rated and the "statement factor" calculation yields a lesser amount. The scope paragraph of SSP 41 was also revised to note that issuers of capital notes should follow the guidance in SSAP 15, Debt and Holding Company Obligations.

SSAP 23, Foreign Currency Translation – The working group voted to conclude consideration of this long-standing issue to review SSAP 23 as consensus among interested parties to amend the standard was not reached.

Consideration of FIN 46(R), FSP FIN 46(R)-4, FSP FIN 46(R)-5 Variable Interests – The working group decided to defer further discussion of this issue while the FASB reconsiders Interpretation FIN 46R. (On September 15, the FASB issued an Exposure Draft, *Amendments to FASB Interpretation No. 46(R)*, which comment period ends November 14.)

Other Items Adopted

The working group finalized rejection of the following GAAP guidance as not applicable to statutory accounting:

- SOP 06-1: Reporting Pursuant to the Global Investment Performance Standards
- FSP AAGINV-1 and SOP 94-4-1, Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans
- FSP FIN46(R)-7: Application of FASB Interpretation No. 46(R) to Investment Companies

SAP Maintenance Agenda Discussion

All issues exposed or re-exposed for public comment have a comment deadline to NAIC staff of November 3 with a public hearing at the Winter National Meeting.

Issue Paper 132 - Accounting for Pensions, a Replacement of SSAP 89 and Issue Paper 133, Accounting for Postretirement Benefits Other than Pensions, a Replacement of SSAP 14 – Both issue papers, exposed at the 2007 Winter National Meeting, propose adoption of FAS 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans with certain modifications including nonadmitting the prepaid asset resulting from the excess of the fair value of plan assets over the benefit obligation. The issue papers propose a requirement to accrue for both vested and nonvested participants, which is currently not required under SSAP 89 or SSAP 14.

The working group held a conference call July 22 to continue discussion of a detailed research memo prepared by NAIC staff that addresses four of the issues raised by interested parties at the public hearing in March, which are as follows:

1. The proposed guidance is punitive compared to GAAP because of the requirement to nonadmit prepaid pension assets.
2. Deferred tax assets created by accruing for nonvested participants should be admitted under SSAP 10.
3. The requirement to accrue a liability for all participants will force companies to amend their benefit plans.

4. The accumulated benefit obligation, not the projected benefit obligation, is the appropriate measure for defined benefit plan liabilities.

After extensive debate, the working group concluded that no changes would be made to the issue papers related to these four issues (for the same reasons stated in the research memo).

At the Fall National Meeting, the working group voted to expose for comment revised issue papers that reflect the following changes:

- Clarify the specific guidance being adopted from FAS 158
- Add guidance on the recognition of prior service costs for nonvested employees that requires such unrecognized prior service cost to be amortized as a component of net periodic cost by assigning an equal amount at each expected future period of service for each nonvested active at the date of adoption.
- Include guidance for consolidating/holding company plans that was inadvertently omitted in the first draft
- Clarify the transition guidance (discussed below)
- Expand the Discussion section of the issue papers to document working group research and key issues considered.

The transition guidance for both pensions and OPEB is as follows:

- For entities for which the surplus effect on an individual basis for each plan is less than 1% of surplus, full recognition is required as of December 31, 2009.
- All other entities can elect to defer recognition of the surplus effect of adoption for a period not to exceed five years with a minimum of 20% for the year ending December 31, 2009.

The working group briefly reviewed the results of the industry-wide survey conducted to ask companies their views on the adoption of Issue Papers 132 and 133. Thirty-three companies responded, twenty-four of which objected to the conclusions in the issue papers and nine of those respondents objecting because of the surplus effect. For the 24 companies objecting to adoption, eighteen noted that their view would

change to support adoption if the prepaid asset related to overfunded plans were to be admitted or the DTA related to underfunded plans were to be admitted.

Measurement of Sufficient Collateralization in Securities Lending Transactions – The working group held a conference call on July 30 to discuss issues related to collateral in securities lending transaction. The Form A proposes revisions to SSAP 91 to clarify that the adequacy of cash collateral received by the insurance company lender, which has been reinvested, should be measured by the fair value of the collateral obtained at inception of the transaction. The Form A also proposes that reinvested collateral, both on and off balance sheet, should be assessed for other-than-temporary impairments.

During the conference call several tentative conclusions were reached. There was consensus that additional disclosures in the annual statement should be required (but that adoption for 2008 financial statements was doubtful). Several regulators expressed the opinion that the definition of restricted and unrestricted collateral needs to be clarified and that the collateral should be recognized on the balance sheet when the insurance company lender has the reinvestment risk of the reinvested collateral.

Further discussion of the issues was deferred at the Fall National Meeting. A conference call will be scheduled for the fourth quarter and will include discussion of the issues discussed above as well as how to apply the nonadmitted asset requirement when cash collateral is received and then reinvested.

FAS 162, The Hierarchy of Generally Accepted Accounting Principles – The working group exposed nonsubstantive changes to the Preamble's Statutory Hierarchy of the APP manual. The proposed revisions adopt FAS 162, with an exception to eliminate a commitment to review all FASB Staff Positions (FSPs) issued prospectively as FSPs have been moved to Level 1 guidance.

FAS 163, Accounting for Financial Guarantee Insurance Contracts – The working group voted to add consideration of FAS 163 to its active agenda and directed NAIC staff to draft an issue paper which would proposed substantive revisions to SSAP 60, Financial Guaranty Insurance. During the brief discussion of this issue during the meeting, the chair noted that the drafting of an

issue paper is just a first step in the process and the FAS 163 guidance on claim liability recognition is a significant departure from current SAP. The Form A on FAS 163 includes NAIC staff recommendations on many issues including the recommendation that the requirement for a contingency reserve not be removed. The Form A is included in the Advance Materials for the Fall National Meeting on the SAP Working Group's homepage.

A&H Claims with Multiple Dates of Service – The working group reviewed a Form A from the Kansas Insurance Department requesting guidance on the determination of the "incurred date" for accident and health claims with multiple dates of service under one covered event. The working group voted to refer the issue to the A&H Working Group for its consideration.

Disclosures for Funding Agreements Issued to a Federal Home Loan Bank

The working group discussed a referral from the EAIWG on the appropriate disclosures due to the increasing number of insurance companies that are members of FHLBs and the use of funds from such banks. The working group voted to expose for comment six new disclosure items to be included in SSAP 52, Deposit-Type Contracts, including a general description of the nature of the agreement with the FHLB, type of funding and intended use, the elements with the agreement that support the accounting as either debt or funding contract and other detailed disclosures.

Portfolio Reinsurance Agreements Between Affiliates – The working group discussed a new Form A which requested that SSAP 62 be amended to allow prospective reinsurance accounting between entities that are 100% owned by a common parent when there is a gain in surplus, but which is the result of the allowance of a ceding commission associated with unearned premium on the policies transferred. The chair seemed receptive to the concept but stated he does not want to inadvertently allow ceding commission to be permitted on wholly retroactive loss portfolio transfers. The proposal was not exposed for comment, but this issue will be included in a future conference call of the working group.

Other Items Exposed

The working group exposed for comment rejection of the following GAAP guidance as not applicable to statutory accounting:

- FSP FAS 142-3, Determination of the Useful Life of Intangible Assets
- SOP 01-6: Accounting by Certain Entities (Including Entities with Trade Receivables) That Tend to or Finance the Activities of Others

Consideration of FIN 48 – The working group heard a brief update from the FIN 48 Subgroup, which held a conference call July 28 during which the subgroup discussed the surplus effect of the proposed adoption, and that the draft issue paper was amended to address the "whipsaw effect" of establishing a FIN 48 liability, resulting in a DTA that would otherwise be nonadmitted. The subgroup directed staff to draft an SSAP consistent with the conclusions of the issue paper (i.e. adoption of FIN 48 at the legal entity insurance company level). The subgroup is anticipating that interested parties will submit a proposal to amend the draft guidance to allow adoption to be "surplus neutral." Once the proposal is received, the subgroup will hold a conference call to consider it, likely during the fourth quarter.

Accounting for Life Settlement Contracts by Third-Party Investors – The working group deferred consideration of this pending a recommendation from the Valuation of Securities Task Force, who in turn is waiting on additional information from the sponsor of the proposal (ACLI).

Amendment to the Permitted Practice Notice Requirement – The working group adopted its proposed revision to paragraph 55 of the Preamble to the Accounting Practices and Procedures Manual to require a five day advance notice period for requests for permitted practices, instead of the current 30 day notice requirement.

Update from Fair Value Subgroup – The working group heard a brief report from the chair of the subgroup, which held two conference call meetings during August to continue its review of FAS 157 and which elements are appropriate for statutory reporting. Subsequent to the conference calls, a "discussion draft" of a proposed SSAP entitled Fair Value Measurements was posted to the SAP Working Group's webpage, which proposes adoption of FAS 157 with some modifications. The most significant deviations are revisions to "clearly indicate that consideration of non-performance risk (own credit risk) should not be reflected in the fair value measurement for liabilities." No proposed effective date has been included in the draft.

A second discussion draft has also been posted for comment which identifies all references to "fair value" in the Accounting Practices and Procedures manual and proposes revisions to the individual SSAPs to make the guidance consistent with the proposed SSAP on fair value. Twenty-three SSAPs and the Glossary include references to fair value so the changes are extensive. Comments on both discussion draft documents are due to the NAIC by October 17.

The subgroup has concluded that they will not be able to finish the project in time to be effective for 2008 financial statements. As a result, FAS 157 disclosure requirements will need to be considered under generally accepted auditing standards for the 2008 audited statutory financial statements. This disclosure issued was referred to the NAIC/AICPA Working Group; see that summary on page 14.

Update from the Separate Account Subgroup
The working group received a report from its subgroup, which was formed to consider AICPA SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts. The subgroup held a conference call August 26 to continue its review of which elements of the SOP are appropriate for statutory reporting. It was reported that the subgroup has agreed that it will first focus on improving disclosures, reporting schedules and annual statement instructions to better understand the nature, operation and risk of the myriad of separate accounts.

To address solvency concerns created by separate account products with general account guarantees, the subgroup is considering amendments to SSAP 56 to require risk charges for both individual and group separate accounts that have these features. It is not current contemplated that SSAP 56 would be amended to be consistent with the SOP 03-1 guidance that only separate accounts meeting specific criteria receive single line item treatment in the balance sheet. However, no proposals have been exposed for comment.

At the Summer National Meeting, it was noted that the subgroup would conduct a second survey to gain a comprehensive understanding of the various types of separate accounts offered in the marketplace. The survey was completed this summer and although the results have not been released, the subgroup indicated that it confirmed the assumption that there is a very wide variety of products offered through separate accounts and a

lot of diversity in practice of which products qualify as a separate account in each state.

Emerging Accounting Issues Working Group

The working group continued work on new and previously addressed issues as discussed below. All issues exposed for comment have a comment deadline of November 3.

INT 08-06, FSP EITF 00-19-2: Accounting for Registration Payment Arrangements – The working group approved a final consensus to adopt this guidance, which requires separate recognition of contingent obligations.

INT 08-07, EITF 07-6: Accounting for the Sale of Real Estate Subject to the Requirements of FAS 66 when the Agreement Includes a Buy-Sell Clause – The working group adopted as final a consensus to adopt EITF 07-6, which requires that all relevant facts are to be evaluated with respect to a buy-sell clause to determine the impact of the continuing involvement analysis.

INT 08-08, Disclosures for Funding Agreements Issued to a Federal Home Loan Bank

The working group exposed for comment this Interpretation, which reflects the consensus the regulators reached at the Summer National Meeting: arrangements with an FHLB should be accounted for based on the substance of the transaction. For example, when FHLB funding agreements are used as part of a yield enhancement strategy, they would be accounted for as a deposit-type contract in accordance with SSAP 50 and SSAP 52. When done for other purposes, the funding agreement would be considered debt.

Contractual Terms of Investments and Investor Intent – In response to numerous inquiries to NAIC staff, the working group discussed investments in securities with terms that are reset at predefined dates or have other features an investor believes may result in a different term than the related contractual maturity, such as auction-rate securities, which interest is regularly reset through a Dutch auction. The working group concluded that such securities should be accounted for based on the maturity at the date of acquisition except where other specific rules within SAP currently exist.

EITF 04-10: Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds – The working group exposed for comment a tentative consensus to reject this guidance as not applicable to statutory accounting.

EITF 05-7: Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues – The working group agreed to remove this issue from its agenda as the guidance has now been superseded by EITF 06-6, Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments.

International Solvency and Accounting Working Group

Interim Meeting

On September 3, the working group held a joint meeting with the Financial Condition Committee to discuss the Solvency Modernization Initiative. The following summarizes the public meeting, which was followed by a regulators only meeting on September 4.

Presentation on Solvency Modernization Initiative
In June 2008, the work plan for the Solvency Modernization Initiative was adopted with a charge to analyze other financial supervisory modernization initiatives and identify areas for U.S. regulators to consider including in the current NAIC programs. Analysis and comparison to other supervisory approaches will include Basel II for banks; solvency work done by the International Association of Insurance Supervisors (IAIS); solvency proposals under consideration in Australia, Canada and the E.U.; and accounting standards being developed by the IASB. The work plan also includes following developments in Europe on the impact of Solvency II on U.S. insurers and reinsurers doing business in Europe.

The SMI is put forth as the next logical step in U.S. insurance regulation that started with risk-based capital requirements in the 1990s, codification of accounting principles in 2001, governance via the Model Audit Rule and proposals around reinsurance and principles-based reserving. Competition is also a factor driving the comparison of the current U.S. regulatory approach to where the foreign regulators are heading. The Virginia Commissioner questioned whether there could be a "division of standards between internationally active and domestic" companies, where there might not be a level playing field between U.S. companies with different mixes of business.

Another competitive question raised was whether foreign-based companies would have a competitive advantage in U.S. markets by way of lower group-wide capital requirements relative to U.S. based companies.

Presentation on Capital Requirements

This exploratory session included wide-ranging discussions around the comparison of capital requirements from a U.S. regulatory perspective as compared with other measures (eg. economic capital, rating agency capital, IAIS Prudential Supervision). The American Academy of Actuaries also presented a comparison between a proposed U.S. principle-based approach (PBA) and international solvency frameworks (eg. Solvency II). Related to all of this was a discussion on whether risk-focused examinations have been successful to date, with commentary from commissioners suggesting some diversity in practice. Concerns were raised as to whether companies were ready to provide that level of insight to regulators and whether the legal system was ready to authorize action in a system without bright lines on which to compare actual results. Enterprise Risk Management (ERM) was also discussed as a possible basis which a regulator could use to go about its functions.

Presentation on Group Issues

A representative from the Chief Risk Officer Forum addressed the concept of group supervision proposed under Solvency II. Key features of group supervision were presented by the CRO Forum as 1) the mechanism by which diversification benefits are recognized and active capital management facilitated and 2) more efficient management of key group supervisory issues (eg. consolidated method for determining group solvency, risk concentrations, risk management, information exchange between solo and group supervisors). This aspect of Solvency II has yet to be finalized.

Presentation on International Accounting

Current developments outside the U.S. are causing the ISAWG to begin to evaluate the impacts of International Financial Reporting Standards on statutory accounting principles. Presentations were made by the Group of North American Insurance Enterprises (GNAIE) and the American Academy of Actuaries. Presenters suggested that one driver is the SEC's announcement of a Roadmap that may replace U.S. GAAP with IFRS as the accounting basis for public companies in the U.S. If this were to ultimately impact the future maintenance of U.S. GAAP standards, options to consider could include 1) developing a Codification

II process to evaluate IFRS as the basis for SAP or 2) utilizing IFRS for statutory accounting purposes.

It was also noted that regulators in the EU and elsewhere are considering General Purpose Accounting or adjusted General Purpose Accounting rather than a separate statutory accounting basis. It was noted that Canada is likely to use IFRS as their regulatory basis after their 2011 adoption of IFRS. Separately, Solvency II was noted as yet another driver for consideration of IFRS due to the connection between those two initiatives.

It was recognized that IFRS does not currently have a comprehensive insurance contract valuation standard and therefore that a full analysis of the appropriateness of IFRS will need to take into account the Phase II project as it develops. An exposure draft is expected in the second half of 2009 with the potential standard issued in 2011. It was observed that IFRS Insurance Contract Phase II project has many unanswered questions, such as the most appropriate measurement basis for insurance contracts on a statutory basis, a single model for treatment of life and non-life contracts, and how to apply discounting and risk margins. However, it was noted that in theory, the Phase II standard and the NAIC's Principle Based Reserving Initiative are both expected to be "principles-based." Discussion about the Phase II discussion paper also included day one gains, current exit value versus "contract fulfillment value" and market vs. entity specific assumptions.

Overall, regulators acknowledged the global pressures to consider IFRS and/or fair value based accounting and regulation, but they were also doing so from a perspective that the current accounting and regulatory system is adequate to meet their needs. As such, the evaluation of these matters is expected to be comprehensive and measured. As an example, the Pennsylvania representative stated that the most important overarching consideration was to take the appropriate time to complete the process. He said that regulators needed feedback on the prioritization of the initiative. The chairs of the working group and committee asked interested parties to provide written comments and asked that they provide priorities in their comments

Fall National Meeting

Due to a regulator-to-regulator session to discuss issues regarding Basel II with the Office of Thrift Supervision, the working group held only a brief

discussion on the following items during the Fall National Meeting:

Update on Solvency Modernization Initiative

The working group emphasized that in the light of recent market events, it was probably "time for reflection and a careful examination" of what has happened. The working group noted that regulators need to determine what lessons are to be learned from the recent turmoil and that there had "clearly been a failure of risk management systems by sophisticated entities."

The working group asked NAIC staff to draft a document by October 31 that summarizes the non-accounting issues that will need to be considered in the Solvency Modernization Initiative for review by the working group prior to exposing the document for a 45-day comment period.

Per the request of the International Insurance Issues Committee, NAIC staff prepared a document that compares U.S. and EU solvency systems in regards to the principles, accounting, capital resources and related calculations, group supervision, reinsurance, and various other issues. This analysis of U.S./EU Solvency was released for further comment by October 31.

In addition, the working group will recommend to the Financial Condition Committee to draft a single comprehensive document describing the U.S. regulatory framework.

IAIS Subcommittee Update

The working group stated that the solvency subcommittee papers need a second review "based on the new information gained from the recent collapses of financial institutions." It was noted that there were a number of areas of overlap between the solvency subcommittee and the new corporate governance subcommittee, and the papers should be reviewed again in the light of the recent market events.

Commissioner Gross noted that there were three papers due for adoption in Budapest in only a couple of weeks. The three papers are 1) Issue Paper on Group-wide Solvency Assessment, 2) Principles for Group-Wide Supervision and 3) Role of the Group-Wide Supervisor. He asked that members closely review these papers, focusing specifically on the structure of capital, enterprise risk management, and internal models papers. The working group announced that an interim conference call would occur in the near term and

that NAIC staff would redistribute the papers to the working group.

Update on IASB Activities

Based on the recent report by the NAIC staff, the most significant event since the Summer National Meeting was the announcement by the SEC, after a unanimous vote of the SEC Commissioners, that they will promulgate a "Roadmap" for the adoption of International Financial Reporting Standards in the United States with effective dates between 2013 and 2015. The SEC has identified a number of milestones that will need to be cleared before the plan can go into operation. The SEC will make a final decision based on these milestones in 2011

In addition to the insurance contracts guidance discussed above, the Board continues to work on improving the fair value guidance for illiquid market and improving the liquidity and sensitivity disclosures in IFRS 7.

Project to Consider IFRS for Statutory Reporting

The working group requested that the Statutory Accounting Principles working group accumulate and summarize information from regulators, industry, auditors and others, on implementation issues related to transitioning to IFRS for statutory reporting, as well as some of the more significant issues that would need to be considered in implementing such a change.

International Insurance Relations Committee

The committee approved the 2009 charges to strengthen the international insurance regulatory system and provide a forum for cooperative efforts between the NAIC, international regulators, and multinational associations of regulators on issues of mutual interest. The committee is also charged with providing support to the federal government in insurance related trade issues.

International Relations Leadership Group:

The committee discussed the newly-created International Insurance Relations Leadership Group which will oversee development of guidance on NAIC involvement in international standard setting and trade issues. Specifically, charges for the 2009 year include:

- Monitor and analyze federal legislative/regulatory actions with international implications regarding financial services

- Work with other standing groups and communicate NAIC's policy views to the IAIS
- Develop a strategy and program for directly engaging NAIC members with non-U.S. insurance supervisors and international organizations.

IAIS Reports

The committee received reports on the International Association of Insurance Supervisors, including the addition of two NAIC members to the Executive committee in October, and the Annual Conference in Budapest.

IAIS has been actively working on closer cooperation and convergence among financial regulators, including the development of a global insurance solvency framework, principles on group-wide supervision, and implementation of a multilateral memorandum on understanding.

Blanks Working Group

The working group adopted six blanks proposals as final, including those discussed below which are effective for the 2009 annual statement unless otherwise stated.

- Revisions were made to the instructions to Exhibit 4 - Dividend or Refund statement of the life annual statement to clarify that coupons should be included in this exhibit. (Agenda item 2008-27BWG)
- Instructions were added to the Five Year Historical Page regarding the restatement of prior year numbers and disclosures when the reporting entity is part of a statutory merger. Consistent with SSAP 3, the two most recent years should be presented on a merged basis. (Agenda item 2008-28BWG)
- The reference to Medical "Malpractice" in all quarterly and annual statement instructions and schedules was changed to Medical "Professional Liability". This change is effective for the first quarter of 2009. (Agenda item 2008-30BWG)
- The instructions to Schedule H for the calculation of earned premium were clarified to exclude advanced premiums, consistent with SSAP 54. (Agenda item 2008-31BWG)

- A CUSIP identification column was added to Schedule DA, Part 1. Entry of the CUSIP identification number is only required and valid for certain money market mutual funds. (Agenda item 2008-33BWG)
- A market conduct contact was added to the electronically captured version of the Jurat page of the quarterly and annual statement, effective for the first quarter of 2009. (Agenda item 2008-03BWG)

Four previously exposed blanks proposals were withdrawn by the sponsors, including one which would have made substantial changes to the reporting of derivative holdings in Schedule DB (Agenda item 2008-29BWG) and another which would have add questions to the Supplemental Exhibits and Schedules Interrogatories for the collection of a proposed Market Conduct Annual Statement and certificate of compliance (Agenda item 2008-32BWG). The sponsors of the Schedule DB proposal are working with regulators to develop a revised proposal, which they expect to be back on the Blanks Working Group agenda by the 2009 Spring National Meeting.

The working group also exposed new proposals for comment, which ends November 5. Some of the more significant exposed proposals would:

- Add reference to inclusion of income tax amounts from Intercompany tax sharing arrangements in Schedule Y of the health annual statement. (Agenda item 2008-34BWG)
- Modify the instructions for the time frame to be used in responding to the quarterly general interrogatories. (Agenda item 2008-35BWG)
- Add Exhibit 1, Direct Premiums and Deposit-Type Contracts, to the fraternal quarterly statement to be consistent with the life quarterly statement. (Agenda item 2008-36BWG)

All Blanks proposals, including those adopted and exposed for comment, can be viewed at the NAIC's webpage for the Blanks Working Group.

Report from the Premium Survey Subgroup

The subgroup, formerly known as the Schedule T subgroup, held two conference calls in September in response to the Financial Condition Committee charge to survey the states regarding the methods of allocating premiums that are acceptable for the

purposes of taxation and guaranty fund assessments.

A draft survey is expected to be completed in October which will be presented to the Financial Condition Committee for approval. Surveys will be sent to all states with a 30-day response period. The outcome of the survey may result in the reconsideration of recently adopted Schedule T instructions which permit allocation of group insurance premiums based upon situs or location of risk. The subgroup will meet via conference call on October 7.

Report from Property & Casualty Subgroup

The subgroup is currently considering two blanks proposals, one which would require bail bonds to be reported separate from surety and another which would require motorcycle coverage to be reported separate from auto coverage within the annual statement. The subgroup held one conference call during to discuss these charges and plans to meet on October 15 to continue its discussion.

NAIC/AICPA Working Group

MAR Discussion Items

The working group updated its ongoing survey of the progress of states' adopting the revised Model Audit Rule (MAR), which has a proposed effective date of January 1, 2010. As discussed in previous meetings, Virginia and Alabama have completed adoption of the revised MAR, which are consistent with the NAIC's version, i.e. a requirement for management to attest on internal controls beginning with 2010 financial statements. Since the Summer National Meeting, Oregon has adopted its proposed changes. Other state activities include the following:

- Connecticut, Delaware, Nebraska, South Carolina and Wisconsin have exposed revised regulations for public comment.
- Alaska has adopted enabling legislation but has not yet released proposed regulations to adopt the changes. California has released but not yet adopted its enabling legislation.
- Of the remaining states, eighteen jurisdictions reported to the NAIC that they plan to present amendments to their state legislatures or revise current regulations in 2008. Another 27 are planning for a 2009 adoption; three states reported that their plans are not yet known.

The results of the quarterly survey of states' plans for adoption is available on the NAIC's website at http://www.naic.org/documents/committees_e_naic_aicpa_wg_survey_mar_fall08.pdf

Referral from the PBR Working Group

The PBR Working Group asked for assistance from the NAIC/AICPA Working Group on understanding the type of work that is contemplated by the independent auditors and whether such work would evaluate the insurer's methods, models, assumptions and margins under PBR. The AICPA issued a comment letter dated August 18, which was discussed by the working group at this meeting. Key points include the following:

- The auditor's opinion is on the financial statements taken as a whole, not on individual balances such as benefit liabilities.
- Materiality is considered in designing the nature, timing and extent of audit procedures. Benefit liabilities are typically the most significant liabilities in a life insurer's financial statements. However, the current PBR proposal would be implemented on newly issued contracts, not all in-force contracts. If principle-based reserves are not material to the financial statements taken as a whole, the auditor may conclude it is appropriate to limit or perform no audit procedures.
- When the auditor determines audit procedures are required, such procedures may include some of the following: obtain and read the PBR Actuarial Report, gain an understanding of the methodologies and assumptions used, gain an understanding of the relevant controls around the PBR process, evaluate the design of those relevant controls and determine whether those controls have been implemented, test the operating effectiveness of those controls to be relied upon, perform analytical procedures, test data integrity, review the company's validation procedures of the reserve model and perform independent reserve model validation procedures.

The working group referred the comment letter to the PBR Working Group.

Presentation from AICPA on Risk Assessment Standards

At the request of the regulators, representatives from the AICPA gave a presentation on the new

and revised risk assessment auditing standards (SAS Nos. 104-111), the objective of which is to guide auditors to areas of greatest audit risk, whether caused by error or fraud. The presentation focused on the risk assessment process and how the revised standards differ from previous standards.

Quarterly AICPA Update

An AICPA representative reported that the Auditing Standards Board recently finalized revisions to Statement on Standards for Attestation Engagements No. 15, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated with an Audit of Its Financial Statements*, which is effective for integrated audits for periods ending on or after December 15, 2008.

The revisions include guidance to be consistent with PCAOB Auditing Standard No. 5.

Referral from SAP Working Group

The working group very briefly discussed a referral from the SAP Working Group requesting assistance from the working group and the AICPA on drafting sample disclosures for GAAP disclosure pronouncements whose consideration has not yet been completed for SAP. The referral from the SAP Working Group includes FAS 157 and FIN 48 disclosures as examples but notes there could be additional applicable disclosures. A conference call will be scheduled to discuss the referral and related issues.

Valuation of Securities Task Force

The task force met in Washington D.C. and discussed the following issues:

Securities under Regulatory Review

The task force reported that there are currently no securities under Regulatory Review. In other words, in 2008, the Securities Valuation Office has not made a determination that a security filed with it cannot be analyzed because of the lack of either an NAIC policy governing the security or the asset class or the lack of an appropriate methodology. Therefore, no insurance company should use the administrative symbols NR* or Z* to report securities to their state regulators for year-end 2008 reporting.

Expand Filing Exemption for Common Stock

The task force noted that there is a conflict between valuation related reporting instructions in the filing exemption for common stock in part four of the Purposes and Procedures (P&P) Manual

and valuation procedures applicable to all securities contained in part six of P&P Manual.

The filing exemption applies to common stock that is not restricted as to transferability and is listed on specific named exchanges. In other words, this rule requires insurers to report common stock that is restricted and common stock that is traded on any other than the named exchanges.

The new valuation procedures apply to all insurer-owned securities. The procedure requires insurers to report a fair value determined in accordance with one of the five permitted methodologies and to identify the source of fair value. The valuation procedure does not impose any criteria or condition on exchanges that can serve as sources for fair value of reported securities which conflicts with the specific named exchange criteria noted above.

The task force instructed the NAIC staff to work with interested parties to develop new language for the Purposes and Procedures Manual to expand the Filing Exemption for common stock to include all exchanges.

Report of the Derivatives Market Study Working Group

The task force heard and adopted the report from its working group, which is coordinating with the interested parties to revise and finalize the blanks proposal for Schedule DB.

NAIC staff recently conducted a survey of the states to determine whether Model Derivatives Regulation 282 should proceed with a requirement for written derivatives use plans that can be filed and used or should prior Commissioner approval be required. Based on the survey results, most states do not currently have procedures to permit the department to conduct a review of a derivative use plan and would have to develop such procedures. The majority of states also responded that they do not believe it is consistent with best regulatory practices to permit a company to engage in derivative activity before the department understands what the company proposes to do. In addition, most states responded that company should have to demonstrate that controls are adequate before permitting the company to engage in derivative activity.

Changes to Purposes and Procedures Manual

The task force adopted new language for the P&P Manual that would make the process for placing securities under regulatory review more

transparent by requiring a public declaration by the task force of any security placed under regulatory review. The task force voted to defer any action at this time on a new blanks proposal regarding securities under regulatory review and their reporting within Schedule D.

Referral of Hybrid RBC Working Group:

The task force voted to implement the recommendations of the Hybrid RBC Working Group which include development of a matrix of investment risks to be used to adjust the classification of investments; consider the use of the risk focused surveillance framework to assess whether known risks exist in new securities; and to look at risks other than credit to determine if they are reflected in the current regulatory regime. The new tasks will be assigned to the current ongoing work of the Invested Asset Working Group.

Announcement from SVO on Certain Money Market Funds

On September 26, the Securities Valuation Office made the following announcement:

"The SVO is removing the six (6) Reserve money market funds from its "approved" list on September 30th, 2008. To be eligible for inclusion on the SVO's "approved" Class 1 Money Market Fund List a fund, among other things, 1.) must have a minimum rating of "A" or better from Moody's, or "Am" or better from S&P, or similar ratings from the other NRSROs; 2.) must maintain a constant net asset value of \$1.00 at all times and 3.) must allow a maximum of seven-day redemption of proceeds. [Certain] Reserve funds no longer meet one or more of these requirements making them in-eligible for inclusion on the list. There are six additional Reserve Funds that have been downgraded to "B" by Moody's and put on Negative Watch by S&P that remain on the "approved" list. We will continue to monitor these funds. Additionally, Putnam's Prime Money Market Fund is being removed at month-end from the "approved" list because the funds management announced it was being closed and liquidated."

The specific CUSIPs of these funds are available from the SVO.

Invested Asset Working Group

The working group met via conference call September 9th. Issues discussed include the following:

Technical Advisory Risk Subgroup

The working group received an update from its Technical Advisory Risk Subgroup, which charge is to identify and define all known investment risks in individual fixed income securities and to opine whether and how they are addressed in the current regulatory framework or, if not currently addressed, how they might be addressed. The subgroup consists of regulators, NAIC staff and industry persons with backgrounds in regulation, finance, capital markets, risk management, actuarial science, accounting, law and regulatory financial reporting.

The subgroup reviewed 28 potential individual security risks but determined that only eight of those risks (i.e., credit, event, liquidity, call, extension, deferral, currency and leverage) are present in fixed income securities. The subgroup developed definitions for each of these eight risks. The report of the subgroup includes five exhibits. Exhibit One identifies and defines the eight individual security risks. Exhibit Two lists those risks found not to be individual security risks. Exhibit Three presents the views of the subgroup as to how the eight identified individual security risks are addressed in the current regulatory framework and presents recommendations for improvements. Exhibit Four discusses financial innovation, a risk that the subgroup concluded is in need of improvements in the regulatory process but a more appropriate way of looking at it is as a subset of operational and management risk. Exhibit Five explains how default losses and recovery rates are accounted for by credit rating organizations. The report was released for a 60 day comment period.

Policy Statement on Transparency Process

The charge for the Policy Statement originated with the five separate procedures adopted by the Valuation of Securities Task Force to improve transparency in how the NAIC makes and communicates regulatory guidance on securities. An important aspect of the initiative is that the NAIC acknowledged that market participants are one of its constituencies and committed to creating a process to allow greater and speedier contact between regulators and market participants.

The working group voted to expose two documents related to this charge, which are posted to the VOS Task Force's webpage: Policy Statement on Transparency of Regulatory Decision Making for New Investment Products for the Purposes and Procedures Manual and Investment Risk

Assessment Worksheet. Comments are due by November 7.

Periodic Reporting of Exposures

During the interim meeting, the working group discussed a recent survey to identify what information regulators need to better understand investment exposures of insurance companies. Thirty-four responses were received; 31 out of 34 states responded that they have a need for information on investment exposure associated with quarterly and annual review processes as well as special examinations. The survey also indicated that while the departments are very interested in invested assets that become the focus of attention in the financial press, there is also significant interest in asset classes not under public scrutiny. This suggests an interest in general information reports on specific asset categories, such as real estate investments and a need for a more formal monitoring process at the SVO which the staff would like to follow up on. The working group has asked the SVO to develop plans for an expanded monitoring process.

Use of Pricing Information in Regulation

The working group received a report from NAIC staff regarding how development of analytical tools that would show whether market price for different strata of credit risk could be helpful to regulators monitoring insurer portfolios. The NAIC staff used credit default swaps indices that are widely available for price data. A limitation of this choice is that some indices only provide information on credit spread out to five years. The key objective of the analysis is to compare the credit spreads of the securities in life insurer portfolios to the benchmarks to identify certain securities that require more focus by the regulators. If deemed necessary, similar analysis could be performed by the SVO or by insurance departments.

Database Symmetry and Examiner Priority Code Projects

The working group also discussed the status of the database symmetry and examiner priority code project. The database symmetry is an information system initiative to assign group codes to insurer owned securities in NAIC securities databases so these securities could be aggregated by asset type and details about the attributes of securities within each group could be developed. The system would give regulators a snapshot of company and industry exposure to specific assets classes using information from vendors instead of increasing the information burden on insurers.

The examiner priority code project involves attaching brief narratives of the type of risk associated with a given group of securities and then assigning a relative priority level. The priority level would be an internal NAIC tool permitting regulators to more efficiently allocate resources to those security groups that contain the greatest risks in relation to the then current economic climate. A priority code could help regulators highlight specific classes that may need further analysis.

The working group is soliciting industry comments; the projects are intended as internal analytical tools and would not impose information requirements on the industry.

Capital Adequacy Task Force

The task force met via conference call July 11 and September 16 and again in Washington D.C. and discussed the following items.

Principles-Based Reserving

The task force discussed its charge to consider changes to the life RBC formula and other related items which may be necessary in conjunction with the principles-based reserving initiative. The task force will create a task plan and provide periodic updates to the Principles-Based Reserving Working Group. The chair of the task force recommended that such solvency modernization be compared to Solvency II, the international standard, and that the task force would work with LHATF on this project through a joint subgroup. Consideration of Solvency II was evident in other RBC meetings in Washington D.C. During the meeting of the Catastrophe Risk Subgroup, the subgroup discussed how various tentative conclusions with respect to the catastrophe risk charge compared to Solvency II capital formulas.

Risk Retention Group Task Force Referral

The task force received a referral from the Risk Retention Group Task Force to develop a RBC formula specific to captive RRGs. The task force noted that the P/C RBC formula is not useful as captives generally prepare financials on a Generally Accepted Accounting Principle basis and frequently utilize letters of credit as capital. The task force discussed possible options and decided to pursue a relatively simple RBC sensitivity test to make the RBC formula adaptable to RRGs. The task force requested NAIC staff to draft such a proposal for discussion at a future meeting.

Hybrid Securities Referral Document

The task force discussed recommendations included in the final report of the Hybrid RBC Working Group. The recommendations are primarily addressed by other working groups. However, the task force will consider the impact on capital adequacy that may result from any changes made as a result of the recommendations.

LHATF/CADTF Joint Subgroup

The task force agreed to reconvene its subgroup which will be working on two issues:

- Assist the Principles-Based Reserving Working Group with its "to-do list" including coordination of principles-based reserves and capital issues with LHATF and the Life RBC Working Group.
- Compare capital required by the RBC formula to that required by the European Union Solvency II and ultimately determine whether any improvements to RBC are warranted.

C-3 Results Subgroup

The task force re-established its C-3 Results Subgroup, which will be reviewing and updating documentation on C-3 Phase II data that had been previously collected.

Life Risk-Based Capital Working Group

The working group met face to face for the first time in several months. There were also two interim conference calls since the Summer National Meeting.

Life RBC Trend Test

The working group rejected a proposal from Pennsylvania to raise the Life RBC trend test threshold from 250% to 300%, which would make the Life RBC formula consistent with a similar test for P/C RBC. The chair noted that in the last 5 years, an average of less than 3 companies per year fell into the 250% to 300% range. In addition, a change to the trend test would require a change to the RBC Model Law, which is an accreditation standard. Although they rejected the proposal because it would result in little benefit to regulators, they requested data for companies with even higher RBC levels be gathered and presented.

C-3 Phase III

The working group also discussed details of C-3 Phase III including how changes in experience after the valuation date should be included. The group is working towards guidance that will require

companies that are close to the action level to re-run their stochastic models using year-end data and require an additional filing if the results changed by a yet undetermined percentage.

Other Matters

The working group discussed a year-old recommendation to the Capital Adequacy Task Force to consider implementing a RBC credit for derivative hedges. The ACLI volunteered to work on a study to address this recommendation.

Also on the agenda for the meeting was discussion of a proposal from the ACLI to modify the mortgage experience adjustment factor because of the potential material effect on RBC due to volatility in the MEAF. A representative from the ACLI stated that they are still working on the proposal, which they anticipate presenting at the Winter National Meeting.

P/C Risk-Based Capital Working Group

The working group did not meet since the Summer National Meeting but its Catastrophe Risk Subgroup did meet in Washington D.C.

Catastrophe Risk Subgroup

The subgroup has been charged with evaluating the possibility of developing a RBC charge for catastrophe risk and of using catastrophe modeling to develop that charge.

The meeting was spent reviewing a newly released Catastrophe Risk Charge Issues Discussion Points document which summarizes nine issues raised as a result of comments received on the draft proposal. Significant tentative conclusions and/or changes to earlier drafts include the following:

- The subgroup agreed with interested parties that a 1-in-100 year event standard, which is line with what is used by rating agencies, should be used instead of the original proposal of 1-in-250 year standard.
- The proposal was not changed to give credits for tax loss carrybacks and carryforwards. The subgroup heard from several interested parties that at a minimum credit should be given for tax loss carrybacks as those amounts are fixed and do not require the entity to show taxable income in the future.
- The subgroup clarified that the proposal will not require the results of three commercially available modes to be averaged for the

calculation of the risk charge. However, this is still the stated preference of the subgroup.

- The proposal will allow companies to make their own choices of key parameters in their RBC calculations but will require management to describe in the RBC report the treatment of each key parameter for both internal risk management and for RBC purposes and an explanation of any assumptions that differed from the RBC standard assumptions.
- With respect to the verification of modeling data used, the subgroup has agreed to remove the requirement for an external audit of the modeling data after the AICPA commented that such work would have to be done as an "agreed-upon procedures" engagement. There was extensive discussion of the requirement for management attestation of data used. The chair noted that "management attestation is one of the primary requirements" that the subgroup is looking for in the proposal.

At the conclusion of the meeting, the chair noted that a revised proposal will be exposed for comment shortly, with comments due within 30 days. A conference call will be scheduled during the fourth quarter.

Health Risk-Based Capital Working Group

The working group held a conference call on June 12 and discussed the issues below. The August 28 interim call was cancelled and will be rescheduled shortly.

Health RBC Trend Test

A representative from the American Academy of Actuaries provided an update on the Health RBC Trend Test. The AAA HRBC Trend Test Work Group (AAA Work Group) benchmarked its work against a default proposal, which consists of a Health RBC ratio between 200% and 300% and a combined ratio greater than 105%. The AAA has also reviewed companies that are identified as a false positive to determine if those companies have characteristics that would otherwise need the attention of a regulator such as rapid growth causing the need for additional capital.

A report from the AAA Work Group was presented during a September regulators only conference call. However, the results of this meeting were not discussed during the Fall National Meeting as a result of the cancellation of the August conference call. The requirements for Health RBC trend test

are expected to be put in place for 2009 or 2010 reporting and may require updating the Health RBC Model Law. Another regulator only call is scheduled on October 10th to discuss the next step.

Medicare Part D Factors

The working group continued its review of Medicare Part D RBC factors. The working group reported that the AAA has concluded they will not be able to rely on the data included in the Medicare Part D Coverage Supplement filed with the annual statement as the primary source to support changes to the Part D factors because of concern about the data. The working group continues to consider a survey of Part D carriers to obtain information to update the RBC factors.

2008 Health RBC

The working group adopted the 2008 RBC instructions and formula.

Reinsurance Task Force

Reinsurance Modernization

The task force held numerous regulator-only and public meetings and conference calls since the Summer National Meeting and met again at the Fall National Meeting for a final push to complete its development of the Reinsurance Regulatory Modernization Framework.

Summary of Framework

At its meeting in Washington D.C. the task force reviewed the final proposal dated September 12 which includes the following key elements as summarized by NAIC staff:

- The Framework proposes two new classes of reinsurers in the U.S.: national reinsurers (U.S. companies) and port of entry (POE) reinsurers (non-U.S. companies). Uniform minimum standards are required for reinsurers to qualify for either classification. To assume U.S. reinsurance, national reinsurers would be licensed through a single home state, and POE reinsurers would be certified through a single "POE state."
- The Framework provides for the formation of the NAIC Reinsurance Supervision Review Department (RSRD), which would be responsible for evaluating the regulatory systems of non-U.S. jurisdictions to determine which are eligible to be recognized by a POE supervisor. The RSRD would be responsible for establishing the uniform standards

discussed above for a state to qualify either as a home state or POE supervisor.

- These supervisors would establish the appropriate supervisory rating and collateral requirements, based on the supervisory rating.
- The Framework applies prospectively to reinsurance entered into after its effective date (which has not yet been determined)
- U.S. licensed insurers who chose not to become national reinsurers would continue to operate under the current regulatory framework.

Final Revisions to the Framework

The September 12th Framework includes the following significant changes from the previous May version:

A new section, Implementation of Proposal, recommends the passage of federal enabling legislation, which would provide appropriate authority to the RSRD. The Framework notes the following:

A federal approach would facilitate incorporation of the concepts of mutual recognition and reciprocity into the framework by eliminating any legal concerns with respect to inclusion of these concepts under a state-based implementation approach. Congressional approval will allow POE supervisors (or the RSRD) to negotiate reciprocal recognition for reinsurers licensed and domiciled in the U.S.

The Framework now includes guidance on the applicability of the proposal to life reinsurance, stating that the guidance would not be applicable to life reinsurance until the earlier of twenty-four months from the effective date or the implementation of U.S. principles-based reserving standards for life insurance.

One significant change was made to the collateral requirements: within two years after the first full year of operations under the new collateral requirements, the RSRD will be required to re-evaluate the collateral requirements and make recommendations with respect to the appropriate collateral amounts for national and POE reinsurers.

Final Comments and Task Force Vote

At the Fall National Meeting, the regulators asked for final comments on the September 12th draft as a follow up to the six comment letters received. Several trade associations and interested parties spoke, providing comments consistent with their previous written comments. Spokesmen for trade associations representing U.S. ceding companies commented at length, again objecting to the removal of collateral requirements for non-U.S. reinsurers, especially given recent market events.

Before voting, the chair stated that the task force should not be "thrown off course because of recent events." As the NAIC continues to work on the implementation plan, the chair noted that they will have enough time to consider everything and can adjust the Framework as circumstances require. The chair noted the proposal will be refined during the fourth quarter before adoption by Executive Committee and Plenary.

The task force then voted to adopt the Framework with only one (or two) states voting no. The Financial Condition Committee also adopted the Framework at its subsequent meeting with little discussion and no final comments from interested parties. A regulator did ask regarding the composition of the RSRD; the chair commented that RSRD would be comprised of state regulators, but other details have not been determined.

Life Insurance and Annuities (A) Committee

Actuarial Guideline VACARVM

During a September 10 conference call the committee discussed and adopted the Actuarial Guideline, Reserves for Variable Annuities (AG VACARVM). The guideline, which LHATF has been working on since 1998, codifies the basic interpretation of the Commissioners Annuity Reserve Valuation Method (CARVM) by clarifying the assumptions and methodologies that will comply with the intent of the Standard Valuation Law. The committee member from Connecticut expressed concerns with the procedural process used by LHATF to develop the guideline and highlighted outstanding substantive issues raised by Connecticut that were not addressed in the final product. Other members noted that in the interest of finalizing the guideline, a compromise was necessary, and LHATF will be examining Connecticut's issues in the future.

Viatical Settlement Model Regulation

An update on the status of adoption by states of the Viatical Settlement Model Regulation was provided by NAIC staff. It was noted that 26 states have introduced bills related to viatical or life settlements; approximately half of these states have introduced a version of the bill substantially similar to the NAIC model regulation, while others have introduced versions supported by NCOIL. Other versions were termed Hybrids, containing elements of both the NAIC model and NCOIL proposal. A total of 13 states have enacted a viatical settlement legislation in some form.

The committee also heard a presentation from the Ohio Director on her experience working with the Ohio legislature to enact the viatical settlement legislation. She recommended soliciting the support of AARP and noted that ultimately a hybrid approach may be necessary to obtain legislative approval in most states. It was also noted that an education session will be held in November on viatical settlements.

New York Broker Commission Hearings

The committee heard from the First Deputy Superintendent of the New York Insurance Department regarding public hearings on compensation arrangements for insurance agents and brokers held by the N.Y. Insurance Superintendent and the N.Y. Attorney General in July. The purpose of the hearings was to discuss such issues as contingent and supplemental commissions, producer compensation disclosure and deceptive or anti-competitive practices. The potential for additional regulation of compensation and disclosure was also discussed.

Annuity Disclosure Working Group

This newly formed working group is charged with reviewing the Annuity Disclosures Model Regulation and proposing any necessary amendments to improve disclosure. The working group met via conference call on August 5 to discuss a list of potential issues, including whether to expand the scope of the model to include other annuity products in addition to fixed individual annuity products, whether illustrations should be considered part of disclosure, and whether guidelines should be considered instead of revisions to the model regulation in order to build in flexibility to fit new products. The working group also discussed a work plan for completing its charge and plans to meet in October continue its consideration of the topic.

Suitability of Annuity Sales Working Group

IMSA Suitability Report

The president and general counsel of the Insurance Marketplace Standards Association's (IMSA) appeared before the working group to provide an update on a pending report on member compliance with suitability requirements. The report was prepared at the request of seven states (NH, MO, IA, IL, OR, OH and PA) for insight on effective compliance practices. IMSA is working with these states to finalize the report, with a goal to post the final document on their website in early October.

IMSA's methodology involved analyzing the three annuity types (fixed, variable, indexed) to the types of distribution systems used by members, including captive and independent agents, broker-dealers, financial institutions, general agencies, brokerage general agencies, personal producing agencies and independent marketing organizations. In all, IMSA identified 56 different combinations of products and distribution channels.

According to IMSA representatives, the report illustrates that there is not a one-size fits all approach for successful supervisory and monitoring functions. In fact, when asked by a regulator if there were any surprises as a result of IMSA's review, the president indicated that there were no surprises, but rather confirmation that there is a great disparity between distribution systems and, therefore, supervision and monitoring systems.

In addition to identifying various supervisory and monitoring systems, the report will identify common practices employed by IMSA companies, including screens, filters, and "red flag" techniques. The report will also contain a proposed methodology for analyzing a life insurer's supervisory and monitoring practices.

To facilitate regulatory use of the report, the following will be included in the report's Statement of Intent:

To the extent the state insurance regulator can identify a life insurance company's practices as falling within the range of practices identified within the report, it would be acknowledged that these practices will be deemed to constitute appropriate evidence of the life insurance company's compliance with the supervision requirements of the Model

Regulation or other annuity suitability law or regulation

WI Annuity Sales Supervision Advisory Committee

Having previously provided the working group with nine standards it agreed should act as guiding principals for the revision of the NAIC Suitability in Annuity Transactions Model Regulation, the WI committee, which was formed to review industry suitability practices, presented the working group with twenty-three guidelines establishing how appropriate supervision over annuity sales may be implemented.

The regulator from Wisconsin suggested that the suitability model had gaps in the area of training, supervision and monitoring and explained that its guidelines were intended to reflect proscriptive steps towards filling those gaps.

Draft Changes to the Model Suitability Regulation

Recognizing the need for improvements on the NAIC model, the working group indicated that it would distribute a draft of proposed revisions to the model suitability regulation and would hold a conference call before the Winter National Meeting to discuss any comments received on that draft.

Life and Health Actuarial Task Force (LHATF)

Principle-Based Reserves

While several specific and lingering guidelines were adopted by LHATF, their focus was to finalize the Standard Valuation Law (SVL) as best they could. Since this is necessary to implement Principle- Based Reserves (PBR), and the legislative window in some states may be closing for another two years, the pressure was on. By the middle of the second day, the agenda was thrown out the window and LHATF members confronted several key aspects of the law. After many hours of discussions, debates, disputes and drama, it appears that the task force is now very close to adopting revisions to the SVL for PBR.

Modifications to the SVL

In the early moments of the discussion of PBR changes to the SVL, a LHATF member pointed out that if the SVL revisions are not passed this year the task force may miss the two year legislative cycle of many states, and could, in effect, defer adoption for at least two more years.

With that deadline in mind the group dove into various amendments which they broadly

categorized as related to confidentiality, principle-based valuation, minimum reserve floor, and miscellaneous items. They sailed through the miscellaneous items as well as the items covering confidentiality. However, when they reached their discussion of principle-based valuation, the wind left their sails.

Extensive debate and dialogue swelled as waves of opinions, understandings, points and counterpoints continued throughout the afternoon of the second day of the LHATF meeting. By the end of the debate, the industry proposals were mostly eliminated and LHATF created a new revised exposure draft of the SVL covering what the group sees as the requirements of a principle-based valuation. The new language will include a hierarchy of sources for non-prescribed assumptions.

They then turned their attention to the minimum reserve floor. The debate involved whether the minimum floor should be defined in the law or simply referenced in the law and defined in the valuation manual. Emotions were high as industry representatives stated that the current draft would cause no less than the failure of otherwise solvent small insurance companies. Without reaching consensus, but recognizing time was running out, LHATF agreed to amend the draft SVL that included a provision that minimum reserve floors specific to products will be in the Valuation Manual.

The task force then voted to expose the revised law and agreed to schedule an interim call to finalize the language. LHATF members were optimistic that they could adopt the SVL in time for it to be passed by the Life Insurance (A) Committee and Executive Committee by the end of this year. It is not clear whether state legislatures will be comfortable approving a revised SVL when many of the details are included in a currently incomplete Valuation Manual.

Valuation Manual

LHATF used nearly all the time scheduled for discussion of the Valuation Manual on the SVL. The only exception was VM-20 (Life Products). The working group invited the AAA to discuss their letter to LHATF explaining the benefits of company generated scenarios over a group of mandated scenarios. While relatively well received, LHATF members remained concerned that such scenarios may not sufficiently cover an appropriate range of scenarios and suggested a summary of key statistics should be developed to alleviate this

concern. A conference call to discuss this will follow.

Other Matters

Reserves for Variable Annuities (Actuarial Guideline VACARVM)

As discussed earlier in this Newsletter, Executive Committee adopted at the Fall National Meeting AG VACARVM, which will now known as AG 43 (or AG XLIV) with an effective date of December 31, 2009. (The guidance was adopted by LHATF and the Life Insurance (A) Committee in interim calls this summer.) In conjunction with the adoption of AG 43, AG 34 and AG 39 have been repealed effective December 30, 2009. While an effective date of the last day of the year is unusual, it is not unprecedented. Generally, laws, regulations and guidelines are effective on the first day of the year.

A year-end effective date results in a presumed change in valuation basis between a company's third quarter statutory filing and the year-end annual statement filing.

Some actuaries have expressed a concern that, since this new guidance will apply to all business on a statutory basis, but on a tax basis will only apply to new business issued on or after December 31, 2009, there may be a significant difference between statutory and tax reserves for older blocks of business where the guarantees are deep in the money.

Actuarial Guidelines CCC

The task force reviewed several proposed amendments to the recently exposed guideline which address the treatment of traditional life products that contain intermediate cash benefits. After accepting some of these amendments, including an effective date of January 1, 2009 for new filings and January 1, 2010 for new issues, LHATF voted to adopt the guideline. A return of premium benefit on a life insurance policy where there is continued life insurance coverage after the return of premium benefit is paid is an example of the type of policy addressed in this Actuarial Guideline.

Actuarial Guidelines GWP

The task force adopted AG GWP which dictates the use of the 2005 Group Term Life Waiver Reserve Table for calculating minimum reserves for waiver of premium disabled lives for disabilities on or after January 1, 2009. AG GWP contains floors for mortality and recovery that the American Academy of Actuaries believes will come into play for half of companies in this market. The guidance

also contains a requirement for companies to report their experience to their domiciliary state.

Preferred Class Mortality Tables and Margins

The AAA and the Society of Actuaries group working on this table provided an update to the task force including a proposed loading formula. LHATF encouraged this group to continue their analysis. Several interested parties noted that further analysis of how any new table will eventually be used in a PBR environment needs to be considered. The ACLI presented a position that suggested a non-loaded table is more appropriate for PBR purposes. LHATF asked the AAA to evaluate the ACLI's proposal and report back to the task force.

2009 GRET Factors

LHATF members participated in lively and occasionally jovial discussion of the experience backing the 2009 GRET expense factor tables that are required as part of the Illustration Model Regulation. After deciding to form a subgroup to investigate the recent volatility in the experience as well as the relatively large percentage of companies that are classified as "other," LHATF adopted these new tables.

Accident and Health Working Group

Health Actuarial Opinion

The working group made minor changes to the opinion and voted to expose it in its current form. An item that received considerable discussion was a change to require a reconciliation of the appointed actuary's work with the Underwriting and Investments Exhibit Part 2B of the Health Blank.

Medicare Supplement Refund Formula

While work is continuing and the recently formed subgroup retains the goal of creating a product to present to Congress by 2009, no significant actions were taken.

PBR for Health Insurance

The working group did not discuss VM-26 (Credit Life and Disability Reserves) but considered new amendments to VM-25 (Health Insurance Minimum Reserves). No actions were taken.

Casualty Actuarial Task Force

The task force began the meeting discussing and agreeing to their charges for the upcoming year, with their focus on providing support to regulators and others on numerous actuarial topics, with a

key focus on better regulating the medical liability market.

The task force then received status reports and updates on its various projects. Highlights on some of the more significant projects are as follows:

Actuarial Opinion Guidance Document

The task force provides annual guidance to actuaries that sign statements of actuarial opinion, and discussed finalization of the guidance document at the meeting. Key elements to this document include direction from regulators to actuaries to provide timely feedback to companies regarding their opinions, and a reminder to opining actuaries that it is expected that they will meet with the board or audit committee. Among other elements, the guidance also describes the new opinion filing requirements for companies that have 100% pooling agreements, and suggests actuaries provide additional disclosure in cases where the reserves are generated from service contracts, directors and officers' coverages, and from the current economic conditions.

Catastrophe Modeling

The Catastrophe Modeling Subgroup discussed a list of key questions that could be developed into formal regulatory guidance, with the purpose of improving regulators ability to better understand the risk management process that is employed at companies.

P&C Line of Business Definitions

The Property and Casualty Line of Business Subgroup continues to review the line of business definitions within the annual statement instructions, in particular for certain workers compensation coverages that may be reported either as workers compensation or other liability. This may be an issue with the reports that are generated, including the Profitability Report. The issues group is developing a work plan and is identifying issues to be addressed.

Risk Transfer Survey

The chair of the American Academy of Actuaries' Risk Transfer Working Group gave a final report on a reinsurance risk transfer survey submissions that have been received from the industry participants. The purpose of the survey is to measure the improvement in the corporate governance of reinsurance and the overall processes surrounding risk transfer since the prior survey was performed in 2005. Some highlights from the survey:

- More large insurance companies have adopted written policies surrounding the evaluation of risk transfer, and many fewer large companies are entering into finite reinsurance contracts.
- Smaller companies have shown much less improvement from a governance perspective, and many smaller companies still use finite reinsurance.
- Many companies still use the "10/10 rule of thumb", which is a 10% chance of a 10% loss, as a key threshold in assessing risk transfer, although more methods are being used now as compared to three years ago.
- Most companies continue to only perform cash flow testing for those arrangements where risk transfer is not viewed as being reasonably self-evident.

Financial Regulation Standards and Accreditation Committee

The committee met in Washington D.C. and discussed the following issues:

Multi-State Designation for Certain Captives:

NAIC staff recently received a question regarding whether certain types of captives would be subject to the accreditation standards. Historically, risk retention groups (RRGs) incorporated as captive insurers have primarily been the only type of captive that has had a multi-state impact. As captives continue to grow and become more sophisticated in how they are structured, regulators believe it is appropriate to revisit this issue.

The committee discussed comments received related to whether non-risk RRG captive insurers should be considered multi-state, thereby being subject to the Part B: Regulatory Practices and Procedures accreditation standards.

Although this subject had been discussed during the 1990s, current accreditation guidance does not specifically address this issue. It was noted that the comment letters included persuasive arguments that non-RRG captives do not constitute multi-state insurers. In addition, it was noted that RRGs represent the vast majority of group captives, and RRGs are subject to the accreditation standards.

After some debate, the Committee agreed that non-RRG captives should not be considered multi-state insurers and should not be subject to the Part

B accreditation standards. NAIC staff will prepare language to be included in accreditation guidance to formalize this decision.

Part A Standards for RRG License as Captives:

At the Summer National meeting, the Risk Retention Group Task Force and the Financial Condition Committee adopted the task force's recommendations regarding what Part A accreditation standards should apply to RRGs licensed as captive insurers. Currently, captive RRGs are specifically excluded from the Part A: Laws and Regulation standards.

The committee voted to expose for a 45-day comment period a referral received from the Financial Condition Committee regarding the applicability of the Part A: Laws and Regulations accreditation standards to RRGs organized as captive insurers. The referral discusses which standards, and what portions thereof, should be considered applicable to captive RRGs going forward.

Operational Effectiveness of NAIC Accreditation Program:

During 2005 and 2006, the NAIC engaged Michael Hamm, an expert on accreditation programs, to review the operational effectiveness of the NAIC Accreditation Program and to compare the Program's policies and practices to those utilized by comparable national accreditation programs. Hamm's final report included 26 recommendations for areas of possible improvement or refinement to the Program. These recommendations relate to various topics such as committee structure and voting, moving to a pass/fail system for accreditation reviews, training and composition of accreditation review teams and other administrative matters. It is anticipated that comment letters will be discussed via a conference call this fall, and the recommendations and related action items will be presented to Plenary for its consideration at the Winter National Meeting.

The Committee voted to expose for a 20-day comment period proposed action items related to these recommendations.

Catastrophe Reserve Working Group:

The working group met by conference call on August 14th. During the call, the working group discussed written comments from several industry trade group organizations relating to the Catastrophe Reserve Proposal. None of the written comments supported the suggestion to

proceed with requiring insurers to establish a catastrophe reserve unless Congress amends the IRS Code to provide favorable tax treatment to the reserve. The working group will hold another conference call in the near future to vote on whether to proceed with reconsideration of the NAIC's Tax-Deferred Pre-Event Catastrophe Reserve.

Terrorism Insurance Implementation Working Group

The working group did not meet during the quarter, but plans to meet shortly to address two items that have been recently published by the Terrorism Risk Insurance Program (TRIP) Office and one item that will be published next week. The three items to be considered are: 1) an interim final rule that follows up on the interim guidance that was provided early this year for the Reauthorization Act published in the Federal Register on September 16, 2008; 2) a proposed rule for TRIP Recoupment was published in the Federal Register on September 17, 2008; and 3) a proposed rule for the TRIP cap on annual liability that is expected to be published next week in the Federal Register. All three items have 30 day comment periods.

Climate Change and Global Warming Task Force

Climate Risk Disclosure Proposal

The task force and its working group both met in Washington D.C. The Climate Risk Disclosure Working Group held an interim meeting in Madison, Wisconsin on July 16 to discuss comments received from interested parties on the previously exposed draft of the Climate Risk Disclosure Proposal. A revised draft of the proposal was exposed on August 15, 2008 for a 30-day comment period.

The working group also met in Boulder, Colorado at the National Center for Atmospheric Research (NCAR) on September 11. The working group heard from three scientists regarding current climate change research and modeling and received a presentation from Risk Management Solutions (RMS) examining current hurricane model capabilities and reliability. The working group also discussed the August 15 draft of the Climate Risk Disclosure Proposal and received verbal comments from interested parties.

In Washington, D.C. the working group received presentations from two hurricane catastrophe

modelers regarding how climate change is considered in their models. The working group learned of the difficulties of combining atmospheric data with historical hurricane data in catastrophe models; however the modelers agreed that there will be a greater frequency of intense hurricanes in the next several years. There is less certainty, however, with regard to the number of hurricanes that will make landfall in the United States.

The task force discussed the August 15 draft Climate Risk Disclosure Proposal, including the 14 interested party comments received. An interested party (a representative from Travelers Insurance Companies) gave oral comments at the meeting stating that Travelers felt questions 1-6 (public questions) were acceptable for public access and consistent with the Carbon Disclosure Project. However, questions 7-9 (proprietary questions) were felt to be more problematic in that they required more forward looking statements that could create potential liability.

The chair of the task force stated that additional consensus is needed on the questions within the Climate Risk Disclosure Proposal at the working group level. He also indicated that the working group would be developing stronger safe harbor language to protect companies' public statements from inadvertent public disclosure of sensitive company information and legal threats. There appears to be a consensus among regulators and interested parties that additional discussions need to take place before Climate Risk Disclosure Proposal is finalized. The task force hopes to have a final proposal by the end of the year. The proposed effective date is year-end 2009 for insurers with premiums in excess of \$500 million.

Corporate Strategy on Climate Change

The task force then heard a presentation from AIG to obtain a better understanding of what some insurers are doing with respect to leading corporate strategy on climate change. Topics included the policy and programs on the environment in regards to insurance, investments, and financial planning and consulting; domestic and international climate change advocacy activities; discussion on policy strategies and considerations in funding carbon offsets; and AIG's internal activities to "be green" (e.g., reducing energy use, recycling, reduce paper use and etc.)

Risk Retention Group Task Force

The task force held two interim conference calls to continue its consideration of the applicability of Part

B: Regulatory Practices and Procedures accreditation standards to risk retention groups organized as captives. These accreditation standards cover such issues as qualifications of regulatory staff, adequacy of supervisory review, priority-based financial analysis, and reporting of material adverse findings as well as actions taken as a result of those findings. Members of the task force are finding these standards to be generally applicable to regulators of captive RRGs, and as a result the review of the Part B standards is taking considerably less time than the Part A: Laws and Regulations accreditation standards which were finalized at the Summer National Meeting.

In Washington, D.C. the task force discussed two Part B accreditation standards which may not be fully applicable to captive RRGs. Work on this issue will continue.

Receivership and Insolvency Task Force

Restructuring Mechanisms for Troubled Companies Subgroup

During the Fall National Meeting the subgroup continued its research and discussion in preparation for its anticipated White Paper, "Run-off of Existing Blocks." Regulators heard presentations on the following issues: U.K. Schemes of Arrangement, Chapter 15 Bankruptcy proceedings, and U.K. Part VII portfolio transfers and the U.S. equivalents.

The presentation on schemes of arrangement noted these represent a binding compromise or arrangement between a company and its creditors, which has been used with increasing frequency for insurer restructuring and for solvent run-offs. The need for such arrangements to meet with regulator and creditor approval in order to be implemented was discussed. Also described was the process guidelines issued by FSA, which sets forth considerations for the FSA in determining whether to approve a solvent scheme.

A few regulators on the subgroup expressed concerns regarding the use of schemes, including (1) the potential for solvent companies to commute obligations and stay in business, and (2) they enable solvent companies to avoid full-payment to creditors. The presenter from a large auditing firm responded that he was not aware of any instance where a company had utilized a scheme to commute obligations and stay in business. In addition, he maintained that the majority of creditors are paid at or close to 100%. An insurance company representative made the point

that 100% payment is often based on the scheming insurer's valuation of the claim, which is binding on a creditor even if, in the creditor's mind, the claim is worth more. Therefore in his opinion payment percentages were much less than 100%.

The subgroup then briefly discussed the new Chapter 15 of the U.S. Bankruptcy Act, which provides U.S. creditors of an insolvent entity the forum to address claims in an ancillary proceeding.

In the U.K. Part VII transfers are judicially approved contractual novations that enable liabilities to be transferred to a third party. These transactions might be initiated by management or, in the event of an impaired or insolvent insurer, by the court appointed receiver. Depending on the situation, the degree of regulatory, creditor or court involvement would differ.

Industry representatives criticized the Part VII concept in that it substitutes the policyholders' insurer of choice with one that may have a lower credit rating or may be undesirable of other reasons. In response, it was indicated that in the UK many Part VII transactions involved restructuring within an insurer's holding company and, therefore, did not substantially change the contracting party.

The subgroup will next turn its attention to New York Regulation 141 Plans (commutation of reinsurance) in an upcoming conference call.

Receivership Model Act Revision Working Group

The working group continued to address outstanding issues related to potential revisions to the Life & Health Insurance Guaranty Association Model Act. Key to this was for the group to gain an understanding of Medicare Parts C and D to determine whether there is a need for the model to provide coverage for same. To this end, a representative from America's Health Insurance Plans presented background information in this area. Regardless of whether the Medicare coverage should be added to the model, industry representatives suggested that there should be language added to the act either setting forth coverage or excluding coverage in order to eliminate ambiguity and minimize exposure to the guaranty associations.

Advisory Group on Structured Settlements

After receiving the report from the Advisory Group, the task force:

- Approved a motion to increase structured settlement annuity coverage limits in the Life & Health Insurance Guaranty Association Model Act to \$250,000, with language that states may want to increase this minimum amount (no other language changes approved);
- Directed the Receiver's Handbook Working Group to add a section regarding alternative methods of communications or claim filing process that may apply to structured settlement annuities;
- Approved a proposal to the Blanks Working group for a general interrogatory for life insurers to determine whether the insurer is providing structured settlement annuities;
- Referred an interested party comment letter on the topic to the Model Act Working Group for consideration.

The next National Meeting of the NAIC will be held in Grapevine, Texas December 5-8. We welcome your comments regarding issues raised in this newsletter. Please give your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor: Jean Connolly, Managing Director, PricewaterhouseCoopers LLP, 200 Public Square, 18th Floor, Cleveland, Ohio, 44114-2301 — (440) 893-0010 or jean.connolly@us.pwc.com.

Disclaimer

Since a variety of viewpoints and issues are discussed at task force and committee meetings taking place at the NAIC meetings, and because not all task forces and committees provide copies of agenda material to industry observers at the meetings, it is often difficult to characterize all of the conclusions reached. The items included in this Newsletter may differ from the formal task force or committee meeting minutes.

In addition, the NAIC operates through a hierarchy of subcommittees, task forces and committees. Decisions of a task force may be modified or overturned at a later meeting of the appropriate higher-level committee. Although we make every effort to accurately report the results of meetings we observe and to follow issues through to their conclusion at senior committee level, no assurance can be given that the items reported on in this Newsletter represent the ultimate decisions of the NAIC. Final actions of the NAIC are taken only by the entire membership of the NAIC meeting in Plenary session.