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# **NAIC Meeting Notes**

Global Insurance Industry Group, Americas

## **NAIC 2012 Spring National Meeting**

The National Association of Insurance Commissioner held its Spring National Meeting in New Orleans March 1-6. 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

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- The NAIC gave final adoption to the ORSA Guidance Manual and approved the accompanying request to develop a new model law to implement the requirement by statute. (page 2)
- The Commissioners narrowly approved on November 22 a resolution to "expeditiously consider legislation amending the MLR provisions of the PPACA in order to preserve the consumer access to agents and brokers." The resolution was rejected by HHS shortly thereafter. (page 3)
- The joint working group of the Life Insurance and Annuities and Financial Condition Committees made significant progress on its project related to reserving for universal life products with secondary guarantees; separate guidance will be developed for in-force and prospective business. (page 3)
- The Statutory Accounting Principles Working Group adopted as final SSAP 92 on OPEB, SSAP 102 on pensions, SSAP 103 on transfers of financial assets and Issue Paper 129 on share-based payments. The working group exposed for comment an SSAP 101 Question and Answers Implementation Guide for income taxes, but deferred adoption of the controversial proposed guidance on accounting for the annual fee mandated by the federal government under PPACA. (page 4)
- The Capital Adequacy Task Force is close to adoption of significant revisions to the 2012 RBC factors for deferred tax assets that would be consistently applied for all three formulas. The regulators adopted the current factors for commercial mortgages through 2012 and heard a more detailed report of the long-term commercial loan proposal. The C-1 Factor Review Subgroup continues to study a recalibration of RBC C-1 risks and is considering a "plus/minus" scale to augment 2, 3 and 4 rated securities. The Life RBC Working group has a new chair and met for the first time in over a year. The Catastrophe Risk Subgroup hopes to expose for comment shortly a proposed narrative disclosure of catastrophe risk for the 2012 RBC filing while work on the catastrophe risk formula continues. (pages 7)
- The SMI Task Force voted to expose a draft white paper describing its conclusions thus far on the future of US insurance regulation. The Group Solvency Issues Working Group agreed with industry that the ORSA requirement should be adopted through a new standalone model law, expected to be developed by the end of the year. The ORSA Subgroup was formed to oversee an ORSA feedback project and work on other implementation issues. (page 10)
- The International Accounting Standards Working Group heard updates on ComFrame and the insurance contracts and financial instruments projects of the FASB and IASB. (page 13)
- The Valuation of Securities Task Force approved a new policy that will permit additional ratings organization to receive ARO status. The task force is considering reforming the Derivatives Market Study Working Group to consider certain technical issues that have arisen with the Schedule DB reporting instructions. The Invested Assets Working Group continued its consideration of Working Capital Finance Notes. (page 15)
- The Reinsurance Task Force discussed next steps in assisting states adopting the revised Credit for Reinsurance Model Law and Regulation and the concept of Certified Reinsurer. (page 16)
- The newly formed Captives and Special Purpose Vehicles Subgroup developed a survey completed by 31 states on how they regulate captives and SPVs. Results of the survey were reviewed in New Orleans. (page 17)
- The Blanks Working Group adopted three blanks proposals as final and exposed twenty-five new proposals for public comment, including a controversial proposal which would require insurers sponsoring separate accounts to file separate statements for insulated separate accounts and non-insulated separate accounts. (page 18)
- The Financial Regulation Standards and Accreditation Committee approved 2010 revisions to the Financial Condition Examiners Handbook and 2008 revisions to the *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition* as applicable for accreditation

purposes. A proposal to approve the 2010 revisions to *the Insurance Holding Company System Regulatory Act and the Model Regulation* as applicable for accreditation purposes was exposed for public comment. (page 19)

- The Life Insurance and Annuities Committee adopted the report of its Contingent Deferred Annuities Subgroup which concluded that CDAs are annuities and should be regulated as such, but also formed a working group to further study solvency and consumer protection issues identified by its subgroup. (page 20)
- The Life and Health Actuarial Task Force re-exposed a revised PBR Valuation Manual until May 1 and heard recommendations related to the PBR VM-20 Impact Study. (page 21)
- The NAIC held an Annuity Sales and Suitability Issues Symposium in New Orleans to discuss issues related to the implementation of the new suitability model. (page 24)
- The Casualty Actuarial and Statistical Task Force approved significant changes to the P/C Actuarial Opinion and Summary, which will be effective for 2012 after adoption by the Blanks Working Group. (page 25)
- The Examination Oversight Task Force reviewed comments from its industry survey of views on the implementation of the risk-focused examination process. (page 26)

## Executive Committee and Plenary

Note: All documents referenced in this Newsletter can be found on the NAIC's website at [naic.org](http://naic.org).

### Adoption of New or Revised Models

The Commissioners adopted the following items which were the subject of public hearings and debate as they were considered by various groups of the NAIC:

- NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual and related model law development request
- Amendments to the Standard Nonforfeiture Law for Life Insurance
- Amendments to the Health Carrier Grievance Procedure Model Act
- Amendments to the Utilization Review and Benefit Determination Model Act
- Accreditation Standards in the 2008 revisions of the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition
- Revisions to the Capital and Surplus Part A Standard Applicable to Risk Retention Groups
- Consumer Alert: Limited Medical Benefit Insurance Plans/Mini-Med Plans

In addition, Executive Committee discussed the following matters:

- Establishment of a joint working group of the Property and Casualty Insurance Committee and the Market Regulation and Consumer Affairs Committee to review issues relating to low-income households and the auto insurance marketplace.
- Designation of the NAIC President and CEO or their designees as representatives on the US/European Union Steering Committee to speak on behalf of the U.S. national state-based system of insurance regulation.

## FIO Update

The Treasury Department's Federal Insurance Office (FIO) was expected to complete and issue its report to Congress on how to modernize the insurance regulatory system in January 2012. Many observers are anxiously waiting for the FIO's report to gain insight into how the FIO sees insurance regulation evolving, but the report has not yet been issued. Until then, regulators, the insurance industry, and other interested parties are left to speculate as to when the report will be released and what the FIOs recommendations will be.

## Health Care Reform

### NAIC Resolution

The NAIC held an Executive/Plenary call on November 22 to vote on a resolution sponsored by 22 states to ask HHS to consider legislation amending the MLR provisions of the PPACA. The resolution was entitled *Resolution Urging the US Department of Health and Human Service to Take Action to Ensure Consumer Access to Professional Health Insurance Producers*. While most commissioners stated support for the work of agents and brokers, they had procedural concerns about the process (e.g. no opportunity for the public to comment at Plenary). One regulator stated that he believes the resolution is a symbolic gesture only and puts HHS on the spot as Congress is the body that must act on the resolution. After a very lengthy and spirited debate, the resolution was adopted in a 26-20 vote, with five states abstaining.

On December 2nd, the Centers for Medicare & Medicaid Services issued a final regulation prescribing how the Patient Protection and Affordable Care Act's medical-loss ratio should be applied, which rejected the NAIC's adopted resolution.

### Health Reform Solvency Impact Subgroup

The working group met February 21 via conference call and adopted changes to the Supplemental Health Care Exhibit and instructions for 2012 reporting. The proposal was then referred to the Blanks Working Group and exposed at the Spring National Meeting (agenda item 2012-24). The most significant change adopted was to amend line 1.6, State Insurance, Premium and Other Taxes and Assessments, of Part 2 of the Exhibit to be consistent with the final guidance of PPACA as it relates to community benefit expenditures. The issue of whether for-profit health plans are allowed to utilize this category was deferred as this needs to be confirmed with HHS.

The subgroup also adopted a new charge to develop a reconciliation between the Supplemental Health Care Exhibit and the HHS MLR rebate form. The subgroup expects to use the reconciliation for the 2012 reporting year for analysis and auditing purposes and to consider whether an annual statement reconciliation form should be developed for reporting in 2013 and later.

## Joint Working Group

The joint working group of the Life Insurance and Annuities Committee and the Financial Condition Committee was formed at the Fall National Meeting to address the contentious issue of reserving for universal life products with secondary guarantees (ULSGs). The charge of the joint working group is to "determine whether it is prudent and necessary to develop interim guidelines and/or tools to be utilized by regulators in evaluating reserves for these products and, if so, to promptly develop such interim guidelines and/or tools." Per the joint working group's chair (Texas) the overarching goal of the group is to have a "level playing field" for all insurers who write these products. This project is one of the NAIC's top priorities for 2012.

The working group met twice in December and quickly concluded that no new guidance will be effective for year-end 2011 as the working group carefully deliberates the complex issues. In January the working group exposed a Draft Framework document covering in-force and prospective business separately and extended the scope to include Term UL products. On February 21, the joint working group adopted the Phase I Decisions of the Draft Framework which recommends a bifurcated approach for in-force and prospective business and approves retaining independent actuarial consultants to advise the working group. The Draft Framework anticipates that the closed blocks of in-force business would be evaluated by actuaries on a standalone basis and all states would rely on the conclusions reached in the actuarial evaluations. If reserves are determined to be deficient based on the evaluations, reserves would be increased by the company.

Work will now commence on the Phase II and Phase III issues including decisions on which products and blocks of business will be subject to the actuarial evaluations, which actuaries will perform the evaluations, the methodologies and assumptions that will be used, and the cut-off date for the in-force blocks, in addition to many other issues. The Draft Framework suggests July 1, 2012 as a possible cut-off date for the closed block of in-force policies.

## Statutory Accounting Principles Working Group

The working group met in via conference call December 7 and in New Orleans and discussed the following issues. (After each discussion is a reference to the NAIC's agenda item number.)

### Adoption of New Standards or Revisions to SSAPs

#### SSAP 94- State Tax Credits

During its December 7 public hearing, the working group adopted both Issue Paper 145 and SSAP 94R on transferable and non-transferable state tax credits, effective for 2011 financial statements. The revisions allow entities that purchase or acquire tax credits that are subsequently non-transferable to reflect the credits as admitted assets if the domestic state law requires the credit to be used in that taxable year. (#2011-08)

SSAP 92, Accounting for Postretirement Benefits Other than Pensions, and SSAP 102, Accounting for Pensions - After six years of consideration, the working group unanimously adopted both these SSAPs as final, with an effective date of January 1, 2013, with early adoption permitted and the ability to elect a ten year phase-in period. Prior to adoption, the working group discussed the three final comment letters received and agreed to minor revisions to the guidance suggested by interested parties and agreed to draft additional implementation guidance for underfunded plans with a prepaid benefit cost. The working group did not adopt revisions long-suggested by the American Academy of Actuaries (and others) related to not requiring accrual for non-vested employees in an OPEB plan. (#2006-30)

SSAP 103, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities  
The working group voted to adopt this SSAP as final, which supercedes SSAP 91R effective January 1, 2013. The new standard adopts the guidance in FAS 166 and is to be applied prospectively. The SSAP also includes the guidance from *ASU 2011-03 Transfers and Servicing, Reconsideration of Effective Control for Repurchase Agreements*. (#2009-14)

SSAP 86 Revisions - The working group adopted revisions to SSAP 86 for the disclosure requirements for embedded credit derivatives within a financial instrument (including beneficial interests) that expose the holder to the possibility (however

remote) to make future payments in the financial statements. They also adopted revisions to SSAP 86 to adopt guidance from ASU 2010-11 that revises the seller of credit derivatives disclosures in 815-10-50-4K (already adopted for statutory) to clarify those disclosures do not apply to embedded derivatives features related to the transfer of credit risk that is only in the form of subordination of one financial instrument to another. Thirdly, the working group voted to reject all other revisions from ASU 2010-11, as embedded derivatives are not separately recognized as derivatives under SSAP 86. (#2011-19)

SSAP 27 Revisions - The working group adopted amendments to SSAP 27 to ensure that the embedded derivatives discussed above in the SSAP 86 revisions are included in the disclosures of financial instruments with off-balance-sheet risk. (#2011-19)

Fund Demand Disclosures for Institutional Business  
The working group adopted new guidance for SSAP 1 to reference the stress liquidity templates that were recently approved to be included in the Financial Condition Examiners Handbook. The disclosures are considered confidential and will not be included in the statutory financial statements. (#2004-27)

SSAP 43R Revisions - During its December 7 conference call, the working adopted changes to SSAP 43R to reflect changes in the modified filing exempt process adopted by the Valuation of Securities Task Force in late 2011. The working group also adopted the SSAP 43R Flowchart which has been posted to the SAP Working Group's webpage. (#2011-37)

National Flood Program - The working group adopted additional accounting and reporting guidance in SSAP 62R for National Flood Program expenses during its December conference call. (#2011-43)

Issue Paper 129, Share-Based Payment - At the Fall National Meeting, the working group exposed for comment a revised issue paper which significantly amends the previous issue paper originally exposed in 2006. The issue paper has been modified to adopt, with minor modifications, all the related GAAP guidance currently included in the FASB Codification. At the Spring National Meeting, the working group adopted Issue Paper 129 and voted to expose for comment the draft SSAP 13R, Stock Options, which reflects revisions from interested parties related to the intent of the guidance for

consolidated/holding company plans, and suggests a January 1, 2013 effective date. (#2006-13)

## **Exposure of New Guidance and Discussion of New and On-going Projects**

Items exposed for comment had a comment deadline of May 18 (unless otherwise stated).

### SSAP 101 Questions and Answers Implementation

Guide - The working group exposed for comment this draft Q&A via an email vote February 20, which is a comprehensive update of the SSAP 10 Q&A. Per NAIC staff, the guide includes the following:

- Guidance for the requirements of the statutory valuation allowance adjustment (Question 2)
- Updated examples for calculating the amount of admitted adjusted gross DTA for RBC and non-RBC reporting entities. (Question 4a)
- Together Question 2 and Question 4a provide guidance related to admission of DTAs by offset with DTLs related to reversal patterns
- Guidance for calculating the ExDTA ACL RBC Ratio (Question 4b)
- A practical expedient to determining the current period adjusted capital and surplus as required by paragraph 11.b.ii. of SSAP 101 (Question 4c)
- Updated examples for illustrating how to apply the phrase "expected to be realized" in paragraph 11.b.i. (Question 6)
- Updated guidance related to recognition of a liability for tax loss contingencies under paragraph 3. (Question 9a and 9b)
- Updated illustrations for presentation of deferred income taxes in the statutory financial statements, exhibits and footnote disclosures,
- Guidance for the use of tax-planning strategies for determining the need for a statutory valuation allowance adjustment and admission of DTAs.

An expedited comment period ending March 23 was agreed to with interested parties so that the guide can be finalized and used for the first quarter 2012 statutory statements. (#2011-42)

SSAP 61 and SSAP 62 Amendments to Incorporate the Concept of Certified Reinsurer - The working group exposed for comment proposed revisions to the life and P/C reinsurance SSAPs to provide specific accounting guidance for reinsurance ceded to certified reinsurers, a concept that was adopted by the NAIC as part of the Reinsurance Modernization

Framework. The proposed guidance defines a certified reinsurer as "an assuming insurer that does not meet the requirements to be considered authorized in the domestic state of the ceding insurer, but has been certified by such state and is required to provide collateral as security for its reinsurance obligations incurred under contracts entered into or renewed on or after the effective date of certification." The proposed effective of the guidance is December 31, 2012. (#2011-10 & 11)

Appendix A-785, Credit for Reinsurance - The working group exposed for comment proposed revisions to A-785 to reflect the recent changes to the Credit for Reinsurance Model Law. (This is the version of the model law maintained in the APP Manual.) The proposed changes are extensive and also include the concept of certified reinsurer discussed above. (#2012-12)

SSAP 100 and Review of ASU 2011-04 - The working group exposed for comment proposed revisions to SSAP 100 to adopt, with some modifications, the GAAP guidance in ASU 2011-04, *Fair Value Measurements*. The proposed revisions are extensive and may result in a new SSAP which would supersede SSAP 100. The working group wants the guidance to mirror US GAAP as much as possible, but has also proposed rejecting the guidance for fair value of liabilities, including non-performance risk. No effective date was suggested in the meeting materials.

Not included in the proposed revisions is clarification of the issue of transfers in and out of the Level 3 rollforward; the preliminary conclusion would require all transfers in and out of Level 3 in the same reporting period to be included in the reconciliation. Resolution was expected during the December 7 conference call but a final consensus was deferred then and in New Orleans due to the complexity of the issues. (#2012-14)

SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers - The working group had exposed for comment a proposed conclusion that the guidance in ASU 2011-06 be rejected for statutory accounting and instead proposed that SSAP 35R prescribe the accounting for the annual fee mandated by the Patient Protection and Affordable Care Act. These proposed changes would require accrual of the annual fee on health insurers in 2013, instead of 2014 as prescribed by ASU 2011-06.

The working group received four comment letters, all of which had similar arguments that the no liability arises in 2014 and requiring accrual in 2013 would create complexity and cause unintended harm to industry and consumers. As a result of the extent of comments received, the working group voted to defer action at the Spring National Meeting to allow time for additional review and discussion. The working group also re-exposed the issue for comment until March 30 and requested additional information from the health insurance industry; a conference call will be scheduled for early April. (#2011-38)

[ASU 2010-20 Receivables-Disclosures About the Credit Quality of Financing Receivables and the Allowance of Credit Losses and ASU 2011-02, Receivables-A Creditors' Determination of Whether a Restructuring is a Troubles Debt Restructuring](#)  
At the Fall National Meeting the working group exposed nonsubstantive revisions to adopt guidance from ASU 2011-02 into SSAP 36 to provide additional guidance on whether a restructuring constitutes a troubled debt restructuring. The working group also recommended rejection of the troubled debt restructuring disclosures pertaining to financing receivables from ASU 2010-20 but proposed additional disclosures for creditors that pertain to all troubled debt restructuring.

At its meeting in New Orleans, the working group reviewed comments from interested parties asking that the GAAP disclosures required by ASU 2010-20 be included for statutory reporting because insurers will have to prepare them anyway in the audited financial statements due to the requirements for Other Comprehensive Basis of Accounting financial statements. Interested parties also requested that the additional disclosures developed by NAIC staff not be adopted. The working group re-exposed the document for comment which includes proposed revisions to SSAP 37 and narrows the scope of the ASU 2010-20 disclosures to mortgage loans only. (#2011-22)

[SSAPs 48, 97 and 68 "Basis Differences"](#) - Exposed for comment was a clarification to three SSAPs that the basis difference between purchase price and underlying GAAP equity of minority owned SSAP 48 entities should be amortized, similar to goodwill for SCA entities. (#2012-05)

[SSAP 86 Revisions](#) - The working group exposed for comment a proposal to move guidance currently shown as a criteria for a hedged forecasted transaction (par. 21e) to reflect it as a criteria for a fair value hedge (new par. 19f). (#2012-08)

[SSAP 26 and Credit Tenant Loan Disclosures](#) - The working group exposed for comment proposed deletion of credit tenant loan disclosures in the bond footnote of the audited financial statements because this separate category was eliminated from Schedule D beginning with 2011. Interested parties suggested that this revision seems to reach a conclusion that all credit tenant loans are not SSAP 26 bonds. The working group disagreed, stating that since such investments are no longer a separate bond category in Schedule D, the category should be eliminated in the audited financial statement disclosures, but that interested parties should comment why the disclosure should be retained. (#2012-13)

On a related matter, the chair noted that a six member SSAP 43R Definitional Subgroup has been formed (at the request of interested parties) to study whether the recently revised definition of loan-backed and structured securities in SSAP 43R should be further clarified or amended. The subgroup will be chaired by New York and plans to meet sometime this spring. Industry is hopeful that the subgroup does not reach the conclusion that all asset-backed bonds are "SSAP 43R-like" securities, because many of these securities have SSAP 26 bond-like characteristics.

[SSAP 11 and EITF 06-2](#) - The working group voted to expose for comment proposed changes to SSAP 11 on postemployment benefits to address this EITF guidance on sabbatical leaves. (#2012-01)

[Title Insurer Admitted Assets](#) - Revisions to paragraph 19g of SSAP 57 on title insurance were proposed to make the guidance consistent with paragraph 16 of Appendix A-628. (#2012-03)

[Retained Asset Disclosures](#) - The working group concluded it will not move these disclosures from an annual statement note to Exhibit 7 as proposed last fall.

[Impact of Loss Portfolio Transfer on Provision of Reinsurance](#) - This proposal from a large P/C insurer addresses situations where collection risk for third party reinsurance has been transferred and secured by the counterparty in a LPT, but where novation has not occurred. The proposal would allow the minimum reserve to be reduced in such situations. At the Spring National Meeting, the working group deferred action and requested that the interested party provide additional information on the proposal including how to define the exception to a Schedule F penalty more narrowly. (#2011-45)

### **GAAP Guidance Rejected for SAP**

The working group proposed rejecting the following recently issued GAAP guidance, EITF 07-1, Accounting for Collaborative Arrangements. The working group asked interested parties to comment on whether such arrangements are prevalent within the insurance industry. (#2012-02)

### **Emerging Accounting Issues Working Group**

The working group voted to nullify twelve INTs issued in 2000 and include the guidance directly in the relevant SSAPs. The SAP Working Group also approved these changes, which will be reflected in the 2013 APP Manual.

### **Capital Adequacy Task Force**

The working group met three times December through February and at the Spring National Meeting and discussed the following issues.

#### **RBC Deferred Tax Proposal**

During its December 8th conference call, after a lengthy discussion, the task force exposed for comment the proposed RBC treatment for deferred taxes for all three formulas:

- a 1% charge (outside covariance) on DTAs admitted per paragraph 11a of SSAP 101 (taxes paid in prior years that can be recovered through loss carrybacks) if the insurance company files its tax return with its non-insurance company parent, or
- a .5% charge on DTAs admitted under paragraph 11a if the insurer files a standalone tax return or the parent company is an insurance entity, plus
- a 1% charge on DTAs admitted under paragraph 11b of SSAP 101.

At its meeting in New Orleans, the task force discussed a comment letter from interested parties regarding the DTA RBC treatment, which supported the proposal but suggested amendments to correct referencing and for clarification. The task force elected not to adopt the proposal until the changes have been made by NAIC staff, and can be reviewed by the task force. A conference call will be scheduled to adopt the proposal, which would be effective for 2012 RBC filings.

### **Short-Term Commercial Loan Project**

During its December 13th conference call, the task force voted to extend for 2012 reporting the current factors for commercial mortgages and the mortgage experience adjustment factor because the long term project will not be completed in time for 2012 RBC.

### **Long-Term Commercial Mortgage Project**

At the Fall National Meeting, the task force received a written report and short presentation from the ACLI on its proposed treatment of commercial mortgages within the Life RBC formula. During its December 13th conference call, the task force had a longer discussion of the written report. A representative from the ACLI noted that the goals of the project are five-fold: 1) balance precision with a workable framework for reporting, 2) a verifiable framework for regulators, 3) confidentiality, 4) create a system that encourages sound economic decisions and 5) hold commercial mortgages to a similar standard to other assets held by life insurers.

Debt service coverage and loan-to-value will be the metrics used to categorize the loans, which the ACLI believes are key metrics tracked by most mortgage lenders and are readily available. These two metrics will be used in the modeling to produce five risk categories and grids that show the risk factors for each of the components. With respect to debt service, they are proposing a standardized 25 year amortization period, which they believe will "level the playing field" between different types of loan structures. One regulator stated the concern that the proposal may include company information that might not be available to regulators and may require new filings.

At the New Orleans meeting of the Life RBC Working Group, the regulators heard a brief update from a representative of the ACLI, who noted that they will be submitting a revised and more formal proposal in the next few weeks. The chair responded that it is very critical that the working group is comfortable with the proposed modeling and would like to get the American Academy of Actuaries involved in the review of the modeling.

### **Life Trend Test**

The task force adopted at the Spring National Meeting changes to the Life RBC formula to reflect the previously adopted changes to the RBC model to increase the trigger of the trend test from 250% to 300%. However, until all states have adopted changes to their RBC models the formula page will still have to reflect that either 250% or 300% triggered the trend test. This change will be effective

for 2012. The task force also voted to recommend to F Committee that this change to the trend test be made an accreditation standard.

#### ACLI Callable Assets Proposal

The task force adopted the callable assets proposal which clarifies in the Life RBC instructions that callable assets are excluded from the interest rate risk calculation. This change will be effective for 2012.

#### Response to PBR Working Group

During its February 15th conference call, the task force reviewed its response to the PBR Working Group on various SMI related projects. With respect to the project of "consider regulatory capital versus economic capital," the new chair of the Life RBC Working Group asked that the status be changed from "completed" to "in progress" as he would like his working group to reconsider the conclusion that RBC be maintained as a regulatory minimum capital calculation versus a target capital calculation.

### **C-1 Factor Review Subgroup**

The newly formed C-1 Factor Review Subgroup is charged with reviewing the current C-1 factors and delivering a recommendation for the new factors to the Capital Adequacy and Valuation of Securities Task Forces. C-1 is the risk of assets' default of principal and interest or fluctuation in fair value used in the RBC calculation.

The subgroup has met frequently since the Fall National Meeting, focusing primarily on the corporate bond modeling project and discussions of granularity within the bond portfolio. With respect to the modeling project, the subgroup has enlisted the help of the AAA, which has been working to recruit additional resources for this large project. At the Spring National Meeting, the Academy representative noted they hope to deliver a report on the working construct of the model with initial assumptions and methodologies within the next two months and perhaps generated numbers within six months. Among the tentative conclusions that appear to have been reached include the use of cumulative bond default rate (as opposed to an annual rate), a time horizon of ten years of projecting out cash flows and a modeling size of 400-600 bonds.

With respect to the granularity issue, the subgroup is currently focusing on four categories of bonds: corporate, municipal, foreign government and loan-

backed and structured securities. With respect to expanding the number of NAIC designations from the current 1 through 6, the chair noted that the goal of the subgroup is to use existing structure as much as possible due to the pervasive use of these designations in NAIC materials and state law. The chair noted that rating agencies have been internally using plus and minus for 2, 3 and 4 rating designations for some time, which could be an easy fix for expanded NAIC designations, e.g. an NAIC 2 designation could be expanded into 2+, 2 and 2-. The chair also commented that they might not need plus and minus for municipal bonds.

During its February 16 conference call the subgroup had a lengthy discussion of whether the bond factors should be pre or post tax. The chair of the AAA modeling group stated that would be "very unlikely" that they decide to go back to pre-tax factors for Life RBC so the only question is whether the Health and P/C RBC factors should be post tax. A subgroup member responded that one reason to use pre-tax rates is that companies have different effective tax rates. A trade association representative commented that if company's tax rate is used, it should be the marginal tax rate not the effective tax rate. The chair commented that is obviously a complex issue and that the subgroup is sure to have many lengthy discussions on the issue.

During its New Orleans meeting, the subgroup also discussed potential issues related to gathering sufficient "loss given default" data (i.e. severity of loss data). The subgroup plans to schedule meetings with the NRSROs to discuss their data availability of this information. The subgroup then assigned pairs of subgroup members and industry members to research the assumptions under the current RBC factors for bonds, equities, mortgages, real estate and Schedule BA assets and to recommend potential alternative approaches, if any.

The subgroup plans to hold a full day meeting May 1 at the SVO offices in New York. The subgroup hopes to complete most of its work in 2012 to make a proposal to the Capital Adequacy and Valuation of Securities Task Forces after that.

### **SMI RBC Subgroup**

The subgroup has not met since the Fall National Meeting.

## Life Risk-Based Capital Working Group

Having obtained a new chairperson (Kansas), the working group met for the first time in more than a year, via conference call February 22 and at the Spring National Meeting. The goal of both of these meetings was to finalize the group's 2012 Working Agenda. The working group agreed that its two highest priorities for 2012 are to complete the commercial mortgage loan project and consider proposed changes to C-3 Phase 2.

The commercial mortgage update is discussed in the CADTF summary above. With respect to the C-3 Phase 2, a representative from the AAA noted that they had completed significant work on the project but that they need input from the regulators. The C-3 Phase 2 and AG 43 Subgroup plans to begin meeting again in the second quarter.

In adopting the group's 2012 Working Agenda, the chair highlighted a new agenda item, which is to provide input to the Own Solvency and Risk Assessment Subgroup as work on the new model law progresses.

## Catastrophe Risk Subgroup

The subgroup is continuing its work in developing a comprehensive catastrophe risk charge, as this peril is considered by the NAIC to be the most significant risk not currently captured by an RBC formula. At its meeting in New Orleans, the subgroup reviewed decisions made during its December 1 and January 26 conference calls. First, value-at-risk (VaR) will be used as a measurement standard. Second, all affiliate reinsurance will be excluded from the contingent credit risk charge. Thirdly, in order to maintain consistency with the overall RBC formula, the catastrophe risk charge will not be tax-effected. Additionally, a 10% charge has been included in the proposal for the catastrophe-related contingent credit risk; however, there is concern that 10% might be too high. The subgroup discussed that efforts are underway by the American Academy of Actuaries to re-evaluate credit risk charges for the Capital Adequacy Task Force, and has asked for this work to be expedited.

The current draft of the catastrophe risk charge reflects a change from "event" to "loss" to indicate that the RBC charge would be for the total modeled loss for the worst year in the specified period and not the modeled loss for the worst event. The subgroup continued discussions on the difficulties related to attempting to remove catastrophe losses from the

RBC underwriting risk calculation. Discussion included use of Property Claim Services (PCS) data for estimating historical industry hurricane and earthquake losses but the subgroup acknowledged that because PCS data is not complete and may not represent the majority of the industry, it is not a viable solution. Adding a confidential schedule of insurer data to the confidential RBC report appeared to be the most complete solution but would also add an additional reporting burden to companies. The subgroup agreed to assess the level of detail of data needed; the initial expectation is for Schedule P-type data by annual statement line of business for a limited number of lines. Representatives from two trade associations expressed support for evaluating this approach.

The subgroup also discussed adding a narrative component to the RBC calculation to provide disclosure of a company's assessment of its catastrophe risk. The narrative was proposed as a way to give regulators a tool to use immediately while the subgroup continues to pursue adding a catastrophe risk calculation to the RBC. The subgroup discussed timing in hopes that the narrative disclosure could be made for the 2012 RBC. However, no draft has been exposed to the industry for comment yet. The subgroup agreed to move forward both a change to the RBC calculation to provide Schedule P Part 1 type data for catastrophe amounts and the additional of a narrative disclosure to the RBC report. The subgroup still hopes to have a proposed formula by year-end, and if possible, to start data collection on an informational-only basis for year-end 2012 filings. A conference call will be scheduled in the next few weeks to continue this work.

## Property/Casualty Risk-Based Capital Working Group

In discussion of its 2012 Working Agenda, the working group reviewed the appropriate risk credit charge for reinsurance, which is currently 10% but some members think it may be too high. Conclusions on this project could have a significant effect on the catastrophe risk charge. An actuarial subgroup continues to work on this issue.

The working group reported that AAA study of the underlying methodology for updating the underwriting risk factors for the formula continues; some industry representatives believe the current methodology has led to "excessively high" capital requirements for reinsurers. There have been no recent updates to the working group by the Academy on this project.

With respect to the industry proposal to use the same lower factors used by the Life RBC formula for investments in low-income housing tax credits, the CADTF conclude the change will be made the P/C formula for 2013, instead of 2012.

The working group also reviewed a proposal from the Risk Retention Group Task Force to require the P/C RBC formula for RRGs with some modifications. Most of adjustments are proposed because RRGs generally prepare GAAP not SAP financial statements and/or use letters of credit for capital purposes. The working group concluded that additional review of this proposal is required.

## **Health Risk-Based Capital Working Group**

The working group held a conference call February 13 and discussed its 2012 Working Agenda. The working group does not have any new issues on the agenda but monitoring the impact of federal health care reform and identifying missing risks from the formula are high priority items. The working group member from New York noted that there is so much uncertainty with health care reform that regulators should be monitoring their domestic health plans very closely and cannot necessarily wait for the Health RBC formula to be updated to address new risks.

The chair noted that the AAA is currently reviewing the risk of reserve inadequacy for long-duration products, long-term care insurance reserve adequacy risk and disability income reserve adequacy risk. A representative from the Academy noted that the disability reserve and long-term care valuations tables should be completed by the end of 2012.

## **Solvency Modernization Initiatives Task Force**

The task force is developing a new white paper *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative*. The white paper is a significant component of the NAIC's self-evaluation to improve the insurance solvency regulatory framework. The task force discussed a preliminary draft of the white paper, which includes the previously adopted US Insurance Financial Solvency Framework (2010) and new sections on "Regulating for Solvency Protects Consumers," "Effective and Efficient Markets Protect Consumer-Analysis of US Markets" and the "Future of US Financial Insurance Regulation."

The paper describes the current US system and the conclusions reached by the task force. The paper will be modified as the task force continues to make decisions this year. The white paper is being revised as requested at the meeting in New Orleans and will be released for comment soon, with responses due April 30. The regulators expect to complete the white paper by the end of this year.

## **Group Solvency Issues Working Group**

The working group met three times December through February via conference call and in New Orleans and discussed the following issues.

### Own Risk and Solvency Assessment (ORSA)

Following the adoption of the ORSA Guidance Manual by the working group and the SMI Task Force at the Fall National Meeting (subsequently adopted by Executive Committee and Plenary at the Spring National Meeting), the working group's attention has shifted to the legal mechanism for implementing the new ORSA requirement.

The working group had initially discussed integrating the requirement into Form B of the Insurance Holding Company Model, but received strong objections to the proposal from industry commentators due to confidentiality concerns. During a conference call on December 15, the working group received a proposal from a group of trade associations presenting three alternative approaches: a standalone model law, modifications to the Examination Model Audit Law, or modifications to the Model Audit Rule.

The group presented draft wording for all three proposals to the working group, which agreed to expose the draft model law for comment. The working group discussed concerns about the ability of the NAIC and the states to get a standalone statute in place in advance of the 2014 Financial Sector Assessment Program review by the IMF; however, during a conference call on January 12, it agreed to make a formal request to create a ORSA Model Law, which was adopted at the Spring National Meeting.

During its January conference call and on a further conference call on February 17, the working group continued to discuss the industry's draft model law, focusing on the roles of the lead and non-lead supervisors, confidentiality provisions, including where the NAIC provides central ERM expertise, the size exemption threshold for the application of the

requirements, and the implementation date. A large part of the February discussions revolved around the need for a uniform implementation date across the states, and whether provision should be made for the requirements to come into effect only once a majority of states had adopted it.

During its December call, the working group also discussed the need to require a common group consolidated financial income statement and balance sheet, and agreed to carry out further research.

Following the adoption of the request for model law development in New Orleans, the working group will start work on a formal model law proposal.

Discussion of other aspects of the implementation of the ORSA, including the 2012 pilot exercise has been moved to the newly created ORSA Subgroup, which is discussed on page 11.

In New Orleans, the working group also received an update from Nebraska on the confidentiality agreement for states' receipt and sharing of the Form F-Enterprise Risk Filing. The agreement is drafted and ready for states to begin signing.

#### IAIS activities

At the Spring National Meeting, the working group discussed the IAIS's ComFrame (Common Framework for the Supervision of Internationally Active Insurance Groups) project, focusing on Modules 1 and 4, scope of application and supervisory cooperation and interaction, respectively. Key issues discussed by the working group included the scope of ComFrame, reporting requirements, provisions on crisis management, the operation of cross-border colleges of supervisors, and the identification of the group-wide supervisor.

Different measures are being considered to set the scope of the framework, although the NAIC's preference is for it to initially capture a relatively small number of groups, then to be expanded later if considered appropriate. Its application to different operating structures is also being considered, including branch structures and individual companies which operate internationally. The proposed reporting requirements of ComFrame currently require an IAIG to provide an annual reporting package with prescribed elements. The working group discussed the level of prescription in the proposals, and a preference for ComFrame to specify outcomes, with flexibility for Colleges to decide how they should be achieved.

The working group also considered the current proposed requirement for IAIGs to establish a crisis management plan to be inappropriate. The

consensus of the working group was that a supervisor is better able to engage in dialogue around crisis management once familiar with the unique risks of a group, and further, that any plan established in advance is unlikely to consider the individual characteristics of a particular crisis, which is by nature unpredictable.

The working group discussed the identification of the group supervisor for ComFrame, and potential regulatory implications where the regulator of the top company in the group is not the most appropriate group supervisor, albeit it recognized that this should be rare in practice.

The working group also discussed the review of ICP 9 (supervisory review and reporting) against ICP 23 (group-wide supervision), by the IAIS's Insurance Groups and Cross-sectoral Subcommittee (IGSC) considering in particular revised requirements on regulator/ insurer communication, corporate governance, independent review of reports and information, and assessment of the fair treatment of customers, conduct of business requirements and consumer regulations.

The working group also reviewed the results of the IGSC's supervisory college roundtables and survey. The working group heard that the results indicated significant progress in the effectiveness of colleges, although best practices for the supervision of international groups continue to be developed.

#### New Charge

At the Spring National Meeting, the working group also discussed and adopted a new charge: "[i]n collaboration with the National Treatment and Coordination Working Group, develop procedures to implement a consolidated public hearing for acquisitions involving multiple jurisdictions under the NAIC Model Holding Company Act and Regulation."

## **ORSA Subgroup**

Following the Fall National Meeting, the Group Solvency Issues Working Group provided a set of recommendations on the implementation of the new US ORSA requirement to the Financial Condition Committee, which is responsible for implementation. The committee received and discussed the recommendations on a December 19th conference call, and voted to create an ORSA Subgroup to carry out the charges contained in the

recommendations. The new subgroup was therefore created with the following charges:

- Create an ORSA Feedback Pilot Project in 2012 for five to ten undisclosed groups to voluntarily submit an ORSA Summary Report for regulatory review under a confidentiality agreement in order for regulators to be able to provide some high-level (non-group specific) feedback to industry prior to the actual ORSA Summary Report effective date.
- Develop an enterprise risk management education program where regulators will benefit from additional guidance and/or training and then facilitate a delivery method to provide such applicable assistance.
- Develop a glossary to include in the ORSA Guidance Manual to provide clarification of terminology.
- Study the need for the NAIC to hire an ERM expert to provide staff support and future maintenance of the NAIC guidance on ERM and ORSA, and to provide assistance and training to states as they implement examination and analysis of ORSA.

The committee also established new charges for the Financial Analysis Handbook Working Group and Financial Examiners Handbook Technical Group. Both groups were charged to incorporate guidance into their respective handbooks to assist analysts and examiners in reviewing ORSA summary reports.

The implementation of the ORSA requirement is a priority for the Financial Condition Committee during 2012, and the committee plans to monitor progress closely. Once discussions over the legal framework are concluded by the Group Solvency Issues Working Group, the committee intends to establish an effective date, expected to be 2014 or 2015 at the latest. The committee also intends to provide a proposal to the Financial Regulation Standards and Accreditation Committee with respect to ORSA-related accreditation standards.

The new ORSA Subgroup met for the first time by conference call on February 2nd, and subsequently met in person in New Orleans. The subgroup discussed and initiated the planned pilot project for the ORSA, inviting insurers and groups to participate. At the time of the Spring Meeting, 12 insurers had applied to take part in the pilot, with several more expressing interest. While the identity

of the volunteers is confidential, the subgroup reported a good mix across life, P&C, title, health and reinsurance companies and noted the inclusion of international groups where US regulators do not carry out a group supervisor role. They also noted that some insurers taking part were slightly below the size exemption threshold. The subgroup heard that the international community is very interested in the outcome of the study, and discussed the importance of continuing to be engaged at the international level.

Insurers participating in the pilot have until June 30th to provide either a partial or complete ORSA, and have the option of providing non-actual numerical information. The subgroup plans to meet to discuss the reports in late July, but did not specify a date when feedback would be released to the industry. One focus for the subgroup will be to identify any areas where the interpretation of the ORSA Guidance Manual is not clear and potentially therefore to make clarifying amendments.

The subgroup also exposed a draft glossary of the terms contained in the ORSA Guidance Manual, prepared by the North American CRO Council for public comment until April 18.

The subgroup also discussed plans for a multi-year Enterprise Risk Management education program for state insurance department staff involved in assessing ERM and the ORSA, and heard presentations from volunteer ERM experts offering to provide assistance. The first phase of the program is due to start in May, and is likely to cover topics including the different models and maturity levels for ERM, proportionality and the assessment of ERM by rating agencies. Finally, the working group discussed the knowledge and skills requirements for a potential state or NAIC ERM specialist.

## PBR Working Group

Completion of the PBR project is one of the NAIC's major objectives for 2012, with adoption scheduled for the Fall National Meeting to allow presentation to state legislatures in 2013. Discussions on the project continued at the Spring National Meeting, with the PBR Working Group receiving a summary report on the final results of the VM 20 Impact Study. The results of the Impact Study were provided in full to Life Actuarial Task Force at the Spring National Meeting, and are discussed on page 21. LATF's current target completion date for the Valuation Manual is June 2012.

## Corporate Governance Working Group

The working group met at the Spring National Meeting in New Orleans, and continued its discussions on its charges to consider US corporate governance principles, and to identify potential improvements to the US regulatory solvency system.

The majority of the working group's focus at the Spring National Meeting was on its timetable to complete its charge by the end of 2012. The working group had planned to finish identifying any differences between US corporate governance practices and the Insurance Core Principles by the time of the Spring National Meeting. However, given that substantial progress on this task had not been made, the working group decided to divide and assign among the working group members the seven principles of the US Insurance Financial Solvency Framework, and the corporate governance practices identified in relation to each principle in the working group's document on Existing US Corporate Governance Requirements.

The working group discussed its approach to the comparison with the ICPs, and agreed that it would be a "comparative analysis," rather than an assessment of gaps. Where differences are found, the working group agreed to decide whether to make changes or to keep current US practice unchanged despite the difference to the ICPs, because in some cases the current US approach may be a different but equally valid approach to regulation. The working group also discussed the possibility that its review may identify potential improvements to corporate governance regulation that are not included in the ICPs.

Under Principle 1 (Regulatory Reporting, Disclosure and Transparency), these discussions will include a discussion of a referral from the NAIC/AICPA Working Group to consider the incorporation of SEC disclosures on board of director risk management and executive compensation. The NAIC/AICPA Working Group had previously developed an extensive blanks proposal for the reporting of this information, and had received a counterproposal from industry, concerned about the potential reporting burden of the proposed changes. Given the overlap with the work of the Corporate Governance Working Group, the matter was received for future consideration. The working group did not indicate any preliminary thoughts on the referral from the NAIC/AICPA Working Group.

Going forward, the regulators plan to meet regularly by conference call to compare existing practices with the ICPs and to discuss potential differences, in order to recover the previously agreed timetable for the project and to provide its recommendations by the end of the year. The working group also plans to hold an interim in-person meeting, and to keep an open dialogue with North American CRO Council and the industry.

## International Solvency and Accounting Standards Working Group

The working group met at the Spring National Meeting, and received updates on the progress of IFRS 9 (financial instruments), the insurance contracts project, and the activities of the IAIS Accounting & Auditing Issues Subcommittee (AAISC) and Solvency & Actuarial Issues Subcommittee (SSC).

### Insurance Contracts project

The working group heard that limited progress had been made on the insurance contracts project since the Fall National Meeting, and further that the timing for a revised draft standard had been extended from the second quarter of 2012 to the second half of 2012. The working group discussed the possibility that this may make a joint IASB/FASB exposure draft more likely, and that it may better align with the timetable for the financial instruments standard. However, the working group also recognized that further extensions were possible.

The working group also received an update on the FASB and IASB Boards' current discussions on the use of the premium allocation approach (also referred to as the unearned premium approach). The Boards were in broad agreement about the eligibility criteria for the approach, including the eligibility of contracts with a coverage period of one year or less. However, the Boards were divided on whether the approach should be optional for eligible contracts, with the IASB supporting optional application and the FASB supporting mandatory application.

### Financial Instruments Project

The working group heard that the Boards met in February to discuss the contractual cash-flow characteristics assessment, and tentatively decided that a financial asset could be eligible for a measurement category other than fair value through profit and loss. Significantly for the insurance industry, there was explicit recognition that the

Boards would consider the application of fair value through OCI to the insurance industry, which would be considered a positive step to reducing unnecessary volatility in the income statement. The Boards also continued their discussions on the three-bucket impairment model.

#### ComFrame

The working group received updates on the work of the AAISC and SSC, both of which are involved in the development of the ComFrame. The working group discussed the AAISC's recommendation that IFRS be used as the valuation basis for ComFrame. A significant factor in this recommendation is the working assumption that, by the time ComFrame is in operation, US GAAP and IFRS will have substantially converged, in particular for the large international groups to which ComFrame will apply. However, the working group discussed the fact that the proposed use of IFRS, and the potential additional books and records that will need to be maintained, continues to be a major concern for the industry.

The working group also discussed drafting work carried out by an SSC drafting group on Module 3, Element 5 of ComFrame, covering group capital. The topic of group capital is still subject to ongoing discussion, and the working group heard that the current drafting of Module 3, Element 5 reflects the strategic direction provided by US insurance regulators, and provides for regulators to establish group-wide capital risk measurement taking into account the nature and extent of solvency regulation in the different jurisdictions in which an IAIG operates. The risk measurement must address all material categories of risk.

However, the update stressed to the working group that the current wording is still draft, and remains subject to review by the SSC and Technical Committee, which has asked for the wording to be narrowed. Notwithstanding this, however, in response to an industry request the working group agreed to release the current draft wording of Module 3, Element 5 for public comment until March 23.

## **International Insurance Relations Committee**

The committee met at the Spring National Meeting, and received updates on many international activities and projects. The committee heard that joint technical discussions with the FIO had recently

been held with the EU, and that a new steering committee with three members each from the US and EU had been created to guide technical workstreams exploring areas for mutual analysis and discussion. The NAIC also recently held a cross-sector meeting with EU regulators for the insurance, banking and securities industries. The committee heard that discussions with the EU continue to be very productive. The NAIC and FIO also recently participated in a Joint Economic Committee meeting with the China Insurance Regulatory Commission.

The committee also received an update and discussed the Joint Forum's draft Principles for the Supervision of Financial Conglomerates, released for public comment in December 2011. The objective of the principles, which cover supervisory powers and authority, supervisory responsibility, corporate governance, capital adequacy and liquidity, and risk management, is to support consistent and effective supervision of financial conglomerates, in particular those active across borders. The committee heard that the next stage for the principles is not entirely clear at present. However, it is considered not improbable that, following adoption, they will be implemented and potentially enforced through a mechanism such as the Financial Sector Assessment Program.

In its discussion of IAIS activities, the committee discussed Connecticut Insurance Department's recent signing of the IAIS' Multilateral Memo of Understanding (MMoU), and how it has encouraged other states to enter the process. The committee also heard about recent Supervisory Forum discussions on confidentiality, the low interest rate environment, and the current economic environment.

The committee also discussed the IAIS Financial Stability Committee (FSC). The committee heard that the FSC will open its process to public comment soon, and that public consultation is expected in the near term on the FSC's proposed methodology for the identification of insurance G-SIFIs (Global Systemically Important Financial Institutions) and proposed prudential measures. The FSC has been performing data collection and analysis, and expects to issue a new data call in the summer. Based on the data collected, the FSC expects to make recommendations to the Financial Stability Board, who will make a determination of which insurers are considered to be G-SIFIs.

## Valuation of Securities Task Force

The task force met twice since the Fall National and in New Orleans and discussed the following issues.

### Final Instructions for Structured Securities

During a November 29 conference call, the task force adopted a previously exposed amendment to the SVO Purposes and Procedures Manual that provides final valuation rules and instructions for financially modeled and non-modeled structured securities subject to SSAP 43R. A flowchart which depicts the reporting requirements for modeled and non-modeled structured securities subject to SSAP 43R was also adopted and referred to the Blanks Working Group with a recommendation that it be considered as authoritative guidance.

### Consideration of New ARO Policy

During its November 29 conference call, the task force discussed a proposal from the New York State Insurance Department to change the policy and procedures for adding a nationally recognized statistical rating organization (NRSRO) to the NAIC's Acceptable Rating Organization (ARO) list. The proposal would permit any NRSRO that publishes its rating and research reports in English, and that is willing to negotiate a contract with the NAIC specifying the terms under which it will provide its ratings to the NAIC, to become an ARO. The proposal was exposed for a public comment period which ended January 13.

During a January 26th conference call, the task force considered the proposal for adoption. Several task force members expressed concerns that while the proposal is presented as a general change in policy directed to all NRSROs, the immediate result will be the addition of just one or two additional AROs which do not meet the criteria in the current SVO policy. Other regulators believe the new policy will spur competition. After further discussion, the task force adopted the proposal, with Wisconsin, Minnesota and Iowa voting against. In New Orleans, the task force adopted an amendment to Part One, Section 4 of the Purposes and Procedures Manual to eliminate the current threshold requirements to become an ARO and to permit any NRSRO to apply to be added to the NAIC List of Credit Rating Providers. The SVO will now begin contract negotiations with Kroll Bond Rating Agency and with Egan-Jones Rating Company.

### Exempt Obligations for AVR and RBC

The task force received and exposed for a thirty-day comment period a proposed amendment to Part Six, Section 2(e) of the Purposes and Procedures Manual. The amendment would conform the list of securities considered "exempt obligations" for purposes of determining the asset valuation reserve and the risk-based capital calculation to recently adopted instructions for government securities in Part Two, Section 4.

### Classification Methodology

The task force received and exposed for a sixty-day comment period a proposed amendment to the Purposes and Procedures Manual that would permit the SVO to notch the NAIC designation of a security subject to classification methodology, rather than instructing the insurer to report the investment in a different reporting category. Securities subject to notching would be indicated with an "S" subscript, which would enable regulators to query an insurer's Schedule D for the subscript. This proposal is expected to affect a relatively small number of securities.

### Methodology Review for Loan-Backed and Structured Securities

The task force received a preliminary research report and presentation from SVO staff regarding the implications on capital of mapping the intrinsic price produced by financial modeling to RBC. The research is focused on two aspects: (1) comparing the relative performance of the various RBC approaches (Modeling, FE-ratings based, Modified FE) currently used for structured products, and (2) analyzing the sufficiency of RBC to cover the expected losses.

Per the SVO presentation, RBC as a percentage of book adjusted carry value for RMBS was 2.4% for modeled securities, 11.2% for FE securities and 10.6% for Modified FE securities. The results for CMBS were 1.1%, .9% and .8%, respectively. The consultant to the SVO noted that difference between modeling and FE/MFE is that modeling takes severity of loss into account. The SVO expects to finalize its study shortly, and a task force meeting will be scheduled soon after to review and discuss the final research report.

### RMBS/CMBS Mid-Year Review

The task force voted to discontinue the annual requirement to have SVO staff conduct a study of the status and trend of the RMBS and CMBS markets. The task force concluded that the study is no longer necessary.

### Derivatives Market Study Working Group

The task force received a request from New York to reconstitute the Derivatives Market Study Working Group in order to consider certain technical issues that have arisen with the Schedule DB reporting instructions and to make recommendations for changes as necessary. New York will develop a scope for the project and the task force will meet to consider the proposal. New York indicated that there are only a few technical issues and hopes that the work can be completed quickly to be effective for 2013 quarterly statement reporting.

### **Invested Assets Working Group**

#### Working Capital Finance Notes (WCFN)

The working group continued its discussion on WCFN noting that on a February 7 conference call, the working group heard a summary of discussions it had with the FDIC on how trade receivables are regulated followed by a testimony on trade receivable financing in banking by a Citibank representative. The discussion with the FDIC noted that trade receivables are a niche business primarily conducted by larger, sophisticated banks. Trade receivable financing is labor intensive, involving significant recordkeeping. Banks disclose detailed information about each receivable and the applicable valuation procedure and keep detailed payment history that regulators use to drive probability of default and loss given default calculations. Trade receivables are assigned a flat 8% charge under Basel I but effective 2013, higher quality credits will get a lower charge and lower quality credits will get a higher charge.

With working capital finance notes, the insurance company is secured in the sense that it owns the receivable and therefore, is a trade creditor and has the same status as a secured bond holder. The working group discussed a letter received from the trade association ACLI recommending that WCFN programs be prescribed under the same capital treatment as other assets designated NAIC 1 or 2 by the SVO.

The working group discussed a proposal from the Connecticut Insurance Department relating to WCFN treatment as admitted assets incorporating 23 criteria. Key proposed criteria include the following:

- Program documents must be reviewed and approved by the SVO with any amendments to the program documents being re-filed prior to any purchase

- Eligible trade receivables should be limited to those arising from an actual transaction between the seller/vendor and the obligor and purchased within 30 days of the transaction
- Eligible trade receivables must require a confirmation from the obligor that all requirements of the vendor/seller have been fully and completely satisfied, that all rights of set-off have been waived and that a specific payment date has been confirmed
- Programs are subject to an annual SSAE 16 service organization report, which is to be filed with the SVO
- Obligors are restricted to investment grade corporate entities

The working group voted to release the proposal for a 14-day comment period, ending March 18.

### **Reinsurance Task Force**

The task force met in New Orleans and discussed the following projects.

#### Credit for Reinsurance Models

The task force discussed next steps to assist the states in implementing the revised *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786). The task force is establishing a drafting group to develop an NAIC process to review non-US jurisdictions, identify which jurisdictions will be initially reviewed, and develop a timeline for implementation. The task force also plans to form a second group to provide advisory support and assistance to states in the review of reinsurance collateral reduction applications. The task force hopes to finalize the formation of these two groups within the next few weeks.

The task force also plans to develop instructions for Form CR-F and CR-S, which are annual filings required to be completed by certified reinsurers under the revised Credit for Reinsurance models.

NAIC staff reported on the progress of states adopting the revisions to the Credit for Reinsurance Models. Both Florida and New York have adopted legislation and approved reinsurers for reduced collateral. New Jersey and Indiana adopted revised statutes in 2011; New Jersey is currently working on the corresponding regulation. In 2012 Indiana proposed further revisions to its statute to be consistent with the NAIC models, and is working on

the corresponding regulation. Staff is not aware that either state has approved any reinsurers. Virginia is expected to adopt similar legislation in 2012.

#### Accreditation Discussion

The task force exposed for a 30-day public comment period proposed key elements for the "reinsurance ceded standard" under the Financial Regulation Standards and Accreditation Program with respect to the revised models. After adoption, the task force will forward the document to F Committee recommending expedited adoption.

There was significant discussion among task force members regarding whether the recently adopted revisions to the two reinsurance models are "voluntary" or not for accreditation purposes. The accreditation process has always been to require states to adopt new standards (after the lengthy exposure period) that are stricter than then current standard. Since these revisions reduce collateral requirements, they are not viewed as more strict. Several regulators expressed the view that uniformity among the states is critical, while others noted that it would be nonsensical for a state to lose its accreditation status merely because it did not adopt the reduced collateral requirements for reinsurance. The task force appeared to conclude that if a state reduces its collateral requirements, then the revised model guidance is mandatory. Otherwise, the reduced collateral standards are voluntary.

#### Collection of Reinsurance Recoverable Balances

The task force briefly reviewed its referral from the Financial Condition Committee and the Receivership and Insolvency Task Force asking for assistance in providing a recommendation for enforcement of the collection of undisputed balances held by ceding insurers in receivership. This could include consideration of a NAIC Model Law or Guideline so that states have additional authority to collect such balances. NAIC staff is performing additional research on the issue and plan to report to the task force at a later meeting.

## **Capital and Special Purpose Vehicle Use Subgroup**

This newly formed subgroup met via conference call on January 27 and in New Orleans to begin work on its revised charge, which is as follows: "study insurers' use of captives and special purpose vehicles (SPVs) to transfer other than self-insured risk in relation to existing state laws and regulations and

establish appropriate regulatory requirements to address concerns identified in this study. The appropriate regulatory requirements may involve modifications to existing NAIC model laws and/or generation of a new NAIC model law." The subgroup clarified that RRGs are also excluded from its review (in addition to self-insured risks). Voting members of the subgroup are representatives from Texas (chair), Missouri, Michigan, New Jersey, New York, South Carolina and Vermont. The subgroup also has two "monitoring non-voting members" from Rhode Island and Vermont.

Thus far, the subgroup has spent most of its time developing and compiling a detailed twenty-question survey sent to all states asking for information on how they regulate captives and SPVs. Responses from thirty-one states were received, which were summarized (with no attribution to specific states' responses) and reviewed in detail in New Orleans. Among the more significant discussions was acknowledgement of the fact by many regulators that there are legitimate uses for captives and SPVs, but that the role of this subgroup is to determine which uses are legitimate. One regulator commented that their recommendations should not reduce the "creativity and flexibility" provided by captives, while another regulator responded that "we are not here to protect the captive industry."

Question 11 of the survey asked what are the differences in solvency standards for captives and SPVs that assume third party risk from insurers as compared to commercial insurers writing a similar product. State responses included lower minimum capital and surplus requirements, not being subject to RBC requirements, more flexibility in reserving and capital requirements and confidential treatment of captive financial information. In response to Question 18 as to whether captives and SPVs should be subject to accreditation standards, fifteen states responded "yes," nine responded "no" and seven responded "not sure" or "not applicable."

The subgroup also distributed an ambitious proposed timeline showing bi-monthly conference calls starting March 30, with the goal of a draft model law/whitepaper to be exposed by June 26, with a public hearing on the draft at the Summer National Meeting. Topics for discussion at these calls include transparency, confidentiality and information sharing, types of business and risks underwritten by captives and SPVs, capitalization, credit for reinsurance, accounting and reporting and holding company analysis.

## Blanks Working Group

The working group adopted the following three blanks proposal effective for the 2012 annual statement. The proposals were previously exposed during the Fall National Meeting.

- Instructions to the annual statement Notes were modified to indicate that certain disclosures are captured electronically, and to clarify that certain disclosures must be presented in a format consistent with the illustration to facilitate the data capture. (Agenda item 2011-37BWG)
- New instructions were added for RRGs that report on a GAAP basis, utilizing the P/C blank. The instructions are applicable for the annual and quarterly blanks, and clarify how certain GAAP items that are inconsistent with SAP should be reported. (2011-38BWG)
- The illustration and instructions for Note 9A were modified to reflect the disclosure requirements of the recently adopted SSAP 101, Income Taxes. (2011-39BWG)

The working group discussed a proposal (2012-25BWG) which would require insurers sponsoring separate accounts to file separate statements for insulated separate accounts and non-insulated separate accounts. Concerns have been raised by some regulators regarding the growing trend of life insurers to include non-unit linked (non-insulated) products within the separate account. The proposal is supported by the chair of the Financial Condition Committee as a mechanism to further enhance financial statement disclosures with respect to assets backing separate account products, and specifically, support the effort to clearly differentiate the information in the separate account between insulated and non-insulated products.

Industry representatives expressed significant concerns related to the increased reporting burden. They also suggested that the proposal was premature, noting that other NAIC groups are still evaluating the matter. Following discussion, the proposal was exposed for public comment and referred to the SAP Working Group to consider whether a definition of insulated and non-insulated separate accounts should be included within SSAP 56.

Twenty-four other new proposals were exposed for a public comment period which ends May 14. These

proposals will be considered for adoption on a conference call to be scheduled in June. Some of the more significant proposals would:

- Add an illustration for Note 21F (4) to data capture admitted and nonadmitted state tax credits. Other illustrations in Note 21F would be modified to reflect the inclusion of non-transferable state tax credits in the disclosure. (2012-1BWG)
- Modify Question 3.1 of the General Interrogatories to reflect the requirement to report Schedule Y, Part 1 each quarter. The proposal also would add a requirement to provide a brief description of the nature of any changes to the schedule as previously reported. (2012-3BWG)
- Add Exhibit 5 Interrogatory disclosures for contingent deferred annuity contracts and lifetime income benefit contracts. Disclosure requirements already exist for other synthetic products, other types of guaranteed living benefits, and off-balance-sheet risk. (2012-4BWG)
- Add a definition to the Investment Schedules General Instructions for Other Loan-Backed and Structured Securities. The proposal would clarify that those securities subject to the guidance in SSAP 43R but not included in the definition of RMBS or CMBS should be included in Other Loan-Backed and Structured Securities. (2012-5BWG)
- Add a flowchart to the Investment Schedules General Instructions which illustrates the reporting of SSAP 43R relating to the application of the Modified FE process. The proposal would also eliminate reference to the "SM" NAIC designation suffix from the Schedule D instructions, as changes adopted by the SAP Working Group for SSAP 43R eliminated the need for the "SM" suffix. A new "S" suffix would be added to the bond matrix for Schedule D, which would indicate that the SVO has notched the bond as part of its review. (2012-7BWG)
- Revise instructions for the P&C Actuarial Opinion, P&C Actuarial Opinion Summary, and Title Actuarial Opinion. (2012-16BWG) (See further discussion of this proposal on page 25.)
- Add a line to the Five Year Historical Data page(s) to require companies to identify which amounts of investments reported in the current

Investments in Parent, Subsidiary, and Affiliates section are in an immediate or indirect parent. (2012-18BWG)

- Add instructions and modify reinsurance schedules for the reporting of certified reinsurance in the annual and quarterly statements. Separate blanks proposals were exposed for each blank. (2012-19BWG through 2012-23BWG)
- Split the Expatriate Column in the Supplemental Health Care Exhibit into two separate columns for small group and large group plans and add new instructions to clarify the reporting requirements. (2012-24BWG)

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

## **Receivership Separate Accounts Working Group**

The working group met three times via conference call in January and February and again at the Spring National Meeting. The working group first discussed its new charge from the Financial Condition Committee to consider receivership issues related to the current separate account mix of products and assets, including, but not limited to, issues related to identification and disclosure of insulated and non-insulated assets and products. The working group agreed to form a subgroup chaired by Ohio to draft a document on the expectations of the SEC and insurance receivers related to separate account receivership with registered products and the subgroup will try to arrange a meeting with the SEC to discuss this.

The working group had extensive discussions on several occasions of a proposed Blanks change, which would greatly expand separate account reporting. Industry is strongly opposed to the proposal, but it was exposed by the Blanks Working Group at the Spring National Meeting over their objections. See discussion above in the Blanks Working Group summary.

## **Financial Regulation Standards and Accreditation Committee**

The committee met in New Orleans and took the following actions.

### **Revisions to Documents Required for Accreditation**

Revisions made during 2011 to publications that are required for accreditation purposes (e.g., the Annual Statement Blanks and Instructions; Life and P/C RBC Formulas; the SVO Purposes and Procedures Manual; the Accounting Practices and Procedures Manual; and the Examiners Handbook) were adopted by the committee at the Spring National Meeting as revised accreditation standards. No revisions were deemed to be significant to the accreditation program.

### **Insurance Holding Company System Regulatory Act and Model Regulation**

The committee discussed the 2010 revisions to the Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation. A proposal to include these revisions within Part A: Laws and Regulations of accreditation standards was exposed for a thirty-day comment period. The committee will hold a conference call in December to consider comments and vote on the proposal.

### **Risk-Based Capital for RRGs**

The committee received a referral from the Risk Retention Group Task Force which would require states that charter risk retention groups to adopt the Risk-Based Capital for Insurers Model Act for accreditation purposes. The referral was exposed for a thirty-day comment period.

### **Standard Valuation Law**

The 2009 revisions to the Standard Valuation Law were re-exposed for comment until December 31, 2012. The Standard Valuation Law is expected to become a significant element for Part A: Laws and Regulations of the accreditation standards, and was previously exposed at the 2010 Spring National Meeting. However, the committee is awaiting finalization of the PBR Standard Valuation Manual and plans to consider both items for accreditation purposes in 2013.

### **RBC for Health Organizations Model Act**

The committee discussed the possible inclusion of the Risk-Based Capital for Health Organizations Model Act as an accreditation standard. RBC is currently an accreditation standard for both life and property/casualty insurers. As of July 2011, 37 states have adopted a health RBC statute, consistent with or similar to the model act. The committee took no action on the proposal in New Orleans, but is expected to continue this discussion at the Summer National Meeting. If the model act is adopted as an

accreditation standard, it would likely have a January 1, 2015 effective date.

#### Model Risk Retention Act

The committee received a referred from the Risk Retention Working Group which would require states that charter risk retention groups to adopt the Model Risk Retention Act for accreditation purposes. The corporate governance standards within the model act were developed to ensure that insurers implement and operate within effective risk management and internal control systems, including determining the level of internal economic capital that should be held for solvency purposes. The referral was exposed for a thirty-day comment period.

#### Risk-Based Capital for Insurers Model Act

Revisions to the Risk-Based Capital for Insurers Model Act were exposed for a thirty-day comment period. The revisions were adopted by the NAIC in November 2011 and changed the level at which the life RBC trend test is triggered to be consistent with the level for health and property/casualty RBC.

#### Revisions to Review Team Guidelines

A referral from NAIC staff proposing two new review team guidelines for examination was exposed for a thirty-day comment period. The first proposed guideline relates to addressing all risks identified by examiners in a risk-focused examination. The second proposed guideline requires a state insurance department to notify the Examination Oversight Task Force if an exam report has not been issued within 22 months of the examination "as-of" date.

The committee also adopted previously exposed revisions to the timing guidelines for financial analysis. Effectively immediately, state insurance departments are required to analyze supplemental filings from non-priority insurers within 120 days from receipt. These supplement filings include the annual audited financial statements, applicable holding company filings, and Management's Discussion and Analysis.

## **Life Insurance and Annuities Committee**

The committee met in New Orleans and discussed the following issues:

#### CDA Subgroup

At the conclusion of a lengthy discussion of contingent deferred annuities (CDAs) at the Fall

National Meeting, the committee voted to form a group to study the new market of contingent annuities and similarly designed products from an actuarial and policy standpoint, and to discuss how the product should be classified and whether they should be sold under existing statute or model law.

A contingent annuity is essentially a stand-alone guaranteed living withdrawal benefit (GLWB). Parties in support of CDAs as annuities include most insurance companies and an AAA working group formed to address the issue, which had recommended that the NAIC classify a contingent annuity as an annuity and not as a financial guaranty product. Conversely, some insurers and consumer groups believe the product is not an annuity and that the product could lead to reserving and capital issues.

The subgroup met five times via conference call December through February to discuss this contentious issue. The subgroup's summary to the committee noted that 125 parties participated in the calls and "all participants were afforded the opportunity to present views, ask questions and raise concerns." At the Spring National Meeting the chair of the subgroup (New Jersey), presented the conclusions of the subgroup (also presented to interested parties during its February 16th conference call), which include the following:

- CDAs are similar in structure and risk profile to GLWB riders inside variable annuities and many of the same regulations should apply.
- CDAs should be sold by life insurers, not financial guaranty insurers.
- The subgroup's study raised both solvency and consumer protection issues as there has been little discussion of the embedded financial guaranty aspects of the CDAs and GLWB riders, and there have been significant revisions to the basic design of GLWB riders that have changed the risk/reward equation for insurers and consumers.
- The subgroup recommends that a new working group be formed to address the solvency and consumer protection issues identified.

The task force then heard comments from interested parties. A representative from the Center for Economic Justice commented that he disagrees with the subgroup's conclusions due to the risk posed to

consumers of CDAs and that sales of CDAs should be halted until the NAIC adopts "stop gap" guidelines.

The committee then voted to adopt the CDA Subgroup report, which included adopting the subgroup's finding that contingent deferred annuities are annuities and subject to existing state laws and regulations applicable to annuities. The committee also voted to form a Contingent Deferred Annuity Working Group to evaluate the adequacy of existing laws and regulations as applied to CDAs and GLWBs and whether additional solvency and consumer protection standards are required. Wisconsin will chair the new working group.

#### Viatical Settlements Working Group

The newly re-formed Viatical Settlements Working Group met for the first time at the Spring National Meeting. The working group reviewed its charge, to "review and consider revisions to the *Viatical Settlements Model Regulation* (#698) for consistency with the 2007 revisions to the *Viatical Settlements Model Act* (#697), including reviewing and considering revisions to or replacement of, as appropriate, Appendix A – Informational Brochure."

The working group discussed a list of questions related to the revisions to the Viatical Settlements Model Regulation, which included reports, anti-fraud plans, brochures, and how to take account of developments since the amendments to the Viatical Settlements Model Act, and states which have already updated their regulations. The questions are available for comment until April 2, following which the working group intends to meet by conference call to discuss the comments and decide on potential revisions to the model regulation.

## **Life Actuarial Task Force**

The task force has a new chair (Texas) and vice-chair (Ohio) for 2012. The majority of LATF's day and a half meeting (and its nine interim conference calls since the Fall National Meeting) were spent on finalizing issues related to the Principle-Based Reserves (PBR) project and changes to the working draft of the Valuation Manual, culminating in the exposure of a revised draft of the Valuation Manual. In an unusual move, Insurance Commissioners from Texas and Tennessee (chair of the parent committee of LATF) addressed the task force with remarks stressing the NAIC's commitment to have a proposal for adoption of PBR during the 2013 legislative sessions, at which all states will be participating. To this end, the Life Insurance and Annuities Committee wants to adopt PBR in 2012 and will play a more active role in clarifying expectations, setting

deadlines, and providing guidance to ensure LATF is appropriately focused on the items necessary to achieve this objective.

#### **PBR Valuation Manual**

Several changes to the Valuation Manual were discussed and adopted during the meeting, while other changes were adopted during conference calls between the Fall National Meeting and this meeting. LATF voted to expose the current working draft of the Valuation Manual for a two-month comment period, with comments due May 1. LATF is targeting mid-June for adoption of the Valuation Manual. Following is a summary of key areas of discussion.

#### Life Reserves (VM-20)

Changes to VM-20 were primarily focused on mortality assumptions, net premium reserves and investment rate assumptions. During an interim conference call, LATF adopted a modified framework for determining the mortality assumption. The new framework simplifies the approach for determining the mortality assumption and changes the process for grading to industry tables. In finalizing the draft Valuation Manual, the task force spent considerable time discussing the guidance related to setting prudent estimate mortality assumptions, specifically the approach for determining the sufficient data period that will be considered credible for purposes of assigning credibility to a company's own experience in setting anticipated experience assumptions. Several clarifying changes were discussed and approved, although the number of claims used to determine the sufficient data period remains open. LATF anticipates resolving this open item prior to final adoption of the VM. Other changes address the application of mortality improvement factors to industry tables and grading of the anticipated experience assumption to the industry table.

LATF also spent considerable time discussing the Net Premium Reserve (NPR), and the need to evaluate this reserve in the context of the deterministic and stochastic reserves, particularly for ULSG products. The NPR is the minimum reserve under VM-20 and is uniquely defined for Term and ULSG products. The NPR is likely to serve as the tax reserve under PBR. Ideally the NPR should be close to the deterministic model reserve and not overly excessive. Results from the VM-20 Impact Study indicate variation in companies' interpretation of the NPR requirements for ULSG, and overly conservative NPR results stemming from application of a level premium methodology to a product that specifically provides for flexible

premiums. The ACLI is analyzing alternative methods and expects to present proposed changes by late April. Final guidance on the NPR is expected to be completed in time for inclusion in the adopted VM later this year.

Alternatives for determining investment and reinvestment rates had been debated at the Fall National Meeting and a resolution was reached in a January conference call. Alternative 1, originally proposed by New York, is the more simplified approach of the two alternatives and produced the higher reserves of the two alternatives. Alternative 2 is the original approach proposed in VM-20 and has a more complicated structure. A compromise was reached and LATF adopted a version of Alternative 2 that reflects a more conservative credit quality blend in the maximum spread that can be assumed.

#### Experience Reporting (VM-50 and VM-51)

Discussion regarding experience reporting focused on confidentiality and changes needed to the current language to preserve data confidentiality and clarify accessibility to data. The Standard Valuation Law has very specific and strong provisions for the identification and protection of confidential information, and references in VM-50 and VM-51 were modified to be equally as strong. References to the Society of Actuaries, the AAA, or "professional actuarial organizations" were removed from the Valuation Manual, recognizing that the NAIC will assign resources from the appropriate organizations as needed to perform the necessary data analysis and experience studies. The selection of premium as the metric to determine company size for purposes of the New York pilot project was also discussed, and the second data call for that project is expected shortly. The Policyholder Behavior Data Format of VM-51 will be exposed separately from the Valuation Manual, with the deadline for comments three weeks prior to the Summer National Meeting.

#### Reporting and Review (VM-30 and VM-31)

The PBR report is intended to be used as the Actuarial Memorandum, or at least comprise a substantial component of the memorandum, and the disclosure requirements are the main elements. Amendments to these sections reflect changes in VM-20 since the last exposure, primarily related to disclosures regarding the impact of margins, including identification of implicit margins in the anticipated experience mortality assumptions. Another change was an option for companies to determine an anticipated experience assumption for prescribed risk factors (e.g. default costs) and

disclose margins resulting from use of the prescribed assumptions.

#### Process and Coordination (VM-00 & VM-01)

The working drafts of these sections were modified to include a requirement that regulators coordinate requests for information through the NAIC as a means of protecting confidentiality. The revised language will be included in the exposed materials.

#### **PBR VM-20 Impact Study on Life Products**

Towers Watson presented an overview of the final 351 page report that was released to the NAIC in February (detailed findings and analysis had been previously communicated to the task force). Phase I of the study was designed to assess the impact of PBR on the US life insurance industry through focus on implementation and comparison of results to formula-based reserves. Phase II was focused on evaluating sensitivities and assumptions. The presentation included observations for all fourteen original study objectives including financial impact, effectiveness of exclusion tests and minimum requirements, bases for assumption setting, reporting and documentation issues, identification of regulatory benchmarks for evaluating results, and implementation challenges.

General conclusions were that VM-20 methodology will have the greatest impact on ULSG and level term products, with term reserves generally lower and ULSG reserves generally higher, relative to current reserve levels. Exclusion tests appear to be effective, and there was little impact from reducing the level of granularity used to define model cells or reducing the number of scenarios used in the stochastic reserve. The results showed significant volatility in the NPR as a percentage of CRVM reserves from company to company, and for term insurance, the NPR was the maximum reserve in a majority of cases, which was not the desired result.

Based on the analysis and observed results, Towers Watson made several recommendations including:

- Clarify whether term gross premiums used in the deterministic reserve exclusion test should be applied over the level term period or over the life of the contract, as this was a source of confusion
- Modify the NPR to be more effective as a floor and not a maximum reserve
- Clarify the intent of the application of margins to YRT reinsurance premium rates, as this was a source of inconsistency between companies

- Review the mortality blending requirement as it appears to be adding a significant margin to the ending PBR reserve
- Increase the corridor for starting assets as a percentage of modeled reserves (deterministic or stochastic) to be 5% instead of 2%, to lessen the number of iterations required to meet the threshold.

LATF is currently evaluating the NPR requirements and mortality blending requirements and will include the other three items noted above as items to be quickly addressed before June for inclusion in the VM when it is adopted by LATF.

#### **Actuarial Guideline XXXIII (AG 33)**

The Academy's Annuity Reserve Work Group presented a report on recent activity including compilation of responses to an informal survey on CARVM anomalies, and development of a deterministic reserve for use in PBR for fixed annuities (VM-22). The survey originated from the Academy's awareness of questions and issues related to the application of AG 33 to Guaranteed Living Income Benefits (GLIBs). The results of the survey indicated concern about GLIB reserve levels, as well as questions about the synchronization of calendar year statutory valuation rates with the current economic environment, refreshing of valuation rates for "CD" annuities (that renew subsequent to the initial interest and surrender charge guarantee periods), and proper valuation rates for settlement option elections. Other areas of uncertainty include valuation rates for use with contracts with temporary market value adjustments, treatment of multiple index crediting options with different guarantees, and contingent surrender charges. LATF asked that the work group continue its efforts on VM-22, and to investigate potential issues with AG 33.

#### **Nonforfeiture Improvement**

The AAA Nonforfeiture Improvement Working Group reported to the task force on continued discussion of the recommendations presented at the Fall National Meeting (the "Report"). The Academy Working Group, LATF and the ACLI Standard Nonforfeiture Law Modernization Work Group have held conference calls to discuss the Report and specifically the operation of the Gross Premium Nonforfeiture Method (GPNM) that was outlined.

The GPNM is a retrospective approach utilizing actual policy gross premiums and reflecting the funded portion of the risks in the policy. After further review of an example demonstrating the

methodology, LATF requested that working group study the actuarial issues associated with the choice of assumptions that would be used and make specific recommendations concerning how the assumptions should be established and any guardrails deemed appropriate from an actuarial perspective. The working group will prepare a report on the considerations in choosing assumptions, but needs resolution of related issues before developing a specific proposal. With the push to get PBR adopted by mid-June, LATF's focus on non-forfeiture improvement will be deferred to late June.

#### **Mortality Tables**

LATF received a report from a joint Society of Actuaries and AAA group regarding the status of two separate mortality table projects. For guaranteed issue (GI), simplified issue (SI) and preneed (PN) products, data has been submitted from 15, 33 and 12 companies, respectively. Data cleansing and analysis will be completed this spring, and the goal is to have first draft of the new tables by late 2012.

Work on the 2014 Valuation Basic Table to support PBR is progressing. Data from 2007-2009 is being incorporated with original experience data for 2002-2007. The initial focus is on developing aggregate tables, then smoker/non-smoker splits, followed by preferred tables. Preliminary analysis of selection period, mortality improvement and graduation basis is complete. Originally, experience from 2002 through 2007 was collected for purposes of this study. However, with delays in PBR, data from 2007 through 2009 have been collected from 40 companies and is being included in the analysis. This additional information will greatly increase the amount of preferred underwriting experience data on which the new table will be based.

The joint SOA & Academy group also noted that the 2012 Individual Annuity table has been exposed for several months now but only two comments have been received. This table is a generational table instead of static, as it has been in the past, and there is some concern among regulators that the exposure draft is difficult to find, and that companies are not aware of the potential challenges with implementation of a generational table. LATF approved changes to the Model Regulation to recognize the 2012 Individual Annuity Reserve (2012 IAR) table for use in valuation of annuity contracts and voted to expose the changes for a 45 day comment period. Adoption of the table is planned for Summer National Meeting.

### **Moody's Corporate Bond Index**

Disagreement over the contract terms between Moody's and the NAIC was resolved and the NAIC will continue to publish the Moody's rates for use in establishing dynamic interest assumptions.

### **Standard Nonforfeiture Law**

LATF adopted changes in the Standard Nonforfeiture Law language to make it consistent with PBR requirements and the revised Valuation Manual. These changes tie the applicable mortality table and non-forfeiture interest rates to the Valuation Manual, for policies issued after the effective date of the Valuation Manual. Non-substantive changes included clarifying the mortality table references and the applicability relative to policies issued before or after the operative date of the VM.

### **IIPRC Report**

The Interstate Insurance Product Regulation Commission provided a report of recent activities related to life and annuity product filings, including the issuance of a Filing Information Notice (FIN) regarding separate accounts. This requires companies to disclose whether separate accounts are insulated or not, and establishes filing standards for Group Term and Group Life products. During the summer, the Commission will begin the five-year review of life standards. Product standards are evaluated every five years and the Commission asks staff and interested parties to present proposals and recommendations for consideration, which will determine the need for any changes. If no changes are implemented then the standards are approved for another five year period.

## **Annuity Sales and Suitability Issues Symposium**

As state insurance regulators begin to implement the annuity suitability model regulation, the life insurance industry continues to implement the new processes designed to meet regulatory standards and avoid market conduct action. This was evident on March 2 when the NAIC held a symposium designed to answer questions related to the implementation of the new suitability model. Panelists included Commissioner and Chair of the Life and Annuities Committee, Julie Mix McPeak, Joseph Borg, Director, Alabama Securities Commission, Andrew Favret, FINRA, and Jim Mumford, First Deputy Commissioner and Securities Commissioner of the Iowa Insurance Division.

The symposium was well attended by approximately 100 life industry representatives, regulators, and other interested parties. A healthy dialogue ensued related to several "red flags" regulators would be looking for while conducting a suitability analysis. While the following is not an exhaustive list, regulators will likely note the following when conducting a suitability analysis.

- Were there higher than average surrenders by product or by producer?
- Did the applicant opt not to supply suitability information?
- Did the annuitant make any withdrawals that were close to the issuance date?
- Does the annuitant's age indicate that the product may not have been suitable?

In addition, regulators spoke candidly about their approach when suitability issues arise during a market conduct exam. Specifically, the panel acknowledged there would be challenges associated with implementation of the suitability model and explained that they would be willing to work through them with regulated entities, while ensuring that the consumers' interests are protected.

The symposium also included a Social Media panel lead by Tim Mullen, Director of the Market Regulation Division at the NAIC, Keith Nyhan, Examiner in Charge for the New Hampshire Insurance Department and Donald Walters, President and CEO of CEFLI. The panel focused on the use of social media by insurance producers as a means to build relationships and their professional networks. In addition, the panel discussed a white paper entitled, *The Use of Social Media in Insurance*, which has been adopted by the Social Media Working Group.

The white paper notes the use of social media by the insurance industry is on the rise. While several insurance departments are regulating through market conduct examinations, others are regulating on a case-by-case basis when complaints arise. Currently, there is no plan to develop a model law or regulation about the use of social media in insurance. The panelists noted that the dynamic nature of social media requires regulatory flexibility, which is often difficult with a statute or regulation.

The panels described the nexus between the suitability and social media discussions. First, the actions of those using social media are expected to be supervised and monitored. Second, record keeping requirements need to be considered and enforced. Lastly, insurers need to set clear standards about what their expectations are from their

producers as they relate to both suitability and the use of social media.

## Health Actuarial Task Force

### Long Term Care

The LTC Actuarial Working Group held its meeting to kick off the task force's session. The primary topic of discussion was continued work on the development of a new LTC valuation table. Data issues delayed the analysis but task force members have begun the tabulation of claims incidence rates and termination rates. Reasonableness checks are targeted for completion by the end of June, with issuance of a draft report by mid-August for presentation at the Summer National Meeting.

### Long Term Disability

The task force received an update from a joint Academy & SOA group that is developing a new LTD valuation table to replace the 1987 Commissioners Group Disability Table. The group presented a proposed table and methodology that incorporates a company's own experience into the termination rates used for valuation purposes, taking into account the credibility of the company's data.

The proposed table contains a 15% margin in the termination rates relative to the base table, and limits carriers own experience margins applied in years 1-5 to 5%-15% based on the credibility of the underlying experience. The group plans to finalize the proposal for exposure in the coming months, targeting a complete recommendation by June and Commissioner approval at the Summer National Meeting.

### Health Care Reform

Various subgroups of the Health Care Reform Actuarial Working Group presented updates, which included discussion of a recommended approach for establishing state-specific thresholds for annual review of "unreasonable increases in premiums for health insurance coverage," as required by PPACA. The threshold for the initial year of the rate review program (Sept 2011 - August 2012) was set at 10% for all states, and state-specific thresholds are to be established thereafter. Members of the Center for Consumer Information and Insurance Oversight (CCIIO) presented a draft discussion document recommending an approach similar to that used to establish the 10 % threshold, but that would account for state-specific variations in specified data elements and would allow states to propose their own thresholds. The CCIIO plans to finalize the

recommendation in March, expose the document in April and adopt a recommendation by June 1, to be effective September 1, 2012.

## Casualty Actuarial and Statistical Task Force

At the Spring National Meeting, the task force adopted proposed changes to the Annual Statement instructions for the 2012 Property/Casualty Actuarial Opinion, Property/Casualty Actuarial Opinion Summary, and Title Actuarial Opinion, including improvements to the documentation requirements in the detailed Actuarial Report maintained at the company. Changes to the Actuarial Report are significant and incorporate a description of the appointed actuary's relationship to the company with clear description of the actuary's role in advising the Board and/or management regarding the carried reserves.

The Actuarial Report should identify how and when the appointed actuary presents the analysis to the Board and, where applicable, to the officer of the company responsible for determining the carried reserves. The Report should include an exhibit of reserves which agrees to the annual statement and compares the actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis, and the actuary's conclusions including the actuary's point estimate, range of reasonable estimates, or both. The Report should also include an exhibit or appendix showing the change in the estimates from the prior actuarial report, including extended discussion of factors underlying any material changes.

The task force discussed two issues related to appointed actuaries who do not write acceptable actuarial opinions. The first is the standards of practice under which actuaries operate (i.e., Actuarial Standards of Practice) are not always drafted to meet the needs of regulators. The second relates to the fact that the commissioner has authority for corrective action when the work of a life company appointed actuary fails to meet regulatory needs or requirements while for P/C companies, the commissioner does not have comparable authority. The task force is considering how best to handle these issues and one option proposed was to revise the *Property and Casualty Actuarial Opinion Model Law* (#745). The task force discussed that approval of both Property and Casualty Insurance Committee and Executive Committees is needed prior to

amending a model law if the task force decides to proceed with this option. The task force discussed the establishment of a subgroup to draft the required paperwork to amend the model law.

The task force also discussed the need to consider ways to improve financial reporting to make it more meaningful. It was noted that some information within the annual statement is more useful than others. Additionally, some requirements may be more obscure. Thus, a request was made to hold a conference call and invite the industry (i.e. appointed actuaries) to provide feedback to improve the usefulness of financial statement reporting and to discuss industry concerns. The task force then adopted modifications to the NAIC Statistical Handbook to insert information about the *Medical Professional Liability Closed Claim Reporting Model Law* (#77).

## Examination Oversight Task Force

The task force discussed a survey of the states regarding progress toward adopting the revised *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition*. Of the 35 states that responded to the survey, 17 states have adopted the revised model, 12 states plan to adopt, and 1 state plans to adopt with changes. Three states are unsure and two states are not planning to adopt as they feel the revisions are already covered by other statute. For states planning to adopt, 6 are adopting in 2012, 4 in 2013, and remaining 3 have no timeline.

The task force heard a presentation of the risk-focused exam industry survey results from the Risk Focused Surveillance Working Group, which asked for "constructive comments that can be used to make positive changes to improve the overall effectiveness and efficiency of risk focused exams." A total of 26 responses were received from 22 companies, 1 trade organization, and 3 contractors.

The survey results revealed general concerns from the industry that risk-focused examinations are not being consistently applied among the states. Specific comments related to the number of examiners, number of interviews, increased examination fees, lack of utilization of SOX/MAR work, and unsecured data transmittal. The most common challenge noted was the examiner's lack of understanding of the company which was evident during interviews with top level management. Response on the use of contract examiners was mixed, ranging from contract examiners being more organized with better workflow management to a perceived lack of

understanding of state laws and risk-focused approach along with lack of communication between the contractor and state examiners. The three most common responses to increase efficiency were more reliance on work performed by internal/external auditors and SOX/MAR documentation, more reliance on other state's work or prior exams, and better management of the planning phase.

The task force plans to address issues noted in the survey results. The task force also discussed a need to request that the Financial Regulation Standards and Accreditation Committee announce publicly that the states will not be subject to accreditation sanctions for doing less work in conjunction with performing a risk-based audit.

A member of the task force expressed disappointment with the lack of responses and suggested a re-survey. A request to reconcile the number of responses was raised, in particular those related to feedback received from trade organizations in order to ascertain an accurate number of responses since the 26 responses do not appear to be indicative of the number of entities actually responding. NAIC staff will coordinate work on this.

## Climate Change and Global Warming Working Group

The working group received a presentation on the United Nations Environment Programme Finance Initiative Principles for Sustainable Insurance (PSI) Initiative. The presentation included information on the objectives, development and implementation of the global principals of the PSI.

### Impact of Climate Exam Subgroup

The subgroup is charged with reviewing risk-focused examination questions for possible inclusion of specific questions regarding the impact of climate for inclusion in the 2013 Financial Condition Examiners Handbook. The subgroup has identified four areas (Exhibit Y-Examination Interviews, Exhibit B-Examination Planning Questionnaire, Exhibit V, and the applicable risk repositories) for possible inclusion of questions addressing the impact of climate change. The subgroup requested NAIC staff to draft proposed updates to these areas.

### Impact of Climate Disclosure Survey Subgroup

The subgroup is charged with modifying the NAIC Climate Risk Disclosure Survey to have greater financial emphasis. The subgroup considered the results of United Nations Environment Programme Finance Initiative Global Survey, "Advancing the

Role of the Insurance Industry in Climate Change Adaptation." The subgroup plans to meet monthly following the Spring National Meeting to address potential changes to the NAIC Climate Risk Disclosure Survey.

## Title Insurance Task Force

At the Spring National Meeting, the task force received an update on projects as follows.

Modernize the solvency regulation of title insurance  
A joint subgroup of members from the task force and the Capital Adequacy Task Force (CADTF) will be established to identify major risks for title insurance and how those risks might be addressed and to see whether it makes sense to develop a risk-based capital formula for title insurers or modify the current P/C RBC formula to add risks associated with title insurance. Some regulators believe the solvency risk of title insurers does not warrant the resources to develop an RBC tool for title insurers, but the task force is generally supportive of forming a subgroup to study the issues further.

Develop risk-focused financial examination guidelines for title insurers - The Financial Examiners Handbook Technical Group agreed to consider what type of guidance related to title insurance should be added to the Examiners Handbook.

Develop early warning tools for title insurers - The Financial Analysis Research and Development Working Group has made substantial progress over the last few years in developing regulatory financial tools for title insurers. The early warning tools are for regulators only. The task force will consider if additional early warning tools for title insurers are necessary.

Revive work on Title Insurance Guaranty Fund Model Act and promote the use of blanket lenders' policies and individual owners' policies to replace policies issued by insolvent insurers - At the Receivership and Insolvency Task Force meeting, a subgroup was formed, chaired by Texas, to review and provide recommendations to address these two referrals.

A subgroup was formed whereby Kansas and Ohio will work with other regulators in determining the feasibility of promoting effective consumer shopping for title agents and insurers without delaying real estate closing schedules, and in developing best practices for the design and implementation of title cost comparison guides for consumers.

Title Insurance Market Conduct and Mortgage Fraud Working Group - The working group convened in a two-part session of meetings. In the first session, the working group heard from interested parties, the American Land Title Association and a large title agent in Colorado regarding concerns over mortgage fraud (e.g. defalcation, embezzlement, and escrow theft). The working group agreed that action is needed to limit escrow theft in order to protect consumers. The working group also agreed to develop a white paper to identify issues concerning escrow theft and develop solutions that the industry and regulators can implement. A subgroup was formed, chaired by Nebraska, to develop the outline of the white paper.

## Risk Retention Group Task Force

The task force discussed a December 2011 report on RRGs published by the Government Accountability Office (GAO). The report examined the current financial condition of the RRG industry, noting that it has remained profitable. The report also discussed the regulation of RRGs, which it noted often varies among states, in particular given that the Liability Risk Retention Act (LRRA) is silent on certain issues including registration requirements, fees, and the types of insurance coverage that RRGs can write. In some cases this has led to litigation between state insurance regulators and RRGs.

The report also highlighted the unique provisions of the LRRA which allow RRGs to be supervised by their domiciliary state regulator, and to write business across other states without being subject to supervision by the non-domiciliary state regulator. The report noted that this has resulted in RRGs being concentrated in a small number of states, and cited evidence that this may be because of lower minimum capitalization requirements and other comparative financial and regulatory advantages.

The report also referenced an earlier 2005 GAO report, which recommended the establishment of more uniform, baseline standards for RRGs, and discussed subsequent changes made by the NAIC, including the extension of risk-focused examinations and RBC to RRGs.

The report recommended that Congress consider clarifying certain provisions of the LRRA regarding registration requirements, fees and coverage, a conclusion with which the NAIC concurred. However, both working group members and industry commentators agreed that a focus on minimum capitalization standards for RRGs, which

can be low, was misleading, as lead state regulators consistently require RRGs to hold capital above the minimum required standard. The working group also discussed the importance of communication between domiciliary and non-domiciliary state regulators, to provide confidence to the non-domiciliary state regulator that the RRG is being supervised effectively.

## Risk Retention Working Group

The working group met via conference call on December 14; however because the working group did not have a quorum, items discussed on the conference call were taken via response to an electronic vote on December 21. The working group approved a response letter to the National Treatment and Coordination Working Group regarding the draft Form 16b, Statement of Voluntary Dissolution for RRGs to recommend that completion of the form and notification of non-chartering states be made mandatory. The purpose of the form is to notify the registered states when an RRG voluntarily dissolves its corporate status in its chartering state. The task force requested that the working group consider whether Form 16b should be mandatory, and if so, whether the chartering state should be required to communicate the information to all other states in which the RRG is registered.

The working group also discussed a referral from the Financial Regulation Standards and Accreditation Committee regarding the exemption of RRGs from the Business Transacted with Producer Controlled Property/Casualty Insurer Act for accreditation purposes. The working group voted to respond to the Property and Casualty Committee that it agrees with the recommendation of the task force that the Act be applicable to RRGs.

The working group also received a report from the Risk Retention Handbook Subgroup. The subgroup has approved revisions to Sections II and II of the Risk Retention and Purchasing Group Handbook and continues to consider revisions to the remainder of the handbook.

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The next National Meeting of the NAIC will be held in Atlanta August 11-14. 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 at [jean.connolly@us.pwc.com](mailto: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.

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