
NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2012 Summer National Meeting

The National Association of Insurance Commissioner held its Summer National Meeting in Atlanta August 10-14. 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 announced that Dr. Terri Vaughan will be stepping down as its CEO effective in early 2013. (page 3)
- The NAIC's newly formed Health Care Reform Alternatives Working Group began discussing alternative paths to implementing state-based exchanges being considered by various states. (page 3)
- The Joint Working Group of the Life Insurance and Annuities and Financial Condition Committees voted unanimously on August 28 to adopt its August 21 proposal on reserving for ULSGs under AG 38, effective year-end 2012 for certain in-force business and January 1, 2013 for new business. (page 3)
- The Statutory Accounting Principles Working Group adopted as final its SSAP 101 Question and Answers Implementation Guide for income taxes, and adopted revisions to reinsurance guidance to incorporate the concept of "certified reinsurer." The working group also adopted guidance to defer accrual of the annual fee mandated by the federal government under PPACA from 2013 to 2014, but added disclosure of the estimated effect in 2013 financial statements. (page 4)
- The Capital Adequacy Task Force adopted the 2012 RBC factors for deferred tax assets that will be applied to all three formulas. The C-1 Factor Review Subgroup is ready to begin bond modeling with new assumptions. The SMI RBC Subgroup heard reports on potential improvements to the P&C RBC formula, and the Life RBC Working group had detailed discussions on its two highest priority projects: revised factors for commercial mortgages and C-3 Phase 2. The Catastrophe Risk Subgroup adopted a requirement for companies to submit U.S. catastrophe loss data as part of their confidential 2012 RBC reports and non-U.S. catastrophe losses as part of a separate, informal process. (pages 8)
- The SMI Task Force discussed comments the NAIC will make to the IAIS on ComFrame; the task force also reviewed input received on its white paper on the future of U.S. insurance regulation. (page 11)
- After noting adoption of the Valuation Manual by the Life Actuarial Task Force, the PBR Working Group heard presentations from the American Academy of Actuaries on implementation and review of PBR and from the ACLI on critical open issues it would like to see resolved by year-end. (page 13)
- The Group Solvency Issues Working Group appears to have reached industry consensus on its Risk Management and Own Risk and Solvency Model Act and anticipates adoption by its parent committee on September 6th effective for 2015 filings. The ORSA Subgroup discussed in detail its review of ORSA Summary Reports as part of an ORSA pilot project. (page 13)
- The Corporate Governance Working Group exposed its draft Proposed Responses to Comparative Analysis for comment; this paper compares U.S. corporate governance requirements to the IAIS Insurance Core Principles and suggests recommendations for improvement to the U.S. system. (page 16)
- The International Accounting Standards Working Group heard updates on the insurance contracts and financial instruments projects of the FASB and IASB. (page 17)
- The Valuation of Securities Task discussed a potential shift toward more conservative assumptions in the 2012 financial modeling of RMBS and CMBS investments to the concern of many interested parties. The task force also authorized a new NAIC Credit Rating Provider and adopted an amendment to the SVO Purposes and Procedures Manual which allows the SVO to notch NAIC ratings designations downward for certain investments to reflect the existence of non-payment risk other than credit. The regulators also released a proposed statutory accounting framework for working capital finance investments. (page 19)
- The Reinsurance Task Force formed two working groups to assist states adopting the revised Credit for Reinsurance Model Law and Regulation and the concept of Certified Reinsurer. (page 21)
- The Captives and Special Purpose Vehicles Subgroup continued work on its draft white paper on the use and regulation of captives and

- SPVs, which recommends significant changes to the current regime. (page 22)
- The Blanks Working Group has adopted thirty blanks proposals as final since the Spring National Meeting, including a controversial proposal which requires insurers with separate accounts to file separate statements for insulated separate accounts and non-insulated separate accounts. (page 23)
- On a quickly scheduled call August 17th, the Life Insurance and Annuities Committee adopted the Valuation Manual, with a pledge to regulators and industry to continue to work on open issues with resolutions by year-end 2012. (page 25)
- The Life and Health Actuarial Task Force worked diligently over the spring and summer to complete the Valuation Manual, which they adopted August 2. (page 25)
- The Contingent Deferred Annuity Working Group received presentations from a consumer representative, the NAIC's Health and Life Policy Council, life insurance representatives and the U.S. Department of Labor as the working group evaluates the adequacy of existing laws and regulations as applied to CDAs. (page 28)
- The Separate Account Risk Working Group continued to analyze the definition and use of insulated products held in separate accounts. (page 29)
- The Financial Regulation Standards and Accreditation Committee voted to include the significant elements of the Risk-Based Capital for Health Organizations Model Act as accreditation requirements effective January 1, 2015. (page 29)
- The NAIC held a lengthy public hearing on lender-placed homeowners insurance. The host committees received testimony from consumer representatives, actuaries, insurance companies and industry trade associations. (page 30)
- The Casualty Actuarial and Statistical Task Force concluded it will pursue amending the P&C Actuarial Opinion Model Law to make it consistent with the disciplinary action provisions of the Life Actuarial Opinion Model Law. (page 31)

Executive Committee and Plenary

Note: All documents referenced in this Newsletter can be found on the NAIC's website at naic.org.

During Executive Committee's meeting in Atlanta, the Commissioners approved the removal of the Life Insurance and Annuities Committee's charge to review and consider revisions to the Viatical Settlements Model Regulation for consistency with the 2007 revisions made to the Viatical Settlements Model Act. However, at the subsequent meeting of Plenary, the larger group of Commissioners reversed this decision and reinstated the charge and the Viatical Settlements Working Group.

Adoption of New or Revised Models

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

- Updates to the Product Filing Review Handbook related to healthcare matters
- Updates to the Uniform Product Coding Matrices related to P&C inland marine and personal property lines
- Amendments to the Business Transacted with Producer Controlled Property/Casualty Insurer Act (#325) to remove the exemption for Risk Retention Groups.
- Amendments to the Health Insurance Reserves Model Regulation (#010) to reference a new table for the valuation of group long-term disability liabilities.
- Amendments to the Standard Nonforfeiture Law for Life Insurance
- Adopted The Use of Social Media in Insurance white paper
- Adopted the Uniform Suspected Insurance Fraud Reporting Instructions and Form

Resignation of NAIC CEO

At the close of the Summer National Meeting, the NAIC issued a press release announcing the resignation of its chief executive officer Dr. Theresa Vaughan; Dr. Vaughan plans to depart sometime in the first quarter of 2013 and the NAIC is working to find a replacement.

FIO Update

The Treasury Department's Federal Insurance Office (FIO) was expected to complete and issue its report to Congress on how to modernize the insurance regulatory system in January 2012. The report still has not been issued. During the fall, the FIO will be collecting data on behalf of the IAIS for the global systemically important insurers (GSII) determinations.

Health Care Reform

Health Reform Solvency Impact Subgroup

The subgroup met four times in April and May and adopted proposed revisions to the 2012 Supplemental Health Care Exhibit which were subsequently adopted by the Blanks Working Group (see page 24). With respect to its new charge to develop a reconciliation between the Supplemental Health Care Exhibit and the HHS MLR rebate form, the subgroup drafted a proposed reconciliation form during the spring, but industry expressed significant concerns regarding the timing for completion of the form for 2012, the cost of implementation and confidentiality issues related to variance explanations. Alternatives to company preparation for 2012 included suggestions that the reconciliation be completed by NAIC staff or by regulators as part of an examination or exception report. The subgroup members agreed to postpone adoption of the reconciliation to allow for further discussion later this year.

Health Care Reform Regulatory Alternatives Working Group

In Atlanta, the Health Insurance and Managed Care Committee established the Health Care Reform Regulatory Alternatives Working Group. The committee noted that more than half of the states are currently considering alternative paths to implementing PPACA-compliant state-based exchanges. The new working group will provide a forum for discussion of the alternatives being considered by state regulators, and will consider the implications of such alternatives on NAIC member regulatory authority. The committee was clear that

the working group is not intended to be a forum for criticizing federal healthcare reform, but it is tasked with identifying opportunities for NAIC members to continue to innovate and regulate outside of a federal exchange.

The working group held an unscheduled first meeting after being appointed by B Committee. There are currently only two members, Pennsylvania and Wisconsin, and the additional states are needed for the working group. Once the full working group is formed, the regulators will accumulate questions and issues for the group to address, and a series of conference calls will be scheduled for the early fall.

Joint Working Group

The Joint Working Group of the Life Insurance and Annuities Committee and the Financial Condition Committee was formed at the 2011 Fall National Meeting to address the contentious issue of reserving for universal life products with secondary guarantees (ULSGs). While much of the NAIC's work over the spring and summer on resolving the reserving issue for ULSG products under Actuarial Guideline XXXVIII (AG 38) was performed behind the scenes, the joint working group held two public hearing conference calls prior to the Summer National Meeting. During these calls, the joint working group provided a status of their work and received comments from regulators and interested parties.

The joint working group's framework calls for splitting the revised guidance between policies written between July 1, 2005 and December 31, 2012 and new business written on or after January 1, 2013 (and prior to the effective date of PBR). For existing business at year-end 2012, a new section 8D will be added to AG 38 which establishes reserves as the greater of (1) those calculated using the reserve methodology and assumptions for which the company filed their year-end 2011 annual statement, and (2) reserves calculated using the same requirements for deterministic reserves under VM-20 of the most recently adopted Valuation Manual with modifications for net investment income and discount rates. This new section does not apply if minimum gross premiums for the policies are determined using the lowest premiums in the policy regardless of terms in the policy that limit the use of those premiums. The most recent revisions also include an exemption for companies with immaterial amounts of ULSG that fall under this section of the guidance. In addition, those companies required to comply with this new section 8D will also be required to file an actuarial memorandum by April

30th each year to support year-end valuations. The first actuarial memorandum will be due April 30, 2013.

For new business written in 2013 and later, a new Section 8E will be added to AG 38 which is similar to the existing requirements of Section 8C with modifications for determining minimum gross premiums. Those modifications include two options: (1) for products meeting one of three described policy designs (expected by regulators to be the majority of product designs), using the minimum premium in the policies with limitations on policy credits tied to the composite yield on seasoned corporate bonds as published by Moody's Investors Service, and (2), for other designs, using the lowest schedule of premiums that keeps the policy in force and produces the greatest deficiency reserve at issue.

The joint working group has been advised by their consultants to refer to the NAIC's PRB Working Group the possibility of, once adopted, making PBR retroactive for products covered under AG 38. It is not clear whether the joint working group will follow that advice nor what the PBR Working Group would do with such referral.

Industry representatives continued to express concern that the current draft is too conservative, that it makes some elements of PBR effective retroactively and that there is not enough time for companies to implement these solutions by year-end 2012 for the in-force business. In Atlanta, the chair of the joint working group reiterated the regulators' intent to adopt with the effective dates discussed above. After the Summer National Meeting, the joint working group exposed a significantly revised proposal dated August 21, and held a conference call on August 28 to discuss the proposed guidance. Despite an extremely short 7-day comment period for a relatively complicated document, the joint working group unanimously voted to adopt the proposed changes to AG 38. Interested parties were not given an opportunity to comment during the call. The guidance must still be adopted by the parent committees of the joint working group as well as Executive Committee and Plenary, but approval by these committees is expected.

Statutory Accounting Principles Working Group

The working group met twice in both May and June via conference call and in Atlanta and discussed the following issues. (After each topic is a reference to the SAP Working Group's agenda item number.)

Adoption of New Standards or Revisions to SSAPs

SSAP 101 Questions and Answers Implementation Guide (Agenda item 2011-42) – The working group adopted the proposed Q&A (revised at the Spring National Meeting) after two public hearing conference calls in May. Most of the discussion related to paragraphs 2.5 and 4.13, which interpret paragraph 11.c of SSAP 101, on calculating gross deferred tax assets and liabilities and admitted adjusted gross DTAs and the contentious issue of scheduling reversals of DTAs and DTLs.

The regulators and interested parties ultimately agreed on an interpretation that paragraph 11.c does not require the scheduling of temporary difference reversals beyond what is necessary to support the statutory valuation allowance assertion. The Q&A clarifies that the requirement to “schedule reversal patterns” generally only applies to filers that used DTLs as a source of income to meet the “more likely than not” statutory valuation allowance test. However, the Q&A further states that “there may be circumstances that affect the ability of a reporting entity to offset DTLs against DTAs” and that such information should be considered. During the May 7 public hearing, interested parties acknowledged that companies are not allowed to have a “free pass” when making determinations under paragraph 11.c. The Q&A also provided further clarification that both the statutory valuation allowance assessment and DTA admissibility test are performed on a separate company, reporting entity basis.

The long process to adopt SSAP 101 and the related Q&A concluded with comments from interested parties thanking the working group and NAIC staff for engaging in a collaborative process to reach a long-term solution for income taxes. The commissioners adopted the SSAP 101 Q&A during their Executive and Plenary session on August 14.

SSAP 61 and SSAP 62 Amendments to Incorporate the Concept of Certified Reinsurer (2011-10 & 11) – During its June 7th conference call, the working group adopted the proposed revisions to the reinsurance SSAPs to provide specific accounting guidance for reinsurance ceded to certified reinsurers, a concept that was adopted by the NAIC as part of the Reinsurance Modernization Framework. The guidance defines a certified reinsurer as "an assuming insurer that does not meet the requirements to be considered authorized in the domestic state of the ceding insurer, but has been certified by such state and is required to provide collateral as security for its reinsurance obligations incurred under contracts entered into or renewed on or after the effective date of certification."

During its June 7th conference call, the working group exposed proposed guidance and disclosures to both SSAP 61 and 62 related to certified reinsurers which have been downgraded. That proposed guidance has been exposed until October 5th. All the new guidance is expected to be effective December 31, 2012.

Appendix A-785, Credit for Reinsurance (2012-12) The working group adopted proposed revisions to Appendix A-785 to reflect the recent changes to the Credit for Reinsurance Model Law. (This is the version of the model law maintained in the APP Manual.) The changes are extensive and also include the concept of certified reinsurer discussed above. The revisions are effective December 31, 2012.

SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers (2011-38) – Last November, the working group had exposed for comment a proposed conclusion that the guidance in ASU 2011-06 be rejected for statutory accounting and instead proposed that SSAP 35R prescribe the accounting for the annual fee mandated by the Patient Protection and Affordable Care Act. These proposed changes would require accrual of the annual fee on health insurers in 2013, instead of 2014 as prescribed by ASU 2011-06. Insurance entities subject to the fee strongly objected to this proposed accounting, arguing that the no liability arises in 2014 and requiring accrual in 2013 would create complexity and cause unintended harm to industry and consumers.

The SAP Working held a joint conference call with the Financial Condition and the Health Insurance and Managed Care Committees to discuss the issue on June 29 (the day after the Supreme Court decision on health care reform was announced). The

regulators announced that they will not require accrual of the fee for 2013 because "the relevant section of the Affordable Care Act does not go into effect until 2014." However, because companies will have "sufficient information" to estimate the dollar effect of the assessment at year-end 2013, the SAP Working Group proposed a disclosure in the 2013 annual and audited statements in accordance with SSAP 9, Subsequent Events. The proposed disclosure "shall provide information regarding the nature of the assessment and an estimate of its financial impact, including the impact on its risk based capital position." Companies would also be required to consider whether to present pro forma financial information regarding the impact of the assessment, based on materiality. The working group adopted this disclosure at the Summer National Meeting.

The second phase of the project is to determine how to account for the assessment in 2014 and subsequent years. The working group plans to hold interim conference calls this fall to develop guidance. During its meeting in Atlanta, the working group briefly discussed accounting issues related to the fee, including whether the expense should be recognized ratably for the first nine months of 2014 as the assessment will be paid in September 2014 or whether the entire expense should be recorded as of January 1, 2014. The working group will also need to conclude whether a liability should be accrued at the end of 2014 for the following year's assessment.

SSAP 104 – Share-Based Payments (2006-13) – The working group adopted this SSAP as final, which incorporates guidance from FAS 123R, will supercede SSAP 13, and is effective prospectively as of January 1, 2013, with early adoption as of December 31, 2012 permitted.

SSAPs 48, 97 and 68 "Basis Differences" (2012-05) The working group adopted a clarification to three SSAPs that the basis difference between purchase price and underlying GAAP equity of minority owned SSAP 48 entities should be amortized, similar to goodwill for SCA entities. The guidance will be effective January 1, 2013 for entities that had previously not been amortizing the basis difference, and is to be applied prospectively to new and existing minority-owned investments.

ASU 2011-02, Receivables-A Creditors' Determination of Whether a Restructuring is a Troubles Debt Restructuring (2011-25) – At the 2011 Fall and 2012 Spring National Meetings the working group exposed revisions to adopt guidance from ASU 2011-02 into SSAP 36 to provide additional guidance on whether a restructuring

constitutes a troubled debt restructuring. The working group also proposed additional disclosures for creditors that pertain to all troubled debt restructurings.

In Atlanta, the working group reviewed comments from interested parties and rejected their request to delete the additional disclosures not required by ASU 2011-02, as the regulators believe the disclosures will be valuable. The proposal was modified to require disclosures only in the audited financial statements and was adopted effective January 1, 2013, with early adoption permitted.

SSAP 26 and Credit Tenant Loan Disclosures (2012-13) – The working group deleted the requirement for credit tenant loan disclosures in the SSAP 26 bond footnote of the audited financial statements because this separate category was eliminated from Schedule D in 2011.

SSAP 11 and EITF 06-2 (2012-01) – The working group adopted proposed changes to SSAP 11 on postemployment benefits to address this EITF guidance on sabbatical leaves. This guidance requires that the compensation cost associated with a sabbatical or other similar benefit arrangement be accrued over the requisite service period when conditions of paragraph 6 of FAS 43 are met.

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

EITF 07-1, Accounting for Collaborative Arrangements (2012-02) – The working group rejected this recently issued GAAP guidance as not applicable to statutory accounting.

Movement of Guidance within the APP Manual
The working group adopted the following placement revisions within the Manual, which are not intended to change statutory accounting:

- SSAP 77, Real Estate Sales, is nullified and its guidance is moved to SSAP 40, Real Estate Investments. (2012-06)
- SSAP 86 guidance currently shown as a criteria for a hedged forecasted transaction (par. 21e) is moved to reflect it as a criteria for a fair value hedge (new par. 19f). (2012-08)
- SSAP 95 (par. 18) guidance on long-lived assets to be disposed of other than by sale is moved to SSAP 90, Accounting for the Impairment or Disposal of Real Estate Investments. (2012-19)

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

SSAP 100 and Review of ASU 2011-04 (2012-14)

At the Spring National Meeting, the working group exposed for comment proposed revisions to SSAP 100 to adopt, with some modifications, the GAAP guidance in ASU 2011-04, Fair Value Measurements. The working group wants the guidance to mirror U.S. GAAP as much as possible, but has also proposed rejecting the guidance for fair value of liabilities, including non-performance risk, and had proposed expanded disclosures. At the Summer National Meeting, the working group briefly discussed comments from interested parties who noted two substantive concerns. Firstly, interested parties object to expanding the ASU 2011-04 disclosures to non-public companies for certain items. Secondly, while interested parties agree with rejecting the guidance related to non-performance risk, they believe the GAAP guidance related to the fair value of a liability when quoted prices in an active market for an identical liability are not available is valuable and should be considered.

The working group directed staff to begin work on an Issue Paper to adopt ASU 2011-04 with the specified modifications and to work with interested parties to address their comments. An effective date for the proposed new standard was not discussed.

Disclosure of Permitted Practices (2012-04) – The working group exposed for comment a proposal to amend SSAP 1 to require disclosure in each applicable financial statement note if the amounts reported in that note have been adjusted by state prescribed or permitted practices. This would be in addition to the certain disclosures related to practices that differ from NAIC prescribed.

Policyholder Loyalty Program Obligations (2012-15)

The working group exposed for comment proposed amendments to SSAP 65, P&C Contracts, to address loyalty program benefits declared by the insurer's board of directors that will be payable in the future to the policyholder if a triggering event occurs such as death, disablement or retirement.

Actuarial Calculation of DDR Reserve (2012-16)

In response from a request from an actuarial consulting firm, the working group exposed proposed revisions to SSAP 65 on additional guidance on reporting the death, disability and retirement (DDR) reserve. The Form A for the proposal states that current guidance has been inconsistently applied. The working group will also

ask the Casualty Actuarial and Statistical Task Force its views on the proposal and will ask the Reinsurance Task Force how reinsurance transactions involving the DDR reserve affect the reporting of the reserve.

ASU 2011-22, Disclosures about Offsetting Assets and Liabilities (2012-17) – In its on-going review of newly issued U.S GAAP guidance, the working group considered ASU 2011-22 and concluded that for comparable financial information among insurance entities, the following is proposed: 1) revise and clarify guidance to ensure offsetting only in accordance with SSAP 64 and incorporate disclosures for when offsetting occurs; 2) remove existing guidance in SSAP 103/91R that allows offsetting for repurchase and reverse repurchase transactions in accordance with master netting agreements; 3) clarify in SSAP 86 the rejection of GAAP guidance that allows offsetting for derivative transactions under master netting agreements; and 4) reject ASU 2011-11.

Additional Pension and OPEB Guidance (2012-18 & 19) – The working group exposed for comment three additional implementation examples for underfunded pension plans with a prepaid benefit cost (no deferral elected, deferral elected with a funded ABO and deferral elected with an unfunded ABO). Also exposed for comment was a proposed change in the effective date of the measurement date change from January 1, 2013 to December 31, 2013 and clarification that INT 03-18, Accounting for the Change in Additional Minimum Liability, is nullified by SSAP 102.

APP Manual References to AROs – The working group exposed for comment proposed revisions to replace the reference of Approved Rating Organization (ARO) to the newly adopted term Credit Rating Provider (CRP) in the APP Manual Glossary, SSAPs 41 and 62R and INT 04-02.

SSAP 43R Subgroup – At the request of interested parties, the working group formed a subgroup in 2011 to study whether the recently revised definition of loan-backed and structured securities in SSAP 43R should be further clarified or amended. Due to conflicts, the subgroup has not yet met, but has scheduled an organizational call with the SAP Working Group on September 6th.

ASU 2010-20 Receivables-Disclosures About the Credit Quality of Financing Receivables and the Allowance of Credit Losses (2011-22) – The working group briefly discussed proposed revisions to incorporate GAAP “financing receivable” disclosures specific to mortgage loans. They agreed to defer this

item in order to receive input from the NAIC/AICPA Working Group.

Impact of Loss Portfolio Transfer on Provision of Reinsurance (2011-45) – The working group will hold an interim conference call to discuss this proposal from a large P&C insurer, which addresses situations where collection risk for third party reinsurance has been transferred and secured by the counterparty in a LPT, but novation has not occurred.

Title Insurance Bulk Reserves – The working group agreed to take on a project to clarify the accounting for title insurers’ bulk reserves as requested by the Financial Analysis Working Group. NAIC staff was directed to begin drafting an Issue Paper and the Title Insurance Financial Reporting Working Group will be asked to participate.

Restricted Asset Issues – The working group discussed a referral from the Financial Analysis Working Group requesting research and discussion of certain guarantees and other financial activities that have pledge-like restrictions. The working group asked NAIC staff to begin work on addressing the issues including consideration of enhanced disclosures.

LATF Response on Treatment of Reinsurance – The working group received a short report on the treatment of reinsurance in VM-20, Life Insurance, which could change the current methodology for calculating the credit for reinsurance. The working group did not take any action on the report.

Update on FASB/IASB Insurance Contracts – The working group heard an update from representatives from two property/casualty insurers on insurance contracts convergence efforts. They have significant concerns related to the requirement to discount non-life claims reserves and asked the NAIC to write a comment letter this fall to the FASB and IASB. The working group asked for the comment letters sent by industry to the FASB and IASB, and NAIC staff will draft discussion points for a future conference call.

Emerging Accounting Issues Working Group

The working group voted to nullify fifteen INTs issued in 2001 and include the guidance directly in the relevant SSAPs.

Capital Adequacy Task Force

RBC Deferred Tax Proposal

Via an email vote June 15, the task force adopted the RBC DTA proposals that had been re-exposed for comment at Spring National Meeting, with some clarifying guidance added to the instructions. The revised charges will be effective for 2012 RBC filings.

Restricted Assets

The task force voted to add a referral from the Financial Analysis Working Group to its working agenda. FAWG is concerned with some companies' material amount of invested assets which are restricted in some way (excluding reinsurance collateral and licensure deposits to state insurance or treasury departments.) One regulator suggested an RBC treatment where the charge increases as the level of restricted assets increases. The task force will hold a regulator-only call to get additional detail from FAWG.

Title RBC

The task force agreed to participate on a new Title Insurance and Capital Adequacy Joint Subgroup and consider whether a title RBC formula is necessary. See further discussion on page 32.

Confidentiality

The SMI RBC Subgroup had a charge to consider whether or not the RBC results should continue to be public information. The subgroup communicated to the task force that it believes this issue should be addressed by them. In the task force's discussion of this topic in Atlanta, one regulator noted that RBC is "frequently misused" and that it is not a proxy for more sophisticated solvency benchmarks. The task force asked for input from interested parties regarding whether or not the RBC results should continue to be public or should be confidential. Comments are due within 30 days.

C-1 Factor Review Subgroup

The subgroup continues to consider a recalibration of RBC C-1 factors. The C-1 factors are used in the RBC calculation and are intended to capture an asset's risk of default of principal and interest or fluctuation in fair value. These factors have not been updated since 1991. The subgroup has met frequently since the Spring National Meeting and continues to focus primarily on the bond modeling project. The AAA has taken the lead on the modeling project and has provided periodic updates to the subgroup on its progress.

At the Summer National Meeting, the Academy representative noted that they had completed the development of the bond model which replicates the 1991 model. When using the 1991 scenarios and assumptions, the new model generates the same or very similar C-1 factors. The model can now be utilized to generate revised factors using new assumptions. The subgroup discussed considerations regarding the selection of a cumulative bond default rate. One significant consideration is whether to use the last 10 years or last 20 years of bond default data. While the number of below investment grade issues has increased significantly in the last 10 years, the subgroup seems to be favoring the 20-year period so as not to overly influence the determination of the C-1 factors with recent market experience. Another significant consideration is whether to use S&P or Moody's default rate experience. It was noted that there are significant differences in the way the two ratings organizations measure default experience. Moody's, which was used in the 1991 factor determination, excludes securities from its default experience if it has withdrawn its rating, while S&P continues to include these securities in its calculations. The subgroup is likely to select the S&P data, believing this approach is a more accurate portrayal of default risk.

The Academy outlined its remaining project plan for bonds, noting that over the next few months it will finalize its selection of assumptions, construct representative portfolios of 400-600 securities, and run the bond model to develop proposed factors. The Academy expects to present granular details of its results at the Fall National Meeting. It is anticipated that the subgroup would be in a position to endorse the methodology and assumptions by February 1, 2013. The Academy's preliminary analysis will present results for each bond rating category. The subgroup will consider the results, and a decision as to whether to expand the number of NAIC ratings designations from the current 6 to either 12 or 18 is expected by March 31, 2013.

The subgroup also received updates from subgroup members on their consideration of the following asset classes: common stock, mortgages, real estate, derivatives and other invested assets. The C-1 factor considerations of these asset classes are not as advanced as the bond C-1 factor considerations. The subgroup also discussed the need to understand how the 1991 AVR factors were selected in determining how AVR should be considered in the subgroup's work.

Once the subgroup has completed its work it will make a proposal to the Capital Adequacy and Valuation of Securities Task Forces, with a goal of implementing the revised C-1 factors for the 2014 RBC calculation. The subgroup expects to hold bi-weekly conference calls over the next several months to continue its considerations.

SMI RBC Subgroup

The subgroup met by conference call in July and then in person in Atlanta. A significant part of the subgroup's discussions over the summer related to the ongoing research carried out by the American Academy of Actuaries into potential improvements to the methodology for risk diversification and the underwriting risk charge within RBC.

On request from the AAA, the Casualty Actuarial Society formed two working groups to carry out research into each of the questions, and draft reports from these working groups were presented to the subgroup by the AAA in Atlanta. Both reports state that they are purely research projects, and do not make any recommendations with respect to revisions to RBC. Both reports consider whether the formula can be improved significantly within its current structure, followed by whether improvements could be made to the current structure. The reports explain the research carried out by the groups, including comparison to other capital formulas including rating agency models and the proposed Solvency II standard formula.

The reports both identify a number of areas where RBC could be improved, both within its current structure and by changes beyond the structure. The first report, covering "dependencies and calibration in the P&C RBC formula including the extent to which risk diversification should be reflected in the formula," suggests the following initial deficiencies in the RBC formula, while noting that further research is being carried out that may change the conclusions:

- The adequacy of the RBC is lower than the initially established level, including the insufficient reflection of catastrophe risk.
- Charges are relatively too low or too high for certain types of companies.
- Safety level standards are not specified.
- Dependency among risks is not properly reflected.
- Simplifications in RBC do not properly reflect risk in total or differences by company.

The second report, covering underwriting risk, raises the following initial results:

- Current data sources do not provide enough information for stable estimates of RBC factors from one calibration cycle to the next.
- Current data filtering methods eliminate a significant amount of experience from the current calibration method.
- Basing the RBC reserve risk factor on empirical reserve run-off ratios exposes the factors to high volatility from one period to the next.
- The current calibration method may understate the reserve risk charge for companies with smaller booked reserves and overstate the charge for companies with larger booked reserves.
- The fixed investment income offset discount factor of 5% is inconsistent with the current environment.
- RBC currently measures risk over the claim run-off period, while Solvency II uses a one-year time horizon; RBC reserve risk factors are illustrated in the report on the basis of a one-year horizon.

Work on the projects by both CAS working groups is ongoing; per the Academy the project represents a significant and challenging research effort, and may take some time to complete. In particular, detailed work on calibration of RBC would require a significant investment of time and resource. The subgroup discussed the implications of the research project timing, and whether it would fit the overall timeline for the SMI. The subgroup discussed the potential to ask additional resources to support the project, potentially through a university, and also agreed to consult with the SMI Task Force and Capital Adequacy Task Force on whether it should proceed with research requiring this magnitude of time and resources.

The subgroup discussed the potential inclusion of a specific charge for operational risk in RBC. While initially agreeing that operational risk should not be included, the subgroup re-opened the question in Atlanta, and agreed to carry out further research, including what data would be needed to quantify operational risk, and the stress tests that could be developed, following guidance in ICP 17, Capital Adequacy. The subgroup also discussed seeking further guidance on whether operational risk should be covered through an RBC charge, or through the ORSA or corporate governance requirements.

The SMI Roadmap indicates that historical documentation of RBC should include determination of the average calibration of RBC, and the subgroup discussed this point on its July conference call. The subgroup discussed establishing and documenting the calibration of individual risks where possible, and potentially a confidence level and time horizon to use as a reference point for future work on RBC. The subgroup noted that the determination of such a confidence level and time horizon would not necessarily lead to an overall effort to recalibrate RBC accordingly. However, in Atlanta, the subgroup also noted feedback asking it to continue discussions on the calibration of RBC, and indicated that it would hold further discussions on this topic.

Life Risk-Based Capital Working Group

The working group met in June and August via conference call and in person in Atlanta and discussed the following projects.

Long-Term Commercial Mortgage Project

The working group spent substantially all of its time during the three meetings discussing the commercial mortgage RBC proposal; extensive work on this project seems warranted given the ACLI estimate that total commercial mortgages constitute approximately \$325 billion (9%) of life insurers' general account assets.

In connection with these discussions, the ACLI updated its October 31, 2011 written proposal with a more detailed proposal dated May 18, 2012. The revised document includes more description of the ACLI's commercial mortgage modeling process and how the ACLI worked with Moody's Analytics "to simulate the historical performance of hypothetical loans with defined debt service coverage and loan to value ratios, property types and amortization maturity periods." This modeling produced five new risk categories for commercial loans in good standing, which the ACLI proposes to be .9%, 1.75%, 3%, 5% and 7.5% for CM1 through CM5, respectively. No change is proposed to the current RBC charges for past due mortgages (18%) and mortgages in foreclosure (23%).

The most contentious issue in the ACLI proposal is the use of a standardized 25 year amortization period for debt service coverage, which the ACLI believes will "level the playing field" between different types of loan structures and is much less complex than using the actual amortization period for individual loans. The regulators and interested

parties discussed this issue at length in all three meetings and at the conclusion of the meeting in Atlanta the regulators decided that they will need still more information before concluding on the standard amortization period, including additional information on the new S&P mortgage methodology, which does not use standardized amortizations. The working group and interested parties will have to work quickly to resolve these issues, as the entire proposal will need to be adopted by the end of the year to be effective for 2013 RBC; the proposal has not yet been exposed for public comment.

C-3 Phase 2/ AG 43 Subgroup

The subgroup held two interim calls prior to the Summer National Meeting to discuss this high priority project related to potential changes to the reserving and capital requirements for variable annuities. In addition to discussing the subgroup's charge of an in-depth analysis including company experience in light of recent economic events, the group discussed recommendations from the ACLI and New York regulators.

The ACLI's letter addressed the need to align AG 43 with C-3 Phase II and its view that the standard scenario of AG 43 has been too dominant in practice. New York's recommendations included updating the equity scenarios for the standard scenario of AG 43 to reflect recent volatility experience, proposed requirements to recalibrate a model if it does not validate, revisions to the discount rate for in-the-money benefit streams and counterparty risk. The subgroup's second call focused more on defining the goals of the subgroup and determining a basis for measuring and evaluating the overall effectiveness of changes. The subgroup is planning an interim conference call to further discuss a draft work plan.

Catastrophe Risk Subgroup

Since the Spring National Meeting, the subgroup held three conference calls and met in Atlanta to continue development of a catastrophe risk charge for the P&C RBC formula. When the new catastrophe risk charges for earthquake and hurricane are implemented in the RBC formula, it will be necessary to remove earthquake and hurricane losses from the premium risk charge to avoid double-counting of the risk. It is anticipated that the catastrophe risk elements will be implemented on an informational basis in the 2013 RBC reporting. Full implementation, which will mean incorporating earthquake and hurricane modeled losses into the RBC requirement, will occur later after a review period of two years or possibly more.

In order to obtain sufficient data to calculate the revised new industry underwriting risk charge adequately, updates were made to the 2012 Schedule P, Part 1. The subgroup received approval from the Capital Adequacy Task Force to gather U.S. catastrophe loss data for earthquakes, hurricanes and tropical storms in the confidential RBC Report for 2012. The subgroup adopted a motion for a separate, informal requirement be established to submit the non-U.S. catastrophe losses that are in excess of \$100 million industry-wide total to NAIC staff so the data can be analyzed separately from the U.S. catastrophe losses. This approach would separately capture both U.S. and non-U.S. catastrophe losses, and thus would allow separate evaluation of the data quality and completeness of each set. The main disadvantage of this approach would be the use of an informal channel that would require extra effort from NAIC staff and might negatively impact the completeness of reporting for the non-U.S. catastrophe losses. This difficulty could be eliminated after one year's reporting by revising the RBC report's data input sheets to require separate reporting of U.S. and non-U.S. catastrophe losses through the official reporting channel in the future.

At the Summer National Meeting, the subgroup discussed the status of the non-U.S. catastrophe data-collection issue relating to concerns over data source and quality of data. The subgroup heard a presentation from Reinsurance Association of America who noted that there are three global sources of catastrophe data. The American Academy of Actuaries noted that definitions may vary between U.S. and non-U.S. data collection, e.g. hurricane vs. wind event or tropical storm; it would also be beneficial to obtain data at different threshold levels. The working group will continue to study data collection issues.

At the Summer National Meeting, the subgroup determined that it will revisit the timeline and necessary steps for implementation of formula on an information-only basis for the 2013 annual statement at its next meeting. The working group will also assess implementation and examination issues in future meetings.

Property/Casualty Risk-Based Capital Working Group

The working group discussed a referral from the Risk Retention Group Task Force requesting a review of the additional guidance for RRGs to be included in the Property and Casualty RBC Instructions. The instructions were exposed for a 21-day comment period ending September 2. The working group

reviewed changes to Schedule F for the new certified reinsurer categories. The working group then discussed two major issues related to the RBC Credit Risk Charge for Reinsurance Recoverables: whether the 10% risk charge is too high and whether collateral should be permitted to offset the reinsurance recoverable for RBC purposes. These issues yielded comments from working group members and interested parties. One issue raised was whether another risk is created i.e., asset risk related to the collateral. It also brings into question the quality of the collateral as not all letters of credit provide the same protection. Adverse development risk is another issue as it was not contemplated when the 10% risk charge was developed. Coverage disputes also require consideration. The working group plans to continue discussing these issues in future meetings.

Health Risk-Based Capital Working Group

The working group held a conference call on July 11 and continued discussion of its 2012 Working Agenda. It was noted that the American Academy of Actuaries will be performing a series of studies on the healthcare receivable factors after it receives additional data from the NAIC staff. The Academy expects its analysis will be completed by the end of 2012.

The working group continues to monitor the impact of federal health care reform on the Health RBC formula. The chair noted that the Health Care Reform Actuarial Working Group held a conference call to review the provision of the federal Affordable Care Act (ACA). Several items were identified as requiring consideration in the Health RBC formula, for which the impact to the RBC formula is not anticipated to be significant. An NAIC staff recommended that the working group monitor the trend of the total adjusted capital closely. It is anticipated that the growth of insurer revenues will be significant due to the ACA provisions and as such, the trend of the total adjusted capital will likely increase. The working group requested for the NAIC staff run a report to determine the impact on the total adjusted capital, which will be discussed in the next conference call.

The working group also discussed issues related to industry segment concentration risk. AAA has held conference calls to discuss how to quantify the risk, but no concrete solution could be provided at this time. The chair recommended a review of the 2007 and 2008 data as a starting point to evaluate the relationship between the industry segment

concentration risk and the downturn of the economy.

The working group discussed underwriting risk and investment risk, noting that to determine the interrelationship between the two risks, a review of the data for the past six years should be performed. A data request to the NAIC staff is anticipated soon. It was also noted that AAA may perform a review of the relationship between reputation risk and investment risk.

Solvency Modernization Initiatives Task Force

Prior to the discussion of the agenda, the SMI Task Force recognized the outstanding work of its former chair, Director Christina Urias of Arizona, who retired in June. The task force is now chaired by Director John Huff of Missouri. The task force then discussed the following topics.

ComFrame

The task force discussed the Common Framework for the Supervision of Internationally Active Insurance Groups (IAIGs) in Atlanta. The current working draft of ComFrame was released by the IAIS for public comment in July, with remarks due by August 31. The task force has been developing comments to submit to the IAIS, together with the International Insurance Relations Committee. The comments were presented to several NAIC working groups in Atlanta, and the key themes discussed across all the working groups are summarized in this section.

While it remains highly supportive of the objectives of ComFrame, the NAIC views the current draft, in particular module 2 (covering governance, ERM, structure and strategy, financial condition and reporting and disclosure) and module 3 (covering the group-wide supervisory process, supervisory cooperation, and crisis management and resolution), as too prescriptive. Discussions in Atlanta indicated that this comment applies both for supervisors and IAIGs, for which ComFrame risks implementing an additional layer of regulation, in particular given that the NAIC considers there to be significant overlap with the IAIS Insurance Core Principles. The NAIC supports a more flexible and outcomes-based approach that will allow for variations in insurer business models and that will allow supervisory practices to develop.

The NAIC's comments also cover the working assumption in ComFrame that IFRS will be used as a

reference framework for valuation. The comments note that the NAIC had formerly supported the use of IFRS, which was based on the expectation of a converged IFRS/US GAAP standard for insurance contracts. Given the uncertainty in whether convergence will take place, the NAIC's now recommends that any high quality set of financial accounting standards (which discussions indicated would include U.S GAAP and SAP) may be used by IAIGs for valuation purposes, providing they are consistently applied at group level.

The NAIC's comments also question the current strategic direction of ComFrame towards a partly harmonized approach to capital requirements for IAIGs. While the NAIC notes that it is supportive of supervisors assessing capital at group level, it is not supportive of a move towards a single global capital standard for IAIGs. The NAIC intends to submit its comments by the August 31 deadline.

SMI White Paper

The task force also discussed and heard comments from industry representatives on its draft white paper "The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative." The paper provides an overview of the U.S. regulatory system, structured in 4 sections:

- The United States Insurance Financial Solvency Framework and Core Principles
- Regulating for Solvency Protects Consumers: U.S. Insurance Regulatory Oversight
- Effective and Efficient Markets Protect Consumers – Analysis of U.S. Markets
- Solvency Modernization Initiative – Future of U.S. Financial Insurance Regulation

The paper provides an overview of the U.S. market and regulatory system, and the industry representatives and trade associations who provided comments in Atlanta all expressed support for a white paper on this topic but that some improvements should be made.

Industry representatives provided an overview of their comments to the task force, the majority of which were focused on enhancing the technical accuracy of the paper, including variations between life and P&C practices, and supporting the assertions made. However, further clarity was also sought on the purpose of the paper and intended audience. In particular, industry groups noted that the paper presents a strong message on the success of the U.S. regulatory system. While agreeing that the U.S. regulatory system has been successful,

commentators encouraged the task force to make sure that all assertions made are fully supported in the paper, as well as to recognize that regulation in different states is not necessarily consistent. Industry representatives also suggested revisions to the mission statement and that the paper be updated for recent and proposed future changes to U.S. regulation. The task force indicated that it would schedule an interim conference call to continue to discuss the comments.

SMI Roadmap

The task force asked NAIC staff to update the Roadmap for current activity and policy positions.

PBR Working Group

The working group met in Atlanta, and received a presentation from the American Academy of Actuaries. The presentation covered the implementation and review of PBR after adoption by the states; the Academy discussed the transition to PBR, and the need for prescriptive or limiting elements given the level of discretion available to insurers. However, recognizing that such elements add complexity and are unlikely to align to an insurer's own view of reserves, the AAA indicated that the prescriptive or limiting elements should be phased out over time, as PBR matures. The Academy also discussed the new skills, resources and associated funding that the NAIC may need to review PBR reserves, and suggested that a centralized review facility at the NAIC could be established to assist the states.

The working group also received an update from the ACLI on the current views of its members on PBR. The ACLI reviewed of how well the new framework had met its original objectives, to assist its board in deciding whether to support PBR (which it subsequently voted to support). The ACLI presented four key areas where it believes that additional work is required, and where it would like to see progress before the end of 2012:

- **Field testing:** the ACLI noted that it is already testing the current Valuation Manual requirements, and expects to have a report available by Labor Day.
- **Net Premium Reserve:** the ACLI expects that future changes may be necessary to the NPR, so that it continues to be a good fit against the PBR reserves, and meets the IRS/Treasury requirements for tax deductible reserves.
- **Written governance and due process standards for future revisions to the Valuation Manual:** once the Valuation Manual is adopted by the

NAIC, it is automatically adopted by states that have enacted laws recognizing the manual. The ACLI therefore suggests appropriate processes and governance for amending the manual.

- **Evaluation:** to facilitate uniform implementation of PBR, the ACLI suggested the development of a national evaluation process and guidance for reviewers, as discussed in its August 25, 2011 "trust but verify" letter.

As discussed on page 25, the Valuation Manual was adopted August 17 by the Life Insurance and Annuities Committee, which pledged to make significant effort on the issues identified by the Academy and the ACLI.

Group Solvency Issues Working Group

The working group met several times April through August by conference call and met in person in Atlanta.

Own Risk and Solvency Assessment (ORSA)

The working's group's primary focus over the summer has been the Risk Management and Own Risk and Solvency Assessment Model Act, drafts of which it released for public comment in April and July.

The working group had discussed adopting the model act for referral to the Financial Condition Committee at the Summer National Meeting. However, in Atlanta the group decided to defer adoption to provide additional time for regulators and interested parties to review recent changes and has scheduled a joint conference call with the Financial Condition Committee for September 6th to consider adoption of the model act by both groups. Discussions at the ORSA Subgroup, held later in Atlanta, indicated that the model act may also be passed through Plenary in advance of the Fall National Meeting. Discussions at the working group and with interested parties revolved around a number of key issues over the summer, with broad consensus appearing to have been reached by the Summer National Meeting.

Confidentiality was the most significant topic of discussion, with industry groups supporting strong confidentiality protection for information submitted in the ORSA Summary Report, including restrictions on the circulation of summary reports. The confidentiality wording first proposed in model act was initially developed using the Insurance Holding

Company System Model Regulatory Act as a basis, and was adjusted on several conference calls to recognize the unique nature of ORSA information, including its strategic and forward-looking focus, and the importance of the information to an insurer's competitive advantage.

The role of the NAIC in the coordination and review of the ORSA was discussed extensively, including the NAIC's proposed employment of an ERM expert to support all the states in their ORSA reviews. In the draft of the model act discussed at the National Meeting, sharing of ORSA information with the NAIC by the states was explicitly permitted, but with restrictions on the NAIC's use, subsequent sharing and storage of the information, including a prohibition on the storage of ORSA information in a permanent database at the NAIC.

Provision was also made for states to engage third party consultants to assist in the review of the ORSA, subject to the written consent of the insurer. Conference call discussions indicated that standardized wording providing suitable protection for ORSA data may be developed. Finally, a statement of legislative intent was included in the model act, recognizing the confidential and sensitive nature of ORSA information, and establishing clearly that the information will not be subject to public disclosure.

Another contentious topic of discussion, including a number of close working group votes, was the inclusion of language in the model act requiring insurers to maintain a risk management framework. The language was proposed by New York, who originally proposed for it to apply to all insurers, consistent with its 2011 circular letter #14. Discussions surrounded whether the requirement in the ORSA Guidance Manual to describe the risk management framework implies that the model act should require insurers to maintain such a framework, and whether inclusion in the model act would require a "risk management framework" to be defined, including potentially the need for staff dedicated to risk management.

The model act discussed at the National Meeting included the requirement to maintain a risk management framework, although no associated definition was provided and the model act was renamed Risk Management and Own Risk and Solvency Assessment Model Act. However, the requirement is subject to the same size exemption threshold as the ORSA Summary Report. Individual state insurance departments retain the authority to

extend the requirement to all insurers if they chose to do so (but no state has expressed this intention).

Coordination between lead states and other domiciliary states in the review of the ORSA, in addition to between U.S. regulators and involved overseas regulators, was also discussed, with general agreement between the working group and interested parties that strong coordination will be necessary. However, it was agreed that guidance on this topic should be included in the Financial Condition Examiners Handbook and the Financial Analysis Handbook, rather than in the model act or ORSA Guidance Manual. The working group made an initial referral in June to the Financial Analysis Handbook Working Group and Financial Examiners Handbook Technical Group, requesting them to develop regulatory guidance to ensure coordination during the review of the ORSA.

Provision for sanctions has also been included in the model act. Wording was originally adapted from the Insurance Holding Company System Model Regulatory Act, but was later reduced to provide for late filing penalties for insurers, but without financial and criminal penalties for individual directors and officers of an insurer.

The draft of the model act discussed at the Summer National Meeting included an implementation date of 1/1/15, with the first ORSA Summary Reports due to be submitted during 2015. While at one stage the draft act included a uniform date for all insurers to submit their summary reports, the working group agreed not to include a prescribed date, but to allow insurers to submit their summary reports once each year at a date aligned to their internal risk management and strategic planning processes.

All insurers meeting the threshold test will be required to submit an ORSA Summary Report to their lead state regulator, with other domiciliary state regulators able to request the report. During discussions, several regulators of "second states" indicated that they expected to request ORSA Summary Reports from all insurers above the size thresholds operating in their states. The ORSA Summary Report is expected to require attestation by the CRO or other individual responsible for ERM. The 2015 implementation date, delayed from the original proposed date of January 1, 2014 is intended to provide a realistic timeframe for uniform adoption of the model act by the states.

Following adoption of the model act, the working group intends to amend the ORSA Guidance Manual

for consistency with the model act. The guidance manual is also expected to be amended to reflect the results of the ORSA pilot conducted by the ORSA Subgroup as discussed below.

Update on Holding Company Models

The working group received an update in Atlanta on the states' adoption of the Insurance Holding Company System Regulatory Act and Model Regulation, revised in 2010 by the working group to incorporate the "windows and walls" concepts of group supervision. Nine states had now adopted the revised models, including Pennsylvania, which had included additional wording to provide legal authority to carry out a group supervisor role for an internationally active group.

ORSA Subgroup

The subgroup met in Atlanta, and continued its work; the subgroup reviewed a glossary for the ORSA Guidance Manual prepared by the North American CRO Council, which, after discussion, the regulators agreed to adopt into the guidance manual. While the subgroup did not modify the glossary in Atlanta, it recognized that the definitions will be refined further to take into account the results of the ORSA pilot project.

At the time of the National Meeting, the subgroup had completed its review of 13 ORSA Summary Reports from companies who volunteered for the pilot exercise. The subgroup noted that the process had been valuable, with many lessons learned, although it also noted that the quality of submissions varied. The subgroup reported that of the 13 submitted ORSAs, eight were considered complete and three of those eight reported comprehensive, actual data. Two submissions had the framework of the ORSA document only, and the remaining three provided only certain sections of the summary report.

The subgroup discussed its initial observations from the pilot, and its overall view that the ORSA will have a significant impact on regulation for U.S. insurers, with significant value gained from review of the best ORSA Summary Reports; one subgroup member called the ORSA process to be a regulatory "game-changer." The subgroup also discussed the expected implementation date of the Own Risk and Solvency Assessment Model Act of January 1, 2015, noting that the time until the implementation of the requirement should be used by insurers to develop their ORSA processes and reporting.

The subgroup discussed the following four points of feedback that it expects to reflect in the ORSA Guidance Manual:

- Identification of the basis of accounting.
- Explanation of the scope of the ORSA Summary Report, and the entities covered.
- A summary of material changes since the last filed report.
- A comparison of group risk capital from the prior year to the current year.

The subgroup then discussed additional feedback based on the pilot. While the subgroup does not expect to include these in the ORSA Guidance Manual, it indicated that they will be provided as feedback to those groups that participated in the pilot, and that the subgroup will include these items in its recommendation to the Financial Condition Committee. These proposed enhancements to the ORSA Summary Reports include the following:

- Comparative and trend analysis
- Mapping of results to legal entities, not solely to business segments
- Details of key and material risk limits
- Scenario analysis to assess multiple stresses in combination
- Explanation of the calculation of capital numbers, including use of any models
- A list of risk owners and discussion of "risk heat maps"
- Explanation of the link between risk and compensation; the subgroup indicated that this is considered a significant point
- Comparison of multiple measures of capital other than RBC, for example, economic and rating agency capital
- Liquidity stress testing, in particular for life companies
- Significant focus on stresses to capital
- Executive summary for more complex insurers
- Consideration of emerging risks in the prospective risks section of the summary report.

The subgroup aims to hold conference calls with the insurers that participated in the pilot after the Summer National Meeting, and expects to provide a public report and recommendations, respecting the confidentiality of the insurers that participated in the pilot. The subgroup also discussed the possibility of running a further pilot exercise in 2013.

The subgroup also received an update in Atlanta on its Enterprise Risk Management education program; four educational sessions were given over the

summer to the regulators, including one in August conducted by PwC. Sessions were run at the NAIC Financial Summit and through webinars, with the web-based sessions attracting participation of more than 600 participants. Additional sessions are currently being scheduled.

Corporate Governance Working Group

The working group has been active, meeting eight times by conference call over the spring and summer in person at the Summer National Meeting. These discussions often had spirited debate, as discussed below.

Corporate Governance Comparative Analysis

The working group had previously summarized the corporate governance requirements existing in current U.S. regulation, aligning them to the seven principles of the United States Insurance Financial Solvency Framework, in a document which it adopted in December 2011. At the Spring Meeting, the working group had agreed to divide the principles among the states, and for each group to carry out a comparative analysis against their assigned principle, and to recommend specific enhancements to the working group. On conference calls held between March and July, the working group discussed the recommended enhancements, which it summarized in a document entitled Proposed Responses to Comparative Analysis, which also includes drafts of suggested new disclosures and requirements. The working group voted to expose the document for comments until September 28.

The working group stressed that the recommendations made in the report are draft, and are input from interested parties is highly encouraged. Future conference calls will be scheduled to discuss the comments received, and to adjust the recommendations if appropriate. Overall, the working group viewed the ICPs as over-prescribing corporate governance practices, and the regulators do not consider this approach to be appropriate for the U.S. However, the working group did consider that improvements could be made to U.S. regulation, in particular to enhance uniformity across the states around the practices that are reviewed, and how concerns and deficiencies are remedied.

The working group's report contains the following recommendations:

Principle 1 - Regulatory reporting, disclosure and transparency: The working group identified a need for regulators to receive more regular information on corporate governance, to allow for more frequent consideration and review of corporate governance in between examinations. The report therefore proposes several new disclosure requests, including governance practices and enhancements to the Supplemental Compensation Exhibit. The report also recommends that insurers over a certain size be required to maintain an internal audit function.

Principle 2 - Offsite monitoring and analysis: While recognizing that current analysis processes are fairly extensive, the working group recommended proposing a referral to the Financial Analysis Working Group asking it to clarify the existing procedures in place to review the suitability of officers and directors of insurers on a regular basis; update procedures relating to the review and follow-up of corporate governance issues, and consider adding procedures for holding company analysis at the group level. The report also recommends developing a flexible assessment methodology for assessing corporate governance, including potentially a standardized corporate governance assessment template to be used by regulators reviewing corporate governance across the states. Several interested parties have objected to this last recommendation.

Principle 3 - On-site Risk-focused Examinations: Regulators identified a potential need for additional guidance in Exhibit M, Understanding the Corporate Governance Structure, in the Financial Condition Examiners Handbook, including examples of good and bad practices, and guidance on review of groups.

Principle 4 - Reserves, Capital Adequacy and Solvency: The draft report recommends requiring the appointed actuary for life insurers to present the full actuarial report to the board of directors on an annual basis, consistent with requirements for P&C and health insurers, and for commissioners to be provided with sufficient authority to deem an appointed actuary unsuitable for P&C insurers, consistent with authority for life insurers.

Principle 5 - Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities: The report recommends adding questions to the annual statement on the board's role in overseeing the reinsurance strategy, risk management and

compliance. The working group also recommended that the Reinsurance Task Force consider the corporate governance of an individual non-U.S. reinsurer as part of the review of collateral reduction applications.

Principle 6 - Preventive and Corrective Measures, Including Enforcement: The working group discussed language in the Hazardous Financial Condition Model, which provides specific authority for commissioners to take corrective action over corporate governance practice deficiencies. The report recommends that this language be considered critical for accreditation, as it is currently not required, and that it be linked to the standardized corporate governance assessment template referred to above.

Principle 7 - Exiting the Market and Receivership: The working group discussed contingency planning for large insurance groups, its consideration in Dodd-Frank and ComFrame, and its reliance on strong corporate governance practices. The report therefore recommends that the Group Solvency Issues Working Group consider corporate governance in developing contingency planning guidance for use in U.S. regulation. In addition to the recommendations under the seven principles above, the report also recommends adding an interrogatory to the annual statement on the board's role in overseeing compliance.

The recommendations contained in the report were discussed extensively by the working group by conference call, and with interested parties. One of the key points of discussion with industry representatives over the summer was the appropriateness of the proposed standardized corporate governance assessment template. Industry representatives also commented on the extent of the disclosures, the confidentiality of the information (some of which the working group felt may be appropriate for public disclosure), the role of regulators in corporate governance, whether new requirements would apply at group or legal entity level, potential overlap with the new ORSA requirement and ComFrame, and the potential burden of complying with the new requirements versus their benefit to supervision.

The working group also discussed updates to its project timeline in Atlanta. After consideration of the comments received, the working group expects to release a document outlining its policy decisions in late November, and hopes to adopt the document at the Fall National Meeting. The working group plans

to implement the decisions in 2013 with the assistance from other NAIC groups.

International Solvency and Accounting Standards Working Group

The working group met by conference call in March and July and also met in Atlanta.

Insurance contracts project

The working group received an update on the IASB's progress towards developing an IFRS for insurance contracts. The working group heard that convergence between the IASB and FASB is now looking unlikely, an expectation recently acknowledged by the Chairman of the FASB. The IASB is due to release either a review draft or a new exposure draft of the proposed standard before the end of the year. While the extent of revisions to the standard may indicate that a new exposure draft would be most appropriate, the working group was informed that the IASB may be expected to issue a review draft instead, potentially followed by a non-converged standard. Current significant differences between the IASB and FASB include the use of separate or composite margins, whether the use of the premium allocation approach is optional or mandatory, whether acquisition costs relate to all contracts or just successful contracts, and presentation and disclosure requirements.

The working group also discussed recently released SEC final staff report "Work Plan for the Consideration of Incorporating IFRS into the Financial Reporting System for U.S. Issuers." The report, contrary to original expectations, does not include a recommendation on the adoption of IFRS in the U.S GAAP, either one way or the other, which seems likely to increase uncertainty for U.S. insurers.

The working group also received a presentation from the ACLI on its July 2012 report: "Analysis of Insurance Contracts Project Tentative Decisions." The report is intended to facilitate discussions between the IASB and FASB by providing a "big picture" overview, showing the interaction of major components in the measurement of long-duration life contracts under the proposed standard. The report investigates the treatment of a specific universal life contract using the various options currently under discussion, based on actual data from the last 20 years.

Findings included material differences in discount rate depending on whether a top-down or bottom-up approach is used, and limited differences in acquisition costs depending on whether the costs of unsuccessful contracts are taken into account. Margin run-off patterns and the impact of the margin on income were also presented under the different methods under discussion, which showed significant differences, particularly in situations where the IASB proposals would allow the margin to be unlocked. (In these cases, the report found that the FASB proposals, which do not allow the margin to be unlocked, would produce significant spikes in income as assumptions change.) The report also questioned whether contracts could be unbundled into multiple insurance components, rather than insurance and investment components. The report was shared with the IASB in July, and a meeting between the ACLI and the FASB is scheduled for September.

Financial instruments project

The working group also received an update on the IASB's progress towards updating IFRS 9: Financial Instruments. In contrast to the insurance contracts project, the working group heard that a fair degree of convergence is likely for this project, potentially influenced by pressure to converge from the G20.

International Insurance Relations Committee

The committee met by conference call in May, June and July and in person in Atlanta. The committee received updates on and discussed a number of international matters, including the following.

Financial Stability Committee and GSII's

The committee discussed financial stability issues on a number of occasions, specifically its draft comments to the IAIS's May 2012 public exposure on its proposed methodology for the assessment of global systemically important insurers (GSII's). The IAIS's proposed methodology uses an indicator-based assessment covering 5 categories: size, global activity, interconnectedness, substitutability, and non-traditional and non-insurance activities. The categories are relatively weighted, with the IAIS placing the majority of the weighting on interconnectedness and non-traditional and non-insurance activities.

The proposed methodology differs in several respects from the Financial Stability Oversight Council's recently published proposed rules for

designating U.S. non-bank financial companies as SIFIs, most notably in the significant weighting given by the IAIS to non-traditional and non-insurance activities, and the low weighting that the IAIS gives to size. The IAIS notes that, in fact, given the risk-pooling activities of insurers, size is a positive attribute for stability for insurers.

The committee noted that many of the proposed comments requested clarification of terms and processes, in addition to comments on the relative weighting of the categories and the indicators used to carry out the assessment, and the potential for the weightings of the different indicators to create a false sense of precision in the assessment. One question asked both by the NAIC comments and by interested parties was the cut-off point for insurers to be considered GSII's once the ranking process has taken place. The committee discussed the fact that the primary objective of the assessment methodology is to rank insurers, with the designation of which are GSII's made later by the FSB, working with national authorities.

Industry commentators support the view that traditional insurance and reinsurance business does not pose systemic risk to the global financial system, and additionally that cross-sector comparison with banks will be necessary to determine which (if any) insurers pose systemic risk. The committee noted that the IAIS believes that comparison to other sectors is critical, but also expects that there may be factors unique to insurance which need to be factored into the assessment.

In Atlanta, the committee received an update on the work of the IAIS's Financial Stability Committee, and the now closed exposure period on the assessment methodology discussed above. The committee heard that around 30 stakeholders had commented on the methodology, and that the FSC is now reviewing the comments in detail and considering revisions.

Finally, the committee heard the IAIS is now working on policy measures to be applied to insurers that are designated as GSII's, which may include capital requirements and recovery and resolution requirements. Work is expected to continue through next spring, at which time the FSC will submit a report on its work to the FSB.

US/EU Dialogue and Equivalence

The working group received an update on discussions between the U.S. and the EU. Seven technical committees are currently discussing the

similarities and differences between U.S. and EU regulatory systems, and are expected to complete their review by the end of 2012. A paper is currently being drafted, and is expected to be issued for public consultation in the U.S. and Europe in the near future.

In response to questions from interested parties, the committee indicated that it is too early to reach conclusions about any potential recognition of the U.S. as equivalent with Solvency II by the EU. In particular, the committee noted that the NAIC does not intend to enter the EU's formal equivalence assessment process, and that any decision to recognize the U.S. must be made by the European Commission, so is outside the responsibility of the NAIC to comment. Notwithstanding the above, the committee noted the importance of insurance business between the U.S. and EU, and indicated that both the U.S. and EU were keen to progress through the discussions.

Joint Forum

The Principles for the Supervision of Financial Conglomerates document was adopted by the Joint Forum at the end of June. However, the committee learned that the document was subsequently and unexpectedly returned by the forum's parent committees (IAIS, BAFIN and IOSCO), which asked that the Joint Forum consider the inclusion of resolution and recovery planning in the principles, which had originally been excluded to prevent overlap with other requirements. The timeline for the revision and subsequent re-adoption of the principles is currently unclear.

The committee also received updates on the other work of the Joint Forum, including point of sale disclosures for products similar to collective investment schemes (expected to be completed by the end of 2012), cross-sectoral aspects of mortgage insurance, and the market in longevity risk transfer (expected to complete in 2013).

Presentation on the Role of the IAIS

The committee received a presentation on the IAIS, led by its chairman, Peter Braumüller. The presentation covered the regulatory landscape and the increasing importance of the IAIS's cross-sectoral work, the key priorities and strategies of the IAIS, and its engagement with stakeholders. Further, the Chairman discussed the IAIS's involvement and strategy to contribute to global financial stability, and the globalization of supervision and the increasing importance of internationally active groups.

The chairman also discussed ComFrame, and noted that the IAIS expects to begin field testing the framework from 2013. The IAIS is now also starting to consider the next steps for ComFrame after field testing. Finally, the chairman discussed the role of the Supervisory Forum, the IAIS's role to represent the insurance sector at the Joint Forum, and the role of the NAIC to represent the U.S. perspective at the IAIS.

Valuation of Securities Task Force

2012 Year-End RMBS and CMBS Modeling

During its June 26 conference call, the task force discussed plans for the 2012 year-end financial modeling of RMBS and CMBS investments. The task force noted that since the modeling approach began in 2009, the NAIC staff had been instructed to take a relatively "neutral" bias when recommending the modeling assumptions, scenarios and risk-weighting for the year-end modeling effort. The task force discussed the possibility of shifting to a slightly more "conservative" bias. This discussion was prompted, in part, due to the results of a study on the impact of the financial modeling process on RBC which was completed in March by SVO staff, as part of the task force's review of the existing process. The task force also discussed other factors in both the RMBS and CMBS markets which are influencing the desire to shift to more conservative position. The task force plans to hold at least one conference call in September to discuss this topic further. Interested parties will have an opportunity to comment and any changes will be vetted through the normal assumptions setting process which will also begin in September. PIMCO Advisory and BlackRock Solutions will continue to perform financial modeling of RMBS and CMBS, respectively.

New Credit Rating Provider

During a June 26 conference call, the chair of the task force stated that Kroll Bond Rating Agency (KBRA) had met the requirements to be added to the NAIC Credit Rating Provider (CRP) List. After reviewing an amendment to the SVO Purposes and Procedures Manual which included a conversion table showing the NAIC designation equivalents of KBRA credit rating symbols, the task force voted to add KBRA to the CRP List. The motion passed, with Wisconsin voting in opposition.

Classification Methodology

At the Summer National Meeting, the task force adopted a previously exposed amendment to the

SVO Purposes and Procedures Manual that requires the SVO to reflect the existence of contractual provisions that create additional non-payment risk by notching the NAIC Designation assigned to the security rather than instructing the insurer to report the investment in a different reporting category. Securities subject to notching by the SVO will be indicated with an "S" subscript, which will enable regulators to query an insurer's Schedule D for the subscript.

On the June conference call, interested parties had raised concerns over the lack of clarity as to the definition of non-payment risk. Interested parties commented that non-payment risk was not one of the risks officially identified by the Invested Asset Working Group in its 2008 project to identify risks other than credit. Interested parties also raised concerns over the lack of instruction around how to determine the notch, as well as the interaction with the C-1 RBC Factor project. Similar concerns were raised by interested parties in Atlanta. The chair of the task force responded that the SVO already has the authority now to implement the notching system, but believes the proposal will add transparency to those decisions.

Exempt Obligations for AVR and RBC

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

Local GAAP Financial Statements

At the Summer National Meeting, the task force discussed an industry proposal to allow the SVO to accept audited financial statements of foreign issuers expressed in accordance with a national generally accepted accounting principles (GAAP) or national International Financial Reporting Standards (IFRS) basis of accounting, instead of audited financial statements expressed in, or reconciled to, U.S. GAAP or official IFRS. The SVO staff would need to study the differences between the national GAAP of a proposed country and U.S. GAAP as it relates to the SVO's financial analysis. This would allow an insurer to file audited financial statements expressed in national GAAP or national IFRS with the SVO when it submitted a transaction from issuers domiciled in that country. The task force released the proposal for a 45-day comment period.

Preferred Stock Exchange Traded Fund Category

The task force discussed an NAIC staff proposal to amend the SVO Purposes and Procedures Manual to add an Exchange Traded Fund (ETF) category for preferred stock in addition to the existing bond ETF category. The proposal was released for a 15-day comment period. The task force will hold a conference call after the end of the comment period with the intent of adopting the proposed amendment which will then permit the SVO to process pending transactions.

Working Capital Finance Investments

The task force received and released for a 15-day comment period a proposed statutory accounting framework for Working Capital Finance Investments (WCFI) developed by New York. The SVO has proposed that WCFI be an admitted asset. The New York proposal includes the concepts and proposed definitions from NAIC and SVO staff but also addresses issues raised by the Invested Asset Working Group during its review of the proposal. The task force will hold a conference call after the end of the comment period with the intent of adopting and forwarding a final proposal to the SAP Working Group and related proposals to the Blanks Working Group and the Capital Adequacy Task Force.

Invested Assets Working Group

During the spring the working group finalized its working capital finance investments proposal, which was then forwarded to the Valuation of Securities Task Force for its consideration at the Summer National Meeting (discussed above).

At its July 10th conference call, the working group discussed whether the Financial Analysis Handbook Working Group would consider additional methods, such as liquidity score, to analyze risks other than credit. It was noted the FASB has a proposed accounting standards update on financial instruments, Disclosures about Liquidity Risk and Interest Rate Risk, currently exposed for comment. The chair requested that NAIC staff forward the FASB exposure draft to members of the working group for their review and consideration and possible discussion at a future meeting.

The working group also discussed new asset classes that it may be interested in reviewing, such as contingent convertibles, structured bonds, and synthetic securities. The chair recommended that the working group continue to research new asset classes following a specific procedure whereby:

1) the working group considers the new asset's risk characteristics and submits its recommendation to the Valuation of Securities Task Force; 2) the task force decides whether to have the working group proceed with its research, making additional recommendations; and 3) the working group conducts the technical work, forms a conclusion and makes a recommendation to the task force regarding how to proceed. Comments were received and it was agreed that this matter will be discussed in more detail after the working group's objectives for the year have been determined.

Reinsurance Task Force

The task force met in via conference call May 4 and in Atlanta and discussed the following projects.

Reinsurance Modernization Implementation

The task force discussed progress in assisting the states in implementing the revised Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation. The ten-member Qualified Jurisdiction Drafting Group, chaired by Missouri, will develop a process to 1) review non-U.S jurisdictions, 2) determine which jurisdictions will be reviewed initially and 3) develop an implementation deadline. Pennsylvania will chair the nine member Reinsurance Financial Analysis Working Group, which will provide advisory support to states in their review of reinsurance collateral reduction applications. Both groups are beginning work immediately, but the latter group will be meeting regulator only sessions.

After receiving input from interested parties, the task force also adopted instructions for Form CR-F and CR-S, derived from Schedules F and S, which are annual filings required to be completed by certified reinsurers under the revised Credit for Reinsurance models. The instructions will be attached to the model regulation.

NAIC staff reported on the progress of states adopting the revisions to the Credit for Reinsurance Models. As previously reported, both Florida and New York have adopted legislation and have approved reinsurers for reduced collateral. The following additional states have adopted the revisions: California, Connecticut, Indiana, Pennsylvania, and Virginia. Delaware, Illinois and Texas are currently considering adoption in their legislatures; all together companies domiciled in these states represent 40% of direct written premium.

Accreditation Discussion

During its May 4th conference call, the task force adopted, with some revisions after feedback from interested parties, the following recommendations to the proposed key elements for the "reinsurance ceded standard" under the Financial Regulation Standards and Accreditation Program with respect to the revised models. These recommendations were considered by the Financial Regulation Standards and Accreditation (F) Committee in Atlanta and exposed for comment.

- Revisions to the key elements of the Reinsurance Ceded standard with respect to reinsurance collateral reduction should be an optional standard under the Accreditation Program.
- Changes to the reinsurance model law and regulation that are not specifically related to reinsurance collateral reduction should be considered acceptable but not required by the states.
- F Committee should consider a waiver in its normal timeline for adoption and expeditiously consider modification.

During the comment period, there were again comments from interested parties that reduced collateral standards should be mandatory and not optional in order for there to be uniformity among the states. No changes were made to the proposal, but the task force agreed to revisit the issue of uniformity within three years of adoption of the standard. The chair noted that market forces may encourage adoption by most of the states so that it won't be necessary to make the revisions mandatory, especially considering the number of states that have adopted or in the process of adopting the revised models.

Quota Share Reinsurance

The task force discussed a new referral from the Financial Analysis Working Group expressing concern about the "growing trends with insurers utilizing quota share reinsurance agreements that don't appear to transfer risk but instead serve as financing transactions by creating such provisions as loss corridors, sliding scale commissions and loss caps." The task force representative from New York noted that these new types of contracts have "much less" risk transfer than traditional quota share contracts and such contracts often are the result of companies restructuring due to financial issues. The task force will form a subgroup to study the matter with New York as the chair and will consider

risk transfer, accounting and disclosure issues, including whether these contracts should be accounted for as excess of loss contracts instead of quota share. A representative from the RAA questioned whether this is really a compliance issue and not an accounting issue; he noted that statutory accounting already has significant risk transfer guidance, risk transfer interrogatories and an attestation in the annual statement.

Captive and Special Purpose Vehicle Use Subgroup

This subgroup has been very active since the Spring National Meeting; they met eight times via conference call and again in Atlanta to discuss issues related to life insurers ceding other than self-insured risk to captives and SPVs. The subgroup has determined that the use of captives and SPVs by commercial insurers is primarily for the purpose of “financing XXX and other reserve redundancies.” The subgroup has also discussed the use of securitizations, captives capitalized with letters of credit accounted for assets in support of redundant reserves and parental guarantees accounted for assets for redundant reserves. The goal of this work is to develop guidance and recommendations for its Captives and Special Purpose Vehicles White Paper, the latest draft of which was distributed at the Summer National Meeting.

During the conference calls, the subgroup discussed issues related to transparency, confidentiality and information sharing, types of business and risks underwritten by captives and SPVs, capitalization, credit for reinsurance, accounting and reporting and holding company analysis, and each of these is discussed in the white paper. Preliminary “conclusions and recommendations to Financial Condition Committee” in the white paper include the following:

- With respect to the reserve redundancies, the draft recommendation concludes that “alternative accounting treatment of XXX and AXXX reserves should be pursued, such as disclosed permitted practices, thereby eliminating the need for the separate transaction outside of the commercial insurer.”
- Additional guidance should be developed to assist states in evaluating transactions, including recommendations for the minimum analysis to be performed and on-going monitoring of the

ceding company, the captive and the holding company.

- The subgroup supports the IAIS Guidance Paper on the Regulation and Supervision of Captive Insurers which concludes that captives owned or controlled by insurers or reinsurers, that are not otherwise self-insurance, should be subject to the same regulatory framework as commercial insurers.
- With respect to existing captive/SPV transactions, the subgroup recommends enhanced annual statement disclosure in ceding company statements regarding the impact of the transactions on the financial position of the ceding insurer, including disclosure of “non-trade secret captive information” and disclosure of the overall utilization of captives.

While the draft white paper recommends very significant changes to current captive environment, there is diversity in opinion among regulators with spirited discussion on several of the conference calls and in Atlanta. Representatives from states with significant captive activity appear to support the current model with additional transparency. Representatives from other states, especially Rhode Island and New York, expressed the strong belief that such captives should be subject to all the same requirements as third party reinsurers, and the key to reform is revising the reserving requirements, not through transferring the business to captives. The representative from New York did note that transition to a new regime needs to be carefully considered before any “drastic changes” are made. A representative from the ACLI noted that these captive issues are “very important” to their members, but that they have not reached a consensus position yet. Thus far, the white paper has had no industry input.

The subgroup plans to continue its review of the draft over the next few weeks and then expose the white paper for public comment on a future conference call. The subgroup hopes to finalize the white paper by the end of year, at which time its parent Financial Condition Committee will determine next steps. The chair of the committee noted during the subgroup meeting that this is “clearly just the beginning of this discussion.”

NAIC/AICPA Working Group

The working group met via conference call July 24 and discussed the following issues:

Review of Premium Thresholds for the MAR

The working group reviewed the premium threshold noting that more than 92% of premiums written are covered by the current premium threshold in the MAR. Therefore, no adjustment to the Model Audit Rule is considered necessary at this time.

MAR Implementation Guide

The working group exposed for comment a proposed addition to the MAR Implementation Guide to provide guidance in situations where a holding company or parent insurance company not subject to Section 404 wishes to submit a group Management's Report of Internal Control over Financial Reporting for companies within their holding company system that are subject to Management's Report of Internal Control over Financial Reporting filing requirements.

Title Reserves Data Testing

The working group discussed a referral from the Casualty Actuarial Task Force related to auditing procedures for underlying data used by the appointed actuary to calculate title reserves. The working group agreed to co-sponsor a Blanks Working Group proposal to add a requirement for actuarial data testing of title reserves. It is expected the proposal will be very similar to the current requirement for Schedule P, Part 1 for property/casualty insurers.

Restricted Assets

In response to concerns from some regulators on material amounts of restricted assets at some insurers, the working group asked the AICPA representatives for assistance in determining whether generally accepted auditing standards require bank confirmations of restricted/pledged assets and what specific disclosures are required in audited financial statements.

Blanks Working Group

The working group held a conference call on June 14, adopting twenty-five blanks proposals as final. Some of the more significant adopted proposals effective for 2012 annual statement reporting include:

- Added an illustration for Note 21F(4) to data capture admitted and nonadmitted state tax credits. Other illustrations in Note 21F were modified to reflect the inclusion of non-transferable state tax credits in the disclosure. (Agenda item 2012-1BWG)
- Revised the criteria for reporting bank issued letter of credit in Question 15 of the General Interrogatories. The proposal replaced the reference to letters of credit with a NAIC rating of 3 or below, with a reference to the issuing or confirming bank being on the SVO Bank List. (2012-2BWG)
- Modified Question 3.1 of the General Interrogatories to reflect the requirement to report Schedule Y, Part 1 each quarter. The proposal also added a requirement to provide a description of the nature of any changes to the schedule as previously reported. (2012-3BWG)
- Added two new interrogatories for the disclosure of contingent deferred annuity contracts and lifetime income benefit contracts to Exhibit 5 Interrogatories. Disclosure requirements already exist for other synthetic products, other types of guaranteed living benefits, and off-balance-sheet risk. (2012-4BWG)
- Added a structured securities flowchart to the Investment Schedules General Instructions which illustrates the reporting of SSAP 43R relating to the application of the Modified FE process. The flowchart chart was developed last year and served as unofficial guidance for 2011 annual reporting. The proposal also eliminates reference to the "SM" NAIC designation suffix from the Schedule D instructions, as changes adopted for SSAP 43R eliminated the need for the "SM" suffix. A new "S" suffix was added to the bond matrix for Schedule D, which indicates that the SVO has notched the bond as part of its review. (2012-7BWG)
- Modified the definition of what is included in U.S. Governments and U.S. Special Revenue and Special Assessment Obligations and all Non-Guaranteed Obligations of Agencies and Authorities of Governments and Their Political Subdivisions in the Investment Schedules General Instructions to be consistent with changes made to the SVO Purposes and Procedures Manual. Interested parties recommended that the blanks instructions reference to, rather than repeat, the definitions in the Practices and Procedures Manual so the two won't get out of sync as a result of future

changes. However, the working group adopted this proposal as exposed and agreed to discuss the recommendation of interested parties at a later date. (2012-8BWG)

- A column was added to the Statement of Beneficial Ownership of Securities page within the SIS Schedule for the Percentage of Voting Stock Directly and Indirectly Owned or Controlled at the End of the Current Year. An interrogatory was also added to disclose whether the state of domicile has granted an exemption or disclaimer of control to any officer or director of the insurer. (2012-12BWG)
- Moved the reporting of certain security lending program information from Question 3 of the Schedule DL, Part 2 footnote to the General Interrogatories for annual and quarterly reporting. Added an interrogatory question that presents the securities lending liability amount from liability page. (2012-15BWG)
- Revised the instructions for the P&C Actuarial Opinion, P&C Actuarial Opinion Summary, and Title Actuarial Opinion to clarify the key aspects that must be included in the Actuarial Report. Regulators indicated that this will provide consistency and aid in the review of financial solvency. (2012-16BWG)
- A line was added to the Five Year Historical Data page(s) to require companies to identify which amounts of investments reported in the current Investments in Parent, Subsidiary, and Affiliates section are in an immediate or indirect parent. (2012-18BWG)
- The reinsurance schedules were modified and instructions were added for the reporting of certified reinsurance in the annual and quarterly statements. Separate blanks proposals were adopted for each blank: Fraternal, Health, Life, Property/Casualty, and Title. (2012-19BWG, 2012-20BWG, 2012-21BWG, 2012-22BWG, and 2012-23BWG)
- The Supplemental Health Care Exhibit was modified to split the Expatriate Column into two separate columns for small group and large group plans and new instructions were added to clarify the reporting requirements. (2012-24BWG)

The most controversial proposal adopted by the working group on the June conference call impacts insurers with separate accounts (2012-25BWG). Beginning with the 2012 annual statement, these

insurers will be required to file separate statements for insulated separate accounts and non-insulated separate accounts. The proposal was submitted by the Receivership Separate Account Working Group as a result of concerns raised by some regulators regarding the growing trend of life insurers to include non-unit linked (non-insulated) products within the separate account. A modification was made to the previously exposed proposal to permit seed money or unsettled fees to be reported in the separate account blank of the corresponding product (insulated or non-insulated), but seed money and unsettled fees would need to be tagged as non-insulated assets in the investment schedules. Prior to the modification, seed money and unsettled fees would have been reported in the non-insulated separate account blank, even if the insurer had no non-insulated products. While this modification was seen as a benefit to most separate account filers, ACLI and other industry representatives continued to express concerns over the proposal noting that the regulatory concerns could be alleviated through expanded interrogatories rather than two new separate account blanks. The ACLI representative requested a deferral of the proposal to permit time to discuss an alternate proposal. However, no working group member offered up such a motion and the proposal was adopted as modified.

At the Summer National Meeting, the previously adopted separate account proposal was further modified by the Accounting Practices and Procedures Task Force to remove the tagging requirement for non-insulated amounts (i.e., seed money and unsettled fees) reported in the insulated blank. Adoption of this revision will allow life insurers that have non-insulated amounts only in seed money and unsettled fees not to file two separate account blanks.

Five new proposals were exposed in June for a public comment period which ended July 11, 2012. These proposals were adopted as final at the Summer National Meeting in Atlanta, and include the following items initially effective for 2013 quarterly statement reporting, unless noted otherwise:

- Modified Note 14F to include disclosure of all loss contingencies, including uncollectible amounts previously required to be presented in Note 21D. This change is effective for 2013 annual statement reporting. (2012-26BWG)
- Updated the quarterly and annual statement instructions and illustrations to reflect the disclosure requirements resulting from the

adoption of SSAP 92-Accounting for Postretirement Benefits Other Than Pensions and SSAP 102-Accounting for Pensions. (2012-27BWG) and the adoption of SSAP 103-Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. (2012-28BWG)

- Added a new Schedule DB for reporting the collateral associated with derivative instruments and made instructional and blank changes to clarify the intended reporting in the other DB Schedules. (2012-29BWG)
- Added an electronic-only column to capture the 20-character legal entity indicator (LEI) number for mortgagors, counterparties, depositories and the issuers of stocks and bonds in all the detailed investment schedules that have been assigned an LEI. The LEI program is designed to create a unique standard identifier to any organization engaged in financial transactions. The identifier will allow regulators to conduct more accurate analysis of global, systemically important financial institutions. LEIs will be assigned by a Local Operating Unit (LOU) designated by the regulatory agencies of the entity's jurisdiction. The United States will have multiple LOUs. (2012-30BWG)

There were no new blanks proposals exposed for comment at the Summer National Meeting. The deadline for submitting new blanks proposals for exposure at the Fall National Meeting is October 30. All Blanks proposals, including those adopted and exposed for comment, can be viewed at the Blanks Working Group page on the NAIC's website.

Life Insurance and Annuities Committee

At its meeting in Atlanta, the committee did not vote on the adoption of the Valuation Manual as expected, as a consensus position among committee members was still being considered. The regulators then held a conference call on August 17 to consider adoption.

After a nearly hour long discussion, the committee voted 10-1 to adopt the Valuation Manual and committed to work diligently this fall to resolve outstanding issues. New York voted against adoption, commenting that it is premature to vote with many unresolved issues. California and Minnesota abstained, noting similar concerns. Regulators in favor of adoption emphasized that now

is the time to “right-size reserves” and provide for uniformity among the states. They view adoption of the Valuation Manual now as critical because states are currently preparing their 2013 legislative agendas and the regulators want to include consideration of PBR. The chair of the committee pledged to continue working with LATF members and industry this fall to address unresolved issues.

Life Actuarial Task Force

PBR Valuation Manual

Between the Spring and Summer NAIC meetings, LATF held several conference calls during which amendments to the Valuation Manual were discussed and adopted. Recent amendments to the chapter on Life Reserves (VM-20) include prescribed mortality margins applicable to experience and industry tables, requirements for grading to industry tables, and other clarifying revisions. The mortality assumption was a topic of discussion during several interim calls, culminating with the adoption of a proposal developed by the American Academy of Actuaries that prescribes margins for experience mortality that vary with credibility levels and attained-age margins applicable to industry tables. Other adopted changes reflect clarifications to Definitions (VM-01) and Actuarial Opinion and Memorandum Requirements (VM-30). The task force adopted then adopted the Valuation Manual on August 2.

Amendment proposals for substantive changes to specific aspects of VM-20 that have been subject to ongoing discussion were not adopted during interim sessions or at this meeting. Conference calls will be scheduled in the coming months to address these items including the following issues.

Net Premium Reserve (NPR)

In the current draft of VM-20 the NPR is the minimum reserve under VM-20 and is uniquely defined for Term and ULSG products, and is defined as the CRVM reserve for other products. The NPR has been a frequent topic of discussion in recent months with some groups expressing concern that the NPR may be overly conservative and others, primarily regulators from New York, suggesting it may not be conservative enough. The current draft of VM-20 reflects the basis proposed by the ACLI this spring and adopted during an interim conference call. LATF discussed a proposed amendment from New York that incorporates premium levels into the current formulaic approach and results in higher net premium reserves. LATF could not reach consensus

on this matter and deferred a decision until later this year after more analysis can be provided.

Aggregate Margins

The current adopted VM-20 prescribes margins for individual assumptions. However, the ACLI and the Academy believe an aggregate margin approach is preferable as a method for quantifying provision for uncertainty, noting that incorporating margins at a granular level makes it difficult to assess the overall margin considering the interplay of assumptions and administrative difficulties in establishing and monitoring such margins. LATF will form a subgroup to consider this issue and will have open calls this fall to discuss this issue.

Interest Rate Spreads & Default Cost Update Process

VM-20 includes a series of tables related to interest rate spreads and default costs. These tables reflect information from 2008 and 2009 so are not necessarily current, and it is not clear which information should be updated annually versus periodically. Moody's and Standard & Poor are currently the default sources, but LATF is in discussions with other rating agencies and broker-dealers to identify other potential sources for the information. LATF reviewed a proposed amendment that provides flexibility to the NAIC for updating the information should the data sources become unavailable or if better sources are found.

Interest Scenarios

LATF discussed an ACLI request that the Valuation Manual clarify the definition of the referenced interest scenario generator and specify the date at which scenarios can be generated for a 12/31 valuation. On a practical basis, companies need to know the date at which scenarios can be applied in performing exclusion tests before year-end. AG43 has language that addresses this issue and the subgroup reviewing this will draft an amendment to the VM that leverages this wording.

Other Items

LATF briefly discussed several other items targeted for clarification before the end of 2012, including the possibility of requiring that the deterministic reserve be calculated on a seriatim basis, incorporating the NPR as an upper bound of the collar on assets relative to reserves (currently 98% to 102%) and widening the collar, and the general process for making changes to the VM in the future. These items and others will be addressed in future conference calls.

Regulators are concerned about having sufficient capacity to review PBR and are looking into ways of pooling resources with the Academy and SOA to accomplish that review. The chair of the Academy's

Life Practice Council declared the council's support for PBR but emphasizing the need to also establish a robust process to facilitate ongoing review, assessment and improvement of a dynamic valuation methodology. The council will work with the NAIC to address the challenges associated with securing resources for PBR review.

Actuarial Guideline XXXIII (AG 33)

LATF received an update from the subgroup established at the Spring National Meeting to address issues raised by the Academy's Annuity Reserve Work Group report on issues related to the application of AG 33 to Guaranteed Living Income Benefits. Those issues primarily included concern about overly excessive GLIB reserve level, but also questions about the applicable valuation rates under different circumstances, treatment of multiple index crediting options with different guarantees, and contingent surrender charges. Two interim conference calls focused on understanding the sensitivity and range of reserves for different product designs, including comparison of reserves for similar benefits calculated under AG 33 and AG 43. The subgroup is still in the exploratory stage of its work, trying to understand what is driving the reserve differences and what is most appropriate for this particular benefit. The subgroup will continue its work on this issue during conference calls this fall.

Payout Annuity Mortality Tables

LATF received a report from the SOA& AAA Joint Project Oversight Group regarding the draft 2012 Individual Annuity Mortality Table. The table was exposed for six months ending in April 2012. Limited comments were received and no substantive changes to the tables have been made as a result of the comments. However, comments regarding the possibility of excess margins in the valuation table are still under review. Amendments to the Individual Annuity Model Regulation to recognize the 2012 Individual Annuity Reserve (2012 IAR) table for use in valuation of annuity contracts were exposed for the same period, during which no comments or questions were submitted. The proposed effective date is January 1, 2013 for new business only. The major change from prior tables is that the 2012 IAM/IAR table is a generational table that changes from year-to-year with mortality improvement, rather than a static table with mortality improvement factors applied.

At the Summer National Meeting, the ACLI presented its position that companies need time to implement a generational table approach in their valuation systems and requested a five year

transition period with an ultimate effective date of January 1, 2018. The proposed transition would also allow companies to use the table immediately if desired. LATF will schedule a conference call for September to discuss a transition period as well as concern about the margins. Considering the importance of these issues it appears likely that the effective date will be delayed.

Generally Recognized Expense Table Factors

The SOA Committee on Life Insurance Company Expenses presented analysis to assist LATF in considering for adoption the recommended 2013 GRET factors. The proposed factors vary by distribution channel, consistent with the current factors, and reflect reductions in the General Agency and Brokerage factors and increases in factors for other distribution channels. LHATF voted to expose the 2013 GRET factors for a period of 30 days. Typically GRET exposures get little or no comments. We expect that the exposed GRET table will be adopted later this year for 2013.

VM-22

LATF received an update from the Academy's Annuity Reserve Working Group regarding the status of the Valuation Manual section covering PBR for fixed annuities, VM-22. The working group will recommend that the deterministic reserve under VM-22, be based on AG 33, while recommendations for the stochastic reserve are still under development. The working group anticipates use of a stochastic exclusion test based on cash flow testing, and has begun to consider issues related to the stochastic valuation of fixed annuity reserves. The working group will work with the LATF subgroup once it is formed and this work should help accelerate the process for completing VM-22.

Experience Reporting - New York Pilot Project

LATF received an update from the New York representative on the NY Pilot Project to gather experience data under the VM-50 and VM-51 frameworks. NY is working with the Medical Information Bureau to gather data for this project and has had two successful data calls. New York plans incremental expansion of the project to include policyholder behavior and other product information. The expectation is that ultimately this data will be used by the NAIC and by the SOA for industry studies, providing a greater level of participation in such studies and facilitating timelier reporting of study results.

IIPRC Report

The Interstate Insurance Product Regulation Commission provided a report of recent activities including development of product filing standards for group life, group term life and certificates for employer groups. The commission has begun the five-year review of life standards which includes requests to IIPRC staff and interested parties to present proposals and recommendations for consideration by the product standards committee, which will determine the need for any changes. The public comment period ends September 1. In June, the commission recommended a conforming amendment to the variable annuity product standards to include guaranteed minimum death benefits on non-variable annuities. Based on questions related to the treatment of rider charges in determining nonforfeiture benefits, the LATF workgroup looking at this issue has recommended that the commission not move forward with the conforming amendment but instead develop new standards for non-variable products.

Corporate Governance Referral

LATF noted that the task force anticipates a referral from the Corporate Governance Working Group to incorporate into regulatory reporting guidance a requirement that appointed actuaries report to their board of directors on the analysis of reported reserves. Such requirement would parallel the requirements in the Property & Casualty Actuarial Opinion annual statement instructions. Section VM-G of the recently adopted Valuation Manual contains such a requirement for principle-based reserves, but not for non-principle-based reserves. It was noted that ideally such change would be incorporated into the Actuarial Opinion and Memorandum Regulation, and would also need to be incorporated into the annual statement instruction prescribed requirements for states that have not adopted the NAIC AOMR.

Health Actuarial Task Force

The task force met in Atlanta and discussed the following projects.

Group Long Term Disability

The task force received a report from the joint Academy & SOA Group LTD Work Group recommending adoption of the 2012 Group LTD Valuation Table for reserving purposes. The 2012 Group LTD Valuation Table is a simplified version of the 2008 table and reflects a 15% reduction in termination rates overall and an additional 15%

reduction in death rates, increasing the explicit margin in the table relative to the prior table. The recommendation included clarification of the Group LTD Model Regulation to distinguish between Group LTD and other disability products, and a credibility-weighted basis for modification of the tables for company experience. The work group recommended development of an actuarial guideline addressing the blending of company experience with the 2012 Group LTD Valuation Table, credibility assignment, company experience margins, and that five years of termination experience are to be used to establish company experience. The proposal includes limitation on the use of a company's own experience if that experience is near either end of or outside the range of industry norms. The proposed effective date of the revised model regulation is for claims incurred in 2014 and later. The task force voted to adopt this proposal and incorporate the necessary changes to the Health Reserves Model Regulation and develop the corresponding actuarial guideline. The proposed valuation table will be exposed for comment for 30 days.

Long Term Care

The LTC Actuarial Working Group report focused on issues related to valuation and reporting. The general consensus is that policy reserves based on the 1994 Group Annuity Mortality (GAM) table are too low (mortality rates are too high) and lapse rates used in valuation are also too low. Considering the continued poor experience of LTC business and companies continued request for rate increases, the working group will review the Health Reserves Model Regulation standards regarding mortality and lapse assumptions. The working group also wants to incorporate into current valuation requirements the experience reporting requirements in VM-50 and VM-51 of the Valuation Manual and is considering whether it is appropriate for direct writers of reinsured business to show gross reserves separate from ceded reserves rather than just the net result. HATF members noted that some companies are assuming premium increases in cash flow testing models and gross premium valuations, whether or not they are approved. This issue will be discussed in connection with review of the model regulation noted above.

Contingent Deferred Annuities Working Group

At the Spring National Meeting, the Life Insurance and Annuities Committee adopted the findings of the CDA Subgroup that contingent deferred annuities

are life insurance products and should be evaluated under existing state laws applicable to annuities. With these recommendations the subgroup's charge was completed, and the committee formed a new working group chaired by Wisconsin to "evaluate the adequacy of existing laws and regulations as applied to CDAs and whether additional solvency and consumer protection standards are required." To this end, the working group has examined CDAs from a variety of perspectives. At a June conference call, the working group heard presentations from the U.S. Government Accountability Office, the AAA, the ACLI, SEC, and the Financial Industry Regulatory Authority (FINRA). At this session several industry groups made presentations focusing on the suitability of CDAs.

Consumer Representatives

Birny Birnbaum of the Center for Economic Justice made comments questioning the suitability of CDAs. Mr. Birnbaum requested that the working group's report provide substantive observations and analysis regarding risks, accounting and revenue recognition, suitability and policyholder behavior, and disclosure, including an example illustrating the operation of the product and appropriate disclosures, as well as pros and cons of CDAs relative to traditional fixed annuities.

NAIC's Health and Life Policy Council

Jolie Matthews from the NAIC Health and Life Policy Council gave a presentation on the NAIC Suitability in Annuity Transactions Model Regulation. The regulation was adopted in 2003 and revised in 2006 and 2010, and sets forth standards and procedures for recommendations to consumers for transactions involving an annuity product. The regulation requires insurers or producers to obtain information providing reasonable grounds for believing the product is suitable for the consumer, to establish a system of supervision that ensures suitable marketing and sales, and to provide appropriate levels of training to producers. The NAIC annuity suitability standards are consistent with those imposed by the FINRA, such that sales made in compliance with FINRA requirements would be deemed to satisfy the requirements outlined in the model regulation.

Life Insurance Industry

Representatives from trade associations and insurance companies provided perspectives on product design, pricing and consumer protections. Considering mortality improvement generally and corresponding retiree longevity, the demand is high for lifetime income products and the insurance

industry is the only industry that can provide such products, manage the risks, and provide for adequate consumer safeguards. Restrictions on the underlying invested funds as well as the sale of products over time both serve to reduce risk exposure. These products are sold under multiple regulatory regimes applicable to the sale of variable and fixed annuities including the NAIC, SEC, FINRA, ERISA and Department of Labor. Sales are subject to disclosure requirements, suitability requirements and fiduciary obligations, and there are many people involved in the transaction to provide a balanced viewpoint to the consumer.

U.S. Department of Labor

Joe Canary, Director, Office of Regulations and Interpretations, Employee Benefits Security Administration, presented the Department's perspective noting that the risk for retirement security has shifted to retirees with the decline in defined benefit retirement plans, and that increased longevity has increased the risk that retirees will outlive their retirement savings. As such, the Department has requested information to facilitate access to lifetime income benefits and is focused on requirements to provide lifetime income illustrations to retirement plan participants, broadening plan sponsor and/or advisor requirements for education of participants about lifetime income issues, and addressing employer concerns about the use of lifetime income options on 401(k) plans. The NAIC's work on the issue of CDA suitability overlaps with ERISA initiatives and the Department requested continued discussion of overlapping issues and concerns.

Time in Atlanta did not allow for the scheduled presentation on the NAIC Standard Nonforfeiture Law for Individual Deferred Annuities, and a conference call has been scheduled for August 29 to hear that discussion.

Separate Account Risk Working Group

The working group met by conference call March 20 and April 30 and decided to focus first on its charge to "compare the U.S. GAAP definition and requirements for separate accounts to statutory accounting requirements, and use the results of this analysis to help discuss what should be allowed as insulated products." To that end, they heard a presentation from the NAIC/AIPCA Working group on U.S. GAAP separate account reporting and the requirements that must be met for a product to be classified within a separate account.

During its March 20th call, the working group exposed for comment product characteristic descriptions, mirroring two of the GAAP requirements for separate account classification, to define what should be considered an insulated product. This exposure included discussion points for limiting insulation to products meeting the specific characteristics. During its April 30 call, the working group had a lengthy discussion of the joint comment letter from the ALCI and the Insured Retirement Institute, which expressed significant concerns with regard to the proposal, noting that allowance of insulation to be tied to a pass-through of investment results would be a "radical change from the current legal and business structure, and would be disruptive to the marketplace and to the operations of the life insurance companies." The comment letter raised other concerns as well.

The working group had scheduled three additional calls this summer, but concluded the members needed more time to review details on insulated products that appear fixed in nature; the working group plans to hold regulator only educational calls, and public conference calls will resume after that time.

At the meeting of the Financial Condition Committee, the chair of the committee, in discussing the report of the working group, reiterated that the charge of the working group is to consider recommendations based on product evaluation and not necessarily be limited to existing state laws. He also remarked that industry seems to be concerned that the NAIC is working to "outlaw everything but unit-linked products," which is not the case. According to the Commissioner, it is not the goal of the regulators to eliminate any separate account products; they just want to build a better framework and better understand the products being offered. He concluded by noting the working group is just at the beginning of the process to consider these complex issues related to insulation.

Financial Regulation Standards and Accreditation Committee

The committee met in Atlanta and took the following actions:

RBC for Health Organizations Model Act

The committee voted to include the significant elements of the Risk-Based Capital for Health Organizations Model Act as accreditation requirements effective January 1, 2015. RBC is

already an accreditation standard for both life and property/casualty insurers.

Model Risk Retention Act

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

Credit for Reinsurance Model Law and Model Regulation Revisions

The 2011 revisions to the Credit for Reinsurance Model Law and the Credit for Reinsurance Model Regulation were exposed for a thirty-day comment period. At the Fall National Meeting, the Committee will consider adoption of the 2011 revisions to the significant elements under the “Reinsurance Ceded” standard currently required for accreditation. The revisions are expected to be effective immediately upon adoption (which is significantly expedited). States are not required to adopt the model law or model regulation, which would provide reduced collateral requirements for certain reinsurance. However, if a state does enact legislation or regulation that permits reduced collateral requirements, it must include the significant elements of the model law or model regulation as determined by the Reinsurance Task Force.

Risk-Based Capital for Insurers Model Act Revisions

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

Revisions to Review Team Guidelines

The committee adopted two new review team guidelines for examinations. The first guideline relates to addressing all risks identified by examiners in a risk-focused examination. The second guideline requires a state insurance department to notify the Examination Oversight Task Force if an exam report has not been issued within 22 months of the examination “as-of” date.

Clarification of Effective Date for Changes to Part A Accreditation Standards

The committee voted to specify with regard to adopted changes to Part A accreditation standards that, unless otherwise clarified, an effective date as of January 1 of a particular year will be enforced on filings due as of December 31 of the same year, as opposed to the preceding year.

Viatical Settlements Working Group

At its meeting in Atlanta, prior to being disbanded by Executive Committee and then reformed by Plenary (see page 2), the working group convened to discuss a list of possible changes to the Viatical Settlements Model Regulation, which are intended to align the model regulation to the 2007 changes to the model law, primarily with respect to disclosure. The working group discussed whether any changes to the model should be done as a guideline or revisions to the model law. The working group asked for comments from interested parties on additional suggested revisions or issues by August 31 and will hold a conference call during the week of September 10th to continue its work.

Annuity Disclosure Working Group

During a June 19 conference call, the working group discussed the need to update the Annuity Buyer's Guide to make it more readable and consumer-friendly in order to address comments that the old Buyer's guide was too technical and lengthy; trade association representatives offered assistance to prepare Buyer's Guide drafts for the Summer National Meeting.

The working group continued its discussion in Atlanta. Trade association representatives reported that four subgroups - compliance, fixed deferred, fixed indexed deferred, and variable (comprised of member companies and lawyers) - worked on parallel tracks to prepare the Buyer's Guide drafts. Two versions of drafts, a general one covering deferred annuities and a specific one covering fixed deferred annuities, were provided to the working group for review. Comments were received at the meeting. The next course of action is for the trade associations to update and submit these two drafts along with the variable annuity draft for review to two funded consumer representatives. A conference call will then be held to discuss questions from the consumer representatives sometime this fall.

Public Hearing on Lender-Placed Insurance

The Market Regulation and Consumer Affairs and the Property and Casualty Committees held a nearly five hour public hearing at the Summer National Meeting. The hearing was intended as an “opportunity for members and interested parties to share their views and to provide insight into lender-placed insurance.” Such insurance is obtained when there is a lapse in coverage by the homeowner and the mortgage provider requires continuous coverage. The committees received testimony from consumer representatives, actuaries, insurance companies and industry trade associations. The discussion focused on the process of lender-placed insurance, pricing, loss ratios, the trend of increasing lender-placed insurance, coverage provisions, and the lack of underwriting. Consumer representatives emphasized the higher cost of the coverage compared to homeowner-purchased insurance, while industry and trade association representatives responded that the higher cost reflects the higher risk of these products. They also emphasized that coverage is not “forced” on borrowers, who are given several notices reminding them that coverage is required under the mortgage.

At their subsequent meetings in Atlanta, the two committees stated that they will review the testimony received and then decide next steps. In the meantime, they will ask Executive Committee to approve a Model Law Development Request to open the Creditor-Placed Insurance Model Act for potential revisions; only four states have adopted the 1996 model.

Casualty Actuarial and Statistical Task Force

At the Summer National Meeting, the task force heard an update from the Appointed Actuary Subgroup, which was created at the Spring National Meeting to consider whether to request from Executive Committee that changes to the P&C Actuarial Opinion Model Law be considered to make the model law consistent with Life AOML’s disciplinary action provisions. Since the Spring National Meeting, the subgroup met six times to discuss proposed changes to the P&C AOML and activity included the following:

- Researched the history of discipline language in the Life and P&C model laws, which determined that is unclear why the Life AOML discipline language was not included in the P&C AOML.

- Surveyed regulators about current and proposed changes - 27 responses were received from 25 states and Puerto Rico with equal representation of chief financial examiners and actuaries. Detailed survey results are as follows:
 - Current AOML use – three states reported invoking the provision requiring a second actuarial opinion and report be issued; 2 of these 3 states found the process to be effective at least some of the time.
 - Reporting actuaries to the Actuarial Board for Counseling and Discipline (ABCD) - Two thirds of states had never reported an actuary to the ABCD while the remaining states indicated limited reporting. Of those that reported, a majority found the process not to be effective. However, when asked whether they had adequate authority to minimize or eliminate substandard actuarial work, about 70% responded affirmatively. Reasons cited included ability to refer or threaten to refer to the ABCD, the option to require another actuarial opinion to be issued, and the independent exam process where state or independent actuaries provide a second opinion.
 - Use of discipline provisions of Life AOMR - 90% had never sought to discipline a life actuary. Of those who did utilize the provision, 5 felt it was effective at least some of the time.
 - Proposed changes to P&C AOML - 75% of respondents supported inclusion of the Life AOML discipline language in the P&C AOML. Multiple reasons were given for support, including ensuring consistency with Life AOMR and as a deterrent effect. Those that were opposed generally felt current authority was sufficient. Some written comments were made about the subjective nature of some of the violations, such as “lack of cooperation” and the costs of the hearing process as other reasons not to support the changes.
 - Actuarial Standards of Practice - 75% of respondents indicated the current standards were adequate. The remainder generally would like to see additional guidance, with some offering specific recommendations.

The subgroup discussed merits of amending the model law and decided to recommend that the task force adopt the proposed model law request to be considered by Executive Committee, initiate formal dialogue with the American Academy of Actuaries’

Council on Professionalism and the Casualty Practice Council to address regulator concerns expressed in the survey about the actuarial guidance and discipline process. The task force also approved the proposal for model law request for the Property and Casualty Actuarial Opinion Model Law and initiation of formal dialogue with appropriate parties.

The task force adopted the annual Regulatory Guidance regarding 2012 actuarial opinions. The guidance details regulatory expectations of the Appointed Actuary's actuarial opinion and documentation. The task force also discussed the definition of "qualified actuary" and decided to continue dialogue on the subject, expecting to work with other actuarial task forces and the American Academy of Actuaries.

Risk-Focused Surveillance Working Group

The charge of the working group is to review the effectiveness of risk-focused surveillance and develop enhancements as necessary. The working group met twice in April and continued its discussion of the findings and recommendations that came out of the risk-focused examination survey. The working group is attempting to provide a response or proposed solution to all of the findings of the survey. The working group expects to expose the document for comment later this year. The working group is also awaiting the results of the peer review of risk-focused exams performed in the last year.

Examination Oversight Task Force

The task force heard a report that the Financial Examiners Coordination Working Group has elected to make public the Coordinated State Listing on the NAIC website. The working group intends to make this listing available once a year and enables companies to determine which state is the designated Coordinating State for the group in which their domestic entity belongs. It was emphasized that the Coordinating State may not be the leading state examiner for separate holding companies. It is hoped that this listing will encourage coordination efforts among states and insurers.

Climate Change and Global Warming Working Group

The working group heard a presentation from Munich Re on sustainable investment strategies driven by climate change. The presentation provided an overview of how the company identifies green investments and integrates those investments into its overall investment strategy. The working group then received reports from its subgroup.

Impact of Climate Exam Subgroup

The subgroup continues to consider specific questions related to the impact of climate change for inclusion in the risk-focused examination questions which will be included in the 2013 Financial Condition Examiners Handbook. The subgroup has worked with interested parties to revise proposed questions to remove any presupposition that the impact of climate change risk will be present in all insurers, and to allow for expanded discussion only after these risks are determined to be present. The subgroup plans to hold a conference call shortly to finalize its proposed changes for inclusion in the Financial Condition Examiners Handbook.

Impact of Climate Disclosure Survey Subgroup

The subgroup met via conference call on April 19 to discuss whether the survey is meeting its objectives and whether any changes could be made to improve any aspects of the survey. After extensive discussion, the subgroup decided to postpone its previously planned monthly conference calls until the most recent survey results from the multi-state initiative could be analyzed. The subgroup plans to resume its monthly calls in September.

Title Insurance Task Force

At the Summer National Meeting, the task force received an update on projects as follows:

Title Insurance Risk-Based Capital Subgroup

The subgroup was formed to consider the possible development of RBC requirements for title companies. During a regulator conference call on July 30, the subgroup discussed ways to examine existing regulator tools applied to P&C insurers and decide if they should apply to title insurers. In order to determine if RBC standards are needed for title insurers, the subgroup will identify unique risks of title insurers, examine causes and impacts of insolvencies, and identify challenges of introducing RBC standards for title insurers. During the call, the subgroup decided to request a meeting with the Title Insurance Guaranty Fund Working Group and the

Title Insurance Financial Reporting Working Group to coordinate efforts.

Title Guaranty Fund - The Title Insurance Working Group and the Receivership and Insolvency Task Force are currently considering the benefits of having a title insurance guaranty fund. During a regulator session on May 22, the working group discussed the charge assigned (i.e., to consider whether a title guaranty fund model law or guideline should be developed), requested NAIC staff to assist with research, and requested for Texas, Michigan, and Virginia to join the working group with requests to Texas and Michigan to comment on their recent guaranty fund payments. During a meeting on June 20, the working group reviewed background research performed by NAIC staff and identified additional areas for research.

Risk Retention Group Task Force

The task force received an update from its Risk-Focused Examinations Subgroup. The subgroup was formed at the 2011 Fall National Meeting to discuss problems encountered and lessons learned by captive Risk Retention Group states which have performed risk-focused examinations of RRGs. The goal of the subgroup was to develop best practice aids or other tools which would create a more efficient examination process for RRGs. The subgroup is waiting to review the results of the Peer Review Project in which the results of risk-focused exams for all types of insurers will be evaluated; these results may impact the work of the subgroup.

The task force discussed the current trend by traditional medical malpractice insurers to form RRGs. The new RRGs provide flexibility to traditional insurers to expand into new markets, but also may provide a mechanism for insurers to more easily raise rates as the healthcare industry and medical malpractice liability exposure changes. The task force also discussed the increased use of surplus notes for initial capitalization in lieu of letters of credit. While under GAAP, surplus notes are accounted for as liabilities, task force members noted that RRG state regulators routinely provide permitted practices to allow RRGs to follow statutory accounting, which treats surplus notes as equity.

Risk Retention Working Group

At the Summer National Meeting, the working group received a report from the Risk Retention Handbook Subgroup, which has approved revisions to Sections I, II III, and V, and Appendices of the Risk Retention

and Purchasing Group Handbook. The subgroup continues to consider revisions to Section IV of the handbook and expects to finalize the revisions in the next month or two. The final handbook is expected to be distributed at the Fall National Meeting.

The working group also discussed amendments made to the Model Risk Retention Act (#705) to incorporate corporate governance standards for RRGs to ensure that insurers implement and operate within effective risk management and internal control systems. The working group had earlier made a referral that would require the states that charter RRGs to adopt the Act for accreditation purposes and it was reported that the Financial Regulation Standards and Accreditation Committee voted to expose this matter for a one-year period comment period. It is expected that a vote will then be made following the end of the comment period in 2014 and the accreditation standard, if approved, will become effective January 1, 2017.

The next National Meeting of the NAIC will be held in Washington DC November 29-December 2. We welcome your comments regarding issues raised in this newsletter. Please give your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor at jean.connolly@us.pwc.com.

Disclaimer

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

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

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