

NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS



NAIC 2007 WINTER NATIONAL MEETING

The National Association of Insurance Commissioners held their 2007 Winter National Meeting in Houston December 2-4. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

Executive Summary

- The NAIC held its annual election to choose officers for the next year. Commissioners from Kansas, New Hampshire, West Virginia and Iowa were selected. At their Executive and Plenary sessions, the Commissioners adopted five new model regulations and guidelines, including Actuarial Guideline 39. (page 3)
- The Principles-Based Reserving Working Group continued its discussion of comments on its exposure draft Life and Health Insurance Principles and Related Principles-Based Initiative Activities document. The principles are meant to guide NAIC task forces and working groups in completing and evaluating all work related to the PBR initiative. (pages 3-4)
- The Statutory Accounting Principles Working Group finalized SSAP 97, Investments in SCA Entities, which replaces the current standard SSAP 88 and also finalized a new disclosure for 2007 related to an insurer's exposure to subprime mortgage related risk. The working group adopted Issue Paper 124, Treatment of Cash Flows When Quantifying Changes in Valuation and Impairment. The working group also exposed two new significant issue papers: Issue Paper 132, Accounting for Pensions, a Replacement of SSAP 89, and Issue Paper 133, Accounting for Postretirement Benefits Other than Pensions, a Replacement of SSAP 14, which propose adoption of FAS 158 for statutory accounting, for both vested and nonvested participants. The regulators continued discussion of significant issues related to uncertain tax positions as described in FIN 48, and a proposal from interested parties was exposed for comment shortly after the Winter National Meeting. Many other conclusions were reached and new issues were added, including a decision to consider FAS 157, Fair Value Measurements, for statutory accounting (pages 4-9)
- The International Solvency and Accounting Working Group reported that it recently finalized the comment letter to the International Accounting Standards Board on its exposure draft, Accounting for Insurance Contracts, with the International Association of Insurance Supervisors (IAIS). The working group also reported that the IAIS Technical Committee adopted the three solvency guidance papers submitted by the IAIS Solvency and Actuarial Issues Subcommittee. (page 10)
- The Blanks Working Group adopted eleven blanks proposals as final, and exposed five new issues for comment. The working group's proposal to adopt significant changes to the Schedule T instructions for the allocation of premium was subsequently deferred by the Accounting Practices and Procedures Task Force. (pages 10-11)

- The NAIC/AICPA Working Group updated its survey on the progress of adopting the revised Model Audit Rule (MAR) noting that four states are planning to have the revised MAR adopted by the end of 2007. The working group reported that the AICPA is updating its survey of insurance departments' continuing to accept reporting under the "Statutory Framework for Reporting Significant Deficiencies and Material Weaknesses in Internal Control to Insurance Regulators (Statutory Framework)" (pages 11-12)
- The Valuation of Securities Task Force approved a proposal to modify Schedule DB of the Annual Statement to reduce redundancy and number of schedules, and to enhance transparency on hedging activities. The task force also adopted a recommendation that the NAIC should revise and retain the Derivatives Instruments Model Regulation as a national standard. (pages 12-13)
- The Capital Adequacy Task Force adopted for the 2008 Life RBC formula revised risk charges related to securities lending transactions as proposed by its Securities Lending Subgroup and exposed for comment similar changes for P/C and Health entities. The Hybrid Risk-Based Capital Working Group held two conference calls this fall and ultimately concluded that the short-term solution for notching of hybrid securities should "sunset" January 1, 2009. The P/C RBC Working Group reviewed proposed changes to the underwriting factors and decided to cap the change to a plus or minus 15% for 2008 and 2009; the indicated changes to the underwriting factors based on a study from the American Academy of Actuaries were significantly in excess of 15%. (pages 13-15)
- The Reinsurance Task Force adopted its Framework Memorandum on reinsurance modernization after discussing comments in Houston and at a two day interim meeting in November. The final proposal introduces the concept of the Reinsurance Supervision Review Department which would evaluate whether non-U.S. jurisdictions are "functionally equivalent" to the U.S. Work on the "outstanding issues" list, including collateral requirements, will continue into 2008. (pages 15-16)
- The Life Insurance and Annuities (A) Committee unanimously adopted proposed revisions to Actuarial Guideline 39, Reserves for Variable Annuities and Guaranteed Living Benefits and continued discussion of proposed revisions to the Unfair Trade Practices Act related to lawful travel. (page 16)
- The Life and Health Actuarial Task Force spent its three days of meetings on the development of Principles Based Reserves, which includes a revised Standard Valuation Law and a new Valuation Manual. The goal is final adoption of PBR by the NAIC in 2008, with states adopting the guidance effective January 1, 2010. (pages 17-19)
- The Climate Change and Global Warming Task Force exposed a white paper titled "Potential Insurance-Related Impacts of Climate Change on Insurance Regulators." Written comments on the white paper are due to the task force by January 11, 2008. (page 21)
- The Disaster Reporting Working Group adopted its revised (November 2007) NAIC Disaster Reporting Framework, which had been amended to address insurer concerns related to confidentiality. The Framework was also adopted by the Financial Condition Committee in Houston, despite remaining concerns related to confidentiality of two trade associations. (page 22)

Executive Committee and Plenary

The NAIC held its annual election of officers. The officers for 2008 are as follows: Commissioner Sandy Praeger of Kansas was chosen as President, New Hampshire Commissioner Roger Sevigny was selected as President-Elect, Commissioner Jane Cline of West Virginia was chosen as Vice-President and Susan Voss of Iowa was elected Secretary-Treasurer.

Executive Committee

At its meeting in Houston, the committee determined that the following model met the criteria for development of a model regulation in accordance with the recently issued Model Law Development Framework:

- Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition.

Plenary

During its Plenary meeting in Houston, the commissioners adopted the following new and revised model and guidelines as final:

- Actuarial Guideline XXXIX - Reserves for Variable Annuities with Guaranteed Living Benefits
- Financial Guaranty Insurance Guideline
- Viatical Settlements Model Act
- Automobile Insurance Fraud Guidelines
- Guidelines for Regulations and Legislation on Workers Compensation Coverage for Profession Employer Organization Arrangements

Principles-Based Reserving Working Group

Principles-Based Initiative Activities

The working group discussed comments received from the Casualty Actuarial Task Force and interested parties on the draft Life and Health Insurance Principles and Related Principles-Based Initiative Activities document. The principles document is intended to guide the numerous NAIC task forces and working groups in completing and evaluating all work related to the principles-based approach (PBA) initiative. The principles include the following sections: principles-based regulatory framework; reserve liabilities; capital adequacy; corporate governance; public disclosure, supervisory reporting and financial analysis; and

financial examinations. The working group will continue to review and modify the principles document in the future as considered necessary.

Standard Valuation Law & Valuation Manual

The working group received a report of the activities of the Life and Health Actuarial Task Force including a status update on the Standard Valuation Law (SVL) and the Valuation Manual. LHATF has completed its review of the amendments to the SVL and will expose a new draft on a conference call later this month. LHATF has decided to remove the requirement for an insurer to obtain an opinion from an independent reviewing actuary from the amended SVL. LHATF, through six subgroups, has begun reviewing the valuation manual, this review will continue in the first quarter of 2008. (The detailed discussion of LHATF activities begin on page 16.)

LHATF requested direction from the working group on the following seven items:

1. Confirm that a Standard Valuation Law that references a Valuation Manual can function legally.
2. Confirm 75% adoption by states and certain market participation is appropriate to establish the operative date of the Valuation Manual.
3. Confirm that it is appropriate to allow the NAIC to license with a statistical agent(s) on behalf of the states.
4. Confirm that the NAIC will commit sufficient resources for completing work on principles-based reserving by the 2008 Summer National Meeting;
5. Consider options for assurance of company reserve calculations (e.g. central review office, independent third party reviews, etc.)
6. Determine whether the initial scope of the Valuation Manual should be limited to certain products
7. Confirm that the Valuation Manual on its operative date can be modified from what is initially presented to legislatures.

With regard to items 1 and 3, the working group requested that NAIC legal staff consider these issues. The working group is expected to consider the remaining items and provide formal responses to LHATF at the Spring National Meeting.

The working group also discussed comments received on the preliminary summary timeline. It was acknowledged that adoption of the Standard Valuation Law and a framework of the Valuation Manual by June 2008 is aggressive, but an appropriate goal.

Report from the Corporate Governances Subgroup

The subgroup was established at the Fall National Meeting to develop recommendations for corporate governance requirements in a principles-based environment. The subgroup held two conference calls in November, the first meeting was a joint call with the CADTF to obtain an understanding of the task force's ongoing development of the Corporate Governance for Risk Management Act. The subgroup plans to devote its immediate attention to the development of corporate governance needed for reserves and capital requirements under a new principles-based approach, as opposed to the more broad focus of good risk management practices for all types of insurers, but the latter will remain a long-term goal. See additional discussion on page 13 as part of the Capital Adequacy Task Force summary.

Statutory Accounting Principles Working Group

Public Hearing

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

SSAP 97, Investments in SCA Entities, A Replacement of SSAP 88 – The working group adopted as final the new SSAP on accounting for investments in subsidiaries, controlled and affiliated entities, which supersedes SSAP 88 and is effective for 2007 audits. Changes adopted since the Fall National Meeting, which include those discussed during an interim public hearing November 9, include the following:

- Foreign insurance SCA entities may obtain an audit based on a foreign statutory basis when there is a reconciliation footnote to audited U.S. GAAP.
- The carrying value of a holding company can be admitted by the parent insurance entity when the audit opinion under U.S. GAAP is qualified or adverse when the departure from GAAP is the valuation of the U.S. Insurance entity on the basis of statutory accounting principles. (This issue is discussed in more detail below in the summary of the EAIWG's INT 03-03 revision.)
- The Tokyo Stock Exchange was added to the list of approved stock exchanges to qualify for market valuation of an SCA

Most of the changes made were for clarification. The primary requirements of SSAP 97, e.g. look-through for SCAs meeting the limited exception requirements, and a reconciliation required to U.S. GAAP equity and net income when a foreign basis audit is obtained, did not change. The working group clarified that for consolidated or combined financial statements of downstream holding companies, the consolidating/combining schedules need include only the entities directly owned by the holding company. However, the U.S GAAP to SAP adjustments are required for all entities owned directly or indirectly by the holding company.

The working group also adopted revisions to clarify that a noninsurance entity may be carried at a negative equity value in some circumstances such as the following:

- A SSAP 97 par. 8.b.ii entity that is carried at GAAP with statutory adjustments (such as a company holding only nonadmitted assets)
- If the reporting entity has guaranteed obligations of the investee or
- If the reporting entity is otherwise committed to providing further financial support for the investee.

The working group also reviewed comments and did not adopt a proposed revision from interested parties to expand the limited exception to downstream noninsurance holding companies with material assets provided those assets are nonadmitted was again rejected. Therefore only those holding companies with immaterial assets and liabilities, outside their investments in SCAs and SSAP 48 entities, can meet the limited exception, and materiality is assessed at the holding company level. The working group had agreed to consider the change at its November 9 conference call but ultimately no working group member supported the proposal.

The final SSAP will be posted to the NAIC's website shortly.

Issue Paper 124, Treatment of Cash Flows When Quantifying Changes in Valuation and Impairment, an amendment to SSAP 43, Loan-Backed and Structured Settlements – The working group voted to adopt Issue Paper 124 with a minor revision suggested by interested parties to clarify that all interest-related other than temporary impairments be recorded through IMR (not just those related to SSAP 43 securities.) The working group also directed NAIC staff to draft the related SSAP which

has a proposed effective date of December 31, 2008.

The adopted Issue Paper amends paragraphs 14 and 16 of SSAP 43 and requires that other-than-temporarily impaired loan-backed securities be written down to the discounted (compared to the current guidance of undiscounted) estimated future cash flows when the decline in value is credit-related, not interest-related. Interest-related declines in value are deemed other-than-temporary only when the investor has the intent to sell the investment, at the reporting date, before recovery of the investment. This guidance is consistent with the guidance in INT 06-07.

Disclosures Related to Subprime Mortgage Exposures – At its interim conference call November 9 the working group noted they had received a charge from the Executive Committee that the 2007 annual statement for all types of insurers should include disclosures related to an insurer's exposure to subprime mortgage related risk. During the conference call, the working group voted to expose for comment detailed new disclosures in three categories: 1) direct exposure through investments in subprime mortgage loans, 2) indirect exposure to subprime mortgage risk including through investments in debt and equity securities of companies with significant subprime exposure, and 3) underwriting exposure to subprime mortgage risk through mortgage guaranty coverage, financial guaranty coverage, directors and officers liability coverage, or errors and omissions liability coverage.

At its meeting in Houston, the working group reviewed comment letters on the proposed disclosures. One prevalent comment received was that insurers have no way to determine the aggregate subprime mortgage exposure of their investments in debt and equity securities of other entities. Interested parties noted that the proposed disclosure attempts to provide a definition of the subprime lending sector, but that other governmental entities have addressed this question and have decided not to provide a specific definition. They recommended that the disclosure should instead provide a set of general characteristics of subprime loans and have the insurance entity describe what it considers its subprime exposure to be based upon those characteristics.

After some discussion, the working group adopted a significantly revised disclosure including the recommendation above related to subprime

characteristics. Shown below is a summary of the revised disclosure, which will be included as section I of Note 20 of the annual statement and will be posted to the SAP Working Group's web page shortly. The instructions to the Note require that the disclosures be made "regardless of materiality."

The revised note provides a list of features that are "commonly recognized characteristics of subprime mortgage loans" such as an interest rate above prime to borrowers who do not qualify for prime rate loans, borrowers with low credit ratings (FICO scores), interest-only or negative amortizing loans, unconventionally high initial loan-to-value ratios, and four other items.

Based on those described exposures, insurance entities are to provide a narrative description of the following:

the manner in which the reporting entity specifically defines its exposure to subprime mortgage related risk in practice. Discuss the general categories of information considered in determining exposure to subprime mortgage related risk. Differentiate between exposure to unrealized losses due to changes in asset values versus exposure to realized losses resulting from receiving less than anticipated cash flows or due to potential sale of assets to meet future cash flow requirements. Discuss strategies used to manage or mitigate this risk exposure.

Note 20 also requires the following:

- Aggregate amount of directly held subprime mortgage loans including carrying value, fair value and value of land and buildings.
- Aggregate direct exposure through other investments, and
- Underwriting exposure to subprime risk through mortgage guaranty and financial guaranty insurance including aggregate losses paid and incurred in 2007 and case and IBNR reserves related to subprime losses at year-end 2007.

Interested parties and the AICPA representative stated that they recognize that the disclosure is required only in the annual statements, but that for companies for which subprime mortgage exposure is material, disclosures will be considered for the audited financial statements in accordance with the

"risk and uncertainties" disclosures required by SSAP 1 and "concentrations of credit risk" disclosures required by SSAP 27.

Accounting for the Gain or Loss on Sale of Real Estate included in a Leaseback Transaction – The working group adopted a proposed amendment to SSAP 22 to allow gain recognition when the transaction is fully settled in cash and the gain is segregated as special surplus throughout the term of the lease. Interested parties had requested that surplus not be segregated and that settlement in assets other than cash be permitted but no change was made to the proposed guidance.

Clarification of SSAP 26 for Reporting Investments in Commercial Paper – The working group adopted as final a nonsubstantive change to SSAP 26, Bonds, that commercial paper should be classified as a bond regardless of the remaining time to maturity at the time of the purchase.

FAS 129, Disclosure of Information about Capital Structure – The working group adopted a nonsubstantive change to SSAP 72 to adopt paragraphs 6, 7 and 9 of FAS 129 and reject all other paragraphs. References to APB 10, paragraphs 10 and 11 were also deleted.

The working group adopted nonsubstantive revisions to Issue Paper 99 to reject the following GAAP guidance as not applicable to statutory accounting:

- SOP 02-2, Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations, and Clarification of the Performance Indicator
- SOP 98-2, Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising
- SOP 03-2, Attest Engagements on Greenhouse Gas Emissions Information

SAP Maintenance Agenda Discussion

All issues exposed or re-exposed for public comment have a comment deadline to NAIC staff of February 15, 2008 with a public hearing at the Spring National Meeting.

Consideration of FIN 48, Accounting for Uncertainty in Income Taxes – The chair noted that the FIN 48 Subgroup has not been able to meet since the Fall National Meeting due to scheduling conflicts. Interested parties again noted that reaching a consensus by year-end on

disclosures for the audited statutory financial statements related to FIN 48 is important. Otherwise, the disclosure requirements of FIN 48 would be in effect for the 2007 audited financial statements due to generally accepted auditing standards guidance on disclosures in Other Comprehensive Basis of Accounting (OCBOA) financial statements which require GAAP-like disclosures if statutory accounting principles have not addressed a new GAAP standard.

The working group noted that the FASB has voted to defer the effective date of FIN 48 for certain nonpublic entities that have not yet adopted FIN 48. The FSP has not yet been exposed for comment, and therefore it is not known which specific nonpublic entities will qualify for the deferral. However, insurance company subsidiaries of SEC registrants (that were required to adopt FIN 48 the first quarter of 2007) may not be granted the deferral since the subsidiaries could be deemed to have adopted FIN 48. As a result, interested parties submitted a revised disclosure-only proposal and asked if the working group could expedite review. The chair noted the FIN 48 Subgroup has not yet concluded whether it is appropriate to conclude on the disclosures before the accounting is finalized, but he agreed to hold an interim conference call, which has now been scheduled for December 13.

The working group member from Pennsylvania questioned why the GAAP disclosures should be "forced" upon the audited financial statements since the SAP Framework includes comprehensive disclosures. He asked that SAP Working Group refer the issue to NAIC/AICPA Working Group of whether the NAIC should approach the Auditing Standards Board for a "carve out" for statutory OCBOA financial statements of this disclosure requirement. Interested parties reminded the working group that they had asked the ASB this same question several years ago and no change was made to the auditing standards.

Subsequent to its meeting in Houston, the working group scheduled an open conference call for December 13 to discuss interested parties' disclosure proposal. The proposed disclosures are similar to those required by FIN 48 except that disclosures are required for "tax contingencies"; FIN 48 uses the term "unrecognized tax benefits." In addition, the disclosures are made at the following levels in the organization:

"Each insurance reporting entity that is a member to a tax allocation agreement shall

disclose the information as it relates to all insurance company members of the tax allocation agreement at the end of each annual reporting period presented. If an insurance reporting entity is not a member to a tax allocation agreement, the disclosure will be based on the reporting entity's individual information."

Consideration of FAS 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – The working group voted to expose Issue Paper 132, Accounting for Pensions, a replacement of SSAP 89, and Issue Paper 133, Accounting for Postretirement Benefits Other than Pensions, a replacement of SSAP 14. The chair, representing the NY DOI, noted that he has some concerns about the accounting prescribed by FAS 158, but that he supports exposure of the issue papers.

Both issue papers propose adoption of FAS 158, including an accrual for both vested and nonvested participants, with certain modifications, which include the following:

- Prepaid assets resulting from the excess of the fair value of plan assets over the benefit obligation would be nonadmitted.
- The provisions within par. 30 of FAS 87, as amended by FAS 158, to allow a market-related value of plan assets would be eliminated with only the fair value measurement method for plan assets being allowed.
- The reduced disclosure requirements for nonpublic entities would be rejected.

The proposed effective date is December 31, 2009 for both pensions and OPEB. An extended transition period is proposed for insurance entities for which the effect of adoption is more than 1% of surplus. Companies would also be required to disclose the projected benefit obligation and corresponding fund status for pensions and the accumulated postretirement benefit obligation and fair value of plan assets as of December 31, 2008.

The working group briefly discussed the survey results of the potential effect of adoption for FAS 158 for statutory accounting. Responses were classified by type of company: stock, mutual and other. Twelve stock companies responded which estimated an 8.1% reduction in surplus if full FAS 158 were adopted for both vested and nonvested

participants. Twenty-six mutual companies responded, representing a 6.1% reduction in surplus and eighteen other entities responded presenting a 4.4% reduction in surplus.

The results were summarized by NAIC staff, which noted the following: "as a whole, industry prefers the current statutory accounting, but yet more companies utilize GAAP for internal management reporting."

Accounting for Debt Securities Subsequent to an Other-Than-Temporary Impairment – The working group voted to expose Issue Paper 131, Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment, which proposes adoption of the GAAP guidance in paragraph 16 of FSP FAS115-1/ 124-1, and provides guidance as to when a reporting entity should consider amortizing/ accreting a previous premium/discount once impairment occurs. The proposed effective date is December 31, 2008.

Consideration of FAS 157, Fair Value Measurements – The working group voted to add this new standard to its active agenda and formed the Fair Value Subgroup to "oversee and develop a new SSAP that defines fair value and establishes a framework for measurement of fair value in statutory accounting." The working group also received a Form A from interested parties on adopting FAS 157 disclosures for statutory reporting for 2008 as an interim measure as a result of the GAAS disclosure requirements for OCBOA financial statements discussed above. The working group referred the Form A to the new subgroup.

The Form A distributed at the meeting in Houston includes the NAIC staff recommendation on the interested party disclosure proposal that such adoption would be "premature." Further it states that "adopting disclosures without concluding on the accounting is outside the normal process and could be assumed to be a conclusion on the accounting."

Consideration of FAS 159, The Fair Value Option for Financial Assets and Financial Liabilities – The working group voted to reject FAS 159 because of the optionality allowed by the standard. However, the working group referred to the Fair Value Subgroup a project to review existing SAP measurement bases and assess the possibility and consequences of moving towards a fair value measurement method.

Consideration of FAS 156, Accounting for Servicing of Financial Assets, an amendment of FAS 140 –

The working group added this standard to its active agenda and directed NAIC staff to draft an issue paper which would propose adoption of FAS 156 with a modification to reject the optional accounting for the servicing of assets and liabilities.

Consideration of SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts – The working group formed the Separate Account Subgroup to consider this SOP.

Consideration of FIN 46R, FSP FIN 46R-4, FSP FIN 46R-5 Variable Interests – The working group voted to reject the accounting required under this guidance. However, the working group adopted a change to SSAP 25, Related Party Transactions, to include implicit and explicit variable interest entities within the example of related parties and expand disclosures to include the maximum loss exposure as a result of these implicit and explicit variable interests.

APP Manual Reference to the Health Reserves Guidance Manual –The working group voted to remove the reference to the Health Reserves Guidance Manual in SSAP 54 and SSAP 55 since there is no formal review process of the working group to review changes to the Manual. The chair noted that he would like to consider whether there should be such a process.

Consideration of EITF 06-5, Accounting for Purchases of Life Insurance - Determining the Amount that Could be Realized in Accordance with FASB TB 85-4 – The working group added this issue to its agenda and directed staff to draft language for review at the Spring National Meeting. One issue that will be considered is whether the amount to be realized for a corporate life insurance policy can exceed cash surrender value for statutory accounting purposes.

Use of Audited Tax Basis Financial Statements
The working group discussed a proposal from interested parties to allow the use of the tax basis of accounting to be an acceptable basis for purposes of admitting investments in SSAP 48 entities (joint ventures, partnerships and LLCs). SSAP 97 currently requires audited U.S. GAAP for such entities less than 10% owned by the insurer. Interested parties noted that for such minor

ownership interests the insurer often cannot obtain an audit in accordance with U.S. GAAP.

After a brief discussion, interested parties agreed to revise the Form A to include both direct and indirect investments in meeting the 10% threshold for the SSAP 48 entities and will resubmit the proposal for the Spring National Meeting. The working group seemed receptive to the concept of allowing the tax basis in these narrow circumstances.

Accounting for Life Settlement Contracts by Third-Party Investors – The working group received a report from the ACLI entitled Life Settlements Overview in response to the working group's request for more information on the life settlement industry. The paper includes sections on history, the form of the life settlement investment and market information. The paper does not suggest proposed accounting and RBC charges, which industry parties will be working on next. The chair of the working group expressed his concern that there is a lack of transparency within the industry, which is similar to comments made by the Valuations of Securities Task Force. The working group agreed to hold a conference call once interested parties have developed the proposed accounting and RBC.

Consideration of FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity – The working group exposed for comment a proposal to reject FAS 150 as the working group has concluded that insurers do not often issue securities or financial instruments within the scope of FAS 150.

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

Principles-Based Reserving Project
The working group heard an update of the detailed proposal from an interested party on a suggested process to incorporate PBR Standards into the APP manual. The presenters gave an overview of "SSAP XX" which they expect will supersede SSAPs 51, 52, 54, 59 and 80 and will amend SSAPs 56, 72 and 97. Their proposal will change all references to reserve requirements in the APP Manual to references to the new Valuation Manual (discussed in detail in the summary of the LHATF meetings).

The working group received the presentation for additional review.

FASB Invitation to Comment on IASB ED, Accounting for Insurance Contracts by Insurers and Policyholders

The working group noted that they had submitted on November 16 a comment letter to the FASB in which they supported a project by the FASB to address accounting for insurance contracts. The comment letter noted that "insurance and reinsurance are international businesses that would benefit from a common accounting standard applicable internationally." The working group also noted that the NAIC's International Solvency and Accounting Working Group provided an comment letter to IAIS on the IASB ED on insurance contracts (see discussion starting on page 10.)

Consideration of Other GAAP Guidance – The working group also voted to reject the following GAAP guidance as not applicable to statutory accounting:

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

Additional Items

There was no discussion of Issue Paper 129, Share-Based Payments at the meeting in New York. The working group had exposed this issue paper in 2006 Fall National Meeting. There was no status report from the Guaranty Fund Subgroup, which is considering revisions to SSAP 35.

Emerging Accounting Issues Working Group

The working group took the following actions with respect to its tentative positions:

INT 07-04: EITF 06-4: Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements - The working group had reached a tentative consensus at the Fall National Meeting to adopt the EITF with modifications to the transition guidance so that it is consistent with SSAP 3, Accounting Changes. At the Winter National Meeting, the working group deferred finalization of this INT pending completion of the SAP Working Group's consideration of FAS 158. Interested parties had commented during the exposure period

that the Interpretation should include guidance that only vested benefits arising from the terms of the split dollar arrangement should be subject to accrual under SSAP 14.

INT 07-05: EITF 06-10: Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements - The working group had reached a tentative consensus to adopt the EITF with modifications to the transition guidance so that it is consistent with SSAP 3, Accounting Changes. At the Winter National Meeting, the working group deferred final adoption so that interested parties can provide additional information on what contractual rights are provided by such insurance arrangements and how such rights should result in an admitted asset.

INT 07-06: FSP EITF 85-24-1: Application of EITF Issue No. 85-24 When Cash for the Right to Future Distribution Fees for Shares Previously Sold is Received from Third Parties - The working group reached a final consensus to reject the FSP EITF as not applicable to statutory accounting.

The working group then addressed new and outstanding issues.

Amendment of INT 03-03, Admissibility of Investments Recorded on the Audited GAAP Equity of the Investee when a Qualified Opinion is Provided - The working group considered a proposed amendment that arose as the SAP Working Group considered SSAP 97, which generally requires audits of holding companies owned by insurance companies. INT 03-03, as originally drafted, does not allow an investment in an SCA entity to be admitted when the audit opinion is qualified or adverse for a departure from GAAP and that departure is not quantified.

Given the fact that holding companies may hold investments in insurance companies that must be valued in accordance with statutory accounting principles by the insurance company parent investor, it did not seem meaningful to convert the insurance companies to U.S. GAAP only to convert them back to statutory accounting for purposes of the parent insurance company valuation. As a result, the working group agreed to the following amendment to INT 03-03 for situations in which a qualified or adverse opinion is issued: "There is no need to quantify the impact when the departure from GAAP is the valuation of the U.S. Insurance entity on the basis of statutory accounting principles." The amendment is effective for 2007

audits.

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

The working group briefly reviewed a Form B from an interested party that requests guidance on whether such funding agreements should be classified as deposit-type contracts or corporate debt. The working group deferred reaching a tentative consensus until they have time to study the issue further.

International Solvency and Accounting Working Group

The working group just recently finalized the comment letter on International Accounting Standards Board's Accounting for Insurance Contracts by Insurers and Policyholders exposure draft with the International Association of Insurance Supervisors (IAIS).

The working group summarized that many of the suggested NAIC positions had been adopted by the IAIS Insurance Contracts Subcommittee, which met in Kansas City November 28–30. The subcommittee spent considerable time discussing the building blocks approach and in particular the issues surrounding profit on inception. Given that IAIS's response to the IASB adequately represented U.S. interests, the working group adopted the recommendation that there was no necessity for the NAIC to issue a separate comment letter to the IASB. The comment letter filed with the IASB by the IAIS supports many of the IASB's tentative conclusions, and many of the underlying directions of the insurance contract project, including the use of some form of exit value for measuring insurance contracts. Given that prices are not available for insurance liabilities in most cases, IAIS believes, in principle, that the three building block approach provides an appropriate methodology for the measurement of those elements of insurance liabilities that are not measured in deep liquid markets.

The working group also reported that the IAIS Technical Committee adopted the documents submitted by the IAIS Solvency and Actuarial Issues Subcommittee. These documents included the three solvency guidance papers on the structure of capital, enterprise risk management, and internal models and a current positions paper on the valuation of technical provisions. A meeting of the IAIS Solvency and Actuarial Issues Subcommittee in early December will discuss first drafts of standards derived from the guidance

papers, together with a first draft of a paper on capital resources.

NAIC staff provided an overview of the draft IAIS Roadmap which focused on promoting international convergence, harmonizing standard setting, and becoming more principles based but with adequate detailed guidance. The chair noted that the IAIS Executive Committee would need to adopt the Roadmap in January 2008.

The working group heard a presentation on Risk Margin Research which stated that for insurers, observable prices for liabilities other than customer premiums are insufficient for adequate calibration or conclusion that the fair value system for insurers is unreliable. The key takeaway from the presentation were that significant calibration of the capital base and the cost of capital rate is needed to ensure that fair values are consistent with market price.

Blanks Working Group

The working group adopted eleven blanks proposals as final, including those discussed below which are effective for the 2008 annual statement unless otherwise stated.

- A new code was added to Schedule D Instructions to designate TBA (To Be Announced) securities.
- The Supplemental Investment Risk Interrogatories instructions were clarified regarding the use of CUSIP numbers for determining the single 10 largest exposures to a single issuer/borrower/investment.
- Instructions were added to Schedules D and E to require reporting of investment income received net of foreign withholding tax. This change will be effective for the first quarter of 2008.
- The working group approved extensive revisions to the instructions for Schedule T and Schedule T, Part 2 for all annual statement blanks. The new instructions clarify appropriate allocation methods of premiums by state for significant life and property/casualty product lines. The results are intended to produce consistent and more accurate state premium tax assessments. Guidance with regard to health insurance products was referred back to the Schedule T Subgroup pending the results of the recently approved

Health Industry Survey. (See the Report from the Schedule T Subgroup below.) The approved changes will be effective for the first quarter of 2009.

At the subsequent meeting of the Accounting Practices and Procedures Task Force, after additional extensive discussion, the task force ultimately agreed with a proposal from interested parties to defer final adoption of changes proposed for Schedule T premium allocation. The task force exposed for comment whether the situs of the contract should be added to the bases for allocation of premium. Comments are due to the task force by February 28.

- The working group modified the Statement of Actuarial Opinion and Actuarial Opinion Summary instructions to provide special requirements for pooled companies that cede 100% of business written to one lead company, but assume 0% of the pooled risk back. All companies in the pool are required to submit a pooled opinion that includes a description of the pool, identification of the lead company, and a listing of all companies in the pool. The IRIS ratios, risk of material adverse deviation discussion and other relevant comments shall relate to the pooled risks and to the surplus of the lead company.
- The Summary Investment Schedule instructions were modified to include Class One bond mutual funds and exchange traded funds in line 2 (other debt and fixed income securities) and to include only mutual funds reported on Schedule D, Part 2, Section 2 in line 3.1 (investments in mutual funds).

The working group also exposed five new proposals for comment. The comment period ends February 28, 2008. Some of the more significant exposed proposals would:

- Add new Long Term Care Experience Reporting Forms and instructions to all annual statement blanks and eliminate the current forms and instructions. (Agenda item 2007-49BWG)
- Modify instructions for Schedule D for consistency of report of stock mutual funds. (Agenda Item 2007-50BWG)
- Add new disclosure adopted by the Statutory Accounting Principles Working Group for

SSAP 72 to the annual statement instructions. (Agenda Item 2007-52BWG)

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

Additionally, the working group received a report from the American Academy of Actuaries (AAA) regarding potential changes to the quarterly and annual statement blanks and related instructions if the principles-based reserve valuation approach is adopted by the NAIC. At this time the AAA has identified very few changes that would be necessary to the blanks; however detailed disclosure and limited interrogatories would likely be added. Given this report, the working group decided not to form a separate subgroup to consider these potential blanks changes.

The working group agreed to update the hybrid securities guidance on the NAIC website with an effective date to 1/1/2009 (see Hybrid RBC Working Group summary), and also voted to disband the investment schedules subgroup as it has completed its consideration of the numerous investment related proposals over that last two years.

Report from the Schedule T Subgroup

The subgroup did not meet following the Fall National Meeting as it awaits the survey results from the health insurance industry. The survey is designed to solicit input from health insurers with regard to the potential costs necessary to comply with proposed premium allocations by state for group health policies with more than 500 covered members (i.e., rule of 500). The survey will also ask whether the company is a single state writer and if it currently applies the rule of 500, what percentage of the company's group insurance contracts that have more than 500 covered members and whether changes to the company's current allocation method would result in a significant cost impact to the company. The survey was issued in October with a 60-day response period, and approximately 30 days is needed to compile the results. The subgroup expects to meet via conference call following the Winter National Meeting to consider such results.

NAIC/AICPA Working Group

MAR Discussion Items

The working group updated its ongoing survey of the progress of adopting the revised Model Audit Rule (MAR), which has a proposed effective date of January 1, 2010. Four states are planning to have the revised MAR introduced or adopted by the end of 2007. Another 17 states plan on

presenting amendments to their legislatures or revising their regulations in 2008.

The chair of the working group from Virginia noted that Virginia has exposed for comment adoption of the revised MAR. The Department has received two comment letters that oppose adoption and one comment letter in support of the revised law. A public hearing will be held February 2. The Alabama Department of Insurance has also proposed adoption of the revised MAR through its proposed Regulation 141; a public hearing has been set for December 13.

Update from the AICPA

The working group heard an update from a representative of the AICPA regarding projects that affect state insurance regulators and the insurance industry. The AICPA representative noted that for 2007 audits SAS 112 will not be revised to incorporate the revised definition of significant deficiency in PCAOB Auditing Standard No. 5. As a result, the AICPA's document, *A Statutory Framework for Reporting Significant Deficiencies and Material Weaknesses in Internal Control to Insurance Regulators (Statutory Framework)*, will not be updated either.

The AICPA representative also noted that the AICPA is updating for 2007 its survey of the state insurance departments that the guidance contained in the Framework above is still acceptable; i.e. that unremediated significant deficiencies and material weaknesses should be communicated to insurance departments. The survey will be updated annually until the Section 11 guidance in the model audit rule becomes effective in 2010. An insurance department should notify the AICPA only if it objects to the extension of the guidance for 2007.

Referral from the SAP Working Group

The working group discussed a referral from the Statutory Accounting Principles Working Group related to the AICPA guidance on GAAP disclosures required when reporting on financial statements prepared on a comprehensive basis of accounting other than GAAP. The referral requested that the task force "review the relevant guidance and determine if renewed discussions" with the AICPA's Auditing Standards Board would be beneficial given that SAP already includes comprehensive disclosures. The AICPA/NAIC Task Force noted they would be happy to work with the NAIC to approach the ASB.

Valuation of Securities Task Force

The task force held a conference call meeting November 29 in lieu of meeting in Houston. A follow up meeting is scheduled for December 20 to continue discussion of issues not completed on the November 29 call.

Report from the Invested Asset Working Group

The task force heard a report from the working group. The chair of the working group reported that it will hold a series of conference calls beginning in December to work on its charge to consider whether improvements can be made to NAIC processes related to assigning regulatory treatment to new securities. The work product here could be language for the Purposes and Procedures Manual, or in the form of a checklist of risks, for use when the working group is called upon to review new securities and a process for considering the likely impact of these risks on the purchaser.

The working group is also charged with (1) considering whether improvements can be made in the way that potential risks in securities or financial products are evaluated and monitored, (2) evaluating the manner in which decisions about how new products fit into the regulatory framework are communicated to the marketplace, and (3) investigating whether the annual statement schedules can be made more transparent to better reflect non-credit risk in new securities.

Report from the Derivatives Market Study Working Group

The task force adopted the recommendation of the working group that Schedule DB of the annual statement should be modified and that the proposed changes should be forwarded to the Blanks Working Group for consideration. The main objectives of the Schedule DB modifications were to reduce redundancy and number of schedules, and to make the hedging activity more transparent. Some of the proposed changes include measurement of hedge effectiveness in transaction level reporting and description of the hedged item.

At the meeting of the task force and during the conference call meeting of the Derivatives Market Study Working Group held November 1, interested parties had requested that the working group not yet refer the proposals to the Blanks Working Group as they wanted a better understanding for the reasons for the proposed changes. For example, why were regulators proposing to include

measurements of hedge effectiveness in transaction level reporting or requiring a description of the hedged item. SVO staff responded that proposed changes are meant to verify whether the requirements of SSAP 86 are being complied with. After significant additional discussion including a request from interested parties to convene a small group of regulators and interested parties to resolve the issues raised by interested parties, the working group voted to forward the proposal to the Blanks Working Group. The referral will include a covering memorandum identifying issues discussed by the working group.

At its November 1 meeting, the working group also adopted a recommendation that the NAIC should revise and retain Derivatives Instruments Model Regulation as a national standard. The working group had earlier been informed that not enough states had adopted the model for it to be considered a national standard; however, the actual number of states adopting the model is nineteen.

The Derivative Instrument Model Regulation has been amended to add a limit on counterparty exposure and credit quality, a requirement for a written derivatives use plan, a requirement for management oversight to determine whether derivative transactions are occurring within the approved guidelines, and a requirement for commissioner approval of the derivatives use plan. The model will be sent to Executive Committee for consideration as a national standard.

Public Dissemination of SVO Determinations

The task force heard a staff report on the development of an internet-based process to disseminate SVO determinations on securities rated by an NAIC Approved Rating Organization. The staff expects the system and process to be operational on or after February 1, 2008. Interested party expressed some concerns that they were given the opportunity to provide comments.

Other Matters

During the Fall National Meeting, the task force approved the proposal that would permit broker-dealers to seek the probable regulatory treatment of new securities from the SVO without being sponsored by an insurance company. However, the proposal would not allow a broker-dealer to provide the "probable regulatory treatment" to non-insurers, i.e. communications with the SVO would be confidential. Several interested parties

expressed that such an approach may actually limit transparency.

The task force discussed a comment letter from the ACLI requesting changes to the adopted proposal to allow non-insurers to utilize the SVO EIV (Emerging Investment Vehicle) and Advanced Rating Service. The task force concurred that non-insurers using these services were free to share the SVO determinations with others.

Capital Adequacy Task Force

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

Report from the Corporate Governance Subgroup of the Principles-Based Working Group

The subgroup held a joint conference call November 14 with the task force and the Principles-Based Reserving Working Group to discuss the status of its draft model act Corporate Governance for Risk Management, which was released for comment a year ago, and which the chair acknowledged was not well received by the industry. The draft focuses on board of director responsibilities and enforcement; it requires the board to approve a risk management system. The purpose of the call was to discuss comments received on the most recent version of the model including the changes that were made after the model had been compared to the Europeans' Solvency II on risk management and corporate governance.

During the call, the chair noted that significant comments were received and that it was "difficult to pinpoint the most significant areas of concern." One of the bigger questions was whether the model should apply to all entities or just those using a principles-based approach to reserving. The chair conceded that changes would need to be made to the model before moving forward with it. The subgroup will continue to review the comments received and determine whether corporate governance model needs to be developed. The chair noted the subgroup is still in the research phase of the project.

Securities Lending Subgroup

At its meeting in Houston, the task force adopted the proposal from its Securities Lending Subgroup for a reduced RBC charge (from 1.3% to .2%) for securities lending programs that conform to specific requirements for Life RBC. The change is effective for 2008 filings. The operating criteria

and safeguards include board of director oversight of securities lending programs through a written plan, written operational procedures to monitor and control risks, and acceptable collateral of only cash, cash equivalents, full faith and credit US securities and NAIC 1 securities.

Prior to adoption, the task force discussed at length an objection from Wisconsin of allowing mortgage-backed securities to be considered acceptable collateral (assuming they are "1" rated), given the additional risks posed by these securities from his perspective. However, no change was made to the proposal prior to adoption.

The task force then exposed for comment for 45 days similar securities lending proposals to revise the RBC charge for property/casualty and health entities. A conference call will be held after that time to consider adoption for 2008 RBC filings.

Collateral Held for Authorized Reinsurance

At its Fall National Meeting, the task force discussed a new issue related to the Life RBC treatment of collateral held by an authorized reinsurer. The key issue is that the Life RBC calculation does not contemplate that a reinsurance transaction between an authorized reinsurer and a non-affiliate will have secured collateral. As a result, the calculation does not provide for any RBC reinsurance credit and the ceding company is charged counterparty risk.

After some discussion in Houston, the task force agreed to form a subgroup to study the issue. The subgroup will include members from California, Delaware, Minnesota, Nebraska and South Carolina.

Suggested agenda items for 2008

The task force heard a request from its Pennsylvania member to make two issues high priority items in 2008: developing a trend test for health entities and expanding the life trend test. The regulator believes these two issues are urgent. In addition, he asked that an agenda item be added to address the P/C risk charge for companies with statutory deposits which generally cannot be used to pay policyholder claims until an insurer is in liquidation.

Hybrid Risk-Based Capital Working Group

The working group held three conference calls following the Fall National Meeting, but did not meet in Houston. During these conference calls the working group considered accounting and reporting

options for hybrid securities. Previously, the working group had identified three possible approaches for reporting of hybrid securities for year-end 2008:

- Option 1, account and report as bonds
- Option 2, account and report as other invested assets on Schedule BA
- Option 3, account and report as preferred stock (consistent with short-term solution)

After considerable discussion and following a three week exposure period, it was decided that hybrid securities should be reported in Schedule D Part 1 with a separate line number (e.g. XX99999) and that the annual statement note disclosure of these holdings be eliminated. This change will be effective January 1, 2009.

On the November 13 conference call the working group discussed the previously exposed American Academy of Actuaries Invested Asset Work Group (AAA) report on its consideration of hybrid securities. Based on its thorough analysis of the risks associated with hybrid securities, the AAA recommended that the RBC for hybrids be based upon the factors for preferred stock and that the short-term solution for notching be reversed because it can produce an "illogical result" (i.e. hybrids that are higher in the capital structure can carry a higher RBC charge than those with lower ratings due to the effect of notching on the NAIC rating basis.). The AAA recommendation is based in part on a comparative analysis of hybrid risks versus other types of securities and how investment risks are captured in the NAIC RBC formulas.

Following comments from interested parties in support of the AAA recommendation to reverse the notching, the chair of the working group highlighted that the AAA report had also recommended further study be conducted with regard to the loss experience for hybrid securities as they continue to develop. The chair further noted that the AAA report did not focus on the latest generation of hybrid securities and that while investment risk is captured in the RBC C3 Phase 1 calculation, not every hybrid security will be subject to cash flow testing models by companies (e.g., non-life companies). Following lengthy discussion and despite opposition of interested parties the working group voted to adopt the AAA report except for the recommendation to reverse the notching. The vote was not unanimous.

On the November 28 conference call the working group reconsidered its previous motion with regard to notching. A revised motion was presented to

adopt all AAA recommendations, but to extend notching until January 1, 2009 and defer any further consideration with regard to hybrid securities back to the Capital Adequacy Task Force and Valuation of Securities Task Force. The motion was adopted with only one opposing member in favor of the November 13 motion. Therefore, if the Capital Adequacy Task Force and VOS Task Force do not take any actions on hybrid securities in the near term the notching provision would sunset on January 1, 2009. Interest parties, while preferring notching to be eliminated for 2008, were satisfied with the compromise. The working group's charge will expire at the end of this year, but it plans to prepare a brief report to the Financial Condition Committee to summarize actions taken, as well as conclusions and recommendations made with regard to the accounting and reporting of hybrid securities. The working group has scheduled a conference call December 19, and possibly January to address these transition issues and to finalize responses to an industry frequently asked questions document.

Life Risk-Based Capital Working Group

The working group did not meet in Houston and did not hold any conference calls since the Fall National Meeting. No future conference calls have been yet scheduled.

P/C Risk-Based Capital Working Group

The working group held conference calls in October and November to discuss the American Academy of Actuaries report on proposed revisions to the underwriting factors (reserve and premium factors) in the RBC formula that had been distributed at the Fall National Meeting. At its conference call in October, the working group heard a presentation from the Academy on its report which noted that the underwriting factors had not been revised since the original adoption of formula. The Academy representative also noted that there was not a lot of documentation of how specific factors were adopted. As a result, the Academy developed a methodology for converting the Schedule P data used into underwriting factors. Ten years of Schedule P data was used.

Based on the AAA report, the changes in indicated RBC from current RBC for premium and reserve factors decreased in total by 3%. However, the reinsurance factors increased by 35% for both reserves and premiums. The factors for homeowners, personal auto and auto physical damage decreased by 35% and 16% for reserves

and premium respectively. The indicated RBC for reinsurance actually exceeded 35%, but the working group capped the increase at 35% for all lines. As a result, the AAA recommended an increase in 35% for reinsurance for two consecutive years.

At its November 27 conference call, the working group reviewed the comment letter from the RAA on the proposed factors and the AAA report. The RAA is concerned with the significant increase in the underwriting risk charges for reinsurance which is based on ten years of Schedule P data. The RAA noted that during the last ten years there have been many changes in the reinsurance marketplace and the data may not be representative of the companies currently writing business.

Because of the concern of the effect on RBC of two consecutive years of 35% increases in the factors, the working group voted to limit the change in the factors for all lines to plus or minus 15% for 2008, and an additional plus or minus 15% for 2009. NAIC staff will test the revised factors against the NAIC database to determine the effect on each company in the database. This work should be completed in time for finalizing RBC for 2008.

In its report to the Capital Adequacy Task Force in Houston, the working group chair noted that they plan to work with the RAA to give them a clearer picture of the analysis that resulted in the higher charges and to explore other alternatives for data filtering that "may lead to a more robust data set for future analyses."

Health Risk-Based Capital Working Group

The working group had a short conference call on October 11 and adopted a proposal from industry to move stand-alone vision coverage from the "other health" category to combine it with dental coverage that had been previously exposed for comment. The other health coverage has a flat 13 %charge while dental coverage has a 12% factor that grades down to 7.6%. The change is effective for 2008.

Reinsurance Task Force

Reinsurance Modernization

At the Fall National Meeting, the task force unveiled and exposed for comment a significantly revised reinsurance framework modernization proposal. The revised proposal is classified into

three components: 1) regulatory equivalence and mutual recognition, 2) a single state U.S. regulator for U.S. reinsurers and 3) a single jurisdiction port of entry for non-U.S. reinsurers. Mutual recognition would be determined by a to-be-formed NAIC group, the Reinsurance Supervision Review Department, which would evaluate which jurisdictions are "equivalent" to U.S. insurance regulation.

The task force held an interim meeting November 7-8 to continue reviewing and hearing comments on the revised modernization proposal and how other non-U.S. jurisdictions regulate reinsurance. Consistent with prior meetings, the task force and interested parties spent much of the time discussing collateral issues. Several parties commented that outside the U.S. the majority of reinsurance programs operate without collateral. A representative of U.S. ceding companies again emphasized that the final proposal should not place additional regulatory burdens on U.S. ceding insurers.

The task force continued to hear final comments on the Framework at its meeting in Houston. The task force approved some minor edits to the 2 1/2 page modernization proposal which includes the three major components discussed above of mutual recognition, single state U.S. regulator for U.S. companies and a port of entry for non-U.S. companies. The outstanding issues list of Framework document includes, among other items, the following significant issues:

- Establish appropriate collateral levels from 0 to 100% on a prospective basis, which would address runoff issues, treatment of downgrades and "slow pay reinsurers"
- Whether the proposal applies to all entities and groups assuming reinsurance and to what extent it should apply to primary insurers assuming reinsurance, including the treatment of affiliated reinsurance transactions
- What regulatory authority is retained by the ceding company's domestic regulator
- How mutual recognition agreements should be negotiated, enforced and terminated
- Uniformity among states

The task force then unanimously voted to adopt the Framework Memorandum. As part of the discussion after the vote, the chair noted that the

New York Insurance Department exposed in October a proposed amendment to its Regulation 20, Credit for Reinsurance from Authorized Reinsurers, which would permit an alternative credit for reinsurance that correlates the required collateral to the rating of the unauthorized reinsurer.

The task force member from New York stated that New York DOI is in favor of the NAIC's modernization proposal as it is consistent with New York's proposal, but that New York will continue to work on their proposed amendments during 2008. The president of the NAIC, Walter Bell, stated that he hopes New York can join the NAIC in promulgating one national standard on this issue.

At the subsequent meeting of the task force's parent, Financial Condition Committee, the committee unanimously adopted the revised Framework Memorandum. Per the chair of the task force, the next step is approval of the Framework by Executive Committee and Plenary, after which the outstanding issues will begin to be addressed through amendments to the Credit for Reinsurance Model Law and Regulation. It is expected the Plenary vote will occur during a conference call before the end of the year. The task force hopes to have an interim meeting in January to begin work on the outstanding issues list.

SVO Approved Bank List

The task force received a report from its SVO Approved Bank Listing Working Group on its consideration of Eligibility Standards and Bank List issued by the SVO. The list is used to determine whether an entity is eligible to be a "qualified U.S. financial institution" to issue or confirm letters of credit or perform the duties of a trustee. The working group recommends that the Eligibility Standards and Bank List be amended to include a second category of "consolidated financial institutions," which are supervised by the SEC. No vote on this recommendation was taken by the task force in Houston.

Life Insurance and Annuities (A) Committee

Reserves for Variable Annuities and Guaranteed Living Benefits

In a conference call held on November 27 the committee received a report from the Life and Health Actuarial Task Force and unanimously adopted the task force's proposed revisions to Actuarial Guideline XXXIX (AG 39) Reserves for

Variable Annuities and Guaranteed Living Benefits. (At LHATF the proposed revisions were adopted in a close vote, with a vote from the chair being the deciding vote.)

Insurer and Producer Bulletin on Sales to Senior Citizens

The committee discussed plans to issue a consumer alert and an insurer and producer bulletin on the use of senior designations in the sale of annuity products to senior citizens. The committee distributed drafts of both the consumer alert and the bulletin and held preliminary discussion on the matter. Comments are due on the drafts January 25.

Suitability in Annuity Transactions

The committee discussed the ACLI Suitability Certification Template proposal related to the Suitability in Annuity Transactions Model Regulation, which was previously discussed at the Fall National Meeting. The proposal is to include the template in the Market Regulation Handbook; it would be used by third parties, such as broker-dealers, to certify to insurers with whom they have contracts that they comply with the supervisory responsibilities for recommendations of annuity transactions required by the Suitability model. The committee adopted a motion to forward the revised template to the Market Conduct Handbook Working Group to be considered for inclusion in the *NAIC Market Regulation Handbook*.

Unfair Trade Practices Act

During the Fall National Meeting, the committee had planned to pursue a dual option approach to revisions to the Unfair Trade Practices Act related to the use of past lawful travel and future lawful travel plans in life insurance underwriting decisions. One reason for this approach was that, at the time, there was a provision within the Terrorism Risk Insurance Revision and Extension Act of 2007 (TRIREA) that was similar to the proposed travel underwriting provisions being considered by the committee. If enacted, it was anticipated that TRIREA would establish a floor, but not a ceiling, and therefore would not preempt states laws that are more protective. Given this and the expectations that a consensus position could not be reached, the committee believed it was appropriate to provide two options that states could choose from to address the travel underwriting issue. However, because the expected TRIREA travel underwriting language was not included in the final legislation, the committee decided in its November conference call to refocus its efforts to on singular approach.

At the Winter National Meeting, the committee agreed to reopen the comment period on the current

draft for committee members until January 10. The committee will then circulate all committee member comments and the current draft of the document for interested parties to comment.

Life and Health Actuarial Task Force (LHATF)

Principles Based Reserves

The Life and Health Actuarial Task Force and the Accident & Health Working Group conducted three full days of meetings in Houston, spending essentially all of this time on the development of Principles Based Reserves (PBR). The goal of LHATF's chair was to go through drafts of the new standard valuation law and parts of the valuation manual at this meeting and then hold conference calls in late December or early January, after which time LHATF hoped to expose some of these documents for comment prior to the Spring National Meeting. This is consistent with their previously announced timetable of having the NAIC adopt PBR in 2008 so that it could possibly be effective for January 1, 2010.

PBR essentially includes a revised Standard Valuation Law (SVL) that will need to be adopted by each state's legislature, and a Valuation Manual (VM) that contains many of the detail requirements of PBR in sections referred to as VM-N, where N is the specific section number in the Valuation Manual. One of the concepts of PBR is that changes in valuation requirements will be implemented quickly through changes in the Valuation Manual that is to be maintained by the NAIC. However, it is unclear as to whether states will or have the authority to delegate that rule-making responsibility to the NAIC.

Prior to the Winter National Meeting, the American Academy of Actuaries took the lead on PBR development by presenting their reports to LHATF each quarter. It was very clear at this meeting that LHATF has now taken ownership of the project including the documents as they work towards completion. Although the Academy was often called on for their opinions and comments, there were no Academy presentations given at this meeting.

Modifications to the SVL

LHATF reviewed the entire 17-page revised SVL draft during this meeting. Various discussions took place during this review, in particular, with regard to definitions, operative date, transition and single state exemption. At the heart of many of these discussions was the question regarding which

requirements need to be part of the revised SVL and which ones belong in the Valuation Manual. In general, the task force thought that broad-based requirements should be in the SVL and specific requirements should be in the Manual.

During the task force's review of the SVL, the topic of the independent peer review requirements surfaced. When industry representatives suggested that the law ought to require the reliance on the independent peer review opinion by the state insurance commissioners, some regulators balked, fearing that such a requirement would preclude them from conducting their own PBR review. In addition, some regulators indicated that their states would not use the independent peer review. Other regulators suggested that they could request companies to provide an independent peer review without such requirement being part of the SVL. Based on this discussion, LHATF voted to remove the independent peer review requirement from PRB.

The task force expects to have a revised draft of the SVL available to regulators for a late December or early January conference call, after which they expect to expose the document for comments.

Requirements for PBR for Life Products (VM-20)

During this meeting, the task force reviewed in detail about one-third of the 53 page draft of the PBR requirements for life products. Many issues regarding these requirements were discussed in detail although no significant conclusions were reached. The LHATF subgroup working on VM-20 is expected to make revisions based on these discussions and present regulators with a revised draft VM-20 for a subsequent call.

The task force discussed whether companies could use June 30th data in their models in support of their year-end PBR calculations. Industry representatives pointed out that Actuarial Standard of Practice 7 addresses this issue and suggested that LHATF consider that guidance. Some regulators felt that since the year-end reserve reports are not submitted to the insurance departments until March of the following year, regulators would be getting reports based on data that is almost 9 months old. A nonbinding vote was taken which indicated that most regulators were not comfortable with allowing 6-month old data but that 3-month old data was acceptable if companies determined it was appropriate, and necessary adjustments were made to account for differences in balances between the date of the data extract and the valuation date.

The issue of aggregation of blocks of business in determining reserves under PBR methodology was discussed at length. Industry representatives were pushing for full aggregation which allows for offsetting of risks from different blocks of business.

Some regulators wanted to restrict aggregation to situations where blocks of business are managed together. Another regulator questioned why regulators would want to discourage companies from selling products which provided a natural hedge to each other by not allowing reserves to consider the offsetting risks. At the end of the discussion, the LHATF subgroup working on VM-20 was given guidance to draft wording to allow for some level of aggregation.

With regard to CTE levels, some regulators suggested that there needs to be different CTE levels for different products. Levels ranging from 65 CTE to 80 CTE were discussed. Regulators also discussed the analysis of CTE variance measures that had been presented in prior meetings and some questioned whether CTE is always the proper measure. Since a group of regulators (identities not disclosed) are working on this issue and were not prepared to make a recommendation at this meeting, discussion was halted.

Also discussed during this session was how much latitude companies would be given in choosing assumptions and guidance for sensitivity analysis. No conclusions were reached.

LHATF also noted that for now, credit life insurance has been carved out of VM-20 and put in a separate section that would only require formula reserves.

Experience Reporting Requirements of PBR (VM-50 & VM-51)

The experience reporting requirements of PBR address the collection, compilation and reporting of insurance experience information. It also includes the experience reporting process, the intended use of the data, the cost of compliance and confidentiality and privacy considerations. LHATF noted that phase one of this part of PBR will address mortality only. Lapses and other experience will be addressed in later phases.

Actuarial Opinion and Memorandum Requirements under PBR (VM-30)

The task force discussed the actuarial opinion requirements under PBR. For now, LHATF chose separate opinions for life and health filings rather

than try to come up with one opinion format that works for both practices.

Reinsurance under PBR

At this time, reinsurance requirements under PBR are embedded in each of the sections dealing with line of business requirements. With regard to life insurance under VM-20, LHATF discussed how reserve credits might work under PBR. No conclusions were reached.

A&H Reserves under PBR (VM-25)

As an introductory step for health reserves under PBR, the Accident and Health Working Group took the existing Minimum Health Reserve Model Regulation and converted it to a first draft of health PBR requirements. A subgroup was formed to study these requirements in more detail.

Other Matters

Reserves for Variable Annuities (Actuarial Guideline VACARVM)

No discussion of VACARVM took place during this meeting. The LHATF chair noted that he expects to meet with the ACLI to finish their joint review of the VACARVM impact survey. He hopes to complete this analysis in early January and conduct a regulator-only call to discuss the results.

Group Long Term Life Waiver of Premium

A conference call will be scheduled to discuss the draft model regulation for the use of the 2005 Group Term Life Waiver Reserve Table for calculating minimum reserves for waiver disabled lives.

Preneed Mortality

LHATF will hold two conference calls to address alternatives for a valuation mortality table for preneed business.

Actuarial Opinion Instructions on Health Blank

The Accident & Health Working Group continued work on its project on revisions to the actuarial opinion section of the health annual statement instructions. The focus at this meeting was on the qualifications and appointment of the appointed actuary and the actuarial memo. The subcommittee will continue its work with the goal of completing the work by the Spring National Meeting. A conference call will be scheduled.

A&HWG Chair

Julia Philips, regulator from Minnesota and long-term chair of the Accident and Health Working Group, announced that she will be stepping down as chair of this working group at the conclusion of

the Winter National Meeting. No replacement has been named.

P/C Reinsurance Study Group

The study group did not meet in Houston and has not met since May. A meeting will be scheduled for the Spring National Meeting to discuss issues including the feasibility of revising the SSAP 62 guidance that requires reinsurance contracts to be signed within nine months. This issue was exposed for consideration in May.

Casualty Actuarial Task Force

The meeting began with a continued discussion of the use of catastrophe models in ratemaking.

The task force received status reports and updates on its various projects run by several of its subgroups. Several of these groups, including International, Workers Compensation Large Deductible, Profitability, and the Credibility of the Actuary, had very brief updates as there was minimal progress since the Fall National Meeting. The subgroups which had more substantive discussion are as follows:

Principles-based Reserving Project

The task force continues to closely monitor the progress of the principles-based reserving project, and provides advice to Principles-Based Reserving Working Group via comment letters. In particular, the task force was updated on, and responded favorably to, a recent decision at LHATF that a comprehensive peer review function would not be incorporated into the final Standard Valuation Law.

Line of Business

The task force is working with the Blanks Working Group on clarifying that excess workers compensation should actually be recorded in the Other Liability line of business in Schedule P. In addition, the task force is planning to take on a larger project next year focusing on clarifying the line of business assignments for certain coverages where there currently exists diversity in practice.

Discounting of LAE

The task force is working with the Blanks Working Group to clarify that NAIC prescribed accounting does not allow for discounting of loss adjustment expenses (LAE), and as such discounting of LAE should only be performed if it is a state prescribed or permitted practice.

Report from the AAA

The meeting ended with a report by the American Academy of Actuaries, which included guidance on loss reserve opinions and risk transfer with reinsurance contracts. Key points include the following:

- The Academy is updating its Practice Note for Loss Reserve Opinions; this update is due in mid-December. There were relatively few changes to the NAIC instructions, and therefore the updates to the practice note are less extensive than in past years. The practice note highlights changes to Exhibits A and B, emphasizes the importance of conforming to the required format, and alerts actuaries to Actuarial Standard of Practice No 43, *Property/Casualty Unpaid Claim Estimates*, which is effective for opinions issued at year-end 2007. The updated Law Manual is also on schedule for issuance later this month.

In addition, the Academy teamed with the CAS in the presentation of two webinars on loss reserve opinion topics: Difficult Situations with Reserve Opinions and Risk of Material Adverse Deviation were recently completed.

- The Academy is still developing its educational document on reserve ranges, and is considering the development of new guidance surrounding ASOP No. 43 and reserving processes and controls aimed at helping companies comply with the upcoming Model Audit Rule.
- The CATF, the Academy and the P/C Reinsurance Study Group are reissuing the "Risk Transfer Survey" that was completed initially in 2005. The purpose of reissuing this survey is to measure the improvement in the corporate governance of reinsurance and overall processes surrounding risk transfer. A recommended draft survey was presented by the Academy to the CATF in Houston. The task force will review and approve with necessary changes at the January conference call. This survey would be issued to companies by early February, with the results compiled in time for the Summer National Meeting.

Also on the topic of risk transfer, the Academy representative noted that the Academy presented a training course on reinsurance and risk transfer at the Financial Examiners meeting last month. The topics included the

basics of reinsurance pricing, what constitutes "reasonably self-evident" risk transfer, and other matters. The Academy will be working with the NAIC to develop this content into a webinar. In addition, the Academy will work with the task force and the P/C Reinsurance Study Group for assistance in enhancing training for actuaries and financial examiners on this topic.

Finally, the Academy will continue to monitor developments from the FASB as they consider updating guidance on risk transfer testing and disclosure requirements.

Financial Regulation Standards and Accreditation Committee

At the Winter National Meeting, the committee heard a report from its subgroup that has been considering comments received related to risk-focused examinations, including proposed revisions to the NAIC Financial Condition Examiners Handbook and the Review Team Guidelines (RTG).

A response was received back from the Risk Assessment Working Group on October 10, and the committee voted to adopt each of the proposed revisions to the RTG effective Jan. 1, 2008. The committee also noted that for examinations commencing prior to January 1, 2010, states will be asked to identify whether those examinations were completed under the current Specific Risk Analysis approach or the new risk-focused surveillance approach in preparation for a full accreditation review in order to determine on which set of review team guidelines the state will be judged.

The committee also voted to adopt the 2006 revisions to the Examiners Handbook developed by the Financial Examiners Handbook Technical Group related to the new risk-focused surveillance approach to conducting financial examinations that the technical group deemed significant to the accreditation process. Use of the new risk-focused surveillance approach will be required for all financial examinations commencing January 1, 2010, and later.

In addition, the committee also approved team members' comment regarding where the supervisory review of examination workpapers should occur. The committee concurs with the team members that given the use of TeamMate by an overwhelming number of states, supervisory review of examination workpapers do not need to

occur in the field work anymore but should still take place within the "reasonable period."

Examination Oversight Task Force

Financial Examiners Handbook Technical Group

The technical group met via conference call in November. During this call, the technical group discussed and adopted the following guidance to be included in the 2008 Examiners' Handbook:

- Changes to the Reporting Examination Progress and Findings section of the Handbook that provide one standard format for all full-scope financial condition examination reports
- Exhibit Y, Examination Interviews, which provides guidance to examiners discussing how and with whom exam interviews should be performed
- Exhibit Z, Examination Coordination, which provides a format for states to document their attempts at coordination in examining companies that are part of a holding company group.
- Revised guidance on the calculation of planning materiality and tolerable error which had not been included in the 2007 Handbook
- Guidance related to the use of materiality in selecting key activities to be tested under the risk-focused examination approach
- Guidance related to testing for state compliance requirements as part of a risk-focused examination.
- Guidance on relying on control test work performed by internal/external auditors in a prior period

Terrorism Insurance Implementation Working Group

The working group met in Houston in a joint meeting with the Government Relations Leadership Council and heard updates as to the status of proposed Congressional and Senate legislation to extend the Terrorism Risk Insurance Act. In September, H.R. 2761, the Terrorism Risk Insurance Revision and Extension Act of 2007 passed the House by a vote of 312-11. In October, the Senate Banking Committee passed a

significantly narrower bill that would extend the program for seven years and add coverage for domestic acts of terrorism. The working group was made aware that President Bush has threatened to veto the House bill, but would "reluctantly" support the Senate bill.

The working group then heard from a representative from the Terrorism Risk Insurance Program of the U.S. Department of Treasury on issues that insurance regulators and the Treasury will need to address once compromise legislation is adopted. The Treasury representative and the working group committed to work together as they have in the past to help implement the changes needed to disclosure forms and policy language. The Treasury representative stated that the Treasury would issue interim guidance on the disclosure forms, mandatory make-available provisions and the new required disclosures related to the \$100 billion cap if those provisions appear in the final law.

Climate Change and Global Warming Task Force

The task force heard from Björn Fischer of 3C, a company that provides carbon neutral services, regarding how the European Union and U.S. carbon trading markets function. He also provided information to the task force about a joint venture product involving 3C and Allianz called Ecomotion. This new product is designed to reward insurance clients who minimize CO2 emissions.

In addition, task force exposed its white paper entitled *Potential Insurance-Related Impacts of Climate Change on Insurance Regulators*, which it had been working on for some time. This white paper documents the potential insurance related impacts of climate change on insurance consumers, insurers and insurance regulators. The draft includes sections on investment issues and opportunities, social policy, property and casualty insurance industry challenges (including loss prevention and capacity issues), life insurer issues and health insurer issues. There is also a separate section for public policy decisions that can affect climate change and the frequency and severity of losses, including land use decisions and building codes, encouraging reductions in greenhouse gas emissions and providing low or no interest loss mitigation loans to make property improvements. Written comments should be provided by January 11. The white paper is expected to be completed by the Summer National Meeting.

Risk Retention Group Task Force

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

Following the Fall National Meeting the task force held a conference call in November and met in Houston. During the conference call the task force discussed the three comment letters received from trade associations regarding the draft reinsurance guidelines; the trade associations' comments were generally in support of the exposed draft.

In Houston, the task force made several editorial and substantive changes to the draft guidelines. The current draft provides that credit for reinsurance may be permitted in situations not meeting the criteria included in the Reinsurance Model Law and Regulation without posting collateral if: (1) the reinsurer maintains an A- or higher A.M. Best rating, or other comparable rating from another rating agency acceptable to the commissioner and maintains a minimum policyholder surplus in an amount acceptable to the commissioner and the reinsurer is licensed and domiciled in a jurisdiction acceptable to the commissioner; or (2) if the reinsurer satisfies various requirements, including filing audited financial statements with the state commissioner where the RRG is domiciled, maintaining a premiums written to surplus ratio of not more than 3 to 1 and submitting to the examination authority of the Commissioner.

The guidelines also indicate that, upon application, the Commissioner may waive some of the reinsurance requirements in circumstances where the risk retention group licensed as a captive insurer or reinsurer can demonstrate to the satisfaction of the Commissioner that: (1) the reinsurer is sufficiently capitalized based upon a review of the most recent audited financial statements; (2) the reinsurer is licensed and domiciled in a jurisdiction satisfactory to the

Commissioner; and (3) the proposed reinsurance agreement adequately protects the RRG licensed as a captive insurer and its policyholders.

For 2008, the task force is charged with reviewing the Part B: Regulatory Practices and Procedures and Part C: Organizational and Personnel Practices accreditation standards to determine their applicability to RRGs licensed as captives and will also consider whether additional accreditation requirements are necessary. As the Part A accreditation standards are not part of the 2008 charges, the task force was expected to finalize this section at the Houston meeting, however due to the substantive changes made during this session it was determined that further consideration was needed. A conference call will be held later this month to adopt the Part A recommendations, including the reinsurance guidelines. Previously, the task force has indicated that once all parts of the accreditation standards are considered the consensus recommendations will be submitted to the Financial Condition Committee and will likely be exposed for public comment in their entirety by the committee before finalization.

Disaster Reporting Working Group

The working group has been working the past year to revise the NAIC Disaster Reporting Framework to address concerns raised by interested parties on confidentiality of data submitted in response to catastrophic events. At the meeting of the Financial Condition Committee in Houston, the working group presented a revised Framework dated November 2007 and asked the committee to adopt the new Framework. The committee then heard comments from two trade associations, AIA and PCI, who stated their belief that the working group has not adequately addressed the confidentiality concerns of interested parties. Several regulators commented that the changes requested by industry were too onerous and the data being given to the NAIC is aggregate data, not individual claim data.

The Financial Condition Committee then voted unanimously to adopt the revised NAIC Disaster Reporting Framework. The Framework includes an overview, and sections on structuring a data call, communications with insurers, data collection systems, inter-state coordination, communication with other state and federal regulators and seven appendices.

NAIC Industry Liaison Committee

During the meeting, the committee received comments from three trade associations (AIA, PCI, and NAMIC) who presented questions on whether the NAIC has a formalized process for formulating and approving its policy positions, particularly in the context of congressional testimonies. They asked about what it entailed, whether they could participate in it and whether the NAIC would consider adopting a formal process for developing policy positions. They asserted that diversity in the regulatory community could lead to confusion.

The trade associations pointed to three categories of occurrences that gave rise to their confusion on NAIC policy positions 1) congressional testimony that seemed to be in conflict with working groups on the same issue, for example, NAIC testimony in favor of an "all perils" approach to insurance when the working group had rejected the policy; 2) NAIC members in their individual capacities, expressing ideas not known to be NAIC positions but advertised or shown on the NAIC website; 3) NAIC news or press releases praising actions by congressional members when it was not known to be settled NAIC policy or principles.

The chair responded that there is a process in place at NAIC for developing policy positions: staff would notify Commissioners, analyze issue(s), receive feedback, prepare a draft, circulate for comments, integrate and prepare it for final submission.

The next National Meeting of the NAIC will be held in Orlando March 28-April 1. We welcome your comments regarding issues raised in this newsletter. Please give your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor: Jean Connolly, Managing Director, PricewaterhouseCoopers LLP, 200 Public Square, 18th Floor, Cleveland, Ohio, 44114-2301 — (440) 893-0010 or jean.connolly@us.pwc.com.

Disclaimer

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

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