

NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS



NAIC 2008 SPRING NATIONAL MEETING

The National Association of Insurance Commissioners held their 2008 Spring National Meeting in Orlando March 29-31. 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

- The NAIC adopted a Conflict of Interest Policy and gave final approval to the Disaster Reporting Framework and Implementation Plan and the Reinsurance Regulatory Modernization Proposal. (page 3)
- The Financial Condition (E) Committee discussed its new charge related to possible changes in the regulation of financial guaranty (bond) insurers and adopted the Blanks Working Group proposal related to allocation bases for life and annuity premiums. (page 3)
- The Principles-Based Reserving Working Group exposed for comment its position paper on assurance of company's reserves, which would not require independent actuarial review, and heard a detailed update on the principles-based reserving project, which is now likely behind schedule for its January 2010 effective date. (page 4)
- The Statutory Accounting Principles Working heard comments on Issue Paper 132, Accounting for Pensions and Issue Paper 133, Accounting for Postretirement Benefits Other than Pensions, and directed staff to draft language for the working group to consider elimination of the requirement to nonadmit prepaid pension assets. The working group exposed SSAP 98, Treatment of Cash Flows When Quantifying Changes in Valuation and Impairment, with an amendment to provide guidance on the discount rate used to determine discounted estimated future cash flows and exposed proposed revisions to SSAP 48 to allow the use of audited foreign basis financial statements and audited tax basis in certain specific circumstances. The working group also heard important updates from its FIN 48, Fair Value and Separate Account Subgroups. (pages 4-8)
- The International Solvency and Accounting Working Group reported that the International Association of Insurance Supervisors Solvency Committee has been drafting multiple solvency papers, including additional papers for capital resources, asset/liability valuation, and the impact of subprime and credit markets. The working group also heard a presentation on Society of Actuaries' Research Project on Financial Reporting for Insurance Contracts under Possible Future International Accounting Standards. This research focuses on performing field tests in actual application as opposed to discussing the theories of IASB insurance contract accounting. (pages 9-10)
- The Blanks Working Group adopted four blanks proposals as final, and exposed twenty-four new issues for comment, including three separate, competing proposals for health insurers related to the highly contentious issue of allocating premium to group contracts for reporting on Schedule T. (pages 10-11)

- The NAIC/AICPA Working Group updated its survey on the states' progress of adopting the revised Model Audit Rule (MAR) noting that two states have adopted the revised MAR and an additional nineteen jurisdictions plan to adopt by the end of 2008. The working group also finalized a letter to the AICPA's Audit Issues Task Force requesting reconsideration of auditing guidance related to GAAP-like disclosures in audited statutory financial statements. (page 12)
- The Valuation of Securities Task Force heard a report from its Invested Asset Working Group on development of a comprehensive investment risk analysis, including new tools, such as investment risk assessment worksheet and use of market pricing information, to assist regulators' understanding and assessment of investment risk. The task force also clarified that the revised SVO Manual guidance on the use of sources other than the SVO for fair value will be effective for year-end 2008, not January 1, 2009 as stated in the December 2007 Purposes and Procedures Manual. (pages 12-14)
- The Capital Adequacy Task Force adopted for the 2008 P/C and Health RBC formulas revised risk charges related to securities lending transactions (which have already been adopted for Life RBC). The task force also exposed a proposed change to the Life RBC instructions to address trustee collateral held by an authorized reinsurer. (pages 14-15)
- The Hybrid Risk-Based Capital Working Group continues to struggle to find resolution and consensus on the issue of RBC for hybrid securities. The working group agreed not to disband and "hand off" outstanding issues to other NAIC groups, and will hold additional conference calls in April and May. If no further action is taken, the short-term solution for notching of hybrid securities will "sunset" January 1, 2009. (page 15)
- The P/C RBC Working Group adopted proposed changes to the underwriting factors, which will limit the change to a plus or minus 15% for 2008; the working group noted in discussion of its 2008 working agenda that development of a catastrophe risk charge for RBC is a main priority. The Health RBC Working Group concluded its highest priority item is development of a trend test for the Health RBC formula. (pages 16-17)
- The Reinsurance Task Force reviewed its deliberations and conclusions from a two day regulators-only meeting in March on its reinsurance regulatory modernization framework. (pages 17-18)
- The Life Insurance and Annuities (A) Committee continued discussion of proposed revisions to the Unfair Trade Practices Act related to lawful travel and proposed revisions to a consumer alert and insurer and producer bulletin on the use of senior designations in sale of annuities to seniors. The committee also heard a report on activities related to suitability of annuity sales and development of supervisory standards. (pages 18-19)
- The Life and Health Actuarial Task Force spent a significant portion of its two days of meetings on the development of principles-based reserves, but also heard a brief presentation on liquidity issues with respect to recent credit downgrades. Due to the absence of the task force's chair, all discussion on AG VACARVM was deferred to the Summer National Meeting. (pages 19-20)
- The Terrorism Insurance Implementation Working Group met twice via conference call and reviewed how the December 2007 adoption of the Terrorism Risk Insurance Program Reauthorization Act of 2007 changes the previous Terrorism Risk Insurance Act that expired at the end of 2007. (pages 22-23)
- The Climate Change and Global Warming Task Force heard comments on its contentious Climate Risk Disclosure Proposal which would require insurers to make mandatory climate risk disclosure interrogatories as part of their annual statement filings. The task force heard from trade association and consumer representatives on their views on the disclosure, which is proposed to be effective for some insurers for 2008. (pages 23-24)

Executive Committee and Plenary

Executive Committee and Plenary

At its meeting in Orlando, the Executive Committee adopted a conflict of interest policy, and received and adopted reports from its working groups and task forces. The committee also received status updates on the development of the several model acts and regulations. No new or amended model regulations were considered for compliance with the requirements of the Model Law Development Framework.

During its Plenary meeting in Orlando, the commissioners adopted the following new items, all of which were the subject of extensive public hearings as the proposals were being debated by the various committees and task forces of the NAIC:

- Disaster Reporting Framework and Implementation Plan
- Reinsurance Regulatory Modernization Proposal
- Preneed Life Insurance Minimum Standards for Determining Reserve Liabilities and Nonforfeiture Values Model Regulation

During Plenary, the regulations also adopted the Conflict of Interest Policy, Acknowledgement Form and Disclosure Statement for Executive Committee Members, after extensive debate. Several of the commissioners commented during the debate that the policy was less stringent than their own states' current laws. However, the Conflict of Interest policy was adopted, with twelve commissioners voting "no."

Financial Condition (E) Committee

New Charge

The committee adopted a new charge at the Spring National Meeting related to possible changes to the regulation of financial guaranty (bond) insurers. Issues the committee will consider include the following:

- The role played by rating agencies in the financial guaranty market, methodologies used by the rating agencies and communications of the results.
- The need for limitations or possible restrictions against insuring certain types of bonds or engaging in certain credit enhancement transactions.

- The appropriateness of current capital and contingency reserve requirements considering changes in financial guaranty business lines.
- The need for bond insurers to strengthen their model for assessing the risks associated with new business activities.

Based upon the results of this analysis, E Committee will make recommendations to Executive Committee; the charge notes that the findings may differ for municipal, corporate and structured finance sectors of the bond market.

Allocation of Life and Annuity Premiums

At the Winter National Meeting, E Committee's Accounting Practices and Procedures Task Force deferred final adoption of changes proposed for Schedule T premium allocation for life and annuity products. The task force exposed for comment whether the situs of the contract should be added to the acceptable bases for allocation of premium. (The proposal is 2007-42BWG.)

During the intervening months, this issue has been hotly debated among the industry and regulators. During a conference call March 18, the APP Task Force voted to add instructions for the allocation of life and annuity premiums which adopt the current industry practice and which allow allocation of group insurance premiums where the group is less than 500 members to one state based on either the situs of the contract, or the residence or employment location of the greatest number of covered members. Premium for groups where there are more than 500 members is allocated based on the residence or employment location of each member. Premium for individual policies is allocated based on the residence of the policyowner, insured, or payer.

During the Spring National Meeting there was again spirited debate among all parties at several meetings, with addition of the discussion of the allocation method for health insurers. (See discussion of Schedule T Subgroup below.) At the final meeting in Orlando, after additional discussion yet again, the Financial Condition (E) Committee voted to adopt the revised proposal from the APP Task Force that includes situs of the contract as an acceptable premium allocation basis for life and annuity premiums. Situs is defined as "the jurisdiction in which the contract is issued or delivered as stated in the contract."

Principles-Based Reserving Working Group

Position on Assurance of Company Reserves

The working group met via conference call on February 21 to discuss several options for regulators to obtain assurance on the appropriateness of a company's reserves developed under a principles-based approach. It was generally agreed by members of the working group and interested parties that incorporating the actuarial review of these reserves into the risk-focused examination and analysis function was more appropriate than requiring an independent actuarial review. In Orlando, the working group reviewed a draft position paper on this topic, which was exposed for public comment.

Standard Valuation Law & Valuation Manual

The working group received a status update from Life and Health Actuarial Task Force regarding the new Standard Valuation Law and the Valuation Manual. LHATF reported that it has reviewed and considered approximately two-thirds of the issues associated with revising the standard valuation law. LHATF hopes to have the revised standard valuation law completed, or substantially completed by the Summer National Meeting. Any issues remaining after the Summer National Meeting are expected to be limited.

With regard to the Valuation Manual, LHATF reported that it has made considerable progress in the last quarter and expects to complete the initial version of the manual by the end of 2008. LHATF also reported on its coordination efforts with the Statutory Accounting Principles Working Group and the Blanks Working Group, noting that a substantial portion of the changes needed to the annual statement have been drafted. (The detailed discussion of LHATF activities at the Spring National Meeting are summarized on page 18.)

LHATF had been expected to adopt the new SVL in advance of this meeting to allow sufficient time for review and approval by the working group and adoption by Executive and Plenary at the Summer National Meeting. Given that this aggressive timeline was not achieved, the working group requested NAIC staff to update and distribute a revised timeline based upon the status report from LHATF and other input received from parties subsequent to the meeting. Based on comments made by members of the working group and interested parties the planned January 1, 2010 effective date for principles-based reserving seems unlikely.

Report from the Corporate Governances Subgroup

The subgroup is developing recommendations for corporate governance requirements in a principles-based environment. The subgroup held two interim conference calls to discuss its charge and considered work prepared by the American Academy of Actuaries on this topic. The subgroup will meet via conference calls over the next few months to consider existing corporate governance guidance contained in the Model Audit Rule and the Financial Examiners Handbook. The next call of the subgroup has been scheduled for April 10.

Statutory Accounting Principles Working Group

Public Hearing

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

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

The working group received six comment letters from companies, trade associations and an actuarial consulting company. Although the issues are controversial, discussion at the public hearing was relatively short. Concerns raised in the comment letters and during the public hearing include the following:

- The proposed guidance is punitive compare to GAAP because of the requirement to nonadmitted prepaid pension assets;
- The requirement to accrue a liability for all participants will force companies to amend their benefit plans;
- The accumulated benefit obligation, not the projected benefit obligation, is the appropriate measure for defined benefit plan liabilities;

- Because OPEB plans are not subject to ERISA requirements and are more easily amended or canceled some companies believe a liability has not been incurred until these obligations vest;
- Some companies do support eliminating the GAAP/SAP difference in calculating the pension and OPEB liability; and
- The comment letter from the actuarial firm included discussion of issues not addressed in the issue papers including how to recognize in expense the liability for nonvested participants, preexisting unamortized amounts and questions related to transition.

After consideration of the comments, the working group took the following actions:

- They voted to include the guidance from SSAP 89 and SSAP 14 on consolidated/holding company plans in the issue papers (as it was not intentionally omitted);
- They directed NAIC staff to draft language for the working group to consider on eliminating the requirement to nonadmit prepaid pension assets. This issue will be discussed at future meetings.
- They asked interested parties to address issues related to the accounting for excise taxes when a plan is terminated and the effect on deferred taxes when the pension and OPEB liability includes both vested and nonvested participants.

Issue Paper 131, Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment – The working group adopted the issue paper as final and directed staff to draft the SSAP. The issue paper adopts the GAAP guidance in paragraph 16 of FSP FAS115-1/ 124-1, and provides guidance as to when a reporting entity should consider amortizing/ accreting a previous premium/discount once impairment occurs. The proposed effective date is December 31, 2008.

FAS 150: Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity – The working group voted to reject FAS 150 as the regulators have concluded that insurers do not often issue securities or financial instruments within the scope of FAS 150. No interested party commented on this issue during the exposure period.

FAS 159: The Fair Value Option for Financial Assets and Financial Liabilities – The working group had initially exposed for comment rejection of FAS 159 because of the optionality allowed by the standard. At this meeting, the working group voted to refer FAS 159 to the Fair Value Subgroup.

Consideration of SOP 97-1: Accounting by Participating Mortgage Loan Borrowers – The working group adopted proposed changes to SSAP 40, Real Estate Investments, to incorporate the guidance from this SOP.

Consideration of FIN 46R, FSP FIN 46R-4, FSP FIN 46R-5 Variable Interests – At the Winter National Meeting, the working group voted to reject the accounting required under this guidance and exposed for comment changes to SSAP 25, Related Party Transactions, to include implicit and explicit variable interest entities within the example of related parties and expand disclosures to include the maximum loss exposure as a result of these implicit and explicit variable interests. At its meeting in Orlando, the working group re-exposed the proposed changes to SSAP 25 after added a definition of "variable interest entity" to par. 2.

APP Manual Reference to the Health Reserves Guidance Manual – After a lengthy discussion, the working group voted to remove the reference to the Health Reserves Guidance Manual in SSAP 54 and SSAP 55 until a maintenance process for reviewing changes to the Manual can be developed. The working group will also ask the Accident and Health Working Group for its assistance. An interested party commented that that Manual is not intended to be inconsistent with the Accounting Practices and Procedures Manual and the Manual includes helpful guidance used by actuaries and interested parties will work with the Accident and Health Working Group to develop a maintenance process. It is not known whether that would be a short or long process.

The working group also voted to adopt as final rejection of the following GAAP guidance as not applicable to statutory accounting:

- FSP SOP 78-9-1 Interaction of AICPA SOP 78-9 and EITF 04-5
- SOP 03-5, Financial Highlights of Separate Accounts

SAP Maintenance Agenda Discussion

All issues exposed or re-exposed for public comment have a comment deadline to NAIC staff

of April 30 with a public hearing at the Summer National Meeting.

SSAP 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, An Amendment to SSAP 43—Loan Backed and Structured Securities – After adoption of Issue Paper 124 at the Winter National Meeting, SSAP 98 was drafted with one change to the issue paper and was exposed for comment at the Summer National Meeting. Paragraph 16 requires impaired securities to be written down to discounted estimated future cash flows. Guidance was added to specify that the discount rate should be one that is commensurate with the risk involved. SSAP 98 has a proposed effective date of December 31, 2008.

FAS 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities –The working group voted to expose proposed changes to SSAP 86, Derivatives, to adopt the guidance included in FAS 149.

FAS 156, Accounting for Servicing of Financial Assets, an amendment of FAS 140 – The working group reviewed and exposed for comment Issue Paper 134, which proposes adoption of FAS 156, with certain modifications, through amendments to SSAP 91.

FSP FAS 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction – The working group exposed proposed changes to SSAP 22 to adopt the guidance in this FSP related to the assumptions and projected timing of income tax cash flows.

Clarification of SSAP 63 Regarding Intercompany Pooling Arrangements – The working group and interested parties had extensive discussion related to this agenda item and ultimately exposed for comment the proposal as drafted by an interested party. If adopted, the guidance would significantly change the reporting by related parties of intercompany pooling agreements. A new paragraph 9 of SSAP 63 would be added as follows:

Underwriting results relating to intercompany pools shall be accounted for as described in paragraph 8, except that the settlement of these transactions may be reported through the Receivable/Payable from Parent, Subsidiaries and Affiliates financial statement

line items and offset against other affiliated transactions if permitted per SSAP 64, *Offsetting and Netting of Assets and Liabilities*.

The proposal also states that arrangements in which all or some companies cede to the pool and do not assume any business (i.e. 0% net share) still qualify as an intercompany pooling. Amounts due to/from the lead entity and all affiliated entities participating in the intercompany pool as of the balance sheet date would be disclosed.

The working group exposed the proposal for comment over the objections of some regulators, but asked for comments from regulators and interested parties.

Allow Audited IFRS or Foreign GAAP Prepared Financial Statements as an Acceptable Basis for Valuing Investments in SSAP 48 – The working group exposed for comment proposed changes to SSAP 48 to allow audits performed in accordance with IFRS or other foreign basis GAAP when there is a footnote reconciliation to U.S. GAAP. This will make the guidance consistent with the SSAP 97 guidance which allows foreign basis GAAP audits.

Use of Audited Tax Basis Financial Statements – The working group exposed for comment an issue that has been discussed for some time, which is to allow audited U.S. tax basis equity as a permitted valuation basis for SSAP 48 entities. The proposal would only allow tax basis for less than 10% owned SSAP 48 entities only when audited GAAP financial statements are not available and "documentation is maintained regarding the reason that audited GAAP basis financial statements could not be provided." The working group also asked that interested parties submit an example of audited tax basis financial statements. The working group directed NAIC staff to analyze the reporting of these investments on Schedule BA to determine the estimated materiality to the industry.

Valuation and Reporting of Residual Interests – After six years of minimal activity, the working group resumed discussion of EITF 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*. The working group exposed for comment proposed revisions to SSAP 43, *Loan-Backed and Structured Securities*, to include these securities within the scope of SSAP 43 and requires that impairment of these beneficial interests be determined with par. 16 of SSAP 43.

(Note that this impairment guidance is being modified by SSAP 98 as discussed above.)

Methods Used to Determine and Report Fair Value of Securities – This proposal is in response to changes to the SVO's Purposes and Procedures Manual and related Blanks Working Group agenda item 2008-22BWG which will allow use of sources of fair value other than the SVO for annual statement and audited financial statement purposes. Per the handout first available at the meeting in Orlando, the changes include the following:

- Paragraph 9 of SSAP 27, Disclosures about Fair Value of Financial Instruments, would delete the following guidance: "Market values published by the SVO, if available, shall always be the fair value amount disclosed. In the absence of SVO published market values, or when amortized cost is used by the SVO as market value, quoted market prices by other third party organizations, if available, shall be used as the fair value of financial instruments."
- SSAP 30, Investments in Common Stock and SSAP 32, Investments in Preferred Stock would be revised to require valuation at fair value with no reference to the SVO manual.

The meeting of the working group ran out of time before this issue could be discussed, but at the subsequent meeting of the Accounting Practices and Procedures Task Force, the chair noted the working group would vote by email to expose the proposed changes.

Discounting of loss adjustment expense reserves acquired in a transfer – The working group voted to expose guidance to clarify existing guidance in SSAP 65, P/C Contracts, that loss adjustment expense reserves should not be discounted.

SSAP 23, Foreign Currency Translation – The working continued its goal of disposing of long outstanding items, one of which is issues related to translating income statement accounts using a weighted average rate. There has been no activity since 2002 when Issue Paper 120 was not adopted due to industry objections. At its meeting in Orlando, the working group asked interested parties and regulators to submit any concerns related to this issue. If none are received, the issue will be removed from the maintenance agenda.

Clarification of SSAP 41 on Several Issues including NAIC Designation Equivalent for NRSRO-Rated Surplus Notes – The working group exposed for comment seven issues related to surplus notes that have been outstanding since 2002. The working group recommends that six of the seven issues be rejected for further discussion and that the seventh issue, Issue 2, be adopted. Issue 2 recommends that par. 10.a.i of SSAP 41 be revised to make it consistent with the guidance in the SVO's Purposes and Procedures Manual for surplus notes that have more than one NRSRO rating.

Goodwill in a Merged Subsidiary – The working group exposed revisions to paragraph 13 of SSAP 68 to clarify that goodwill related to a previous business combination should be written off when that entity is merged or is dissolved.

Other Items Exposed for Comment
The working group also voted to expose for comment rejection of the following GAAP guidance as not applicable to statutory accounting:

- SOP 04-1: Auditing the Statement of Social Insurance
- FAS 160: Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51

Update from the FIN 48 Subgroup – The chair gave a brief report on the subgroup's conference call on March 5 during which they continued their consideration of FIN 48, Accounting for Uncertainty in Income Taxes. Based on comments made by subgroup members at the meeting in Orlando, it appears that the subgroup is leaning towards adoption of full FIN 48 for statutory reporting as several members emphasized their views that statutory should not deviate from GAAP when considering new accounting guidance unless there is a "compelling reason" to do so. At future meetings, the subgroup will address whether the SSAP 10 admissibility criteria for the deferred tax assets that may be created by adoption of FIN 48 should be modified. The next meeting of the subgroup was not announced.

Update from Fair Value Subgroup – The SAP Working Group received a report from its new subgroup which held two conference calls in 2008; the subgroup was formed to review FAS 157, Fair Value Measurements and other fair value issues and to develop a new SSAP that defines fair value and establishes a framework for its measurement.

During the subgroup's conference calls, they **tentatively** [NAIC emphasis] agreed to adopt the definition of fair value per par. 5 of FAS 157. Per the report of the subgroup there is also a "significant desire to mitigate variations between GAAP and SAP, with only the concept of own-creditworthiness being initially identified as unacceptable for statutory accounting."

The subgroup plans to meet every 4-6 weeks by conference call and continue discussion of fair value definition components. Much of the urgency is related to interested parties' concerns regarding FAS 157 disclosure requirements under generally accepted auditing standards for the 2008 audited statutory financial statements.

Update from the Separate Account Subgroup – The SAP Working Group received a report from its new subgroup, which was formed to consider AICPA SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts. The subgroup held two conference calls in 2008 and focused on the SOP guidance on classification criteria of separate accounts, which is now more restrictive than statutory because of the SOP's four criteria that must be met for a separate account to be classified as such in the GAAP financial statements.

The subgroup did a survey in February to obtain a better understanding of separate account products and the related accounting; based on the 18 survey responses received, the subgroup concluded that there "does not seem to be any industry standards regarding which products, or specific characteristics of products, can be classified as separate accounts." The subgroup also noted that some of the products would not meet the classification criteria of SOP 03-1. The subgroup is currently revising the survey to obtain more thorough responses and plans to distribute it the week of April 7.

At its March 6 conference call the subgroup discussed adopting SOP 03-1 for separate account classification unless a compelling reason becomes apparent. The subgroup has asked the trade association ACLI to solicit its members and reach a position on this issue, and if SOP 03-1 criteria are not supported by the members the reasons for that position.

Update on Principles-Based Reserving Project
The working group received a report on the development of the Principles Based Reserving

Manual and the process to maintain the Manual after initial completion. The working group plans to submit comments to LHATF on the maintenance process during the exposure period.

Accounting for Life Settlement Contracts by Third-Party Investors – The working group received a comment letter from the ACLI, which had performed additional research related to life settlement contracts at the request of the working group. The ACLI continues to support the investment method discussed in the FASB FSP on life settlement contracts and recommends classifying direct investments in such contracts as aggregate write-ins for invested assets; they also suggest a 6.8% RBC charge. The working group forwarded the comment letter to the Valuation of Securities Task Force for its consideration.

Emerging Accounting Issues Working Group

The working group continued work on new and previously addressed issues as discussed below. All issues exposed for comment have a comment deadline of April 30.

EITF 06-7: Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FAS 133 – The working group exposed for comment a tentative consensus to reject this EITF guidance as not applicable to statutory accounting.

EITF 06-8: Applicability of the Assessment of a Buyer's Continuing Investment under FAS 66 for Sales of Condominiums – The working group voted to expose a tentative consensus to adopt the guidance in Issue 1 of the EITF with a modification that continuing investment payments made in the form of buyer's notes must be supported by letters of credits from institutions listed by the SVO. The working group also voted to adopt the consensus from Issue 2.

EITF 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference between the fiscal Year-End of a Parent Company and that of a Consolidated Entity or between the Reporting Period of an Investor and that of an Equity Method Investee – The working group voted to expose a tentative consensus to adopt the EITF guidance that defines reporting period change as a change in accounting principle with a modification

to apply only to equity method investments. The GAAP consolidation guidance was also rejected.

EITF 07-3: Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities –

The working group exposed for comment rejection of this guidance; they noted that such nonrefundable advanced payments should be expensed when the advance payment is made.

EITF 02-11: Accounting for Reverse Spinoffs –

The working group exposed for comment a consensus to adopt EITF 02-11, which provides guidance that accounting for the legal form for spinoffs can be overcome based on the substance of the transaction. The working group also voted to disband the APB 29 Subgroup as the subgroup has completed its review of all issues referred to it.

INT 07-05: EITF 06-10: Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements -

In 2007, the working group had reached a tentative consensus to adopt the EITF with modifications to the transition guidance so that it is consistent with SSAP 3, Accounting Changes.

At the Winter National Meeting, the working group deferred final adoption so that interested parties can provide additional information on what contractual rights are provided by such insurance arrangements and how such rights should result in an admitted asset. At its meeting in Orlando, the working group voted to refer the issues to the SAP Working Group for its consideration including admissibility of assets and control of the life insurance arrangements.

Balance Sheet Presentation of Funding Agreements Issued to a Federal Home Loan Bank

The working group again deferred action on the issue and asked interested parties for additional information including the prevalence of property/casualty companies participating in this market. Interested parties noted that a subgroup of fourteen companies involved in these transactions will work together to provide additional detail for the Summer National Meeting.

International Solvency and Accounting Working Group

Solvency Subcommittee Activities

The working group heard a report from the International Association of Insurance Supervisors (IAIS) Solvency Subcommittee. Over the last several months, the Solvency Subcommittee has

been drafting multiple solvency papers which are in process of being adopted by the IAIS. As of the January 2008 meeting, standards and guidance papers on the structure of solvency, enterprise risk management, and internal models have been forwarded to the IAIS Technical Committee for consultation. The standards papers would present the "what" and the guidance papers would present the "how" and offer other alternatives. The standards papers will be written so that they will not need to be changed often. The guidance papers will represent "living documents" that would be updated to reflect emerging best practices on a real time basis. Additional papers for capital resources and asset/liability valuation are expected in 2009.

The Solvency Subcommittee is also drafting a paper to provide an overview of the solvency framework and to address some concepts that carry throughout the papers such as governance and the adjustment of supervisory requirements to reflect the nature, scale, and complexity of a company. This paper may end up being a preamble to the standards or some type of introductory standard. The working group also discussed the need for the IAIS solvency papers to address the effect of issues such as subprime and credit markets.

Insurance Contracts Subcommittee Activities

The IAIS Insurance Contracts Subcommittee continues to discuss the IASB's Insurance Contracts project. Among the many, the following key comments were made to the IASB: 1) the concept of value in settlement vs. transfer value (very few respondents are fully comfortable with a market value notion for all expenses and ignoring entity specific cash flows); 2) requests for field testing of the IASB proposals; 3) boundaries of the contract (does one look at the entire contract, or individual rights and obligations?); and 4) the critical interaction with a number of other projects (especially revenue recognition and financial statement presentation) was discussed.

There is a general feeling that the IASB is moving towards allowing more consideration of entity specific cash flows. There was discussion, and much concern, about the push by the IASB to try to get an exposure draft issued by June 2009 and standard by June 2010. Few thought that this timing would give sufficient time for considered due process regarding the many open issues. Interested parties suggested the NAIC ask FASB to join the IASB in the insurance contracts project, and to do so quickly. The hope is that if FASB were

involved there may be more due process and more ability to do field testing.

Society of Actuaries Study

The working group heard a presentation on the Society of Actuaries' research project on Financial Reporting for Insurance Contracts under Possible Future International Accounting Standards. The research, conducted by PricewaterhouseCoopers with assistance of 18 Actuarial Task Forces, focused on performing field tests on actual products that have been sold, in contrast to discussing the theory of the IASB insurance contract accounting. The primary objectives of this project included reporting possible financial effects of the implementation of the IASB Discussion Paper on nine U.S. life, health and annuity products.

The study indicated that income is sensitive to the assumptions used and that at the time of contract issuance gain or loss could result, depending on the product involved. It also showed the sensitivity of results to certain alternative approaches and assumptions that might be applied, particularly in the assessment of risk margins, which are some of the key issues involved in the IASB proposal. It showed that income expected to be reported under the IASB proposed approach can differ significantly from the corresponding income from the application of U.S. GAAP, particularly at the time of the contract issuance. In addition, the analysis showed that the impact of the use of discount rates based on a swap curve compared to the U.S. Treasury spot curve at year-end 2006 would not have resulted in a significant difference in income.

European Union's Solvency II

The working group also discussed some issues related to the European Union's Solvency II. The working group believes that both the EU's Solvency II and the U.S. state-based solvency system are risk-focused approaches and there are many similarities in the detailed stages of financial examination. The working group suggested that U.S. should continue to stay engaged in the development of Solvency II's implementation measures.

Blanks Working Group

The working group adopted four blanks proposals as final, which include the following:

- A new disclosure was added to Note 13, consistent with changes adopted for SSAP 72 by the Statutory Accounting Principles Working

Group. This modification requires dividend payments made by the reporting entity to be disclosed in the annual statement, beginning with the 2008 annual statement.

- New long-term care experience reporting forms and instructions were added to all annual statement blanks effective for the 2009 annual statement. The existing forms and instructions were eliminated. The new forms are designed to allow regulators to better track the experience of long-term care insurance by comparing actual experience to projected experience.
- Instructions were modified for certain sections of Schedule D to clarify how distributions from mutual funds should be reported. This change will be effective for the first quarter of 2009.

A proposal to add instructions to Schedule E, Part 1 indicating that the total of all cash on deposit at December 31 should exclude non-admitted amounts when crosschecking to the parenthetical amount reported as cash on the assets page of the blank was deferred in order to add explanatory language to describe under what circumstances cash amounts would be non-admitted. It was noted that certain states have limits on cash amounts on deposit at any one bank, and therefore require any excess to be non-admitted.

The working group also exposed twenty-four new proposals for comment. The comment period ends May 1, 2008. Some of the more significant exposed proposals would:

- Change the premium allocation method for group health insurance contracts on Schedule T. Three separate proposals were exposed. Refer to the report from the Schedule T Subgroup discussed below for further details.
- Require disclosure and discussion of the change in incurred claims and claim adjustment expense reserves in the quarterly statement as required by Note 25 of the annual statement. (Agenda item 2008-01BWG)
- Add a definition of hybrid securities to the investment schedules instructions. New line numbers would be added to Schedules D, DA, and E Part 2 for the reporting of hybrid securities. Note 20, which previously required the disclosure of hybrid securities would be eliminated. (Agenda item 2008-06BWG)

- Add an illustrative example to the instructions for Note 10(L) for disclosures required by SSAP 97 when a reporting entity applies the look-through approach for the valuation of its investment in a downstream noninsurance holding company. (Agenda item 2008-09BWG)
- Add an illustrative example to the instructions for Note 20(H) related to the disclosure of a reporting entity's exposure to subprime mortgage related risk. (Agenda item 2008-10BWG)
- Remove references to exchange traded funds as being reported in Schedule DA as amounts should be reported in Schedule D. (Agenda item 2008-13BWG)
- Modify General Interrogatories to include disclosure of securities lending programs and related collateral. (Agenda item 2008-17BWG)
- Add a column to Schedule D for reporting the method used to obtain fair value. (Agenda item 2008-22BWG) This proposal is a result of the SVO's decision, effective for 2008 annual statements, to allow companies to use sources other than the SVO for fair value. These other sources include an approved pricing service, stock exchange, broker-dealer, insurer custodian, or determined by the insurer.

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

The working group then received a status update from a LHATF subgroup regarding potential changes to the quarterly and annual statement blanks and related instructions if the principles-based reserve valuation approach is adopted by the NAIC. The update primarily addressed seven items previously identified in a report provided to the working group by the American Academy of Actuaries at the Winter National Meeting. The subgroup, consistent with the AAA, believes that very few changes to the blanks will be necessary; however detailed disclosure and limited interrogatories are expected to be added.

Report from the Schedule T Subgroup

The subgroup met four times via conference call following the Winter National Meeting to review the survey results from the health insurance industry and to discuss proposed changes to the allocation of premiums by state on Schedule T of the annual

statement for health insurance contracts. As with the proposal for life and annuity premiums, all of the conference calls had spirited discussion mostly among regulators who have differing positions on the issue.

The health insurance industry survey was designed to solicit input from health insurers with regard to the potential costs necessary to comply with proposed premium allocations by state for group health policies. Over 200 responses were received, of which approximately two-thirds indicated that they use situs of the contract, rather than location of risk, as the method for allocating premium by state on Schedule T. The survey results, when extrapolated to the approximately 1,200 health insurance industry members, indicated that the cost to comply with the proposed revisions to Schedule T instructions, including data collection and changes to administrative systems would be very costly. The survey results also indicated that just 2.5% of premiums would be reallocated to other states if the proposed changes to Schedule T instructions were adopted.

Based on the survey results, following much discussion among the subgroup members, it was agreed to add "situs of the contract" as an acceptable premium allocation option in the proposed amendments to Schedule T instructions for individual and group health insurance premiums. The subgroup also discussed whether the use of situs of the contract as an allocation method should be limited to groups of less than 500 members (i.e., "rule of 500") or to all group insurance contracts. After significant debate among subgroup members over several conference calls, no consensus could be reached.

As a result the subgroup agreed to submit three separate Schedule T proposals (Agenda items 2008-19BWG, 2008-20BWG, and 2008-21BWG) to the Blanks Working Group for review and exposure. One proposal would permit use of situs of the contract as an allocation method for all group health insurance contracts regardless of the number of covered members, while the second proposal would limit such allocation based on the rule of 500. A third proposal would add a new Part 3 to Schedule T, which would require allocation of premium by location of risk rather than situs of the contract.

NAIC/AICPA Working Group

MAR Discussion Items

The working group updated its ongoing survey of the progress of adopting the revised Model Audit Rule (MAR), which has a proposed effective date of January 1, 2010. The working group noted that two states, Virginia and Alabama, have completed adoption of the revised MAR, which are consistent with the NAIC's version, i.e. a requirement for management to attest on internal controls beginning with 2010 financial statements. NAIC staff reported that Connecticut and South Carolina have exposed proposed changes but have not yet adopted final requirements. Other state activities include the following:

- Alaska has adopted enabling legislation but has not yet released a proposed regulation to incorporate the 2006 MAR revisions.
- Wisconsin has issued a "notice of intent" to revise its audit regulation, but has not released any proposed changes.
- A total of nineteen jurisdictions reported to the NAIC that they plan to present amendments to their state legislatures or revise current regulations in 2008. Another 24 are planning for a 2009 adoption; six states reported that their plans are not yet known.

The working group subsequently heard comments from a representative of interested parties who asked that the results of the quarterly survey of states' plans for adoption be released publicly. Interested parties believe knowledge of individual state's plans for adoption will help ensure that the revisions to the MAR are adopted uniformly with consistent effective dates, which interested parties believe is critical. Interested parties also offered assistance to any state insurance department that is beginning the process to adopt the revised MAR.

NAIC staff had already discussed this proposal with state insurance departments and most have agreed to make this information publicly available. As a result, the NAIC plans to post this information to its website April 18.

Referral from the SAP Working Group on GAAP Disclosures

The working group discussed a referral from the Statutory Accounting Principles Working Group related to the AICPA guidance on GAAP disclosures required when reporting on financial statements prepared on a comprehensive basis of accounting other than GAAP. During an interim

conference call March 4, the working group agreed with interested parties that this requirement for GAAP disclosures when the NAIC has not yet concluded on the disclosures is inappropriate. The working group decided to approach the AICPA's Audit Issues Task Force to request that guidance in this area under generally accepted auditing standards be reconsidered.

At its meeting in Orlando, the working group reviewed its draft letter to the AICPA's AITF which requested that the reconsideration of the GAAS guidance for the following reasons:

- Insurance regulators have robust accounting principles and a formalized system to review new GAAP disclosures in place.
- As the determination of appropriateness of informative disclosures is a matter of auditor judgment it may be inconsistently applied in practice.

After a brief discussion the working group voted to finalize the letter and send it to the Audit Issue Task Force, who will be meeting in April 24.

Use of Indemnification Clauses in Engagement Letters

The working group heard comments from its representative from Wisconsin, who noted that its Department had noted several instances during examinations of CPA engagement letters that they include indemnification clauses, which have not been permitted since 2001. The working group adopted a referral to the Financial Examiners Handbook Technical Group to add guidance to the Handbook to review engagement letters for such clauses.

Valuation of Securities Task Force

The task force heard a report on the credit rating status of monoline financial guaranty insurers. With the exception of the ACA Financial Guaranty Corp., whose credit rating was withdrawn, all other monoline insurers continue to be rated by a rating organization. This permits insurance companies that own bonds insured by the monolines to continue to report the securities as filing exempt. As communicated in January of 2008, all bonds insured by ACA Financial Guaranty are to be classified as an NAIC 5 for year-end 2007, unless the bond has its own underlying rating or the bond is subsequently filed with the SVO. Because of the downgrade, the security should be treated similar to other securities with a rating of NAIC 5 in a

company's 2007 statutory financial statements and related filings (e.g. RBC reports).

The task force also clarified that the new valuation methodology adopted for the *Purposes and Procedures Manual* is effective for year-end 2008 instead of for 2009. Confusion arose due to uncertainty about the progress of the blanks component of the proposal. The blanks proposal will be adopted in time to permit the implementation of the valuation rules for year-end 2008.

Report from the Invested Asset Working Group

The task force heard a report its working group which was created in response to concerns expressed by industry and market participants about the decision to review and revise regulatory treatment of hybrid securities. The primary function of the working group is to prevent surprise over regulatory decisions on investments by serving as the NAIC's focal point for communicating concerns about new securities. The working group believes that having a reliable process to identify risks in securities is essential to ensuring swift agreement over the regulatory implications of those risks and is an obvious way to mitigate the risk of surprises from regulatory decisions.

Among the several projects in consideration by the working group is the Other Than Credit Risk Subgroup whose purpose is to develop a comprehensive list of investment risks with definitions and to identify where the risks are covered in the current solvency framework. If the risks are not covered under the framework, the subgroup will determine how they should be incorporated. The first round of discussion was devoted to development of the C-1 (credit risk) risk factor in the risk-based capital formula. C-1 was designed to measure the impact of a security that defaults and is viewed as critical component for assessing investment risk. The subgroup is also in process of reviewing the draft of a new assessment tool, investment risk assessment worksheet, which would be completed by SVO staff and other regulators in discussing and analyzing a new security under regulatory review. The worksheet which consists of five sections is designed to name and define known risks, and provide a general framework for analyzing new securities.

The working group is also assessing the viability of using market pricing information as an indicator of credit risk and to supplement the regulator's understanding of risk in a security or company. Market price changes are useful predominantly

because they often occur in advance of rating actions. Market price changes may provide information to regulators on the credit quality of individual invested assets, thereby supplementing credit ratings, or changes in the credit quality of insurance obligations, thereby supplementing capital adequacy. One of the several projects in discussion is constructing benchmarks for NAIC designations using standard industry benchmark, such as Credit Default Swaps indices. The IAWG will continue to work with NAIC staff in performing various studies and analysis, and assessing the scope of this project, including what the end product would look like.

Another project in consideration by the working group is the draft policy statement on transparency of regulatory decision making for new investment products for the *Purposes and Procedures Manual*. This document lays out the NAIC committee structure and various guiding principles for regulatory review process for investment securities. The draft of the report has been exposed to members and to the interest persons. The goal of the working group is to have the policy statement before the task force for adoption by July.

Public Dissemination of SVO Determinations

The task force discussed a proposed amendment to language in the *Purposes and Procedures Manual* governing the Regulatory Treatment Analysis Service (RTAS) provided by the SVO. The amendment would clarify the obligation of the recipient of an SVO opinion to indicate that the opinion is given for regulatory purposes. The RTAS process can be utilized by broker-dealers and issuers as well as by insurance companies. It replaces the Advanced Rating Service—Emerging Investment Vehicle process which was offered to insurers only.

The task force discussed industry group's comment letter on the broker-deal proposal and whether the broker-dealer or an insurance company can communicate an SVO determination to anyone provided that the role of the SVO is disclosed. The previous language focused only on formal communications between broker-dealers and insurance companies and implied that the entire letter must always be provided to the other party. In response to the concerns expressed, the task force recommended changing the language to state that applicant may provide copies of the SVO letter to anyone as long as a complete copy of the letter is given. There is still an ongoing discussion as to whether applicant must also disclose the regulatory purpose of the analysis before the SVO

letter can be shared with anyone and whether the information can also be shared verbally with others.

Private Letter Rating

An industry group also expressed concern on lack of clarity and consistency surrounding the filing exempt guidance contained in Part Four and in Part Seven of the *Purposes and Procedures Manual* relative to private placement securities. The task force clarified the process that applies to private placements that are rated and monitored by an NAIC ARO. Insurance companies have the option to file evidence with the SVO that the security is rated and monitored, in which case it will be entered into the VOS database as a rated security, or to not file with the SVO, in which case the insurer will maintain documentation of rating status for state regulators.

Mutual Fund List

NAIC staff discovered that ineligible mutual funds had been inadvertently added to the mutual fund lists. The ineligible funds meet all applicable NAIC requirements but are not registered with the SEC either because they are offshore funds beyond SEC jurisdiction or private funds sold under exemption from registration. It has been difficult to ascertain the financial exposure as a result of ineligible funds mainly because Schedule DA does not require CUSIP/PP number. To address this issue, SVO will now use the SEC database to verify registration and develop a blanks proposal to amend Schedule DA Part 1 to add a column for CUSIP numbers. This will permit the staff to compare the funds listed on the approved NAIC Lists to those reported by insurance companies as eligible for bond treatment.

Derivatives Market Study Working Group

During November and December of 2007, the working group and the task force adopted a recommendation to revise Schedule DB; the main objectives of the Schedule DB modifications were to reduce redundancy and number of schedules, and to make the hedging activity more transparent. Some of the proposed changes include measurement of hedge effectiveness in transaction level reporting and description of the hedged item.

Interested parties asked that the adopted proposal not be forwarded to the Blanks Working Group until interested parties have additional discussions with regulators. During the winter, a small group of industry representatives have been developing an alternative proposal which they plan to submit to the working group for discussion later this spring.

Capital Adequacy Task Force

The task force met via conference call twice since the Winter National Meeting and in Orlando and discussed the following items.

Securities Lending Subgroup

At Winter National Meeting, the task force adopted the proposal from its Securities Lending Subgroup for a reduced RBC charge (from 1.3% to .2%) for securities lending programs that conform to specific requirements for Life RBC, effective for 2008 filings. The operating criteria and safeguards include board of director oversight of securities lending programs through a written plan, written operational procedures to monitor and control risks, and acceptable collateral of only cash, cash equivalents, full faith and credit US securities and NAIC 1 securities.

During its February 20th conference call, the task force adopted proposals that provides for the same RBC treatment for property/casualty companies and health entities that enter into securities lending transactions that meet the requirements above. The guidance will be effective for 2008 RBC filings as well.

Authorized Reinsurance Collateral Subgroup

At the Winter National Meeting, the task force voted to form this subgroup to consider the Life RBC treatment of trustee collateral held by an authorized reinsurer. The Life RBC calculation does not currently contemplate that a reinsurance transaction between an authorized reinsurer and a non-affiliate will have secured trustee collateral. As a result, the calculation does not provide for any RBC reinsurance credit and the ceding company is charged counterparty risk. Life insurance companies are allowed to take credit for counterparty risk for authorized reinsurance secured with funds held

The subgroup met three times in 2008 to work on the proposal. The subgroup considered a "non-substantive technical amendment" from interested parties to the Life RBC instructions for the computation of reinsurance ceded, which would reduce the net statement value for trustee collateral used to secure reinsurance ceded with authorized reinsurers.

The final proposal from the subgroup revises the instructions for page LR014, Reinsurance, to include the following in the balance that receives a 0.8% pre-tax credit for reinsurance:

Reinsurance with authorized reinsurers that is supported by equivalent trustee collateral that meets the requirements stipulated in Appendix A-785 (Credit for Reinsurance) where there have been regular bona fide withdrawals from such trustee collateral to pay claims or recover payments of claims during the calendar year covered by the RBC report. Withdrawals from trustee collateral that are less than the amounts due the ceding company shall be deemed to not be bona fide withdrawals.

During the deliberations of this proposal, the subgroup emphasized that the intent of the language was to be very narrow to this set of circumstances so that others, e.g. unauthorized reinsurers, cannot use the guidance as precedent to obtain RBC credit in other fact patterns.

During the meeting of the Capital Adequacy Task Force the members voted to expose for a 21 day comment period the final proposal of the subgroup, which would be effective for 2008 Life RBC.

Hybrid Risk-Based Capital Working Group

The working group held two conference calls following the Winter National Meeting in an attempt to bring closure to its efforts made over the past two years. During these conference calls the working group discussed a draft report which summarizes actions taken and conclusion reached by the working group. The report recommends that regulatory attention should shift from developing a specific risk-based capital charge for hybrid securities as defined by the working group, to a more extensive evaluation of the risk-based capital formula to address a broad range of structured investments which continue to become more complex. The working group intends to recommend to the Financial Condition Committee that such evaluation begin in 2008 and believes that the Invested Asset Working Group is the appropriate venue for such consideration. The report also suggests that further consideration of the accounting and reporting of these securities is necessary and that such consideration should be made by the Statutory Accounting Principles Working Group.

The working group intended to provide this report to the Financial Condition Committee at the Spring National Meeting along with a recommendation to disband. However, following a public exposure period of the document and subsequent review of the responses received from interested parties, the working group agreed to continue its consideration

of the report through conference calls in April and May. The next conference call is scheduled for April 17.

Interest parties expressed strong concerns that after nearly two years of consideration as to the appropriate treatment of hybrid securities by the working group, the ending result was a return to the status quo that existing prior to 2006. Interest parties stated that there was still work needed and urged the working group to reconsider its charge to develop a long-term solution, which would bring finality to the issue, rather than deferring the charge to other NAIC groups.

If no further action is taken by this working group or other NAIC group, including the Capital Adequacy Task Force or the VOS Task Force, the short-term, notching solution will sunset on January 1, 2009. At that time, hybrid securities would likely be reported in Schedule D with a separate line number and the annual statement note disclosure for these holdings would be eliminated. (See Blanks Working Group proposal 2008-06BWG.)

Life Risk-Based Capital Working Group

The working group did not meet in Orlando but held a conference call on March 4 to discuss their 2008 working agenda and other items.

2008 Working Agenda

Significant items discussed include the following:

- The C-3 Phase II working agenda item was amended to reflect that the group will consider the NYID's proposed changes which are believed to be significant.
- Changes to C-3 Phase I calculations and scenario generator are Priority 1 for 2008.
- The group will consider raising the priority of the mortgage experience adjustment factor calculation from Priority 3 after it receives additional information.
- C-3 Phase III will be a high priority for 2008.

Life RBC Trend Test

The working group was asked to consider raising the trigger for the Life RBC Trend Test from 250% to 300%. New York suggested that 400% is more appropriate. The group added this project to the working agenda with a priority level of 3.

C-3 Phase III

The Academy provided an update of its progress; an Academy representative stated that their recommendation is that C-3 would be an after-tax conditional tail expectation (CTE) 90 total asset requirement, less the statutory reserve and would apply to all policies in force.

Since the middle of September, the Academy has been working on four documents. The first document is the updated modeling report. The second is an updated Academy report reflecting changes for the comments and discussion from a prior exposure draft. The third document is a draft C-3 Phase III instructions and formula changes. The last document discusses potential changes to the existing C-3 Phase 1 calculations. The Academy expects to complete the four documents in April, and conference call will be scheduled to discuss.

P/C Risk-Based Capital Working Group

The working group met via conference call on March 24 to discuss the 2008 working agenda and other items in process.

2008 Working Agenda

In addition to the issues discussed below, the working group will perform its annual update of the 10-year experience factors for loss ratio and reserves and will review AAA recommendations related to the 50-50 credibility formula currently used to weight individual industry experience. However, the working group noted its main priority for 2008 is the work of its Catastrophe Risk Subgroup (which is discussed separately below).

The working group also discussed a proposal from the Pennsylvania Insurance Department to increase the risk charge for assets held as state deposits given that access to these assets is "extremely restricted." The NAIC will assist the working group in obtaining data to consider this proposal further.

P/C RBC Underwriting Factors

The working group has been reviewing revised premium and reserve factors since last fall, which had not been analyzed since the original adoption of the formula. The working group had asked the AAA for a proposal and in its Fall 2007 report, the Academy suggested comprehensive changes, with a recommended cap on all lines of +/-35%. The working group agreed with interested parties that an increase of that magnitude should be phased in over time, and a result the working group exposed

for a comment an increase capped at +/-15% for all lines.

During its March conference call, the working group reviewed a revised report from the AAA on the effect of the cap using data from the 2006 RBC database, which noted that the weighted aggregate impact decreased from -3.1% to -1.4%. (Without a cap the report notes that the overall change would have been +9%, influenced primarily by increases in reinsurance factors.)

During the review of the report, the chair noted that the factors should eventually move to a +/-35% cap, and that the Academy should review the factors again next year using 2007 data. The working group then voted to adopt the revised factors. This recommendation was exposed for comment for 30 days by the Capital Adequacy Task Force, which will still allow for final adoption for 2008 RBC.

Update from the Catastrophe Risk Subgroup

The subgroup met via conference call in March to discuss its March 24 "Proposal for a Risk-Based Capital Charge for Property Catastrophe Risk based on the Results of Catastrophe Modeling." The subgroup has been charged with evaluating the possibility of developing a RBC charge for catastrophe risk and of using catastrophe modeling to develop that charge. Catastrophe risk is the one major risk that is not being explicitly or effectively factored into the RBC formula.

The proposal, which has been posted to the P/C RBC Working Group's webpage, includes nineteen preliminary conclusions and related discussion items such as the RBC charge will be the modeled catastrophe losses calculated by any one of the three commercially available catastrophe risk models, using the company's own insured property exposure information as inputs to the model and will be based on the once-in-250 years' modeled loss level.

The issue having the most discussion was item 15, as follows:

Every insurance company will be required to provide as an attachment to its annual confidential RBC Report a report by its independent auditor that provides a clear picture of the quality of the company's exposure data used as input into the catastrophe modeling that forms the basis of the company's catastrophe risk charge in the RBC formula. It is expected that this report will provide substantive

commentary on the accuracy and completeness of the company's exposure data used in its catastrophe modeling. Minimum information requirements that must be included in this report are the percentages of total insured buildings, property values, and premiums that are correctly "geo-coded" to GPS coordinates, or are correctly coded to street address; the percentages that are correctly coded to zip code; and the percentages that are not correctly coded to GPS coordinates, street address, or zip code.

The comment related to this preliminary conclusion is that this requirement "is seen as the cornerstone of our efforts to assure a meaningful result and a responsible application of the models." The subgroup heard comments from the AICPA that independent CPAs do not audit the data from catastrophe models as part of a financial statement audit and that additional discussion would be required to provide a better understanding of the requirements. With that understanding, auditors might be able to develop a report that could be issued under their professional standards, such as an "agreed upon procedures report."

Other comments to the subgroup include the following: 1) generally incorporating catastrophe risk charges based upon publicly available financial data may not be sufficient or accurate in reflecting catastrophe risk in RBC formulas; 2) the calculation must ensure that "double counting" in the current RBC formula is removed before any changes are implemented; and 3) are models accurate enough to use and if so which model and using what assumptions? The next conference call of the subgroup has been scheduled for May 12.

Health Risk-Based Capital Working Group

The working group met via conference call on March 5 to finalize its 2008 working agenda and begin discussion of a health trend test, which has been on the agenda for consideration for many years.

Health RBC Trend Test

The conference call began with very emphatic statements from the working group member from Pennsylvania on the urgency to begin work on a health trend test. In his view, the trend test should be triggered with a 200-300% RBC and a 105% or greater combined ratio. The regulator also thought amending the RBC model regulation and formula at the same time is the ideal approach and this could all be completed in 2008 effective for 2009.

The working group member from Texas observed that because the health RBC ratio can change rapidly use of an operating ratio may work better than a year-to-year trend test. The chair noted that the AAA has done some work with respect to health company data for operating ratios, which will be reviewed by the working group. The trend test is the highest priority item for 2008 for the working group.

Other RBC formula issues to be addressed by the working group during 2008 include review of the Medicare Part D factors, consideration of changes for stop loss insurance and reinsurance, and review of the individual factors for each health care receivables line within the Credit Risk H3 component.

Reinsurance Task Force

Reinsurance Modernization

During 2008, the task force continued its work on development of a significantly revised reinsurance framework modernization proposal. One of the major goals of the task force is to develop a system that would allow for a "single state regulator," certified by a to-be-formed NAIC Reinsurance Supervision Review Department (RSRD). This certification would represent that the state has met a set of standards which enable it to supervise a national reinsurer. This allows a national reinsurer to have one regulator supervisor for all its domestic U.S. business.

The task force met in a regulators-only two day meeting March 11-12. NAIC staff prepared a summary of the meeting for the task force's meeting in Orlando. The memo outlined other aspects of this single regulatory system for national reinsurers which include the following:

- Host states will be required to grant appropriate reinsurance credit for reinsurance ceded by one of its domestic insurers to a national reinsurer authorized by a certified reinsurance supervisor.
- "Appropriate" credit signifies that the ceding insurer's host state supervisor retains the same authority it has under existing law to evaluate the amount of the liabilities ceded and retained and to determine whether the contract transfers risk.
- To be certified as a national reinsurer, a company must be domiciled and licensed as a

national reinsurer under a jurisdiction certified by the RSRD.

The overview provided by NAIC staff also provides additional discussion on the role of the reinsurance supervisors, the role of the host state supervisor, home state notification when there is an enforcement action against a national insurer, extraterritorial application of state law and which companies the proposal applies to.

At the interim meeting in March the task force also heard presentations from New York and Florida insurance departments, both of which states have their own proposals on reinsurance modernization. Both proposals would adjust collateral based on the financial strength rating of the reinsurers. The task force will be working with the New York and Florida to achieve more uniform proposals.

At its meeting in Orlando, the task force reviewed the results of its closed meeting and asked for comments from interested parties on the revised modernization proposal. Compared to previous meetings there were fewer comments made; the task force agreed to accept written comments from interested parties. A due date for comments was not given.

The task force then briefly discussed Senate Bill 929, the Nonadmitted and Reinsurance Reform Act of 2007 which would establish a single-state authority over credit for reinsurance and reinsurer solvency assessment. The chair noted that "piece meal legislation is not a productive path to achieve the goals of the Reinsurance Task Force," but that the Senate Bill does begin to address some of the concerns of the task force. It was also briefly referred to the just-issued report from the Treasury Department, Blueprint for Financial Regulatory Reform, on ways to improve oversight of the financial services sector, noting the Blueprint also includes discussion of reinsurance reform.

The goal of the task force is to complete the revised regulator framework by the end of 2008, and implementation could begin in 2009. Interim meetings will be held throughout 2008, some of which will be regulator only meetings. Issues to be addressed include the port of entry concept, collateral calibration to perceived risk, and what modifications will be necessary to existing statutes, accounting guidance and regulatory tools such as risk-based capital.

Life Insurance and Annuities (A) Committee

Senior Designation Issue

The committee discussed the revised draft consumer alert and insurer and producer bulletin on the use of senior designations in the sale of annuities to seniors. The issue arose from allegations that certain individuals were improperly using new senior designations in order to mislead senior citizens as to the individual's investment and financial expertise. The committee set a two-week comment period on the drafts. After the comment period, the committee anticipates holding a conference call to take final action on the bulletin and consumer alert.

Unfair Trade Practices Act

During the Spring National Meeting, the committee discussed and adopted revisions to the NAIC Unfair Trade Practices Act to address travel underwriting. The revisions prohibit an insurer from refusing life insurance to, refusing to continue life insurance of, or limiting the amount, extent, or kind of life insurance coverage available to an individual based on past lawful travel experiences.

With respect to future travel plans, the revised model prohibits the same actions by insurers unless certain actuarial requirements are met. However, the insurer may take such action if it is taken because either one of the following is true with respect to the specific travel destination: the Centers for Disease Control and Prevention has issued alerts or warnings regarding serious health-related conditions or an epidemic or pandemic alert or response; or there is an ongoing armed conflict involving the military of a sovereign nation foreign to the country of conflict. In another provision, the revised model requires insurers to make any pertinent underwriting guidelines and supporting analyses available to the commissioner upon request.

The revisions will be considered by Executive and Plenary at the Summer National Meeting.

Annuity Sales Supervision Advisory Committee

The committee heard a presentation from the Wisconsin Office of the Insurance Commissioner on its activities related to suitability of annuity sales and the development of supervisory standards. The current annuity suitability law applies to any recommendation to purchase or exchange annuity made to a senior consumer, age 65 or older, by an insurance producer, or an insurer where no producer is involved, that results in the purchase or

exchange of an annuity based on that recommendation. The law requires that an insurer establish and maintain a system to comply with the laws, including maintaining written procedures, conducting periodic reviews, or having a contract with third party to establish and maintain a system of supervision.

Recent regulatory investigations have yielded a number of serious violations which questions the current supervisory system. Thus, at the request of committee, Annuity Sales and Supervision Advisory Committee (ASSAC) was formed to bring all parties to the table to evaluate industry standards for supervising marketing practices and to recommend supervisory standard for consideration. During 2008, the ASSAC will focus on compiling feedback on what is an effective supervisory system, creating an initial outline of supervisory standards for committee review, and revising the current Annuity Buyer's Guide.

Life and Health Actuarial Task Force (LHATF)

Principles-Based Reserves

A significant portion of the two day LHATF meeting was spent on principles-based reserves. In particular, LHATF worked on revisions to the Standard Valuation Law necessary to implement PBR and the Valuation Manual ("VM"), which will include detail valuation requirements. As noted in the summary of Principles-Based Reserving Working Group, LHATF was not able to meet its goal of completing the Valuation Manual in time for adoption by Executive Committee and Plenary at this meeting. Therefore, it has been acknowledged that the task force is behind schedule but a revised timeline has not yet been issued.

Modifications to the SVL

LHATF reviewed an extensive list of changes that are needed to be made to the SVL in order for PBR to be adopted. Many of these changes, even seemingly insignificant ones, were discussed by the regulators at this meeting. Proposed changes that raised the most interest were penalty reserves for companies that intentionally understate reserves and the ability of states to make state specific changes to the Valuation Manual. LHATF voted to expose for comment its recent proposed changes to the SVL.

Valuation Manual

LHATF received reports from the various LHATF subgroups working on portions of the VM.

The VM-0 and VM-1 groups (Introduction and Definitions) reported that they have been working with the Blanks Working Group to determine how PBR would get reported in the statutory annual statements.

The VM-20 (Life Products) group reported that they still needed to complete work regarding mortality requirements, revenue sharing and some definitions specific to life products. In addition, the appropriate discount rate to be used in the PBR calculations was discussed at length and appears to be a critical issue. Some regulators strongly favored using a rate tied to Treasury rates while others appeared to be sympathetic to the Academy's position that the discount rate should be tied to the asset earnings rate underlying the cash flow projections. A discussion of reinsurance credits also took place but no conclusions were reached.

With regard to VM-30 (Actuarial Opinion Memorandum Requirements), there was a back and forth discussion as to whether the AOMR should be included in the VM. At the end of the discussion, LHATF decided to leave it in the Manual. LHATF then discussed whether a separate PBR actuarial opinion would be required. The Academy's position is that the current required actuarial opinion would be sufficient but regulators did not appear as certain.

Other Matters

Reserves for Variable Annuities (Actuarial Guideline VACARVM)

LHATF had allotted 2 hours in their original schedule for this meeting to discuss AG VACARVM. Many expected that the results from last year's survey of the effects of AG VACARVM and LHATF's analysis of those results would finally be made available for discussion. Larry Bruning, regulator from Kansas and LHATF Chair, is spearheading LHATF's analysis of the AG VACARVM survey results. Since Larry was not able to attend this meeting, LHATF postponed all discussion of AG VACARVM until the Summer National Meeting.

Liquidity Issue with Respect to Recent Credit Downgrades

To fill some of the time originally allocated to VACARVM, LHATF invited Commissioner Gross of Virginia to make a presentation to LHATF regarding liquidity issues that companies are facing with respect to recent credit downgrades. Commissioner Gross observed that capital market interest in financing insurance company

securitizations and reinsurance transactions, particularly for XXX and AXXX reserves, is waning.

Commissioner Gross said that he didn't see this as a current solvency problem, but as possibly a future pricing issue as companies may have to charge higher premiums if they cannot secure funding from capital markets. He said that this may be an issue that the task force will need to consider in the future.

Group Long Term Life Waiver of Premium

At the beginning of this discussion, it appeared that LHATF might adopt an actuarial guideline covering the use of the 2005 Group Term Life Waiver Reserve Table for calculating minimum reserves for waiver of premium disabled lives. After a lengthy discussion, regulators were split into three camps; those who wanted the AG to only allow for the use of the table with no provision to adjust the table for a company's own experience, those who wanted the AG to allow for both positive and negative adjustments to the table based on a company's experience, and those who favored only allowing positive adjustments (i.e., increases to reserves) to the table. Interestingly, some regulators voiced their concern that if they allow both positive and negative adjustments to the published table for the company's own credible experience, this might be viewed as a back door way of implementing PBR for this specific type of business. A conference call will be scheduled prior to the Summer National Meeting to discuss further.

Preneed Mortality

Prior to this Spring National Meeting, the task force adopted a model regulation for minimum standards for reserve liabilities and non-forfeiture values for preneed life insurance. The model regulation calls for the use of the 1980 CSO Ultimate Mortality table as the valuation minimum for preneed life insurance. As this business is usually issued on a guaranteed issue or simplified issue basis, the 2001 CSO table is not an adequate mortality table. LHATF's parent, the Life Insurance (A) Committee, also approved this model regulation prior to the Spring Meeting as did the commissioners at Executive Committee and Plenary in Orlando.

Statistical Agent

The model regulation that allows companies to use preferred mortality in their reserve calculations requires those companies doing so to provide mortality information to the commissioner, the NAIC or a statistical agent designated by the NAIC. At the same time, PBR is also expected to require companies to contribute mortality data to regulators. Industry representatives urged LHATF

to make both of these requirements consistent in order to expedite the submission of the data in a cost effective manner. The task force agreed and voted to expose for comment a current draft of standardized forms for experience reporting that is to be used for PBR and the preferred mortality requirement. Even though companies are beginning to use the preferred mortality tables, regulators are not ready to collect the mortality data from companies using the preferred tables. LHATF agreed to draft a letter to send to states letting them know that the experience reporting format is not yet ready and states should waive the requirement of companies using the preferred table to submit experience until the forms are ready.

2008 Valuation Basic Mortality Tables (VBT)

A presentation was made to the task force from the American Academy of Actuaries and the Society of Actuaries' Joint Preferred Mortality Project Oversight Group. The 2008 VBT (the mortality tables before margins are added for valuation purposes) have been completed. There are 72 separate tables included in the 2008 VBT, 56 of which are relative risk table and 16 are aggregate tables. These are the first published valuation tables using actual experience to develop mortality rates for multiple levels of preferred underwriting. Additional information can be found at <http://www.soa.org/research/individual-life/2008-vbt-report-tables.aspx>. An interim conference call will be scheduled to further discuss the tables.

Accident and Health Working Group

Health Actuarial Opinion

The working group has been working on revisions to the actuarial opinion section of the health annual statement instructions. The group discussed differences between life, health and property/casualty requirements in the actuarial opinion processes, such as the requirements to be an appointed actuary. A joint subgroup was formed with regulators from each of the three types of insurance companies that require actuarial opinions; the subgroup will work to consolidate the different processes into a consistent set of requirements. Since any changes to annual statement instructions for 2008 need to be completed by June of this year, the work of this subgroup will not affect the 2008 annual statement instructions.

Medicare Supplement Refund Formula

The working group continues to monitor changes at the Federal level to the Social Security Act with

regard to Medicare and the effects on the refund calculations for insurers to meet minimum loss ratio requirements.

Medicare Supplement Compliance Manual Referral

The working group received a request from the Senior Issues Task Force requesting changes to the Medicare Supplement Compliance Manual to include innovative benefits into the manual. A subgroup was formed to study the issue.

PBR for Health Insurance

Relatively minor changes were discussed to VM-26 (Credit Life and Disability Reserves) to add consistency to different sections of the document.

SAP Working Group Referrals

The working group received an inquiry regarding three referrals made by the SAP Working Group to the A&HWG in 2001. The issues involve premium deficiency reserves, group contracts and the SSAP 54 reference to the A&H Reserve Guidance Manual. NAIC staff will research the status of these issues and regulators will discuss them during an upcoming call. With regard to the A&H Reserve Guidance Manual, the SAP Working Group voted to remove the SSAP 54 reference to this manual. The A&HWG's Vice Chair stated that the manual was never intended to be "official guidance" so she would have no problem with the SAP Working Group removing the reference.

Casualty Actuarial Task Force

The task force received status reports and updates on its various projects. Highlights from subgroups which had more substantive discussions are as follows:

Catastrophe Modeling

The Catastrophe Issues Group will focus on aspects of how catastrophe models are used in pricing and how reinsurance costs and catastrophe costs are allocated. The group expects to provide some updated direction to aid the regulatory review of CAT modeling, which would likely include an update to the questions regulators can ask that are included in the Catastrophe Computer Modeling Handbook, 2001. The task force will coordinate this work with the Catastrophe Insurance Working Group. In addition the task force will ask the American Academy of Actuaries to update its Catastrophe Monograph and the Actuarial Standards Board to update its standard on catastrophe modeling. Interested parties expressed concern that there might be a disconnect in regulatory requirements if companies

are asked to use a model to determine an RBC charge for catastrophe but are not allowed to use that same model to develop rates.

Intercompany Pooling

The changes to the Statement of Actuarial Opinion requirements for intercompany pools will be effective in 2008. However, the changes are limited to cases where there is one lead company that retains 100% of the pool and one or more other companies that retain 0% of the pool. Changes for other types of intercompany pools may be addressed at a later date, but likely not this year.

P&C Line of Business Definition

The Property and Casualty Line of Business Subgroup will begin a project to review the line of business definitions within the annual statement instructions. The task force believes that reporting, especially for commercial lines, is not consistent by line of business. This might be an issue with the reports that are generated, including the Profitability Report. In addition, the subgroup recommended removing the following new wording from 2008 annual statement instructions until the group has chance to review the ramification and study the issue further: "All packaged policies should be reported under multi-peril; commercial, farm owners, or homeowners, as applicable. This includes separate policies that were combined for a package, not just package where the premium is not divisible."

Status of Risk Transfer Survey

American Academy of Actuaries' Committee on Property and Liability Financial Reporting (COPLFR) has been drafting changes to the 2005 Risk Transfer Survey for reissuing. The purpose of reissuing this survey is to measure the improvement in the corporate governance of reinsurance and overall processes surrounding risk transfer.

In February 2008, risk transfer survey was adopted by the task force and sent to property and casualty insurance companies for review. Responses are requested from companies by April 30. In early May, after removing any company references in the data, NAIC staff will forward the data to COPLFR for analysis. COPLFR will evaluate the survey results and provide an update at the Summer National Meeting.

Also on the topic of risk transfer, the AAA noted that the Academy is working with the task force and P/C Reinsurance Study Group for assistance in enhancing training course on reinsurance and

risk transfer for actuaries and financial examiners.

Financial Regulation Standards and Accreditation Committee

Insurer Receivership Model Act

At the Spring National Meeting, the committee discussed amendments to the Insurer Receivership Model Act (IRMA). The 2005 version of IRMA, with some revisions incorporated during 2007, was exposed for comment on January 1, 2008. The revised Section 801 addresses the priority status of claims made during receivership proceedings under warranties and policies of mortgage guaranty and financial guaranty insurance. A new Section 712 was added, which addresses large deductible insurance policies. The current accreditation requirement requires states to have a receivership scheme, rather than having language that is substantially similar to the model. Given that neither of these changes is significant to the regulation of insolvency and receivership, adoption of aforementioned changes are not necessary for meeting the NAIC accreditation standards. The comment period will still end on December 31, 2008.

Accreditation Interlineation Q&A

The committee voted to adopt a "Question and Answer" document that will be included in the Accreditation Interlineations and will clarify certain elements of the new Review Team Guidelines used with examinations conducted under the new risk-focused surveillance approach. During the Winter National Meeting, the committee voted to adopt revisions to the Review Team Guidelines for those examinations that have early adopted the new approach. (Use of the new risk-focused surveillance approach will be required for all financial examination commencing January 1, 2010, and later.) During the subsequent discussions, it was noted that a significant comment letter had been received from the accreditation review team members. This comment letter was forwarded to the Risk Assessment Working Group for its consideration. Some of the team members' comments resulted in further revisions to the Review Team Guidelines, while others did not. For those comments that did not result in changes to the Review Team Guidelines, the Risk Assessment Working Group provided its rationale in the Question and Answer document.

Risk Assessment Working Group

The working group did not meet in Orlando, but held a conference call on March 11 where it received a status update from the Risk Assessment Implementation Subgroup. The subgroup held several conference calls during the past few months to discuss feedback received through the maintenance agenda process, the examination repository project and the advanced training schedule for examiners. As part of its maintenance agenda process, the subgroup is currently considering the relationship between the financial and IT aspects of the examination, and the testing of controls for smaller insurers.

Related to the examination repository project, the subgroup has finalized the exam repository on investments, which was distributed in the materials for the call and has referred the repository to the Financial Examiners Handbook Technical Group. The intent of the examination repository project is to provide optional tools to assist examiners in completing a risk-focused examination by identifying the most common risks that are often inherent in various process of a typical insurance company. The subgroup also continues to work on developing three advanced trainings designed for examiners. The trainings will focus on actuarial considerations of the company as well as interviewing skills.

Terrorism Insurance Implementation Working Group

The working group met via conference call in December and March to discuss the status of Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA), which was signed by President Bush on December 26, 2007. Per the NAIC's webpage on TRIA, significant changes to the initial Act compared to the 2007 extension include the following:

- It revises the definition of a certified act of terrorism to eliminate the requirement that the individuals are acting on behalf of any foreign person or foreign interest.
- The program is extended through December 31, 2014.
- It requires "clear and conspicuous notice" to policyholders of the existence of the \$100 billion cap.

- The Insurer Deductible is set at 20% of an insurer's direct earned premium, and the Federal share of compensation is set at 85% of insured losses that exceed insurer deductibles.
- It requires the Comptroller General to study the availability and affordability of insurance coverage for losses caused by terrorist attacks involving nuclear, biological, chemical, or radiological materials and issue a report within one year
- It accelerates the timing of the mandatory recoupment of the federal share through policyholder surcharges.

At its meeting in March, the working group met with representatives of the Treasury Department's Terrorism Risk Insurance Program Office in a regulators only meeting. Per the summary posted to the NAIC's Meeting Summaries webpage, the parties discussed the Office's development of a regulation related to procedures for determining the pro rata share of insured losses under the program when insured losses exceed \$100 billion.

Climate Change and Global Warming Task Force

The task force held an interim meeting in Kansas City February 28 and also met at the Spring National Meeting to continue work on its white paper *The Potential Impact of Climate Change on Insurance Regulations* and to review initial comments received on the recently released draft *Climate Risk Disclosure Proposal*. The white paper documents the potential insurance related impacts of climate change on insurance consumers, insurers and insurance regulators. The draft includes sections on investment issues and opportunities, social policy, property and casualty insurance industry challenges, and life and health insurer issues. The disclosure proposal was drafted by the newly formed Climate Risk Disclosure Working Group.

One of the key areas of focus in the white paper involves additional disclosure on climate risk and assistance by the NAIC in developing standardized disclosure format. The Climate Risk Disclosure Proposal is a controversial draft proposal that would require insurers to participate in mandatory climate risk disclosure interrogatories as part of their annual statement filings. The proposal borrows questions from existing climate disclosure documents, including the Global Framework for Climate Risk Disclosure, the SEC requirements,

the Carbon Disclosure Project and the Global Reporting Initiative. Four components would be covered in the disclosure, including an emissions disclosure, a strategic analysis of climate risk and emissions management, regulatory risks and physical risks. The proposal calls for a phased system of mandatory disclosures, beginning in 2008 for insurers with premiums in excess of \$100 million and ending in 2011 for insurers with premiums of over \$1 million. Some public companies may already be subject to climate change disclosures under the Securities and Exchange Commission's Regulation S-K.

The task force heard panel discussions on the draft disclosure proposal. The first panel consisted of representatives from insurer trade associations: National Association of Mutual Insurance Companies, Reinsurance Association of America, American Insurance Association, and Property Casualty Insurers Association of America. The second panel consisted of consumer representatives from Ceres, the Center for Economic Justice, and the Rockefeller Family Fund.

The first panel objected to the proposed disclosure requirement claiming that specific financial disclosures of an insurer's assessment of climate change impact does not make sense given that there is no clear connection between effects of climate change and insurers. They believe that specific disclosures ask for categories of information that are inappropriate for the annual statement and pose significant disclosure burden beyond what is needed for effective regulation. In addition, they propose that additional considerations should be given to shifting insurer disclosure of climate risk from interrogatories to other reporting areas like the Management and Discussion Analysis or the NAIC's Risk Surveillance Framework.

The consumer representatives stressed the importance of consistent and mandatory public disclosures by insurers regarding the risk posed by climate change and the insurers' responses to those risks. They claim that climate change will have major impacts on insurer's financial condition and ability to pay future claims, how investors view publicly-traded insurance companies, and affordability and availability of insurance coverage for consumers and businesses. Given that regulators, consumers, and investors often require information about the types of financial exposure insurer face from climate change to monitor the financial condition of insurance companies,

disclosure mandated in the draft proposal is reasonable and necessary.

At the conclusion of the meeting, the task force exposed the disclosure proposal for additional written comments ending April 15. The task force also exposed the revised draft of the white paper for comment for thirty days, with comments due April 30.

Risk Retention Group Task Force

Following the Winter National Meeting the task force held two conference calls and met in Orlando. The task force continues to consider which sections of Part A: Laws and Regulations accreditation standards should apply to risk retention groups (RRGs) licensed as captives. For several meetings, the task force has focused on the Reinsurance Model Law and Regulation, and the development of reinsurance guidelines that would allow state insurance commissioners to exercise some discretion specific to RRGs without violating Part A of the accreditation standards. The draft guidelines provide several circumstances where commissioners may permit RRGs licensed as captives to take credit for reinsurance, when full compliance with the reinsurance model law is not satisfied.

In Orlando, the task force members agreed that RRGs could not apply the reinsurance guidelines to receive reinsurance credit if all policies are ceded through 100% reinsurance arrangements or another lesser percentage as determined by the domiciliary commissioner. In this situation, the RRG would therefore need to comply fully with the reinsurance model law or regulation in order to obtain reinsurance credit.

The task force also finalized language indicating that the commissioner may waive the requirements that the reinsurer submit to a U.S. jurisdiction or the requirement that the reinsurer have a funds-held or similar collateral arrangement, provided that (1) the reinsurer is sufficiently capitalized, (2) the reinsurer is licensed and domiciled in a jurisdiction acceptable to the commissioner, and (3) the reinsurance agreement adequately protects the RRG licensed as a captive insurer and its policyholders. Such a waiver would be required to be disclosed in Note 1 of the RRG's statutory annual statement. The task force adopted the revised reinsurance guidelines, which will be included as a significant element in the Part A standard on credit for reinsurance.

The task force has been scheduled a conference call on April 25 to finalize its consensus recommendations with regard to the Part A accreditation standards and is expected to expose the document for a 30-day public comment period. Following the comment period the task force will provide the Part A recommendations to the Financial Condition Committee.

At the Summer National Meeting, the task force is expected to begin to consider the Part B: Regulatory Practices and Procedures and Part C: Organizational and Personnel Practices accreditation standards to determine their applicability to RRGs licensed as captives and will also consider whether additional accreditation requirements may be necessary.

The next National Meeting of the NAIC will be held in San Francisco May 31-June 2. We welcome your comments regarding issues raised in this newsletter. Please give your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor: Jean Connolly, Managing Director, PricewaterhouseCoopers LLP, 200 Public Square, 18th Floor, Cleveland, Ohio, 44114-2301 — (440) 893-0010 or jean.connolly@us.pwc.com.

Disclaimer

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

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