



# NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS

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## NAIC 2009 SPRING NATIONAL MEETING

The National Association of Insurance Commissioners held their 2009 Spring National Meeting in San Diego March 14-18. 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 Commissioners adopted revisions to two model acts related to guaranty associations, adopted the Valuation of Securities Task Force Policy Statement on Transparency and approved the model law development of a Health RBC trend test. (page 3)
- The Capital and Surplus Relief Working Group discussed progress of its consideration for 2009 certain of the nine ACLI capital and surplus relief proposals that had been rejected for 2008 by Executive Committee. The working group will also work on increasing transparency of permitted accounting practices that differ from NAIC prescribed accounting. (page 3)
- The newly formed Solvency Modernization Initiative Task Force, reporting directly to Executive Committee, will coordinate all NAIC efforts to achieve the goals of the solvency modernization initiative. (page 4)
- The Government Relations Leadership Council heard updates regarding recent Congressional hearings and pending legislation related to financial products and regulatory reform; in addition, the council received a presentation from the Coalition Organized for the Future of Insurance Regulation. (page 4)
- The Principles-Based Reserving Working Group noted that its Corporate Governance Subgroup has exposed for comment proposed corporate governance requirements in a principles-based environment. (page 5)
- The Financial Condition Committee announced that the NAIC and regulators expect information on permitted accounting practices to be disclosed in all filed quarterly statements as well as in the annual statement. (page 5)
- The Statutory Accounting Principles Working Group exposed significant new documents for comment including SSAP 100 on pensions, SSAP 92 on postretirement benefits other than pensions, and a revised Form A on increasing the deferred tax asset limitation in SSAP 10. The working group's Separate Account Subgroup exposed proposed changes to SSAP 56 to address separate accounts guarantees and risk charges in the separate account. The working group also plans to consider a revised proposal from the ACLI on accounting for deferred premium assets and will continue deliberations on securities lending with a new Securities Lending Subgroup. (page 6)
- As a result of recent FASB activities, the Emerging Accounting Issues Working Group has expedited its

review of recently adopted or exposed FSPs on fair value and other-than-temporary impairments and will hold a conference call on March 26 to discuss FSP EITF 99-20-1, FSP FAS 157-e and FSP FAS 115-a. (page 9)

- The Blanks Working Group adopted eleven blanks proposals as final and exposed twenty-two new issues for comment including the long-awaited proposed revisions to reporting derivatives in Schedule DB. The working group's Premium Survey Subgroup completed its survey to states regarding the methods of allocating premiums and concluded no reconsideration of the recently adopted Schedule T instructions is necessary. The working group also approved a survey on accounting for bail bond premium (gross versus net of acquisition expenses). (page 11)
- The NAIC/AICPA Working Group updated its survey on the states' progress of adopting the revised Model Audit Rule (MAR), noting that twenty-four jurisdictions have either adopted revised laws or regulations or have exposed proposed revisions. The working group also discussed a proposed addition to the MAR Implementation Guide to clarify the role of the independent audit committee of Sox compliant entities. (page 13)
- The Valuation of Securities Task Force adopted proposed revisions to the Derivative Instrument Model Regulation, which will require insurers to file and obtain approval of derivatives use plans before purchasing derivative investments. The task force also finalized its consideration of life settlement contracts, recommending to the Statutory Accounting Principles Working Group that contracts with certain characteristics be recognized as invested assets and reported on a new line on Schedule BA. (page 13)
- The Capital Adequacy Task Force adopted a RBC sensitivity test for captive risk retention groups for financial analysis purposes and discussed drafting a policy statement to prohibit "RBC permitted practices" unless allowed by state RBC statute. (page 15)
- The Life RBC Working Group exposed three documents in its consideration of C-3 Phase III for life insurance products and continued work on a short-term solution for the RBC Mortgage Experience Adjustment Factor. The Property/Casualty RBC Working Group adopted the 2009 underwriting risk factors, which will be limited to an additional increase or decrease of 15%. (page 16)
- The Reinsurance Task Force exposed for comment its Guidance Regarding Reinsurance Collateral Requirements, which is part of the capital and surplus relief proposals. The document provides guidance to states which are considering additional forms of acceptable collateral to secure reinsurance agreements. (page 17)
- The newly formed Rating Agency Working Group will consider issues related to the reliance on NRSRO's by the NAIC, the insurance industry and the insurance marketplace. (page 18)
- The Life and Health Actuarial Task Force exposed for comment three capital and surplus relief proposals for proposed use at year-end 2009 (Life 1A, Life 1C and Life 2). The task force has also continued its work on the PBR project and anticipates adoption of a revised Standard Valuation Law for principle-based reserves at the Summer National Meeting. (page 18)
- The Financial Regulation Standards and Accreditation Committee reported that it plans to adopt the Model Audit Rule (effective January 1, 2010) as "new significant elements required for accreditation." (page 22)
- The Climate Change and Global Warming Task Force adopted the Climate Risk Disclosure Survey as final. The survey is mandatory for 2009 for insurers with direct written premium in excess of \$500 million; survey submissions will be available to the public. (page 24)

## Executive Committee and Plenary

### Executive Committee and Plenary

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

- An Overview of Workers' Compensation Independent Contractor Regulatory Approaches White Paper.
- Amendments to the Life and Health Insurance Guaranty Association Model Act (#520); twelve of twenty-three sections were revised.
- Amendments to the Property and Casualty Insurance Guaranty Association Model Act (#540).
- Valuation of Securities Task Force Policy Statement on Transparency; this policy statement includes sections on the guiding principles of the regulatory review process, requesting a regulatory review of an investment security and the public meetings process.
- Part A Accreditation Standards for Risk Retention Groups.

At its earlier meeting, Executive Committee took the following actions:

- Adopted the Climate Risk Disclosure Survey
- After lengthy discussion on the use of credit scoring in policy rating, adopted revised charges for the Property and Casualty Insurance and Market Regulation and Consumer Affairs Committees to conduct a joint investigation of credit scoring with the aim of determining whether current laws on credit scoring are adequate in light of the current economic crisis.
- Approved one model law development request to amend the Risk-Based Capital for Health Organizations Model Act. The proposed changed to this model act would include a trend test for health insurers, similar to that required for both life and property and casualty insurers.

## Capital and Surplus Relief Working Group

In light of the NAIC rejecting all nine ACLI proposals for year-end 2008 (seven of which were endorsed by the working group), the group's charges are as follows: (1) monitor the progress of its recommendations for 2009 adoption, (2) consider the current system of permitted practices, and (3) consider any necessary changes to the NAIC process to accommodate emergency issues.

With regard to the nine ACLI proposals, the working group asked LHATF to finalize proposals Life 1A (expanded use of the 2001 Preferred Mortality tables), Life 1C (use of non-preferred mortality in calculating segments under AG 38), and Life 2 (removing the constraints in calculating X-factors for XXX reserves) by the Summer National Meeting. (See further discussion in the LHATF summary below.) The working group also requested the Capital Adequacy Task Force to finalize the VA2 proposal (elimination of standard scenario in RBC C3 Phase II) and the MEAF proposal. They noted that no action is required for VA1 since AG 39 expires before year end 2009. The deferred tax asset item is being considered by the Statutory Accounting Principles Working Group (see discussion on page 7). The working group will make a recommendation directly to Executive/Plenary for proposal Life 3 dealing with collateral for reinsurance.

With respect to permitted practices, the working group noted that a spreadsheet of all permitted practices (and state prescribed practices that differ from NAIC prescribed) by insurance company legal entity has been posted to the NAIC's homepage for year-end 2008 and 2007. The analysis shows the effect on net income and surplus of the practice and a brief description of the permitted or state prescribed practice. The spreadsheet includes all such practices, not just those granted for the first time for year-end 2008. One regulator stressed that the analysis had to be updated after it was first issued; several dozen companies were not included in the analysis because the data was not captured from Note 1A to the annual statement because those companies did not include the required information in a tabular reconciliation from NAIC prescribed SAP to state prescribed or permitted SAP. That this reconciliation is the required format was also emphasized in the SAP Working Group meeting discussed below.

A consumer representative reiterated his comments made at earlier meetings that the process needs more transparency via public

meetings, especially when consideration of issues in being expedited as was the case in December and January.

### **Solvency Modernization Initiative (EX) Task Force**

Chaired by Virginia Insurance Commissioner Al Gross, this new task force is expected to convene for the first time in April 2009. Its core function is to coordinate the NAIC's efforts to achieve the goals of the Solvency Modernization Initiative, which involve the following subject matters:

- Capital Requirements
- International Group Supervision;
- Valuation (reserves) and
- Reinsurance

The task force's charges include oversight of the (1) Principles-based Reserving Working Group; (2) International Solvency and Accounting Working Group; and (3) the new Group Solvency Issues Working Group. In addition, it is anticipated the task force will support and coordinate international activities with the International Insurance Relations Committee.

#### Group Solvency Issues Working Group

Reporting to the Solvency Modernization Initiative Task Force, this new working group is charged with the following:

- Gathering information from all states regarding Holding Company Model usage and effectiveness, including its responsiveness in light of the recent economic downturn and reporting the need for any changes to the Financial Condition Committee,
- Considering international solvency issues, including the interaction between federal and state financial regulators, and reporting to the Financial Condition Committee the need for changes to the Holding company on this basis;
- Studying the need to develop group-wide supervisions requirements, including capital requirements, and considering potential approaches to such capital requirements, including challenges related to financial conglomerates and non-regulated entities,
- Recommending guiding principles for Supervisory Colleges and other methods of

cooperation among cross-sector regulators, including state regulators.

### **Government Relations Leadership Council**

#### Congressional Update

NAIC staff updated the committee relative to recent congressional hearings of interest:

- On March 12, Wisconsin Insurance Commissioner Sean Dilweg appeared before the U.S. Senate Committee on Commerce, Science and Transportation and testified on behalf of the NAIC on the issue of climate change.
- On March 17, Illinois Insurance Director Michael McRaith appeared before the U.S. Senate Committee on Banking, Housing and Urban Affairs and testified as to the strength of state-based insurance regulation. The testimony was provided at a hearing intended to address a wide range of key issues regarding potential insurance regulatory reforms, including producer registration and licensing, prior legislation to create an optional federal charter (OFC) and Office of Insurance Information, potential reinsurance, surplus lines and holding company reforms; systemic risk, consumer protection; and risk management and corporate governance issues.
- On March 18, Pennsylvania Insurance Commissioner Joel Ario testified before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises on AIG's impact on the global economy.

NAIC staff reported that legislation for an OFC had not been reintroduced to date, notwithstanding statements by former sponsors Reps. Melissa Bean and Ed Royce that they intend to do so. Any legislation re-introduced on this issue is expected to include oversight of systemic risk and increased consumer protection provisions, including a provision requiring an insurance regulatory office in every state. No further details are known.

NAIC staff noted the following pending legislation affecting financial products:

- Legislation has been introduced to create a Financial Products Safety Commission to help consumers use financial products such as mortgages and credit cards.

- Legislation was also introduced to create a Financial Accounting Oversight Board, which would include a member of the NAIC as a board member.
- NARAB II legislation was introduced to further simplify producer licensing.
- HR-83 was reintroduced to allow states with Catastrophe Funds to purchase reinsurance from the federal government
- Legislation proposing the Homeowners Defense Act of 2009 was introduced to allow catastrophe risks to be pooled and transferred to the capital markets.

#### COFIR Presentation

The council also heard a presentation by Alabama Representative Greg Wren on behalf of COFIR, the recently renamed Coalition Organized for the Future of Insurance Regulation (f/k/a the Coalition Opposed to Federal Insurance Regulation). Rep. Wren stated that his group was opposed to federal insurance regulation because they felt that it would create an ineffective federal bureaucracy, which did not make sense since state based regulation has been successful. To support the latter, Rep. Wren pointed to the fact that state insurance regulators have protected the solvency on many insurance companies amid the current financial crisis.

#### **Principle-Based Reserving Working Group**

##### Report and Recommendations of the Corporate Governance Subgroup

In an interim conference call, the subgroup adopted draft provisions for the SVL and Valuation Manual recommending corporate governance requirements in a principles-based environment. Based on the subgroup's recommendation, the working group exposed the drafts for public comment for 30 and 45 days, respectively. The subgroup also sought input from the Life and Health Actuary Task Force (LHATF) as to how to best incorporate the recommended provisions into the SVL and Manual so as to avoid conflicts or redundancies with existing requirements. Finally the subgroup indicated that it hopes to build upon its work on corporate governance beyond principles-based reserves for life insurers, and continue to develop corporate governance standards across all lines of business and operations.

##### Standard Valuation Law & Valuation Manual

LHATF reported that revisions to the SVL are in the final stages and work on the Valuation Manual continues at a steady pace. However, with the recent focus for the past four months on capital and surplus relief proposals, the PBR project has been out of the spotlight. Final adoption of the Standard Valuation Law by the NAIC in 2009 is expected to occur, with adoption of the Valuation Manual shortly after that. However, timing of adoption by states is difficult to estimate. An effective date for new policies beginning January 1, 2012 may be achieved by some states, but it will likely be a few years after that before at the least 26 states have adopted it so it becomes mandatory.

##### Statistical Agent

With the goal of collecting industry data sufficient to update mortality rates (which tend to be one-size-fits-all), LHATF is expanding efforts to capture data and identify qualifying statistical agents. In so doing LHATF will leverage work completed by the New York Insurance Department, which is undertaking a similar endeavor and is farther along in the process. LHATF will also solicit input from the Casualty and Actuarial Statistical Task Force. In addition to identifying qualifying statistical agents, LHATF will also be considering parameters around data collection, including data units and reporting exemptions, as well as other issues such as warehousing data and third party access.

#### **Financial Condition Committee**

##### Quarterly Disclosures of Permitted Practices

At its meeting in San Diego, the committee announced that permitted practices should be disclosed in quarterly financial statements. The committee reminded insurers that this is, in fact, a requirement contained in the APP Manual even though it has not been explicitly set forth in the instructions for completing the quarterly blanks. The NAIC will post on its website an announcement setting forth the requirement so as to minimize any confusion on the issue. In addition, the Blanks Working Group exposed a change to the quarterly instructions to require such disclosure, as discussed below.

##### Discussion of the Timing of Adoption of Technical Group Activity

The chair stated that the question of whether quarterly reporting of permitted practices is required has served to raise the larger question of when is technical group activity deemed adopted, i.e. after approval by the committee or after

approval by Executive and Plenary at a subsequent National Meeting. Resolution of the issue is important in that it directly impacts proposals for technical changes to the Blanks and APP Manuals, which are often presented for adoption immediately prior to their intended commencement dates. It was noted that waiting several months for Plenary adoption could interfere with timely and consistent implementation. One suggestion proposed was to move the timing of the Financial Condition Committee meeting to enable Plenary consideration during the same national meeting. The committee deferred further action on the issue until after the NAIC staff has done additional research.

## **Statutory Accounting Principles Working Group**

### **Interim Conference Call**

The working group held a conference call on January 16 to discuss SSAP 98.

Adoption of SSAP 98 –The chair noted that the working group had adopted SSAP 98 during a November 5 conference call but voted in December to defer submitting the new Standard to the Accounting Practices and Procedures Task Force until after the SEC study on fair value was completed. As a result, the working group met on January 16 to discuss the SEC study entitled "Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting" issued December 30.

The chair noted that the conclusion of the study was that FAS 157 needs to be improved but should not be suspended as suggested by some. A representative from SAP Working Group interested parties noted that they agree that SSAP 98 is not affected by the study. The working group then voted to adopt SSAP 98, effective January 1, 2009 with early adopted permitted and encouraged. The Accounting Practices and Procedures Task Force and the Financial Condition Committee have both subsequently adopted the new Standard.

### **Public Hearing**

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

Accounting for Index-Based Insurance Linked Securities – This issue has been on the SAP Working Group's active agenda since 2002 when

the white paper on insurance linked securities was referred to the working group by the Insurance Securitization Working Group. The working group disposed of the issue at the Spring National Meeting without any revisions to statutory guidance. This action does not preclude interested parties from coming back to the SAP Working Group in the future should demand for these types of products return.

### **Fund Demand Disclosure for Institutional Business**

The working group will continue to work on developing stress liquidity risk disclosures with a focus on which disclosures should be public and which of the proposed disclosures contain company-sensitive information. NAIC staff will perform research on what SEC disclosures are required for this business, and interested parties were given additional time to review the proposal before the working group takes action. The proposed effective date is year-end 2010.

Issue Paper 135, FIN 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Others – In their comments, interested parties noted that the draft issue paper requires, via guidance in a footnote, that three types of related party guarantees be included in the recognition and measurement guidance. Interested parties believe this is a significant difference between GAAP and SAP, and the working group agreed to move the guidance from a footnote to the body of the issue paper. Interested parties agreed to provide input on how to value related party guarantees.

SSAP 48 Audit Report Requirements for Non-SCA Investments – The working group adopted revisions to SSAP 48 to clarify admitted asset guidance when audits of SSAP 48 entities are not completed by the filing of the insurance company investor annual statement or audited statutory financial statements. The adopted guidance makes the SSAP 48 guidance consistent with SSAP 97 on this issue.

Issue Paper 136, Consideration of FAS 163, Accounting for Financial Guarantee Insurance Contracts – The working group received three comment letters from financial guaranty insurers with respect to issues related to the new issue paper. The working group agreed to form a subgroup to accomplish the following during 2009: prioritize adopting enhanced financial guarantee disclosures effective for 2009, conduct conference calls to address technical issues raised in the comment letters, and coordinate with the Financial

Guaranty Insurance Guideline Working Group. The members of the subgroup have not yet been finalized. Issues that will likely be addressed by the subgroup include the effect on premium recognition of the contractual vs. expect term of the policy, early retirement of the insurance financial obligation, discount rates and the definition of written premium.

FSP FAS 150-3 and FSP FAS 150-5 on Mandatorily Redeemable Financial Instruments and Redeemable Freestanding Warrants - The working group adopted as final a proposal to reject these FSPs. However, in connection with these issues, the working group adopted the following guidance to SSAP 72, paragraph 10:

In instances in which a reporting entity has issued puttable warrants or mandatorily redeemable securities, such items shall be reflected as liabilities as the warrants obligate the reporting entity to ultimately transfer cash or other assets to the holder in order to repurchase the shares.

FSP SOP 90-7-1: An Amendment of AICPA Statement of Position 90-7 - The working group adopted as final a proposal to reject this guidance on fresh start accounting resulting from reorganization under the bankruptcy code as not applicable to statutory accounting.

#### **SAP Maintenance Agenda Discussion**

All issues exposed or re-exposed for public comment have a comment deadline to NAIC staff of May 4 with a public hearing at the Summer National Meeting.

FSP EITF 99-20-1, Amendments to the Impairment Guidance of EITF 99-20-1 - During the January 2009 deliberations on the adoption of SSAP 98, an interested party had asked that the SAP Working Group expedite its review of this guidance. At the Spring National Meeting, the working group added the issue to its agenda and referred its recommendation to the Emerging Accounting Issues Working Group and the Fair Value Subgroup. The recommendation proposes incorporation of paragraphs 9 and 10 of FSP EITF 99-20-1 on other-than-temporary impairments into INT 06-07. It appears the proposed guidance would apply to all investments subject to INT 06-07 while the GAAP guidance only applies to securities (certain beneficial interests) within the scope of EITF 99-20.

Deferred Premium Asset and Unearned Premium Reserve – The working group held a conference call December 18 as a last attempt to resolve this long-standing issue by year-end. The working group again heard very heated discussion on this issue of the appropriate accounting under SSAP 61 when reinsurance premiums are paid in full upfront and the policyholder pays on an installment basis. After nearly two hours of discussion on this call, no consensus was reached and several motions failed for lack of a majority. Therefore, no changes to SSAP 61 were adopted.

At the Spring National Meeting, the working group heard comments from the ACLI, who asked that its most recent Form A (issue 2008-15) be rescinded and a new Form A be exposed for comment. Per comments made by the ACLI representative at the meeting, the ACLI believes the effect of the new Form A is as follows:

- The proposed changes to SSAP 61 limit the coinsurance credit so that it does not ever exceed the corresponding amount on the coinsured portion of the direct policy.
- Coinsurance prepaid beyond the paid-to-date of the policy will be an admitted asset value at the gross reinsurance premium and will be included in a new line 14.4 "Modal Reinsurance Premium Asset."
- The proposal would apply to policies issued or newly coinsured on or after January 1, 2010.

The representative also stated that the ACLI believes they have conceded on all issues except retroactivity. They also still need to provide illustrations to the working group to demonstrate the results provided by the revised Form A.

The working group will hold a joint conference call with the Life and Health Actuarial Task Force to review the revised Form A.

SSAP 100 - Accounting for Pensions, a Replacement of SSAP 89 and SSAP 92, Accounting for Postretirement Benefits Other than Pensions, a Replacement of SSAP 14 – With little discussion, the working group voted to expose these new SSAPs for comment. The revised effective date is for year-end 2011 with a transition period of ten years for entities for which the surplus effect on an individual basis for each plan is greater than 1% of surplus.

#### DTA Admitted Asset Limitations

As discussed in our PwC Special Edition Newsletter issued January 29, 2009, Executive Committee rejected all nine ACLI Capital and Surplus Relief proposals, including a proposal to increase the limitation for admissible deferred tax assets (which was approved by the SAP Working Group in early January). As a procedural matter, the working group voted to reject its December proposal (issue 2008-29) and replaced it with a new Form A (2009-06) which incorporates recommendations made by the Wisconsin commissioner at the public hearing of the Capital and Surplus Relief Working Group in January, e.g. the higher DTA may only be recognized by insurers above certain RBC levels, it cannot be used to pay dividends and several other caveats.

The working group then voted to expose the revised proposal for comment and will hold conference calls this spring to discuss the recoverability of deferred tax assets and the relationship of the proposed language to existing model laws. The industry was also requested to show that there is an "economic need to change the language." The chair noted that permitted practices related to DTAs granted by some states were not material overall to industry surplus; another regulator stated that the working group has an "obligation" to consider the revised proposal but that "now is the time to be conservative" given the current economic climate.

Securities Lending – The working group will form a subgroup of regulators and interested parties to continue review of the issues related to securities lending. A representative from interested parties stated that most in the industry agree that FAS 140 should be fully adopted in SSAP 91 which would bring most securities lending arrangements on-balance sheet. The working group had a brief discussion on how to report collateral on Schedule D when the collateral turns over every few days and/or is maintained by a custodian. Interested parties favor a single line item in Schedule D instead of reporting the purchase and sale of every security in the securities lending pool. Several regulators stated that they believe more detail is needed than a single line item presentation in Schedule D.

Several regulators expressed strong views on securities lending, stating that additional limitations should be placed on securities lending activities or perhaps insurers should be required to nonadmit all securities lending assets given the level of risk that such arrangements expose insurers to. The

subgroup will hold conference calls this spring and hope to have guidance finalized for 2009, with an exposure document sometime during the second quarter.

Transfer of P/C Runoff Portfolios – The working group briefly reviewed a proposal from the Winter National Meeting to allow prospective reinsurance accounting for the transfer of "runoff transactions" when specific criteria are in place, given the difficulty in achieving novation of direct contracts. The proposal requires approval by the domiciliary commissioner of the transferring company and the acquiring company and includes guidance on considerations and contractual provisions that should be required by the regulator.

The working group directed NAIC staff to draft an issue paper incorporating these recommendations with a change to explicitly exclude affiliated reinsurance transactions.

FSP FAS 140-3, Accounting for Transfers of Assets and Repurchase Financing Transactions - The working group exposed for comment proposed revisions to SSAP 91R to adopt this FSP.

#### Other Items Exposed

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

- FSP FAS 117-1, Endowments of Not-For-Profit Organizations
- FSP SOP 07-1, Clarification of the Scope of the Audit and Accounting Guide for Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies
- SOP 07-2, Attestation Engagements That Address Specified Compliance Control Objectives and Related Controls at Entities That Provide Services to Investment Companies, Investment Advisors, or Other Service Providers

Consideration of FIN 48 – There was no discussion of this topic in San Diego. An issue paper, likely proposing adoption of FIN 48 on uncertain tax positions, is expected sometime in 2009.

Update from Fair Value Subgroup – The subgroup has not met since the Winter National Meeting as it was postponing further work until the regulators can review the findings of the SEC fair value study



issued in January 2009. The subgroup held a FAS 157 Education Session in San Diego and heard presentations from representatives of the Big 4 accounting firms that included discussion of the following topics: basic FAS 157 concepts, the impact of fair value guidance on statutory accounting, results of the SEC study on fair value, the effect of FAS 157 on impairment analysis, and implementation challenges of FAS 157. There was also an extended discussion of the current developments at the FASB related to FAS 157 and impairments and the issuance of FSP FAS 157-e, Determining Whether a Market Is Not Active and a Transaction Is Not Distressed, and FSP FAS 115-a, FAS 124-a and EITF 99-20-b, Recognition and Presentation of Other-Than-Temporary Impairments. (See further discussion of these new exposure drafts below in the summary of the Emerging Accounting Issues Working Group.)

No conclusions were reached during the educational session, but the subgroup chair stated they will resume progress on their study of FAS 157 and will post the educational session presentation to the NAIC's website.

#### Update from the Separate Account Subgroup

The working group received a brief report from its subgroup, which held a short conference call on March 5 to expose for comment proposed revisions to SSAP 56. The proposed changes include the following new paragraph 27, Risk Charges, to SSAP 56 as follows:

Contract guarantees, for both individual and group separate account products, in which separate account assets or contract performance are guaranteed by the general account require separate account risk charges to be established and paid to the general account in order to provide appropriate compensation for the risk taken by the general account. The level or amount of risk charges shall be appropriate in view of such factors as of the nature of the guaranteed contract liabilities and losses experienced in connection with account contracts and other pricing factors. All separate account risk charges shall be reviewed and opined upon by the appointed actuary for the general account.

The proposal also requires significant new disclosures in the general account financial statements with regard to the separate account, including the general nature of the separate account business, identification of the separate account assets that are legally insulated from the

general account claims, identification of the separate account products that have guarantees backed by the general account and other detailed disclosures related to guarantees of separate account products. Comments are due to the NAIC by April 30.

Referral from the Reinsurance Task Force - The working group will hold an interim conference call to discuss a referral from the task force related to proposed required contractual provisions in reinsurance agreements.

## **Emerging Accounting Issues Working Group**

The working group continued work on new and previously addressed issues as discussed below.

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

The working group had deferred final adoption of this issue until the Spring National Meeting due to comments raised by interested parties as to the interpretation of accounting for funds received from a FHLB that are "in substance funding agreements." In San Diego, interested parties withdrew their comments and INT 08-08 was adopted as final without any revisions.

### Clarification of SSAP 85 for Case and Disease Management Program Expenses

The working group briefly reviewed a new Form B asking for clarification on the classification of disease and case management expenses as cost containment expenses or medical expenses. The working group referred the issue to the Accident and Health Working Group.

### EITF 08-7, Accounting for Defensive Intangible Assets

The working group adopted a tentative consensus that such assets are within the scope of definition of intangible assets per SSAP 20 and are therefore nonadmitted for statutory reporting.

The working group also adopted a tentative consensus to reject the following EITF guidance as not applicable to statutory accounting:

- EITF 07-4: Application of the Two-Class Method under FSA 128 to Master Limited Partnerships
- EITF 07-5: Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock

#### EAIWG Consideration of Recent FSPs on Fair Value and OTTI

Subsequent to the Spring National Meeting, the working group announced a public conference call on March 26 to discuss the recently released exposure draft FASB FSPs and a recently adopted FSP: FSP FAS 157-e, Determining Whether a Market Is Not Active and a Transaction Is Not Distressed, and FSP FAS 115-a, FAS 124-a and EITF 99-20-b, Recognition and Presentation of Other-Than-Temporary Impairments. One possible outcome of the conference call is that the working group could vote to expose these documents for comment for use in statutory accounting.

#### **International Solvency and Accounting Working Group**

##### Comparison of US and EU Solvency Schemes

In an interim call, the working group closed the comment period on the draft paper, "A Comparison of Solvency Systems: U.S. and EU," dated May 22, 2008. The paper will be on hold until Solvency II has been enacted.

##### Discussion of Comments on Paper on Auditor/Actuary Relationships

Comments on the "IAIS Issues Paper On The Roles Of And Relationship Between The Actuary And The External Auditor In The Preparation And Audit Of Financial Reports" previously adopted by the working group were superseded when the IAIS issued a redraft of the paper. The working group indicated that it will likely provide the IAIS Technical Committee with comments prior to the May 15 deadline, and discuss the paper on an interim conference call. See further discussion in the summary of the Casualty Actuarial and Statistical Task Force below.

##### IAIS Solvency Subcommittee Activities

The IAIS Solvency Subcommittee met in February. A drafting team, led by the U.S., was asked to work on recommendations for Insurance Core Principles (ICPs) for solvency, including potential conflicts between IAIS standards and IPC criteria. In the meantime, the subcommittee will be compiling a publication of International Solvency Requirements. Papers for inclusion on regulatory capital, ERM, and internal models were previously adopted in October 2008 and a draft on capital resources for solvency is being considered. The working group is planning on holding a conference call on May 8 to consider comments to the draft.

#### IAIS Insurance Groups and Insurance Contracts Subcommittees

The Insurance Groups Subcommittee, which continues to work towards international standard setting and in a Joint Forum liaison function, met in San Diego. The subcommittee confirmed that group-wide supervision, including supervision through the use of supervisory colleges, is a high priority issues for the IAIS. To this end significant work continues to be undertaken on the IAIS group supervision issues paper. The subcommittee reported that the current draft paper is more in line with the FASB issues paper on the same topic. It is anticipated that the IAIS paper will be exposed for comment on March 26. Other subcommittee activities include a survey to help define "group" vs. "financial conglomerate" and a response to the G20 Washington action plan.

##### IASB, FASB and FCAG Activities

NAIC staff provided an update on IASB, FASB and FCAG Activities, noting that as anticipated FASB has joined IASB in its work on insurance contracts, and, on March 10, the working group submitted comments to the IASB and FASB regarding boundaries of an insurance contract. At the time of the meeting in San Diego, it was anticipated that the IASB would be issuing an exposure draft of its fair value measurement standard. NAIC staff summarized a list of key decisions in this area. In addition the IASB determined that there should be disclosure of the level in the hierarchy for all financial instruments measured at fair value, thus converging with U.S. GAAP (FAS 157).

Under both IASB and FASB, the Financial Crisis Advisory Group has been formed to "consider how improvements in financial reporting could help enhance investor confidence in financial markets. Virginia Insurance Commissioner Al Gross is a member of this group in his capacity as Chair of the IAIS Technical Committee. Meeting three times since January, the group appears to be defending against the inference that accounting or the use of fair value contributed to the recent market crisis. The group is also promoting improvements to restore investor confidence. FCAG issued set of questions soliciting feedback in anticipation of its April meeting. The working group is drafting a response to on behalf of the NAIC.

##### Comments on Non-Accounting Solvency Issues

The working group received four comment letters from interested parties on the draft document on Non-Accounting Solvency Issues that was exposed in December. The working group will hold an

interim call to receive additional oral comments and to discuss revisions to the document.

## **International Insurance Relations Committee**

### International Insurance Relations Guiding Principles

The committee adopted "NAIC International Insurance Relations Guiding Principles," which are to govern their IAIS and other international activities, including the promotion of regulatory authority in line with other financial services regulators, and promoting the development of international standards of insurance supervision, which should include areas of U.S. insurance regulation.

### IAIS Activity

The committee received reports from the IAIS Executive and Technical Committees, and the Reinsurance, Insurance Groups, and Solvency subcommittees. The committee and NAIC staff on the committee's behalf have been active in promoting global solvency benchmarks through the IAIS. In addition, the committee is working through the IAIS to respond to the G20 and Financial Stability Forum calls for financial services reforms, particularly with regard to group supervisory challenges and systemic risk at the group level.

## **Blanks Working Group**

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

- A requirement to inform the commissioner about the initial appointment of an appointed actuary and provide other related information was added to the property and casualty annual statement. (Agenda item 2008-38BWG)
- Instructions for the annual audited financial statements were removed from the annual statement instructions, effective 2010, as appropriate guidance is being adopted by state statute and the Model Audit Rule. (Agenda item 2008-42BWG)
- A prior year-to-date column was added to the quarterly statement cash flow page to enable regulators to more easily compare current and prior year-to-date amounts. The change is

effective for first quarter 2010. (Agenda item 2008-44BWG)

- Schedule BA instructions were modified to clarify where to report reverse mortgages and to add a reference to the Investment General Instructions directing users to INT 00-06, Accounting for Deferred Compensation Arrangements Where Amounts Earned are Held in a Rabbi Trust and Invested for accounting guidance on Rabbi Trusts. The change is effective for first quarter 2010. (Agenda item 2008-45BWG)
- An interrogatory was added to the Supplemental Exhibits and Schedules Interrogatories on the filing of the Accountants Letter of Qualifications with the state of domicile and electronically with the NAIC. (Agenda item 2008-47BWG)
- An Accident and Health Operating Percentages section was added to the Quarterly Statement General Interrogatories. The change is effective for first quarter 2010. (Agenda item 2008-48BWG)

The working group exposed a proposal which substantially changes the reporting of derivatives on Schedule DB (Agenda item 2009-16BWG) in an effort to simplify and streamline the reporting requirements. The proposal is generally supported by regulators and interested parties; however, interested parties expressed some concern with regard to the proposal's requirement to report hedge effectiveness on Schedule DB. As it relates to this proposal, comments relative to the reporting of hedge effectiveness are due by May 1, 2009. All comments on the proposal will also be forwarded to the Statutory Accounting Principles Working Group, to solicit that group's input.

After receiving the requisite two-thirds majority vote, a proposal was added to the working group's agenda, which would specifically require the disclosure of permitted practices on a quarterly basis. After discussion by the working group, the proposal was exposed for comment. The comment period ends April 15, 2009, to allow for adoption effective for the first quarter 2009

The working group also exposed twenty-two other new proposals for comment. The comment period for these proposals ends May 14. Some of the more significant exposed proposals would:

- Add instructions to the Exhibit of Premiums and Losses to clarify where flood coverage other than coverage provided as part of the federal flood program should be reported. (Agenda item 2009-01BWG)
- Add structured settlements' interrogatory questions for life and fraternal companies to disclose reserves established for annuities purchased by property and casualty companies for structured settlements resulting in a release of liability for the insurer. (Agenda item 2009-02BWG)
- Add instructions to Schedule D and Schedule E to clarify the reporting of investments in certificate of deposits via Certificate of Deposit Account Registry Service (CDARs). (Agenda item 2009-04BWG)
- Create a supplement to gather information for the Statutory Accounting Principles Working Group on the reporting of bail bonds policies. (Agenda item 2009-08BWG)
- Modify disclosures in Note 17B to reflect disclosure modifications adopted by SSAP No. 91, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. (Agenda item 2009-09BWG)
- Add a disclosure for Note 5F related to participating mortgage loans. (Agenda item 2008-10BWG)
- Add instruction to Note 14A for the disclosure of guarantees of indebtedness of others. (Agenda item 2008-11BWG)
- Modify the illustration for Note 5E(3) to reflect changes to the instructions as a result of the changes to SSAP 91 to disclose securities lending collateral (Agenda item 2009-13BWG)
- Modify instructions for IMR and AVR for the adoption of SSAP 98, Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments and SSAP 99, Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment. (Agenda item 2009-14BWG)
- Clarify the use of two separate columns for the method used to obtain fair value in Schedule D (one for the code and one for the name of the pricing service, broker-dealer, etc.) (Agenda item 2009-17BWG)
- Add two electronic columns (i.e. not shown in the printed copy) to Schedule D Part 1, one to indicate the collateral type for structured securities reported under the industrial and miscellaneous grouping, and another to indicate whether securities reported under the all other governments grouping are non-U.S. municipals. (Agenda item 2009-18BWG)
- Add an interrogatory to the statement to determine availability of broker or custodian pricing policies and the reporting entity's process for determining the reliability of pricing sources if the reporting entity cannot obtain the broker or custodian's pricing policy. (Agenda item 2009-19BWG)
- Add specific lines to Asset and Liability pages for derivative amounts currently being reported as write-ins. (Agenda item 2009-20BWG)

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

As a result of changes to the NAIC national meeting schedule beginning in 2010, the working group formed a subgroup to propose modifications to the working group's procedures, given the transition from four to three national meetings each year.

#### Report from the Premium Survey Subgroup

The subgroup met via conference call on January 29 and February 26 to discuss the results of a survey which polled states regarding the acceptable method(s) of allocating premiums for the purposes of taxation and guaranty fund assessments. After reviewing the survey responses, the subgroup noted that there may be some inconsistencies within the survey results, but concluded they were not significant enough to require additional surveying at this time. The chair of the subgroup stated that companies should not use the survey data to determine which states to pay premium tax as there is not sufficient information to make that determination.

The subgroup prepared a document which summarizes the survey results and responds to the Financial Condition Committee's request made at the 2008 Fall National Meeting to gather information from the state insurance departments on requirements for determining premium for

taxation and other purposes. The document notes that states use various approaches to calculate premium tax and assessments; as a result, the subgroup did not discuss recommendations for changes to Schedule T reporting or for development of a uniform model law. This document was adopted by the Blanks Working Group in San Diego and referred to the Financial Conditions Committee for further consideration.

#### Report from Property & Casualty Subgroup

The subgroup met via conference call on December 17 to discuss a draft supplement for capturing bail bonds data in the annual statement. The supplement includes 26 questions which provide regulators with the ability to ascertain the size of the bail bond market and the financial performance of insurers who participate in this market. As a result of the relatively high commission rate associated with this product there was considerable discussion between subgroup members and bail bond writers as to whether gross premium or premium net of commissions is the most relevant measure. The chair noted that in order to report on a net basis, companies are required to obtain a permitted practice from their state of domicile. The subgroup voted unanimously to adopt the supplement and submit the proposal to the Blanks Working Group for consideration (Agenda item 2009-08BWG). The proposal was exposed for public comment in San Diego as noted above.

### **NAIC/AICPA Working Group**

#### Disclosures in Audited Statutory Financial Statements

The chair noted that sample footnote disclosures for FAS 157, FAS 158 and FIN 48 for preparers of the audited statutory financial statements have been posted to the NAIC/AICPA Working Group's webpage on the NAIC's website.

#### MAR Adoption

The working group updated its ongoing survey of the progress of states' adopting the revised Model Audit Rule (MAR), which has a proposed effective date of January 1, 2010. Eleven states (Alabama, Delaware, Iowa, Massachusetts, Michigan, New Hampshire, Ohio, Oregon, Virginia, Wisconsin and Wyoming) 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. The chair stated that he is fully confident that all states will complete adoption in time for the 2010 effective date.

Other MAR activities include the following:

- California, Connecticut, Illinois, Indiana, Nebraska, Nevada, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee and West Virginia, have exposed revised regulations for public comment.
- The NAIC Education and Training Department will host a two hour Model Audit Rule Webinar on June 4.

The results of the quarterly survey of states' plans for adoption are available on the AICPA/NAIC Working Group's webpage.

#### MAR Appointment of Audit Committees

The working group discussed questions that have arisen regarding the exclusion within Section 14 of the MAR stating that Section 14 does not apply to SOX compliant entities or wholly-owned subsidiaries of SOX compliant entities. One regulator stated that it was never the intention of the working group that independent audit committees have no oversight responsibilities with respect to SOX compliant entities. Another regulator said that if the SOX audit committee does not want the responsibility for oversight of statutory accounting then perhaps the Section 14 exclusion should not apply. The working group also discussed requiring SOX compliant entities to notify the domiciliary DOI of the assigned audit committee for the insurer.

As a result of the discussion, NAIC staff was asked to develop some proposed guidance to clarify the issue within the Model Audit Rule's Implementation Guide, i.e. that the intent of the exclusion was to prevent conflicting independence requirements (SOX vs. SEC) and not to remove all oversight by the insurer's SOX audit committee. The working group will hold an interim conference call to review the proposed changes to the Implementation Guide. A date has not yet been scheduled.

### **Valuation of Securities Task Force**

The task force met in San Diego and discussed the following issues:

#### Derivative Instrument Model Regulation

The chair noted that Executive Committee had approved the model law development request, to substantially revise the Derivative Instrument Model Regulation (#282). The working group conducted an extensive study of changes in the derivatives market and determined that revisions to

the model regulation were necessary. A survey of states indicated that a majority were in favor of a preapproval requirement (i.e., submission of a derivative use plan for approval as required by New York) before an insurer could enter into a derivative position. It was noted that the SVO is prepared to assist states that may lack the resources or expertise to assess such plans. The task force discussed methods for monitoring the status of derivative use plans of specific insurers as this information needs to be disseminated and available to state regulators. Possible solutions include establishing a database, modifying the disclosure requirements of SSAP 86, and/or adding an interrogatory to the annual statement. Model Regulation 282 was released for a two-week exposure period in early March. In San Diego, the task force adopted the revised model regulation but with an amendment to clarify that the model also requires insurers to present and obtain prior approval of changes to previously approved derivative use plans.

#### Investments in Life Settlement Contracts

The task force discussed a recommendation from NAIC staff that life settlement contracts with specified structural characteristics be recognized as invested assets and reported on a new line on Schedule BA with additional disclosure. Staff also recommended that the Capital Adequacy Task Force consider the appropriateness of the ACLI-based capital treatment proposed by the ACLI and that a valuation standard be developed and adopted for this asset class. It was further recommended that a referral be made to an appropriate NAIC group to consider adding appropriate criteria to the NAIC Investment of Insurers Model Acts for this asset class. The task force adopted the recommendation, which will be referred to the Statutory Accounting Principles Working Group.

#### Credit Default Swap Regulation

The task force discussed recommendations received from the Credit Default Swap Working Group to strengthen the financial regulation of credit default swaps (CDS). The CDS Working Group has requested that the task force: 1) review each of the recommendations, 2) develop and plan for addressing each item, and 3) report quarterly to the Financial Condition Committee the status of the plan. The specific recommendations to the task force, some of which are already being addressed, include:

- Revising investment schedules for derivative transactions

- Increasing the duties of the SVO to identify outlier companies with respect to investment exposure or changes in investment exposure.
- Updating the Derivative Instrument Model Regulation to require the filing of a derivative use plan (as discussed above).
- Developing or enhancing tools to identify riskier securities more quickly and to detect concentrations of risks in insurers' portfolios.

The task force plans to schedule further discussion on these recommendations.

#### Expansion of the Common Stock Filing Exemption

The task force discussed a previously exposed proposal to amend the Purposes and Procedures Manual to conform instructions for valuation of common stock to the previous instructions pertaining to the filing exempt status of common stock. New valuation guidance no longer requires that reported prices come from trades on specified exchanges. The amendment would eliminate the condition that a common stock trade on specified exchange in order to qualify for filing exemption. The task force elected to defer action on the proposal to permit time for further review by task force members.

#### Federal Reserve Term Asset Backed Securities Loan Facility

The chair of the task force reported that New York and SVO staff had discussed NAIC reporting issues associated with loans to insurers under the Federal Reserve Bank's Term Asset Backed Securities Loan Facility (TALF) with one insurer. The SVO concluded that the Purposes and Procedures Manual contains the necessary methodology and policy guidance to enable the staff to respond to questions related to the appropriate reporting framework for these asset-backed programs.

#### Reports from the SVO

The task force received reports from SVO Staff on the following subjects:

- Internal procedures implemented by SVO Staff and results obtained in support of the newly adopted valuation procedures effective for year-end 2008;
- A summary of the status of NRSRO-rated monoline financial guarantors and the impact of this process for municipal securities owned by insurers, and

- A status report of the impact of NRSRO rating downgrades on insurance company holdings of filing exempt securities.

#### 2009 SVO Research Agenda

The task force approved the previously exposed SVO research agenda for 2009. The research projects include the analysis and review of commercially available credit risk models, completion of the annual default impact review, and the development of standardized financial information of incoming unrated transactions for internal benchmarking purposes.

#### **Invested Asset Working Group**

The working group met via conference call several times since the Winter National Meeting and discussed a number of topics, including its primary charge to consider changes to investment schedules to improve information on investment risks. The working group and its technical subgroup identified eight types of investment risks and suggested three areas for improvement: 1) revising the groupings of securities in Schedule D; 2) enhancing the bond characteristics column; and 3) enhancing the Summary Investment Schedule.

With regard to the first area of improvement, it was noted that the annual and quarterly statements currently arrange all bonds into a number of categories which were never intended to convey the investment risks embedded in a security. The working group believes that regulatory understanding of investment risk would be enhanced if the groupings were modified to better reflect investment risk.

The working group has developed a three-step plan to improve the risk-related reporting within the investment schedules. As a first step, the working group classified securities into 20 distinct categories and proposed adding an electronic-only column to Schedule D Part 1 which would require insurers to fill out a two digit code for every reported bond, effective for year-end 2009. The second step will focus on making enhancements to the bond characteristic column, effective for year-end 2010. The third step would require the substitution of the new electronic groupings for the current Schedule D process and create a corresponding Summary Investment Schedule.

Interested parties proposed an alternative to the first step of the proposed plan. Instead of creating an electronic only column for each bond grouping,

they recommended creating an electronic-only column for a more limited number of security categories mapped to the current process. The working group accepted this proposed alteration in approach as consistent with its objective and adopted a proposed blanks change to implement the first part of the plan, which was subsequently adopted by the Valuation of Securities Task Force and exposed by the Blanks Working Group at the Spring National Meeting.

#### **Capital Adequacy Task Force**

The task force met via conference call on January 20, February 9, and March 9 and again in San Diego and discussed the following items:

##### Life RBC Derivatives Collateral Proposal

During the January 20 conference call, the task force discussed and adopted a proposal from the Life Risk-Based Capital Working Group which provides additional guidance on the treatment of derivative collateral in the RBC formula. It was noted that the current RBC formula provided a 6.8% charge for this collateral, which seems onerous since the charge for collateral on derivatives is higher than the charge for derivatives without collateral from the counterparty. Detailed guidance for insurers on how to implement this guidance has been posted to the NAIC's website, which was optional for 2008. For 2009, a more permanent fix will be developed by the Life RBC Working Group.

##### Risk Retention Group Proposal

The task force discussed comment letters received on a proposal for captive risk retention groups (RRGs) to perform an RBC sensitivity test which estimates the affect on total adjusted capital as if the financial statements were prepared in accordance with statutory accounting principles (not GAAP as permitted for many captive RRGs).

Regulators from Vermont and Washington, D.C. expressed concerns that the sensitivity test was too punitive. Most concerning to these regulators was the 100% removal of standby letters of credit, which are recognized as assets by both Vermont and D.C. for RRGs. The chair of the task force noted that the sensitivity test was developed as a financial analysis tool and that it is sufficient for that purpose. It will not be part of an official RBC formula. One member of the task force suggested making the sensitivity test applicable to all companies and not just RRGs. The task force agreed to refer this recommendation to the

Financial Analysis Working Group for further consideration.

#### RBC Permitted Practices

The task force discussed the use of permitted practices to alter the calculation of RBC. The chair stated that RBC is meant to be uniformly applied in all states, and that states are generally allowed to deviate from this when required by state law. It was not intended for states to adjust the RBC requirement calculated by the formula or adjust the authorized control level RBC calculation. Another member of the task force expresses his view that RBC does not fall under the realm of permitted practices since the Accounting Practices and Procedures Manual does not apply to RBC. The chair agreed to draft a statement that RBC is intended to be uniform unless restricted by state law. Once approved by the task force the draft would be referred to the Financial Condition Committee.

#### New Charges

The task force added new charges related to referrals from the Credit Default Swap Working Group and the Derivatives Market Study Working Group. The latter group is requesting that the task force determine whether any changes to RBC will be necessary as a result of the proposed significant change to reporting of derivatives in the annual statement. A conference call will be held to discuss how to address the two new charges.

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

#### C-3 Phase III Proposal

The working group voted to expose for 60 days three reports from the Academy regarding the C-3 Phase III initiative: the Academy's March 2009 Report on RBC C3 Requirements for Life Products, its November 2008 Working Reserve Paper and its March 2009 Comparison Report which compares the current C-3 Phase III proposal with the requirements of PBR VM-20, VACARVM and the existing C-3 Phase II requirements. The working group chair indicated that while they are still working towards a year-end 2009 effective date for C-3 Phase III; everything would have to proceed very smoothly for that to happen. The ACLI indicated that a year end 2009 effective date would be a burden for companies to implement on such short notice. The chair responded that he would like to hear from companies regarding this timing. There was some discussion about allowing companies the option to continue using the current factor-based approach for 2009 if C-3 Phase III is effective for year-end 2009.

#### ACLI Mortgage Experience Adjustment Calculation Proposal

The ACLI submitted a proposal for a short-term solution to the Mortgage Experience Adjustment Factor (MEAF) issue. It is widely believed that the current MEAF calculation does not appropriately reflect the proportionate differences in experience among companies and that the industry experience factor is artificially low since insurers dispose of mortgages in danger of defaulting due to the significant adverse effect on RBC.

The ACLI's proposal calls for the use of a 100% factor (in LR003 line 13) for all companies until a long-term solution is developed. The ACLI's proposal was rejected because it was not "RBC neutral," i.e. overall RBC held by the industry for the MEAF should not change. This concept has been repeated frequently during the recent discussions of the MEAF, but appears to be a new requirement of the working group for changes to Life RBC. A conference call has been scheduled for March 31 to further explore a 2009 interim solution.

#### C-3 Phase II Results Subgroup

The subgroup will be looking at 2008 RBC submissions for compliance with the C-3 Phase II requirements. In prior years, the subgroup has been concerned with inadequate documentation of risks and assumptions. They hope to see improvement in this year's submissions. They are also looking into the possibility of eliminating the standard scenario requirement. The subgroup also noted that C-3 Phase II RBC dropped 50% between 2007 and 2008; reasons cited were cessions to off-shore reinsurers and company reallocations between reserves and capital.

### **P/C Risk-Based Capital Working Group**

The working group met twice via conference call in late December and March and discussed the following topics:

#### 2009 Underwriting Risk Charges

The working group approved the risk charges for 2009, which is the second year of phasing in new charges and which will be limited to an additional plus or minus 15%. Testing performed by NAIC staff shows that overall Authorized Control Level RBC increases slightly with the revised factors. The reinsurance recoverable factor will remain at .094 for 2009. The American Academy has also been asked to review three new years of underwriting risk data (2006-2008) and report back to the working group.



#### Expansion of Schedule P Two-Year Lines

The chair stated that the original RBC proposal almost twenty years ago recommended extending Schedule P development to ten years for all lines, which was not done due to tax considerations. The chair noted that data quality for short-tail lines could be improved, and the working group should revisit the issue. An industry representative noted that the tax issue is still a valid concern. As a first step in its reconsideration, the working group asked NAIC staff to review the short-tail line development in RBC reports.

The working group plans to hold an interim conference call to discuss the RBC treatment of state deposits. Several regulators noted it is one state in particular that requires large deposits and access to those funds is significantly restricted.

#### Catastrophe Risk Subgroup

The subgroup has been charged with evaluating the possibility of developing a RBC charge for catastrophe risk and of using catastrophe modeling to develop that charge. The subgroup met December 18 to discuss the previously distributed revised catastrophe risk proposal. The chair stated that there are three major areas he would like to obtain input from the subgroup on; the first is refinement of the criteria for exempting certain insurers from calculating the risk charge. The current draft exempts companies with no property insured in states bordering on the Atlantic Ocean from calculating a catastrophe risk charge for hurricane risk and companies with no property insured for earthquake risk or for fire following earthquake in specified states from the catastrophe charge for earthquake risk. The second major area is how the examination process should be integrated into the proposal and lastly the effect on RBC results needs to be quantified.

The revised proposal was not re-exposed at the December meeting. The subgroup is expected to hold a conference call in mid-May with an in-person meeting before the Summer National Meeting to continue its work. The subgroup will also work with the Catastrophe Reserve Working Group as it is working on similar issues.

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

The working group has not met since November and did not meet in San Diego. A conference call has been scheduled for March 31.

#### **Reinsurance Task Force**

##### Reinsurance Modernization

The task force discussed for the Reinsurance Regulatory Modernization Framework, including the drafting of federal legislation to implement the Framework, which was issued March 24 with a comment period ending April 23. The task force noted that the comment period is shortened in order for consideration during the current session of Congress. The task force also discussed other aspects of the implementation process including the requirement to assist with model state legislation that will be required for those states who wish to act as home state or POE supervisors. The task force asked that regulators and interested parties submit comments related to the standards that should be required for a state to qualify as a home state or POE supervisor. The task force plans to hold an interim meeting in late April to receive comments on the draft legislation.

##### U.S. Reinsurance Multi-Beneficiary Trust

At the Winter National Meeting, the task force heard a presentation from an interested party related to the requirement in the Model Credit for Reinsurance Law (Section 2(D)(3)) for \$20 million minimum surplus regardless of liabilities assumed. The interested party is requesting revision to this section of the model to grant commissioners sole discretion in allowing an assuming reinsurer to maintain less than \$20 million in surplus if the assuming reinsurer subsequently enters into run-off.

At the Spring National Meeting, the task force noted that they "generally agree with the principle of the proposal" but believe a more "conservative" minimum trustee surplus should apply. As a result, the task force amended the proposal to state that the commissioner with principal regulatory oversight may authorize a reduction in required trustee surplus after an assessment of the risk that the new required surplus is adequate. In addition, the minimum cannot be reduced to an amount less than 50% of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers. The revised proposal was exposed for a 30-day comment period.

##### NAIC Guidance on Reinsurance Collateral

The task force discussed the NAIC Guidance Regarding Reinsurance Collateral Requirements and the related Model Bulletin. Both had been developed in connection with the capital and surplus relief proposals. The task force voted to expose the Guidance memo for a 30-day comment

period but decided not to proceed any further with the Model Bulletin. The Guidance memo provides assistance to insurance departments which are considering allowing additional forms of collateral to secure reinsurance agreements, including guidance on letters of credit. Granting additional types of collateral would not constitute a permitted practice because the commissioner currently has the authority under the NAIC Credit for Reinsurance Model Act and Regulation to allow for additional types of collateral.

## Rating Agency Working Group

This recently formed working group has been charged by the Financial Condition Committee to evaluate the reliance on Nationally Recognized Statistical Rating Organization (NRSRO) ratings by the NAIC, insurance industry and the insurance marketplace. The working group has been asked to gather and assess information on the following:

- problems inherent in reliance on ratings, including the filing exempt (FE) process and RBC;
- reasons for recent rating shortcomings, including but not limited to structured security and municipal ratings
- current and potential future impact of ratings on state insurance financial solvency regulation; and
- the effect of the use of NRSRO ratings on public confidence and public perception of regulatory oversight of insurance.

The working group will prepare a final report documenting the findings and any recommendations for corrective action available to the NAIC, its members, and possible regulatory recommendations to the federal government.

The working group held its first meeting in San Diego to discuss its charge. The co-chairs (NY and IL) noted that the intent of its work is not necessarily to reduce NAIC reliance on NRSRO ratings. However, as part of its review, the working group plans to consider the degree of regulatory flexibility available to reduce reliance. The working group received a report from SVO Staff summarizing the analysis of U.S. federal and international regulators on reasons for shortcomings in NRSRO ratings. Links to the following publicly available reports on this topic have been posted to the NAIC's webpage for the Rating Agency Working Group:

- Financial Stability Forum - Enhancing Market and Institutional Resilience (April 2008)

- Presidents Working Group - Policy Statement on Financial Market Developments (March 2008)
- Securities and Exchange Commission - Issues Identified in the Staff's Examination of Select Credit Rating Agencies (July 2008)
- International Organization of Securities Commission - Report on the Subprime Crisis (May 2008)

The working group also discussed a staff report that outlined the specific areas in which NRSRO ratings are used by the NAIC. The discussion included the use of NRSRO ratings in the filing exempt process and for risk-based capital purposes. The working group discussed an analysis, prepared by SVO Staff, of NRSRO credit rating changes on securities held by insurers and designated as filing exempt. The analysis was prepared to demonstrate the industry wide ramification of rating downgrades for corporate and structured securities. The working group plans to develop a questionnaire that could be provided to rating agencies to highlight concerns and issues in areas of importance to the NAIC and state insurance regulation. NRSRO responses to the questionnaire would assist the working group in determining whether to proceed in its deliberations and, if so, where specifically it should focus.

## Life and Health Actuarial Task Force (LHATF)

### Capital & Surplus Relief Proposals

LHATF was asked by the Capital & Surplus Relief Working Group to reconsider the ACLI's proposals Life 1A, Life 1C and Life 2 from last year-end that were reviewed in an expedited manner. Life 1A allows for an expanded use of the 2001 Preferred Mortality tables. Life 1C involves the use of non-preferred mortality in calculating segments under AG 38. Life 2 proposes to remove the constraints in calculating X-factors for XXX reserves. Some regulators appeared frustrated with the process and questioned whether Executive Committee would seriously consider adopting any of these proposals given their action earlier this year when they rejected all of the ACLI's proposals for year-end 2008. LHATF voted to expose the Life 1A, Life 1C and Life 2 proposals for comment and reopened the subgroup that they formed at year-end, which had originally studied the proposals.

The ACLI requested that LHATF also consider its Life 1B proposal citing that there has been no

public debate on LHATF's earlier rejection of this proposal. Life 1B proposes to allow the AG 38 "Interim Solution," now only applicable to policies issued on or after January 1, 2007, to policies issued on or after July 1, 2005. LHATF did not expose this proposal but referred it to its subgroup.

The Capital and Surplus Relief Working Group is expecting LHATF to complete its work on these proposals by the Summer National Meeting.

### **Principles-Based Reserving**

The following summarizes LHATF's progress on PBR since the Winter National Meeting.

#### Modifications to the Standard Valuation Law

LHATF had hoped to adopt a revised SVL at this meeting with changes required for the implementation of Principles-Based Reserves. However, a late proposal from the Corporate Governance Subgroup of the NAIC's Principles-Based Reserve Working Group was considered to be too substantial to consider without going through LHATF's formal amendment process including exposure. The proposed language involves the procedures for corporate governance and oversight that companies will need to establish under PBR and a provision to allow insurance departments to regulate those procedures. LHATF expects to adopt the revised SVL prior to the Summer National Meeting.

#### PBR Life (VM-20)

LHATF's discussion of VM-20 focused on revenue sharing and scenario reduction techniques. Regulators from New York proposed that only guaranteed revenues should be incorporated into the cash flows used to develop reserves under PBR. It was noted that the revenue sharing language proposed by NY is somewhat more restrictive than what is currently in VACARVM (Actuarial Guideline 43). LHATF agreed to modify the current language in VM-20 with consideration of what is required in VACARVM. With regard to allowing scenario reduction techniques, LHATF voted to include this in PBR. A scenario reduction technique is a methodology that derives a reduced set of economic scenarios from a larger set while maintaining the characteristics and robustness of the larger set.

LHATF also reviewed an American Academy of Actuaries presentation on a proposed methodology for setting prescribed default costs on existing fixed income investments under VM-20. Comments and questions from regulators gave clear indication that what the Academy proposed was a very workable framework. Some regulators

indicated that the thoroughness of the Academy's proposal, especially when it was provided in such a short timeframe, exceeded their expectations.

#### Net Premium Reserves in VM-20

The ACLI made a follow-up presentation to the one they made at the Winter National Meeting on the use of a net premium reserve as part of PBR for life insurance products in VM-20. At least partly driven by federal income tax considerations, the ACLI proposes modifying VM-20 to have three reserve components: (1) a fully prescribed net premium reserve with a cash value floor, (2) a deterministic gross premium reserve, and (3) a stochastic reserve. Currently, VM-20 only includes the latter two elements. Under this proposal, the net premium reserve would include fully prescribed methodology and assumptions for mortality, lapse, interest and expense allowances. If an exclusion test is met, indicating no significant tail risk for a product, the net premium reserve would be the only reserve calculated.

Although LHATF members appeared to be receptive to this proposal, they have made no commitment nor took any action to include a net premium floor in PBR. LHATF asked the ACLI to submit a more detailed proposal in writing and were especially interested in understanding the specifics of the exclusion test.

#### PBR Process and Coordination

The task force discussed the initial scope of PBR for life insurance products. Under current plans, PBR will initially be applicable to universal life and term products with secondary guarantees. However, LHATF discussed the possibility that if the ACLI's net premium concept is included in PBR, a broader scope is possible. LHATF also discussed the six PBR principles to be included in VM-00 and where PBR reserves would be shown in the annual statement blank.

#### PBR Reinsurance (VM-20)

During an interim call, LHATF reinserted the current statutory risk transfer requirements into VM-20 stipulating that these requirements will need to be met in order for a company to receive a reserve credit for a reinsurance agreement under PBR. Also discussed was a report from the Academy analyzing the reinsurance of no lapse guarantees under VM-20?

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

Under PBR, companies will be required to submit experience data to regulators to support their assumptions used to calculate reserves. LHATF

discussed a proposal that would exempt some companies (small or single state licenses) from having to report their data. LHATF was agreeable to such an exemption but expects more dialogue to occur on the specifics of the exemption.

#### Economic Scenarios

The Academy's Economic Scenario Work Group indicated that the Academy's website contains the new interest rate generator that has been calibrated for September 30, 2008. The Academy's site also includes sets of 1,000 and 10,000 interest rate scenarios. The Academy urged LHATF to allow companies to use any generator for regulatory purposes as long as it produces results that satisfy the calibration criteria, with the Academy's generator being a safe harbor.

The Academy is also developing a statistical analysis tool to be used in analyzing the appropriateness of scenarios generated from other sources.

#### Preferred Class Mortality Tables and Margins

LHATF received a presentation from the Society of Actuaries and Academy Joint Project Oversight Group which is responsible for developing the 2008 CSO mortality tables with preferred underwriting classes. The presentation illustrated that, for the most part, reserves calculated under the 2008 CSO tables were very similar to reserves developed under the 2001 CSO tables.

The preferred mortality rates under the 2001 CSO tables were developed from expected differences between preferred and standard mortality while the 2008 preferred mortality rates are based on actual data. The similarities in reserves calculated using both tables validate to regulators and to users of the 2001 CSO table the theoretically developed preferred mortality rates.

Although the primary impetus in developing the 2008 CSO tables is to support PBR initiatives, regulators originally expected to adopt the new table earlier than the expected effective date of PBR for use with current formulaic reserve requirements. Given the results presented to LHATF at this meeting, and comments from industry representatives suggesting the cost of implementing a new table is substantial, regulators now appear to favor putting the new table on hold until PBR is closer to being effective. LHATF did ask the SOA/Academy group to consider including valuation mortality recommendations for pre-need and simplified issue businesses in their analysis and to report back at the Summer National Meeting.

#### Standard Nonforfeiture Law

LHATF has been considering changes that will need to be made to the Standard Nonforfeiture law when PBR is adopted. Current nonforfeiture requirements include factors, such as the discount and mortality rates, that are tied to minimum reserve requirements. Since PBR may not include specific discount and mortality rates, the nonforfeiture law will need to be modified to address this issue. During the discussion, the ACLI asked LHATF to withdrawal the current revised draft Standard Nonforfeiture law because it was based on earlier provisions of PBR, some of which have changed or alternatives are still being considered. The ACLI's net premium proposal for PBR, if adopted, could significantly alter the changes needed to the nonforfeiture law. LHATF agreed to defer discussion on the revised Standard Nonforfeiture law for now.

#### Nonforfeiture Improvement

LHATF received a brief report from the Academy's Nonforfeiture Working Group indicating that progress was being made on this project and that an Academy proposal will be presented this year.

### **Accident and Health Working Group**

#### Changes to Health Annual Statement and Instructions

During an interim conference call, the working group adopted three changes affecting the Health blank and instructions. The first change modifies the Actuarial Opinion Section of the Instructions that clarifies the process of selecting an appointed actuary and requires an Actuarial Memorandum with the Actuarial Opinion. The second change adopted by the working group adds a separate line for Medicare Part D Stand Alone business in the A&H Policy Experience Exhibit. Finally, the working group voted to continue the use of the current long-term care experience forms (A, B and C) for one more year, requiring companies to complete both these forms and the new long-term care experience forms (1, 2 and 3) for 2009. LHATF approved these changes when it adopted the working group's report at this meeting; the proposals will now be forwarded to the Blanks Working Group for its consideration.

#### Medicare Supplement

During the Spring National Meeting, the working group discussed two issues regarding the Medicare Supplement Compliance Manual: deciding to continue to specify that active life reserves should be excluded from any loss ratio demonstration and recommending that certain

plans be pooled for refund calculations. The working group also discussed an Academy report regarding various aspects of the current Medicare Supplement refund formula.

## **Life Insurance and Annuities (A) Committee**

In addition to hearing reports from its Suitability and Annuities Disclosure Working Groups, the committee discussed the following in San Diego.

### Cross-Border Sales

The New York regulator raised an area of concern involving sales practices by certain agents in neighboring states who might be inappropriately selling products to New York residents, which are underwritten by carriers not admitted in NY or otherwise not approved by the NY DOI. The Committee decided to explore ways to discourage this practice on an interim call.

## **Suitability of Annuity Sales Working Group**

### Proposed Revisions to the Suitability in Annuity Transactions Model Regulation

Meeting in two sessions in San Diego, the main task of the working group was to begin discussing, and receiving comments, on proposed changes to the Suitability in Annuity Transactions Model Regulation. In order to facilitate discussion, the working group focused on the following major issues which were reflected in a revised draft of the model:

**Suitability Required:** Unless under limited circumstances at a consumer's direction, the model will prohibit an insurer from issuing an annuity that is not suitable at the time of sale based on the information provided by the consumer.

**Supervision of/by a Broker-Dealer:** Revisions set forth the circumstances under which a broker-dealer can undertake supervisory responsibilities on behalf of an insurer.

**Supervision by Other Third Party:** The working group declined to include language in the model that would have allowed an insurer to delegate by contract any core supervisory function even though the insurer would have retained legal responsibility to ensure compliance.

**Producer Continuing Education:** Under the revised model, insurers will continue to be required to verify that producers complete required ethics and suitability training. The NAIC will support in approving classes and tracking compliance. Also included are provisions seeking to promote suitability by requiring producer training and testing on products sold.

**Safe Harbor:** The revised model includes a provision requiring that the NAIC establish a program to serve as a "safe harbor" for providing technical guidance relative to compliance as long as the guidance is a reasonable application of the regulatory requirement at issue, including guidance on suitability forms and criteria, disclosure, and audit guidelines.

With discussions centering on these high level issues, the working group did not review specific language included in the revised model in detail. The working group hopes to hold a two-day in-person interim meeting to continue work on the model revisions.

## **Annuities Disclosure Working Group**

### Proposed Revisions to the Annuity Disclosure Model Regulation

The working group finalized revisions to the Model Regulation to broaden the model as follows: to include variable annuities, to expand applicability to all "immediate and deferred annuities that contain no nonguaranteed elements and have no surrender charges," to establish the necessary appendices to accommodate Buyer's Guides currently being revised by the Consumer Guides Subgroup and to incorporate a safe harbor provision for annuity contracts regulated by FINRA and subject to the SEC prospectus disclosure guidelines.

### Consideration of Draft Annuity Illustration Guidelines

The working group also began discussing proposed annuity illustration guidelines drafted by the ACLI at the working group's request. The comprehensive guidelines were organized by purpose, timing, scope and applicability, general rules, and mandatory requirements, and included a sample illustration. The guidelines purported to set forth an optional framework for companies who sought to prepare pre-sale illustrations for fixed deferred annuities products. While there was agreement among working group members that the guidelines should apply to pre-sale illustrations and that a one-year transition period for

implementation was appropriate, there was no consensus as to whether the guidelines should be optional or mandatory. This issue was not resolved at this meeting. This question and the remainder of the guidelines will be discussed in an interim call in April.

#### Disclosure of Life and Health Insurance Guaranty Fund Coverage

Finally, the working group continued discussion on the issue of whether life and health guaranty fund coverage should be disclosed to consumers. Currently prohibited, the question was raised as to whether non-disclosure was ultimately in consumers' best interests. It was suggested that a description of coverage might be provided either at the time of sale, or at the time the contract was delivered. Regulators and interested parties expressed varying opinions regarding the appropriateness and timing of disclosure. The working group decided to continue the dialogue on an interim conference call. In anticipation of the call the working group asked ACLI and the National Organization of Life and Health Insurance Guaranty Associations to propose updates to the provisions of the relevant model act to authorize disclosure guaranty association coverage.

### **Casualty Actuarial and Statistical Task Force**

The task force met in January, February and in San Diego and discussed current projects. Highlights on some of the more significant items are as follows.

#### Workers Compensation Large Deductible Reporting

The task force heard a status report from its subgroup, which is currently discussing whether premium assessments should continue to be based on losses or whether a new method based on premiums should be developed. The subgroup hopes to reach some conclusions on this project soon.

#### P&C Line of Business Definitions

The task force adopted a survey to be prepared by selected insurers to determine the level of consistency of reporting by line of business in the annual statement. The survey has only nine questions and asks whether revisions to Annual Statement and Schedule P line of business definitions should be made. Based on the results of the survey, the task force may propose Blanks changes.

#### Premium Deficiency Reserves

The task force has become aware that these reserves are outside the scope of the Statement of Actuarial Opinion. The task force plans to do some additional research and make a proposal in the near future with an expected 2010 effective date.

#### IAIS Issues Paper on the Actuary/Auditor Relationship

The IAIS is developing an issue paper on what they believe would be a best practice arrangement, from a regulatory perspective, between a company actuary (defined as both the lead reserving actuary and the appointed actuary) and the auditor. This document, when finalized, would be intended to provide non-binding guidance to regulators around the globe on this topic. The main theme that the IAIS paper addresses is that a best practice arrangement would include frequent, comprehensive and confidential (unless otherwise agreed by both parties) communication between the actuary and the auditor.

The task force is actively engaged with the IAIS on this paper and recently provided comments to them, which include the following:

- Enhance the issue paper to distinguish between a lead reserving actuary and the appointed actuary, since in the U.S. these actuaries are often separate individuals with clearly defined and separate roles (not changed in the most recent IAIS update)
- Clarify that the appointed actuary may work at the audit firm, as long as their role is distinct from the lead reserving actuary (changed in the IAIS update)
- Clarify that the auditor cannot simply "rely" on the actuary's work, and that the auditor should form his own view (changed in the IAIS update)

The issue paper should be finalized later this year.

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

The committee held to consider new and revised model laws and practices and procedures required for accreditation.

#### Hazardous Financial Condition

The committee exposed revisions made during 2008 to the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in a Hazardous Financial Condition (Model Regulation) for a preliminary comment period of 30 days. The revisions provide additional considerations to be made by the commissioner to determine whether the continued operation of any insurer might be deemed to be hazardous to its policyholders, creditors or the general public. The revisions would also give the commissioner increased authority to issue an order requiring companies deemed to be in a hazardous financial condition to take corrective action.

#### Risk-Based Capital Model

The committee received an update on the 2006 revisions to the Risk-Based Capital for Insurers Model Act (RBC Model), which was previously released for a one-year comment period that ended on December 31, 2008. The revisions were made to incorporate a new "trend test" for property and casualty companies into the RBC Model, which could trigger a company action level earlier than the prior model. At the Summer National Meeting, the committee plans to consider adopting the revisions to the RBC Model as an amendment to the current significant element required for accreditation with an effective date of January 1, 2012.

#### Insurer Receivership Model Act

The committee received an update on the Insurer Receivership Model Act (IRMA), which was previously released for a one-year comment period that ended on December 31, 2008. Currently, the "Receivership" Part A standard only requires that state law set forth a receivership scheme for the administration of insurance companies found to be insolvent as set forth in the Insurers Rehabilitation and Liquidation Model Act. Therefore, the state does not have to have language that is "substantially similar" to what is included in the model, but rather have a scheme similar to what is contemplated in the model. At the Summer National Meeting, the Committee plans to consider adopting IRMA as an acceptable "receivership scheme" a state may have for Part A compliance purposes with an effective date of January 1, 2012.

#### Model Audit Rule

The committee received an update on the 2006 revisions to the Model Regulation Requiring Annual Audited Financial Reports; commonly referred to as the "Model Audit Rule." These revisions require that insurers comply with certain best practices

related to corporate governance, internal controls over financial reporting and auditor independence. The revisions were previously released for a one-year comment period that ended on December 31, 2008. At the Summer National Meeting, the Committee plans to consider adopting the revisions to the Model Audit Rule as new significant elements required for accreditation within the "CPA Audits" Part A standard. The revisions would become effective January 1, 2010.

#### Risk-Focused Examinations for RRGs

The committee discussed the applicability of risk-focused examinations to risk retention groups (RRGs) licensed as captive insurers. Some captive-domiciliary regulators have argued that because of the nature of RRGs, it is typically more efficient to use a purely substantive examination approach for these entities. It was noted that the risk-focused approach does include guidance for small and medium-sized insurers; that guidance still requires the examiner to document a company's risk and controls, although controls do not need to be tested if the examiner knows they will not be relied upon. As guidance specific to captive RRGs is still being considered by a subgroup of the Financial Examiners Handbook Technical Group, the committee voted to delay implementation of the risk-focused approach on RRG examinations. RRG examinations commencing on or after January 1, 2011, would be expected to follow the risk-focused surveillance guidance that is still under development.

#### Company Licensing Standards

The committee discussed proposed company licensing standards which were drafted in response to comments previously made by the Government Accountability Office. These proposed accreditation standards are not expected to be part of the "scored" section; therefore, a state could not fail accreditation based solely on its lack of compliance with the company licensing standards. If deficiencies are noted, the accreditation review team would provide comments to the state insurance department similar to the current Part C standards. Because this would be a significant change to the accreditation program, there would most likely be a two or three year implementation period prior to the standards becoming effective. The committee exposed the proposed standards for a 45-day comment period.

#### **Catastrophe Reserve Working Group:**

The working group has not met since the Winter National Meeting.

## Climate Change and Global Warming Task Force

### Climate Risk Disclosure Proposal

The task force held a joint conference call with its Climate Change Risk Disclosure Working Group on December 17 to finalize the Climate Risk Disclosure Survey. The survey was adopted by the working group during this conference call and subsequently by the task force on a February 29 conference call. The survey is mandatory for insurers with direct written premium in excess of \$500 million for 2009 reporting year and is due in May 2010. Insurers with direct written premium in excess of \$300 million are required to complete the survey following the 2010 reporting year. The survey includes eight questions whose responses will be publicly available. Insurers are not required to provide quantitative information, information that they in good faith believe is commercially sensitive or proprietary, or make forward-looking statements.

The survey disclosures include the following:

- Does the company have a plan to assess, reduce or mitigate its emissions in its operations or organization?
- Does the company have a climate change policy with respect to risk management and investment management?
- Summarize the current or anticipated risks that climate change poses to the company.
- Has the company considered the impact of climate change on its investment portfolio?

The task force expects to develop additional guidance on completing the survey which will likely include sample responses to survey questions

### Climate Change and Global Warming Summit

The task force discussed holding a Climate Change and Global Warming Summit in conjunction with the 2009 Fall National Meeting in Washington, D.C. and plans to conduct webinars in the interim. Topics are expected to include Pay As You Drive insurance, green buildings, investments (loss control), and loss mitigation.

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The next National Meeting of the NAIC will be held in Minneapolis June 13-16, 2009. 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](mailto:jean.connolly@us.pwc.com).

### **Disclaimer**

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

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