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# ***NAIC Meeting Notes***

Global Insurance Industry Group, Americas

## **NAIC 2013 Summer National Meeting**

The National Association of Insurance Commissioners held its Summer National Meeting in Indianapolis August 22-27. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

# Executive Summary

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- The Executive Committee adopted three documents developed by the PBR Implementation Task Force and two model law development requests. (page 2)
- The Financial Condition Committee approved the formation of the Private Equity Issues Working Group, which has been charged with developing best practices that emphasize different regulatory approaches using existing authority to address additional risks created by the ownership of life and annuity insurers by private equity interests and hedge fund managers. (page 3)
- The Statutory Accounting Principles Working Group continued discussion of significant projects including accounting for the Affordable Care Act fee and new 2013 disclosures for restricted/pledged assets. (page 3)
- The Capital Adequacy Task Force adopted risk charges for working capital finance investments for all three formulas. (page 7)
- The Life RBC Working Group discussed outstanding matters on its commercial mortgage proposal and formed a subgroup to reconsider RBC in light of PBR and consider a total balance sheet approach to RBC. (page 8)
- As the Investment RBC Working Group continues to consider the recalibration of invested asset factors, progress continues on the bond modeling project. The working group finalized its recommendations to update the life RBC formula for common stock. (page 8)
- The SMI RBC Subgroup continued its discussions of operational risk and recommended removal of two charges related to correlation/covariance and safety level targets. (page 10)
- The P/C RBC Working Group adopted the reserve and premium factors and ex-cat factors for 2013 RBC reporting and exposed the Reinsurance Association of America's proposal to reduce the reinsurance credit risk charge. (page 11)
- The Catastrophe Risk Subgroup adopted its previously exposed attestation requirement for catastrophe risk modeling and property exposure data validation effective 2014 and decided not to allow a formal exemption for the 2013 catastrophe risk RBC charge requirements. (page 12)
- The Valuation of Securities Task Force amended the SVO Purposes and Procedures Manual to provide quarterly reporting instructions for modeled securities and discussed the timeline for the 2013 financial modeling process after the New York interest shortfall proposal was withdrawn. (page 13)
- The Solvency Modernization Initiative Task Force adopted its white paper *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative* and discussed planned monitoring of adoption by the states of key models and revisions resulting from the SMI. (page 15)
- The PBR Implementation Task Force adopted the revised PBR Implementation Plan and the PBR Legislative Information Package, which has now been bifurcated into two documents, PBR Educational Brief and PBR Legislative Brief. (page 15)
- The Group Solvency Issues Working Group adopted its previously exposed revised Part B accreditation recommendations regarding holding company analysis. The working group discussed comments received on its document *Roles and Responsibilities of U.S. Lead State/U.S. Group Wide Supervisor*. (page 17)
- The Corporate Governance Working Group discussed the industry's draft proposal for a corporate governance model act, which would require all insurers/insurer groups to make an annual corporate governance filing. (page 18)
- The International Solvency and Accounting Standards Working Group discussed the IASB and FASB exposure drafts on accounting for insurance contracts, and the NAIC's intended response to the proposals. (page 19)
- The International Insurance Relations Committee discussed the activities of the Financial Stability Board, the IAIS and ComFrame, and the Joint Forum. The Financial Stability Task Force discussed systemically important insurers and the work of the IAIS, FSB and FSOC. (page 20)

- The Captives and Special Purpose Vehicles Subgroup adopted its controversial white paper and related recommendations on the use and regulation of captives and SPVs by life insurers. (page 24)
- The Reinsurance Task finalized the *NAIC Process for Developing and Maintaining the List of Qualified Reinsurers*. (page 25)
- The Blanks Working Group has adopted sixteen blanks proposals as final since the Spring National Meeting. A proposal which would require additional disclosure of the nature of compensation paid to top executives and directors was deferred by the Accounting Practices and Procedures Task Force and referred back to the working group. (page 27)
- The Life Actuarial Task Force exposed amendments to the Valuation Manual. The Joint Qualified Actuary Subgroup issued a Discussion Draft and a request for more direction. (page 28)
- The Emerging Actuarial Issues Working Group continued its work on addressing implementation issues related to the AG 38 revisions. (page 32)
- The Separate Account Risk Working Group discussed significant comments received on its previously exposed *Non-Variable, Insulated Product Characteristics/Proposed Recommendations* document, which addresses insulation classifications. (page 34)
- The Terrorism Insurance Implementation Working Group discussed a Federal Insurance Office request for comment on issues related to terrorism insurance and the Terrorism Risk Insurance Act which expires on December 31, 2014. (page 36)
- The Mortgage Guaranty Insurance Working Group discussed updates to its Concepts List of Potential Regulatory Changes and heard an update on the development of a new mortgage guaranty capital model. (page 36)
- The Title Insurance Task Force concluded it does not believe it should move forward with the development of RBC standard for title insurers at this time. (page 37)

## Executive Committee and Plenary

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

### Adoption of New or Revised Models

During a conference call on July 26, the Executive Committee and Plenary adopted the following model law development requests to:

- Develop a new Annual Reporting of Corporate Governance Practices of Insurers Model Act which would provide regulators with a better understanding of the governance practices of their domestic insurers.
- Amend the Annual Financial Reporting Model Regulation (#205) to require large insurers (exceeding \$500 million in annual premiums) to maintain an effective internal audit function capable of providing the audit committee with independent assurance about the insurer's governance, risk management and internal controls.

- Amend the Mortgage Guaranty Insurance Model Act (#630) based on the work of the Mortgage Guaranty Insurance Working Group. While most states do not regulate mortgage guaranty insurers, given the recent crisis in the housing industry and the resulting high visibility of mortgage guaranty insurance, the working group determined it was appropriate to move forward with revising the model act to ensure strong and uniform regulation in this area.

At the Summer National Meeting, the Executive Committee and Plenary adopted the guideline amendments to the Viatical Settlements Model Regulation (#698) and amendments to the Coordination of Benefits Model Regulation (#120).

### Executive Committee

In Indianapolis, the Executive Committee adopted three documents developed by the PBR Implementation Task Force: PBR Implementation

Plan, PBR Educational Brief, and PBR Legislative Brief. The Executive Committee also adopted model law development requests for amendments to the Synthetic Guaranteed Investment Contracts Model Regulation (#695) and Standard Nonforfeiture Law for Life Insurance (#808).

## Financial Condition Committee

### Private Equity Issues Working Group

At the request of the Financial Analysis Working Group, which is charged with “coordinating multi-state efforts in addressing potential solvency problems, including identifying industry trends,” the committee approved the formation of the Private Equity Issues Working Group in July. The working group will focus on what regulators perceive as additional risk created by the ownership of life insurers, particularly annuity companies, by private equity interests and hedge fund managers.

The working group has been charged with developing best practices to “provide new or enhanced regulatory authority to regulators in certain areas.” Some possible best practices suggested by the Financial Analysis Working Group include the following:

- Change in Control “Form A” Considerations, such as requiring the acquiring entity to demonstrate that the policyholder is “fundamentally more secure” with the proposed acquisition of control. For example, a regulator could call for the acquiring entity to provide details on the investment strategy of both the insurer and the entire group that can be further examined.
- Perform an annual targeted examination of the insurer and its affiliates to ensure that the investment strategy continues to provide a prudent approach for investing policyholder funds.
- Perform targeted examination procedures on non-affiliated insurers where the direct writer has ceded a material portion of their annuity risk to the private equity-controlled insurer.
- Coordinate outside of the examination with international or other functional regulators where either another non-U.S. insurer is involved, other financial institutions are involved, or where the ultimate controlling entity is not based in the United States.

The working group will be chaired by Doug Stolte of Virginia. The group will likely meet in regulator-only sessions prior to a public call, which has not yet been scheduled.

## Statutory Accounting Principles Working Group

The working group was very active during the spring and summer holding eight conference calls and email votes and also meeting in Indianapolis to discuss the issues below. The most contentious issue has continued to be the proposed accounting for the Affordable Care Act fee as discussed below.

### Adoption of New Standards or Revisions to SSAPs

(After each topic is a reference to the Statutory Accounting Principles Working Group’s agenda item number.)

Restricted Asset Disclosures (2013-11) – During the Spring National Meeting, the working group discussed comments on proposed revisions to SSAP 1 to expand disclosures related to restricted assets in the notes to the financial statements (both annual and quarterly). Based on comments received, the working group agreed to delete the requirement for quarterly disclosures and re-exposed the proposal for comment.

During its May 15 conference call, the working group adopted a revised proposal, which was subsequently adopted by the Blanks Working Group during its June conference call. At the request of interested parties, the working group clarified that the information captured within the disclosure is “intended to aggregate the information reported in the Annual Statement Investment Schedules in accordance with the coding of investments that are not under the exclusive control of the reporting entity, including assets loaned to others, and the information reported in the General Interrogatories.” Therefore, private placement investments that are not coded as restricted in the investment schedules are not to be included in the expanded disclosure.

The working group also clarified through a footnote to the instructions that the disclosure for restricted assets in separate accounts are not intended to reflect amounts “restricted” only because they are insulated from the general account or because they are attributed to specific policyholders. Separate

account assets should be captured in this disclosure only if they are restricted outside of these characteristics.

The working group also agreed with an interest party recommendation to allow contracts that share similar characteristics, such as reinsurance and derivatives, to be reported in the aggregate. However, the working group did not adopt a specific definition of “restricted asset” as suggested by interested parties.

Seed Money Disclosures (2012-23) – The working group adopted a new separate account interrogatory related to seed money and fees and expenses due to the general account during its May 15 conference call. The intent of the disclosure is to identify the materiality of seed money in the separate account. At the Spring National Meeting, the proposal had been revised to allow a prospective building of the disclosure to “age” surplus in separate accounts.

Financial Guaranty/Mortgage Guaranty Insurers SSAP 101 DTA Calculation (2013-12) – During its May 15 conference call, the working group adopted proposed revisions to SSAP 101 to clarify the DTA admissibility test for financial and mortgage guaranty insurers. The clarifications were needed because the wording of paragraph 11.b. did not reflect the original intent of the regulators and interested parties that the ratio of the Realization Limitation Threshold table be calculated as policyholders surplus plus contingency reserves divided by required minimum aggregate capital.

At the Summer National Meeting, the working group exposed for comment proposed nonsubstantive changes to the SSAP 101 paragraph 22 disclosures and Q&A questions 1 and 4 to be consistent with the changes to paragraph 11.b. discussed above. (2013-25)

Quarterly Reporting of RMBS and CMBS Purchased Subsequent to Year-End (2013-16) – The working group adopted at the Summer National Meeting revisions to SSAP 43R to allow for quarterly reporting the use of either the prior-year modeling data or analytical procedures for non-financially modeled securities. Optionality is limited by prescribing specific situations in which the prior-year modeling data should be used, which include when the company had acquired the full prior year modeling database, or when identical securities were acquired.

Impact of Additional Reinsurance on Provision of Reinsurance (2011-45) – The working group adopted in Indianapolis revisions to SSAP 62R to allow an exception for retroactive reinsurance which

substantially duplicates coverage on asbestos and/or pollution exposures. The revisions allow a reporting entity to aggregate reinsurers into one line item in Schedule F reflecting the counterparty under the retroactive agreement for the purposes of determining the provision for reinsurance. It also allows the minimum reserve to be calculated based on the counterparty’s authorization status and payment history. The guidance also includes illustrative journal entries.

Proposed Amendments to SSAPs 64, 86 and 103 (2013-07) – The working group adopted proposed revisions to three SSAPs to require disclosure of gross and net amounts of recognized assets and liabilities for derivative, repurchase and reverse repurchase, and securities borrowing and securities lending assets and liabilities that are offset and reported net in accordance with SSAP 64 (valid right of offset). The guidance also rejects ASU 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*.

Consideration of EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements (2013-02) – The working group adopted proposed amendments to SSAP 92, which requires continued liability recognition for the OPEB benefits regardless of any endorsement split-dollar life insurance contracts. However, the working group agreed to delete a proposed change to SSAP No. 21, paragraph 6, based on interested parties’ comments that the guidance cannot require both booking a postretirement liability and recording a nonadmitted asset. Interested parties believe that an endorsement split-dollar life insurance arrangement does not give rise to a nonadmitted asset.

The working group also approved rejection of the following GAAP guidance:

- ASU 2013-02, *Comprehensive Income – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (2013-04)
- ASU 2013-03, *Financial Instruments: Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities*, as the SSAP 100 disclosure requirements do not distinguish between public and non-public entities (2013-06).

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

Comments on exposed items are due to NAIC staff by October 10 unless otherwise noted.

Insurance Contracts – The working group reported that it plans on commenting on the June 2013 FASB exposure draft on insurance contracts. See summary of the International Solvency and Accounting Working Group for additional discussion.

SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers (2011-38) – In the period since the Spring National Meeting, the working group held four lengthy conferences calls and released a revised exposure draft in July that proposed partial accrual of the ACA in the year before it is paid (i.e. the “data year”); the July 8 exposure draft proposed 25% liability/expense recognition of the 2015 fee in 2014 and segregation of surplus for the remaining 75%, to be recognized in expense over the following three years. During its August 7 conference call, the vote to adopt this exposure draft failed 9-2.

The working group then voted 8-3 to have NAIC staff revise the proposed accounting to adopt the GAAP guidance per ASU 2011-06, with exceptions to nonadmit the deferred asset and segregate surplus for the fee not accrued. This is similar to the AHIP/BCBSA proposal this spring, but excludes the unearned premium reserve concept/adjustment. At the request of Virginia, who strongly opposes this accounting, the revised proposal is to also include how the modified GAAP approach would be in accordance with the Statutory Statement of Concepts.

At its meeting in Indianapolis, controversy on the proposal continued. The modified GAAP approach was considered for exposure for public comment, but the chair noted that the comparison to the Statement of Concepts is not yet complete. After extensive discussion, the working group voted 9-3 to expose the draft without the comparison and to release that analysis when it is completed, which is expected to be shortly. NAIC staff is also working on an issue paper with supportive and alternative views.

At the subsequent meetings of the Accounting Practices and Procedures Task Force and the Financial Condition Committee, Virginia proposed a motion to overturn the exposure of the revised guidance until the comparison to the concepts

statement is complete. These motions failed both times but the vote was close (19-13) at the Accounting Practices and Procedures Task Force.

Three Risk Sharing Provisions under ACA (2013-28)  
The working group distributed a four-page summary of the “3Rs” of ACA: risk adjustment, reinsurance program and risk corridor. The summary does not include any proposed accounting and is meant as a starting point for discussion. The working group assigned a high priority to the topics and hopes to expose an issue paper prior to the Fall National Meeting. The working group also formed a Risk Sharing Subgroup which expects to meet every two weeks to achieve this goal and have final guidance by year-end or early in 2014.

Working Capital Finance Investments (2013-10)  
At the Spring National Meeting, the working group heard comments from interested parties on the draft issue paper including that the legal structure discussion in the guidance should be moved out of Issue Paper and SSAP and into the SVO Manual. At the Summer National Meeting, the working group exposed a proposed SSAP 10x, Working Capital Finance Investments, which classifies these investments as admitted assets when specific criteria are met. The SSAP comment period ends September 13 in hopes of having the guidance finalized and effective for year-end 2013.

Share-Based Payments with Non-Employees – The working group exposed for comment Issue Paper 146, Share-Based Payments with Non-Employees. The proposed guidance would revise SSAP 104 to adopt, with modification, ASC 505-50 *Equity Payments to Non-employees*. The working group had asked interested parties this spring to comment whether insurers provide such payments to non-employees, and the response was that some insurance entities do provide such benefits to non-employee agents. The suggested effective date is January 1, 2014, with early adoption at year-end 2013 permitted.

SSAP 43R Impairment Footnote (2013-15) – The working group exposed for comment a proposal from an interested party to reduce the “cumulative OTTI footnote” for loan-backed securities to report only current year impairment activity. The footnote has become very long for many companies as it includes impairment information by CUSIP for as long as the securities are held.

Restricted Asset Subgroup and Proposed FHLB Disclosures (2013-27) – The subgroup was formed in response to a request of the Financial Analysis Working Group that regulators study certain

guarantees and other financial activities that have pledge-like restrictions. The working group is first focusing on Federal Home Loan Bank transactions and met three times via conference calls in April, June and August to discuss potential new disclosures. The April 29 call was primarily an educational session for regulators to better understand various FHLB transactions. During its June 17 call, the subgroup exposed for comment significant new disclosures related to FHLB transactions in the following areas:

- Reporting of FHLB Capital Stock - The proposal clarifies that the fair value of the stock is presumed to be par value, unless impaired. (SSAP 30 requires all common stock to be valued at fair value, and holders of the stock cannot sell it to others.)
- Placement of FHLB Disclosures – Somewhat duplicative disclosures in SSAP 15 and SSAP 52 will be moved to one place, SSAP 30.
- Classification of FHLB Capital Stock – Holders of the stock would disclose total capital stock held, allocated to different categories: Membership Stock (Class A or B), Activity Stock and Excess Stock along with estimated timeframes for redemption. A new investment code is being proposed to separately classify FHLB stock within restricted assets.
- Collateral Disclosures – Companies would disclose the amount (fair value and carrying value) of collateral pledged to the FHLB as of the reporting date and the maximum amount pledged at any time during the current reporting period.
- Borrowing Capacity – Companies would disclose the maximum amount of aggregate borrowings from the FHLB at any time during the current reporting period, the actual or estimated maximum borrowing capacity as determined by the insurer, with a description of how the borrowing capacity was determined, and whether current borrowings are subject to prepayment penalties.
- Agreement Asset and Liabilities – The proposed disclosures include general account and separate account information for each disclosure, with elimination of the existing distinct disclosure for agreement assets and liabilities.

- General Interrogatories – Proposed changes to the interrogatory would clarify that the FHLB stock and collateral are subject to the RBC off-balance sheet risk charge.
- Collateral Requirements – The proposals do not include any recommendation for nonadmittance when there is overcollateralization (i.e. when collateral exceeds borrowings), which is consistent with the current guidance in INT 01-31, Assets Pledged as Collateral. The issue may be discussed again when the subgroup takes up liquidity considerations this fall.

At its August 13 conference call, the subgroup discussed comments from interested parties, made some minor changes to the proposals and re-exposed the guidance for a comment period ending September 13. The subgroup will then hold a conference call to finalize the disclosures, with a proposed first quarter 2014 effective date.

Derivatives Reporting (2013-13) – The working group directed NAIC staff to prepare an issue paper to consider accounting and reporting guidance for centrally cleared derivatives, including guidance for collateral and initial and variation margins. Work on the issue paper will include assistance from regulators and industry representatives with derivative expertise.

SSAP 5R Revisions (2013-18) – The working group voted to expose for comment adoption, with modification, ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. The only modification from the ASU relates to estimating an obligation: if there is no better estimate within a range, then the midpoint is to be used as the estimate. The guidance also includes disclosure requirements.

Consideration of GAAP Tax Guidance (2013-26) – At the Summer National Meeting, the working group exposed for comment proposed revisions that define tax positions and their settlement. The working group proposed rejection of both ASU 2009-06, *Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities* and FSP FIN 48-1, *Definition of "Settlement."* However, they have proposed a definition of "tax position" that mirrors the GAAP definition to prevent a GAAP to SAP difference for terminology. The working group also recommended gathering more information on settlements and effective settlements relative to tax positions in FSP FIN 48-1 and FIN 48 for application to tax contingencies.

Make Whole Call Provisions and Continuously Callable Bonds (2013-21) – The working group exposed for comment proposed amendments to SSAP 26 to clarify amortization requirements for bonds with make-whole call provisions and bonds that are continuously callable. NAIC staff commented that they have received many questions on the requirement to amortize to “yield to worst.” The revisions would not require insurers to consider make-whole call provisions in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the provision.

Accounting for Single-Member or Single-Asset LLCs (2013-17) – The working group voted to expose for comment a proposal from a large life insurer to account for real estate held by certain LLCs under SSAP 40 (primarily valued at cost) as opposed to SSAP 48 (valued using an equity method and with a higher RBC charge) when certain criteria are met. The working group also asked the Capital Adequacy Task Force to comment on the RBC impact of the proposal. The comment period for this item ends November 22.

Policyholder Loyalty Program Obligations (2012-15) and Actuarial Calculation of DDR Reserve (2012-16) In July, property/casualty insurers were asked to complete a survey as to whether they offer policyholder loyalty programs or no cost/reduced cost extended reporting benefits in the event of DDR; 169 and 103 companies responded in the affirmative, respectively. Additional analysis of the survey results will be performed this fall.

Title Insurance Loss Reserves (2012-33) – During the spring and summer, the working group continued to work with interested parties and regulators to finalize proposed revisions to SSAP 57, Title Insurance, to clarify the reporting of loss reserves including known claims reserves, statutory premium reserves, supplemental reserves and the bulk reserve. The working group exposed a revised proposal during its May 15 conference call and asked for input from the Title Insurance Financial Reporting Working Group, which recommended that the reference to Appendix A-628 (Title Insurance Model Law) should be retained “pending careful study of the implications of title statutory premium reserves or unearned premium reserves requirements for reserving, financial reporting and capital adequacy.” Final proposed revisions were exposed for a short comment period ending September 13.

SSAP 68 and Goodwill (2013-20) – The working group exposed revisions to clarify that the elimination of goodwill when the investee ceases to exist applies to both statutory purchases and mergers, and that internally generated goodwill and goodwill of the reporting entity in itself are not permitted. (2013-20)

SSAP 69 Revisions (2013-22) – The working group exposed revisions to adopt, with modification, ASU 2012-05, *Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows* and clarify that donated, use-restricted financial assets are nonadmitted. (2013-22)

ASU 2013-07, Liquidation Basis of Accounting (2013-19) – The working group exposed for comment rejection of this new GAAP guidance as not applicable to statutory accounting.

## Capital Adequacy Task Force

The task force met via conference call in May and June and at the Summer National Meeting and discussed the following topics.

### Working Capital Finance Investments

After lengthy discussion at five different meetings and conference calls, the task force adopted RBC charges for working capital finance investments during its June 25<sup>th</sup> conference call. After discussing again the liquidity issues related to these investments, the task force agreed to factors 1.25% above the current NAIC 1 and 2 charges, which would be doubled for the asset concentration page. The task force also required a “sunset clause” to review the factors within the next three years to see if they need adjustment.

### Securities/Broker Receivables

During its April 30<sup>th</sup> conference call the task force took no action on the ACLI proposal to lower the RBC charge for these assets. At its meeting in Indianapolis, a task force member (PA) asked that the issue be put back on the agenda for consideration for 2014 RBC.

### Mandatory Convertible Securities

During its May 30<sup>th</sup> conference call, the task force adopted a revised definition of these securities for all RBC formulas. There is no change to the RBC charge.

## Life Risk-Based Capital Working Group

### Commercial Mortgage Proposal

The ACLI commercial mortgage proposal, which replaces the mortgage adjustment experience factor, was adopted as final for 2013 RBC filings at the July 26 conference call of Executive Committee and Plenary. As discussed in PwC NAIC Spring 2013 National Meeting Newsletter, the property value for each loan will be the value determined at loan origination and trended forward using changes in the National Council of Real Estate Investment Fiduciaries (NCREIF) Price Index, which is proprietary information. The NAIC has contracted with NCREIF to provide this information to state insurance regulators, and the ACLI has contracted with NCREIF to supply this information to holders of commercial mortgages. A condition of adoption of the proposal is a charge to the Life RBC Working Group to identify a publicly available data source to provide current LTV information. If no source is identified by the 2016 Spring National Meeting, the factors used in the RBC for the commercial mortgages will be revised to the factors contained in the "Alternate Proposal," which is included as an appendix to the minutes of the Executive/Plenary meeting.

At its August 6 conference call the working group discussed outstanding issues on commercial mortgages: "fully parallel" AVR treatment for year-end 2014 (which will replace the simplified AVR treatment adopted for 2013 filings due to time constraints) and additional Schedule B and BA disclosures for more detailed information on individual mortgage holdings. Neither of these items is ready for public exposure.

### Formation of New Subgroup

The working group formed a new subgroup to address three charges from other working groups. The chair noted that all these projects will require significant time and resources and the formation of a subgroup is likely the most efficient way to work on the charges, which are as follows:

1. Evaluate RBC in light of PBR. Consider changes to RBC needed because of the changes in reserve values, contemplating "right sizing" of reserves, margins in the reserves, any expected increase in reserve volatility, and the overall desired level of solvency measurement.
2. Consider a total balance sheet approach (e.g. total asset requirement (TAR) type calculation

and then subtracting out the PBR reserves) and application of stress scenarios.

3. Evaluate and consider changes, as appropriate, to risk-based capital requirements to address contingent deferred annuities (CDAs).

With respect to charges 1 and 2, at the Summer National Meeting, the working group discussed a document prepared by the chair entitled "Testing the Statutory Total Asset Requirement." The chair stated his intent of the outline was as a "strawman" to begin discussion of an approach on how to address these two projects. The document is included on the meeting materials posted to the Life RBC Working Group webpage.

### "Conflicting Use" of AVR

During its August 6 conference call and in Indianapolis, the working group discussed a letter from a consulting firm which notes the dual use of AVR: "It can be used in asset adequacy analysis and in that context, AVR functions as a reserve. However, for RBC purposes, AVR is treated as capital and is included in Total Adjusted Capital." The letter suggests that AVR should not be permitted to be used in both calculations simultaneously and recommends three alternative solutions. At the Summer National Meeting, the working group exposed the letter for a 45-day comment period.

### Unauthorized reinsurance proposal

In connection with an issue raised by Canadian insurance regulators, the working group exposed a proposal from New York to revise the RBC instructions as follows: "risk ceded to an unauthorized reinsurer may reduce RBC only to the extent collateral is established in the same proportion as collateral for reserves is required. For example, if risk is ceded to an unauthorized reinsurer which is also not certified, collateral equal to 100% of the reduction in RBC must be established."

## Investment Risk-Based Capital Working Group

The working group continues to consider the recalibration of C-1 factors used in the life RBC calculation. The C-1 factors are intended to capture an invested asset's risk of default of principal and interest or fluctuation in fair value. While to-date the focus has been on life RBC factors, ultimately the property and health factors will be considered as well. These factors have not been updated since 1991. The working group generally meets bi-weekly, and

much of the discussion continues to be focused on the corporate bond modeling project led by the American Academy of Actuaries (AAA).

#### Corporate Bond Factors

During 2012, the AAA developed a bond model which replicates the 1991 model, such that when using the 1991 scenarios and assumptions, the new model generates either the same, or very similar, C-1 factors.

Between April and June, the AAA's efforts continued to be principally focused on finalizing the assumptions for corporate bonds, including default and recovery assumptions. For default, the AAA is using Moody's default rate cohort experience from 1983-2012; for recovery, S&P data by instrument type for 1987-2012 will be utilized. Default rates vary by economic conditions and recoveries will be lower in weak economic conditions, particularly in bonds of lower quality. The AAA noted it is working to develop the means of expressing this in the assumptions that will be used in the bond model.

Throughout June and July, the AAA devoted significant time to the construction of the representative corporate bond portfolio to be used in the bond modeling. At the Summer National Meeting, the AAA provided a comprehensive update on the representative portfolio. The purpose of this portfolio is to create a generic portrayal of a life insurer's portfolio structure that captures key features that differentiate C-1 risk, as it is impractical to model every insurer's portfolio. The NAIC provided information on every bond position for every life insurance company as of December 31, 2011. This data did not identify the company or the asset CUSIPs. The data represented approximately 287,000 positions, held by 782 insurers. The AAA adjusted the data to exclude bonds guaranteed by the full faith and credit of the U.S. Government and all zero value bonds. The AAA is currently analyzing the portfolio variables with the largest C-1 impact: portfolio size, quality mix and instrument type mix. Based on this analysis, the AAA may consider a number of potential adjustments to the base C-1 factor. The AAA will then model the 2011 representative portfolios and compare the results to the 1991 model results.

The AAA expects to present the data output from the model in three phases. The first phase would be to present data in a way that would allow regulators to decide on the structure of the C-1 charges (i.e., the number of designations). The second phase would be to present data that would help determine C-1 protection levels. This presentation would show how the C-1 factors would differ depending on the selected time horizon, risk metric and protection

level. The third phase would be a first-level recommendation of pre-tax base factors based on the decisions made by the working group in the first two phases.

#### Common Stock Factors

On its May 24 conference call, the working group discussed the previously exposed Life Insurer RBC Common Stock Report. The report recommended that the base factor be maintained at 30%. No comment letters were submitted during the initial exposure period; however, the AAA did pose questions about some of the assumptions and the methodology used to develop the recommendation. The AAA recommended that a more robust, stochastic analysis be performed instead of focusing simply on historical returns. After stochastic analysis was done by the AAA, the results confirmed the prior analysis based on historical information, thus the proposed base factor, before the beta adjustment, remains unchanged at 30% for unaffiliated common stock of life insurers. The report also studied the effectiveness of beta and noted that the RBC factor could be as high as 45% or as low as 15% after the beta adjustment.

In July, questions were raised regarding how beta is calculated and how the beta adjustment works. It was noted that the beta adjustment compares the relationship of the portfolio's beta to the market (e.g., S&P 500) beta; there is a maximum and minimum adjustment that can be made. Instructions for calculating beta are included in two places, the Asset Valuation Reserve instructions and the RBC instructions. The working group noted that the AVR instructions refer to the S&P 500 index as one example of the type of benchmark to be used when determining the beta for a public common stock portfolio, while LR005 of the life RBC instructions indicated that the S&P 500 must be used. The working group concluded that to promote comparability of beta calculations and consistency between the AVR and RBC instructions, it will recommend that the AVR instructions be modified to require the use of the S&P 500 index.

In Indianapolis, the working group adopted the report and a memo that addresses instruction-related questions regarding the calculation of beta, including the recommendation to change to the AVR instructions. The two documents were referred to the Capital Adequacy Task Force.

#### Derivative Factors

The working group discussed the previously exposed Life Insurer RBC Derivative Report. The report made only one recommendation; i.e., that the potential exposure formula included in the Schedule DB Part A instructions for written credit default

swaps be changed to reflect recovery experience consistent with the RBC approach for bonds. No comment letters were submitted during the exposure period.

#### Real Estate Factors

With respect to directly held real estate, the working group is considering a plan to develop a factor based upon: 1) market price volatility using an index similar to the manner in which the common stock initiative used the S&P 500 data; consideration is being given to the National Property Index (NPI) of the National Council of Real Estate Investment Fiduciaries; and 2) an adjustment to reflect the fact that real estate is carried at depreciated cost, rather than market value, on the statutory statements. A final proposal is expected in December.

#### Other Invested Asset Classes

Progress continues on additional invested asset classes, including mortgages, structured securities and other invested assets.

#### Unhedged Currency Risk

The working group discussed whether unhedged currency risk should have an RBC charge. The AAA noted that currency risk is not covered specifically in C-1, but it might be picked up in C-3 testing. A working group member commented that although this might be addressed in C-3, there is no way to measure to what extent. No formal conclusions have been reached; however, the working group appears to have reached a consensus that currency risk is not likely to be a material exposure for U.S. life insurers, at least at the entity level.

#### Timeline

The working group will continue to hold periodic conference calls over the next several months to continue its deliberations. The working group had been optimistically targeting a 2013 completion date, at least with respect to recommending revisions to the life RBC C-1 factors. This would have permitted the revised RBC factors to be implemented for the 2014 life RBC calculation. However, that timeline appears uncertain given the extensive work that remains to complete the bond modeling analysis, considerations of related changes to AVR, and subsequent changes to the SVO Manual, AP&P Manual and investment reporting schedules which are expected to be necessary. The working group has not developed a formal work plan with specific target completion dates or deadlines to finalize its considerations.

## **SMI RBC Subgroup**

Since the Spring National Meeting, the subgroup held five conference calls and did not meet in Indianapolis. During the conference calls, the subgroup continued its discussion of operational risk and its possible inclusion in the RBC formula, as well as its correlation with other risk categories.

The subgroup discussed its findings and recommendations to the Capital Adequacy Task Force relating to its charges as follows:

#### Correlation/Covariance

As in many advanced insurance regulatory jurisdictions, U.S. RBC incorporates some recognition of the interdependency and diversification of risks. This occurs at the final calculation of RBC where, by use of the so-called "square root rule," the major risk components are assumed to be either fully correlated or fully uncorrelated with each other. A study by the AAA noted that examined jurisdictions apply, to some degree, partial correlations within certain risk components, with the U.S. RBC employing partial correlations within asset risk, underwriting risk, credit risk and business risk. The report also found that Solvency II, Australia and Switzerland employ partial correlations among major risk components, whereas Bermuda, Canada and the U.S. do not. The measurement and inclusion of partial correlations among the major risk components has long been on the subgroup's agenda. Given that the AAA and Casualty Actuarial Society (CAS) are working on enhancements to P/C underwriting risk charges which will incorporate enhancements to risk diversification and dependency methodologies, the subgroup recommended this charge be removed from the subgroup's charges, and that ongoing work of the AAA and CAS be monitored by the Capital Adequacy Task Force and considered for incorporation into RBC as the research matures.

#### Safety Level Targets

The development of calibrated safety level targets for RBC has been prominent on the agenda of the subgroup since its inception. This priority has been driven largely by Insurance Core Principle 17.4 of the International Association of Insurance Supervisors, which states that the prescribed capital requirement (i.e., RBC company action level) be "defined such that assets will exceed technical provisions and other liabilities with a specified level of safety over a defined time horizon." While calibrated safety level targets exist for some risk components (particularly in life RBC), the subgroup's efforts to develop targets for overall RBC have been impeded by a lack of clarity on how to accomplish the task, particularly in

view of the diversity of time horizons and confidence levels currently employed by type of risk and by type of RBC and by advice that statistically valid calibrations of overall RBC are not attainable. The subgroup recommended that efforts to develop calibrated safety level targets for overall RBC be set aside until validly calibrated safety level targets are developed for each of the major risk components within all three types of RBC, in accordance with time horizons and safety levels appropriate for specific risk components. Pursuant to this, the subgroup recommended that all current and future enhancements or reviews of risk components be underpinned, where possible, by defined target confidence levels and time horizons, including the rationale for the chosen calibration targets, and that deviations from those targets be documented.

Based on the above, the one task remaining for the subgroup is development of an operational risk charge for RBC. In connection with this charge, the subgroup heard presentations from the Canadian Office of Supervision of Financial Institutions and Bermuda Monetary Authority on how they assess operational risk in their regulatory capital formulas. The subgroup also heard a presentation by a risk advisory company on operational risk loss databases. The subgroup discussed a workplan to design a factor-based operational risk charge by 2014.

## **Property/Casualty Risk-Based Capital Working Group**

The working group met by conference call April 17, June 19, and July 16, and in-person in Indianapolis and discussed the following topics.

### 2012 RBC Results

The results of the property RBC annual reports were fairly consistent with prior years. The risk retention groups made up a sizable percentage of the companies that were flagged by the trend test or in an action level, likely due to using a different accounting treatment i.e. U.S. GAAP. Overall, the underwriting risk has slightly decreased over time and the assets risk has taken a greater portion of the total risk prior to covariance. The growth of the assets risk is not an industry-wide situation but rather, is dominated by a few large insurers that have been investing in large common stock portfolio. The R3 credit risk does not appear to be a significant risk for property/casualty insurers based on the data showing that it represents 5% of the total risk prior to covariance.

### 2013 Underwriting Risk

The working group discussed and adopted the industry average reserve and premium factors and

ex-cat industry premium excluding U.S. and non-U.S. factors (i.e. Line 1 factors) for use in the 2013 reporting year. Seven lines of business will have ex-cat factors for Underwriting Risk – Net Written Premium (R5A) in accordance with data collected from the 2012 RBC reporting data call.

The working group also discussed and adopted the 2013 Line 4 ex-cat underwriting risk premium factors. Unlike the Line 1 underwriting risk factors, the Line 4 underwriting risk factors are not adjusted annually. This year, Line 4 factors for premium risk were developed in order to calculate the ex-cat capital requirement for the R5A component. Line 4 factors along with the Line 1 factors will be re-evaluated next year using 2013 reporting.

### 2013 Property/Casualty RBC Publications

The working group adopted the 2013 Property/Casualty RBC Overview and Instructions publications. Changes included additional guidance for risk retention groups, incorporation of the Low Income Housing Tax Credit Proposal and Working Capital Finance Investment Proposal, and the addition of new lines to annual statement Schedule F to capture reinsurance data related to captive companies. The footnote for the collection of the catastrophe loss data in the supplemental Schedule P exhibits was updated to allow for use of approved lists of catastrophe events.

### Reinsurance Credit Risk Charge

The working group continued its discussion of reinsurance credit risk charge and the AAA's Report on Reinsurance Credit Risk Charge. Currently, a 10% reinsurance credit risk charge is applied to the ceded balances except for the recoverables from U.S. affiliates and mandatory pools. The reinsurance credit risk charge is included in the R3 component, which could be impacted significantly for those companies relying heavily on the reinsurance. AAA reported that when the RBC formula was adopted, the selection of the 10% risk charge in 1994 reflected expert opinion at the time and that a number of policy considerations played into that decision. A change in the reinsurance credit risk charge would not only impact the P/C formula, but also the life and health formula which is currently under study.

In Indianapolis, the working group heard a presentation by the Reinsurance Association of America (RAA), which has long believed that the existing 10% charge on reinsurance recoverable is too high and should be revised to better match the inherent risks. In its proposal, the RAA requests for the 10% R3 factor to be decoupled from R6 and R7, which will result in a lower factor for R6 and R7. RAA stated that the existing R3 factor is 4 to 7 times higher than the credit risk factors used by S&P for an

A-rated reinsurer. The S&P factors are based on historical default rates for reinsurance recoverables. RAA has developed a proposed framework for determining the R3 charge consistent with the NAIC's treatment of ratings and collateral in the revised credit for reinsurance model. The proposed framework begins with the credit default risk factors used by S&P that are based on historical default rates associated with the financial strength rating of the reinsurer. They believe that this results in a truly risk-based approach by applying lower factors to highly rated reinsurers and higher factors to low and non-rated reinsurers. Those factors are then multiplied by 3 to reflect risks other than credit such as commutation, coverage dispute, risk transfer and extent of reinsurance usage that were identified by the AAA as additional risk components of the R3 charge. Under the RAA framework, the R3 charge would vary between 1.8% for an S&P AAA-rated reinsurer to 23% for an S&P NR-rated reinsurer. The working group exposed the RAA proposal for comment through October 8.

## Catastrophe Risk Subgroup

The subgroup met by conference call May 16 and June 26, and in-person in Indianapolis and discussed the following topics.

### Attestation for Catastrophe Modeling

The subgroup continued its discussion on the Draft Attestation Re: Catastrophe Modeling Used in RBC Catastrophe Risk Charges that had been proposed for inclusion in the confidential RBC Report. Three comment letters were received during the 60-day comment period. Commenters support the flexibility for reinsurers to use proprietary models for their enterprise risk management, as differentiated from RBC purposes. Upon hearing comments, the subgroup made a revision to the draft attestation to include a statement that companies will validate their data to the best of their knowledge without overstating the accuracy of the data. The subgroup adopted the proposal, noting the attestation will be required for the 2014 RBC formula.

### Examiners Handbook

The subgroup continued its discussion on its referral to the Financial Examiner Handbook Technical Group. The technical group had exposed examination procedures to validate catastrophe modeling assumptions and data used by insurers to determine their catastrophe risk charges for a 45-day comment period that ended May 2. The subgroup submitted a comment letter to the technical group proposing revisions. The subgroup chair participated in the technical group's conference calls on May 23 and July 17, and noted that the subgroup's

comments were reflected in the revised examination procedures adopted by the technical group.

### Catastrophe Risk Charge Exemptions

The subgroup continued its discussion on a comment letter received from a trade organization relating to the criteria for exempting insurers from the new catastrophe risk RBC charge requirements. The comment letter requests for three groups of companies to be considered for exemption from catastrophe risk RBC: (1) companies that predominantly write casualty insurance; (2) companies that are small in size, even if more than 15% of their surplus is exposed to catastrophe; and (3) companies with less than 15% of their surplus exposed to cat risk. A subgroup member commented that companies would be required to run a model to manage their catastrophe losses if they are one of the major property writers in catastrophe-prone areas regardless of the size of the company. As such, companies will report "N/A" in PR025 of the P/C RBC formula if they do not have catastrophe risk exposure. A suggestion was made not to include any exemption criteria in the 2013 RBC formula and any information received early 2014 will be used to re-evaluate the need for implementing a formal exemption. The subgroup adopted to proceed without the formal exemption, with regulators acknowledging that there will be companies that will have no information to contribute.

### U.S. Earthquake and Hurricane Event Lists

The subgroup discussed the purpose of creating a U.S. regulator-approved event list which is to allow companies to exclude actual historical U.S. catastrophe losses so that appropriate R5 Underwriting Risk factors can be developed on an ex-catastrophe basis without double-counting actual catastrophe losses and without imposing a cost burden on insurers. An earthquake list has been developed based on 10 years of historical information from Wikipedia, and the industry was asked to review the highlighted events. The hurricane list was generated using data from the website of the National Hurricane Center. Further analysis on damage estimates is required because some of the named storm damage estimates could have a mix of U.S. and international losses. Swiss Re Sigma and Munich Re Nat Cat Service lists could be used to help determine the international losses. The subgroup plans to make the preliminary lists available on the NAIC website later this year.

## Health Risk-Based Capital Working Group

The working group met by conference call May 20 and July 8 and did not meet at the Summer National Meeting. During the interim calls, the working group discussed the following topics.

### 2013 Health Risk-Based Capital Overview and Instructions

The working group adopted the 2013 Health Risk-Based Capital Overview and Instructions. Changes included incorporation of new guidance on Low Income Housing Tax Credits, Working Capital Finance Investments, and Pandemic/Bio Risk – Interrogatories, and the addition of new lines to annual statement Schedule S to capture reinsurance data related to captive companies.

### Underwriting Risk – Experience Fluctuation Risk

The working group exposed a proposal to page XR012 - Underwriting Risk - Experience Fluctuation Risk that would break out premiums, incurred claims and underwriting risk claims ratio by individual, small group and large group for informational purposes. The break-out will allow for future analysis of the impact of the Affordable Care Act on the underwriting risk within the current health RBC formula. The comment period ends September 9.

### Blanks Proposal 2013-12BWG

The working group discussed the adopted Blanks Proposal 2013-12BWG – Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued. The proposal was referred to the Blanks Working Group for 2013 reporting in an effort to gather more meaningful data to evaluate and review the health care receivable factors that are currently included in the health RBC formula. During the Blanks Working Group conference call on June 13, interested parties commented that the instructions for Column 1 and 2 in Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued should be further clarified. Due to the timing of the Blanks requirements, additional guidance will be drafted for the new Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued for year-end 2013 reporting and posted on the NAIC website.

### Medicare Part D Survey

The working group heard a recommendation by the AAA to perform a follow-up review to determine if the Medicare Part D factors should be revised. It has been several years since the AAA reviewed and updated the factors. The AAA believes there is enough run out and experience to now determine the true volatility and whether the current factors are

reasonable related to the experience. In order to perform the review, the AAA made a request for the working group to distribute a survey which will provide additional data on the products that companies offer under Medicare Part D. This data would allow the AAA to analyze exactly how the companies' experiences are emerging versus what companies expected in their U.S. Centers for Medicare & Medicaid Services bids. The working group adopted the distribution and collection of the Medicare Part D survey. The survey was distributed August 1 and results are due September 13.

## Valuation of Securities Task Force

### New SVO Structured Securities Group

In July, the Securities Valuation Office announced the creation a new Structured Securities Group (SVO-SSG) which will be located in the NAIC's New York office. The new unit will perform the Regulatory Treatment Assessment Service for emerging investment structures and support the financial modeling for RMBS and CMBS. In Indianapolis, the task force discussed proposed amendments to the SVO Purposes and Procedures Manual to reflect the pre-purchase assessment process to be performed by the SVO-SSG. The proposal was exposed for a 30-day public comment period.

### 2013 RMBS & CMBS Modeling Process

The task force discussed a previously exposed proposal to modify the financial modeling methodology for RMBS and CMBS to capture interest shortfalls in addition to principal loss, when calculating the expected loss and to revise the discount rate method used to determine the net present value of the expected loss. The proposal was withdrawn by the sponsor (New York) citing the complexities associated with its implementation. It is expected, therefore, that interest shortfalls will not be considered in the modeling process and the rate to discount cash flows will continue to be the coupon rate.

The task force also discussed the timeline for the 2013 financial modeling process. Under the proposed timeline, the SVO Structured Securities Group will meet with PIMCO and BlackRock, and develop recommended modeling assumptions during the first two weeks of September. The recommendations will first be shared with the task force in a regulator-only session the week of September 16. Following this session, the recommendations would be exposed for public comment, with final task force approval expected the

week of October 2. Industry representatives indicated they were supportive of the timeline, which is several weeks earlier than last year.

A meeting of the task force has been scheduled for September 24; the purpose of the call is to hear comments from insurance company investment managers and other interested parties on technical aspects of the modeling criteria proposed by the SSG-SVO.

#### New Credit Rating Provider

At the Spring National Meeting, the task force directed the SVO staff to enter into negotiations to finalize an agreement recognizing Egan-Jones as an NAIC Credit Rating Provider and to amend the NAIC CRP list included in the SVO Purposes and Procedures Manual. The task force adopted the amendments in May through an email vote.

#### Quarterly RMBS & CMBS Reporting

At the Spring National Meeting, the task force referred proposed quarterly reporting instructions of RMBS and CMBS to the SAP Working Group for incorporation into SSAP 43R, Loan-Backed and Structured Securities. The SAP Working Group considered the referral in Indianapolis, and adopted non-substantive revisions to SSAP 43R. The task force subsequently adopted related amendments to the SVO P&P Manual, which indicate the following:

- If the prior year's modeling data, with respect to an RMBS or CMBS security purchased during an interim period, is available to the insurer, then the insurer may use that modeling data to determine the NAIC designation and book/adjusted carrying value;
- If the prior year's modeling data is not available to the insurer, or the insurer elects not to use that data to determine the NAIC designation and book/adjusted carrying value, the insurer should follow the modified filing-exempt process to determine the NAIC designation and book/adjusted carrying value.

#### Foreign Audit Project

On its July 31 conference call, the task force discussed proposed changes to the SVO P&P Manual related to the foreign audit project. The proposal was exposed for a 15-day public comment period. At the Summer National Meeting, the task force adopted the proposed changes, which adds Germany and German GAAP accounting standards to the countries whose national GAAP can be presented to the SVO for investment analysis without reconciliation to U.S. GAAP. The changes also clarify the purpose of financial statement presentation standards as it

relates to the SVO's investment analysis objectives and adds process procedures for the approval of possible future requests to add other national GAAP or national IFRS to the permitted financial statement presentation standards. This guidance does not affect the SSAP 97 audit requirements for SCA entities; German GAAP financial statements must still be reconciled to U.S. for those purposes.

#### NAIC Designation Recalibration Project

In anticipation of possible changes to the NAIC bond rating designation framework (1-6) resulting from the ongoing efforts of the Investment RBC Working Group, the task force adopted an amendment to its 2014 charges to study the impact of such a modification on the various NAIC manuals, model regulations and to the state insurance regulatory structure. The task force will coordinate with other relevant working groups and task forces to formulate recommendations and strategies that will be needed to facilitate implementation of any adopted changes.

#### Structured Agency Credit Risk Securities

The task force heard a presentation from the SVO-SSG on Freddie Mac's Structured Agency Credit Risk (STACR) securities. The SVO-SSG staff indicated that the STACR is designed to perform similar to a traditional RMBS, and recommended that the STACR be included in the year-end RMBS modeling. However, a task force member (New York) expressed concern that STACR does not meet the definition of RMBS and under current statutory guidance applicable to structured notes would be classified as a bond under SSAP 26 and not as an RMBS under SSAP 43R. He further noted that the SVO P&P Manual excludes the modeling of federally issued securities, specifically including securities issued by Freddie Mac. Based on these considerations, the task force member argued that STACR could not be subject to RMBS modeling, absent changes to statutory accounting and the SVO manual. Assuming no changes to the authoritative guidance, by default, STACR would be appropriately designated NAIC 1. After significant discussion amongst task force members and SVO-SSG staff, the task force charged the Invested Asset Working Group to further study the accounting and reporting classification for STACR and to also review the regulatory reporting framework for structured notes.

#### Residual Tranches of Securitizations

The task force discussed a proposed amendment to the SVO P&P Manual to add instructions for the filing of residual tranches of securitizations. A "residual" is a junior and contingent economic interest in an RMBS, CMBS, ABS or other securitization that is designed to absorb credit or non-credit cash flows from the underlying assets.

The proposed changes would clarify that a “residual” should be reported as an equity instrument on Schedule D. However, an insurer would have the ability to request an SVO assessment of a security for possible bond treatment. The proposal was exposed for a 30-day public comment period.

## **Solvency Modernization Initiatives Task Force**

The task force met in Indianapolis, and adopted its white paper *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative*. The paper had been re-exposed for public comment at the Spring National Meeting, and the task force heard that the majority of comments received and edits related to section 5, which documents the activities, progress and outcomes of the SMI. The contents of the white paper did not receive further discussion at the Summer National Meeting, and the document was subsequently, adopted by the Financial Condition Committee. The task force noted that the white paper remains a living document, and that it therefore expects further revisions and opportunities for interested parties to comment on the paper in the future.

The task force also discussed its “dashboard” to monitor the status of adoption by the states of key models and revisions resulting from the SMI. Drafts of maps showing the adoption of PBR and the holding company, ORSA, and credit for reinsurance models by the states were provided to task force members for review; the dashboard was posted to the SMI webpage on September 5<sup>th</sup>.

The task force also briefly discussed the lifespan of the SMI Task Force, and its expectation that the task force would not be disbanded at the end of 2013 pending completion of the corporate governance workstream. It was also noted at the Summer National Meeting that discussions on the IASB’s proposed insurance contracts standard are expected to continue beyond the end of the year.

## **Principles-Based Reserving Implementation Task Force**

The task force held several interim conference calls and met in-person at the Summer National Meeting. The task force discussed its PBR Implementation Plan and Legislative Packet on its interim conference calls, and discussed a number of PBR

implementation topics in Indianapolis. The task force also retained an external consultant to assist it with its charges, including evaluation of captive transactions, evaluation of the findings and recommendations of the Captives and SPV Use Subgroup, and assessment of the impact of PBR and assistance with implementation issues.

### PBR Implementation Plan

The task force had exposed a draft of its PBR Implementation Plan for comment at the Spring National Meeting, and held several conference calls to discuss comments on the plan, which were received from the AAA and the ACLI. Task force discussions included resource requirements, analysis by the proposed Actuarial Resource, clarity of regulator expectations, data collection, the use of data collection agents and data collection costs, confidentiality, and the PBR implementation timeline. The task force also discussed the potential for volatility in results following implementation of PBR, and the possible role of a smoothing mechanism, which it suggested should be considered by the Life Actuarial Task Force.

Following changes, the task force adopted the revised implementation plan in two stages, by adoption of the charges contained within the plan on a late-June conference call, and by adoption of the entire plan on a late-July conference call. On both votes, New York abstained. The PBR Implementation Plan was adopted by the Executive Committee at the Summer National Meeting.

The PBR Implementation Plan has evolved significantly from the initial draft originally produced by the PBR Working Group, summarized in PwC NAIC 2012 Fall National Meeting Newsletter. Significant elements proposed by the plan include:

- Formation of an NAIC Actuarial Resource to provide specialist resources to implement and operate PBR. The plan also considers the resources that will be required by the NAIC and the states to implement PBR more generally.
- Formation of a new NAIC working group, the PBR Valuation Analysis Working Group, to work collaboratively with states and encourage consistent application of standards.
- Standard financial reporting and analysis tools, including updates to blanks, the Statement of Actuarial Opinion and the annual actuarial memorandum.

- Experience data collection, which thus far has been carried out by New York, with Kansas also starting data collection. NAIC data collection is ultimately expected, and will leverage the work done by New York and Kansas. The task force discussed expense mechanisms in the meantime to spread the cost beyond New York and Kansas companies.
- Pre-implementation and training needs, including early review processes and training for state insurance department staff.
- Procedures for updating the Valuation Manual, including evaluation of the effectiveness of the PBR methodology.
- Evaluation of RBC in view of PBR.
- Further evaluation of captives in the context of PBR by a new Captives Working Group.
- Accreditation requirements, including the date PBR would be required for accreditation, and the need for the Valuation Manual used by any particular state to be substantially similar to the NAIC's version.
- The PBR implementation timeline, including a PBR Roadmap, to be developed.

The plan also contains charges to other task forces and working groups which will be required to implement elements of the plan.

#### PBR Legislative Information Package

The task force had exposed an initial draft of its proposed legislative packet at the Spring National Meeting, and discussed industry comments on the document on several subsequent conference calls. One of the major changes made to the legislative packet was to separate it into two documents, a high-level Legislative Brief, providing orientation on PBR for states considering adoption, and a more detailed Educational Document, providing answers to frequently asked questions. Discussions on subsequent conference calls included the clarity of the figures presented in the legislative packet to explain the expected impact of PBR on reserves, and the need to place greater emphasis on the “right-sizing” of reserves than on whether increases or decreases to reserves are expected. Changes were also made to reflect expectations that PBR will reduce incentives for captive “workarounds” to reduce reserves. The two documents, which the task force expects to be presented to legislators as a

package, were adopted by the task force on a conference call in June, with New York abstaining, and were subsequently adopted by the Executive Committee in Indianapolis.

#### PBR Implementation Activities

Following the adoption of its PBR Implementation Plan and Legislative Packet on its interim conference calls, the task force proceeded to discuss several PBR implementation topics in Indianapolis. The task force appointed the new PBR Review Working Group, which was established with the charges set out in the PBR Implementation Plan adopted by the task force. The new working group's mission is to coordinate financial analysis, examination, and actuarial review procedures in relation to PBR.

The task force also heard presentations on the PBR data collection work carried out by New York and Kansas, hearing that the cost of data collection has tended to decrease over time, and that the quality of information received has tended to increase. The presentation from New York also discussed the role of the Department of Financial Services' staff to oversee the data collection, and its coordination with MIB, its statistical agent. The task force also heard that New York and Kansas plan to coordinate by using the same data format and eliminating any duplication in reporting. The presentations also discussed confidentiality considerations in relation to the data collection. The task force also heard a presentation from MIB on its work with the New York DFS, hearing that the cost of data collection per company is expected to decrease as the number of companies providing data increases. The presentation also noted the risk of diverging requirements as more states begin data collection.

The task force also discussed the potential need for specialist modeling resources to implement PBR, in response to a letter from California proposing a requirement for the NAIC and the states to retain computer modeling specialists. The task force heard that this recommendation was based on California's experience reviewing models, and the recommendation is consistent with comments made by California at the Fall 2012 Executive Committee and Plenary meeting at which the Valuation Manual was adopted. The task force, which adopted the recommendation after discussion, heard that the amendment was specifically drafted to require modeling specialists to be retained, rather than relying on modeling knowledge among actuarial staff, but that it was intended to be flexible as to whether the modeling specialists are retained at state-level or by the NAIC.

### Captives and SPVs

At its meeting in Indianapolis, the task force very briefly discussed referrals from the Financial Condition Committee in relation to the Captives and Special Purpose Vehicle Use Subgroup's white paper, which was adopted by the Executive Committee and Plenary in July. The white paper contains four recommendations that the task force will now consider:

- Develop possible solutions for addressing any remaining XXX and AXXX perceived redundancies prior to the effective date of PBR.
- Study the issue of confidentiality related to commercially owned captives and SPVs.
- Consider enhanced disclosure in ceding company statements regarding the impact of transactions on the financial position of the ceding insurer.
- Develop guidance in the Financial Analysis Handbook for the states' review and ongoing analysis of transactions involving captives and SPVs, including specific considerations of such transactions when performing holding company analysis.

### Next Meeting

The next week of the task force is scheduled for September 12; the regulators will discuss PBR education plans, company outreach and hear plans for the PBR Review Working Group.

## **Group Solvency Issues Working Group**

The working group met by conference call in July, and then met in person at the Summer National Meeting.

### Holding Company Analysis

On its interim conference call, the working group adopted its revised Part B accreditation recommendations regarding holding company analysis, which it had previously exposed for comment at the Spring National Meeting. The working group received only one comment letter suggesting editorial changes, which were incorporated into the document.

### Roles and Responsibilities of the U.S. Lead State/U.S. Group-wide Supervisor

The working group also discussed its *Roles and Responsibilities of U.S. Lead State/U.S. Group Wide*

*Supervisor* document. This document had been exposed at the Spring National Meeting, and the working group received two comment letters from industry associations and a comment letter from Connecticut.

On its interim conference call, the working group discussed the changes proposed by Connecticut, which it agreed to refer to the Financial Analysis Handbook Working Group. The working group elected to separate the changes proposed by Connecticut from those proposed by interested parties so that Connecticut's changes could be considered for procedures used for 2013 annual statements. The working group did not consider it feasible for the remainder of the changes to be finalized by year-end. Connecticut's changes, as adopted by the working group, included new questions on captives and the use of derivatives, and updates to the non-lead state checklists.

The working group agreed to expose the remainder of the changes to the checklist for an additional 30-day public comment period, and resumed discussion of the document at the Summer National Meeting. On its interim conference call, the working group had noted that it was generally comfortable with the changes proposed by interested parties to that point, and in Indianapolis, its discussions were focused on new comments received in the July/August comment period. The working group agreed to make a number of changes to the document, including relating to the roles, responsibilities and supervisory practices of the lead state, non-lead state(s) and group-wide supervisor, communication of the identity of the lead state to groups, and considerations for international groups.

The working group also discussed comments from an interested party on the sample supervisory college confidentiality agreement included in the document. The working group heard that the proposed changes were intended to recognize the relevant insurer explicitly in the confidentiality agreement as the owner of its confidential information, to ensure that the insurer is notified should a member of the college receive a legally enforceable demand for any confidential information relating to the company, and to provide for the insurer to take action to preserve the confidentiality of the information. The proposed changes were also intended to make the confidentiality agreement binding on all parties. The changes received strong support from other interested parties present in Indianapolis. However, while not disagreeing with the proposed changes, the working group expressed doubts that all members of

a supervisory college would have legal authority to enter into the confidentiality agreement as modified, and noted that the sample agreement would be unlikely to be used exactly as drafted by any individual supervisory college in any case. The working group ultimately agreed to remove the sample confidentiality agreement from the document entirely.

Following its discussions, the working group agreed to adopt the document and move it to the Financial Analysis Handbook Working Group for further development.

#### IAIS Revisions to ICP 23: Group-wide Supervision

The working group also received an update on the activities of the IAIS with respect to its ongoing revisions to ICP 23: Group-wide Supervision. The working group heard about recent IAIS drafting group decisions to de-link ICP 23 from the ComFrame project, and to improve consistency with the Joint Forum's Principles for the Supervision of Financial Conglomerates through a merged drafting group. The working group heard that the drafting group now plans to consider groups issues across all of the ICPs, before revisiting ICP 23, which will be used to cover residual issues not covered by the other ICPs to avoid double jeopardy issues. The drafting group also expects to make ICP 23 outcomes-based and capable of accommodating both direct (supervisory authority at holding company level) and indirect (cooperation between concerned legal entity supervisors) approaches to group supervision. However, the working group heard that the drafting group is also incorporating direction from the Financial Stability Board, which favors a direct approach. In common with the International Insurance Relations Committee, below, the working group discussed the perceived current influence of the Financial Stability Board on IAIS projects not explicitly connected to the G-SIIs workstream, and the potential for consequential reduction in the IAIS's independence as a standard-setting body.

The working group heard that the ICP 23 drafting group now needs to obtain approval for its approach to revising ICP 23 and the groups issues contained in the other ICPs, and that the approach will be considered by the IAIS Technical Committee at the IAIS's 2013 Annual Conference in October. The working group also discussed potential legal issues that may prevent state regulators from having direct authority over group holding companies, and heard that similar issues had been encountered in the Joint Forum's work in relation to the supervision of financial conglomerates.

## Corporate Governance Working Group

At the Summer National Meeting the working group met and discussed industry's draft proposal for a corporate governance model act, which was presented for the first time at this meeting. Much of the content of industry's proposed Corporate Governance Annual Filing Model Act was excerpted from either the Risk Management ORSA Model Act or the recently adopted corporate governance Exhibit A (which summarizes the corporate governance framework). The industry representatives gave an overview of their proposal stating an annual filing would be required by all insurers or insurer groups, which protects confidential information submitted by insurers and which "removes redundant filing requirements." The regulators commented that Section 5, Filings Not Required, is too broad as it would exempt insurers which prepare the corporate governance report from filing "any financial examination requests relating to information outlined in the most recent Exhibit M of the Financial Condition Examiners Handbook." The representatives responded that they would revise the section.

The working group noted that the Corporate Governance Drafting Subgroup has been formed and is comprised of representatives from Vermont (chair), Indiana, Ohio and Pennsylvania. The subgroup hopes to have a draft model within 4-6 weeks and a final model by the Fall National Meeting, with a possible effective date of 2016 (as recommended by Pennsylvania). The industry proposal was not exposed for comment, but their draft will be reviewed and considered by the subgroup in developing its own draft for consideration.

The Internal Audit Subgroup has also been formed with members from Virginia (chair), Connecticut, Iowa and New York. The subgroup will draft a new section for the Model Audit Rule which would require large insurers (greater than \$500 million in annual premium) "to maintain an effective internal audit function capable of providing the audit committee independent assurance in respect of the insurer's governance, risk management, and internal controls." The subgroup will also receive input from the NAIC/AICPA Working Group.

At its meeting Indianapolis, the working group also adopted a revision to Exhibit A that management and oversight of critical risk areas should include discussion of the organization's market conduct decision making processes. This recommendation

came from the Market Regulation and Consumer Affairs Committee.

## ORSA Subgroup

The subgroup did not meet in Indianapolis, and held no interim conference calls. The subgroup's primary current project is the 2013 ORSA Pilot, and review of the ORSA Summary Reports provided by volunteers is expected to take place over September and October 2013.

The SMI Dashboard shows that five states (Iowa, Maine, New Hampshire, Rhode Island and Vermont) have fully or substantially adopted the Risk Management ORSA Model Law and seven additional states have it under consideration.

## International Solvency and Accounting Standards Working Group

The working group met by conference call in July and August, followed by an in-person meeting in Indianapolis. The working group's principal topic of discussion was the exposure drafts (EDs) issued by the IASB and the FASB on accounting for insurance contracts, and the NAIC's intended comments on the IASB's ED, which it plans to provide through the IAIS. Note that the SAP Working Group will be providing comments on the FASB ED.

The IASB's ED consulted on seven questions, and the IASB had indicated that it does not intend to reopen topics and decisions outside of these specific questions. The working group therefore discussed its draft comments within the framework of these questions. On its July conference call, the working group discussed initial observations on the ED, to find general commonality in state regulator viewpoints ahead of a meeting of the IAIS's Accounting and Auditing Issues Subcommittee in July. The working group continued its discussions in August, and then heard presentations in Indianapolis from the ACLI and the U.S. P&C Coalition on their views on the ED. In Indianapolis, the working group also discussed a draft document summarizing key points of its current views on the ED, incorporating the key points discussed by interested parties, which it intends to finalize by conference call on September 10<sup>th</sup>.

In Indianapolis, one of the key themes stressed by interested parties was the continued benefit of reaching a converged IASB/FASB standard.

Interested parties noted that non-converged standards would risk reducing the understandability of insurer financial statements, and may have a consequent impact on the ability of insurers to raise capital, in addition to increased implementation and ongoing costs. Many interested party comments therefore focused on areas of inconsistent accounting treatment between the IASB and FASB EDs, including the treatment of both long term and short term contracts. Particular areas of concern included requirements for the bifurcation of cash flows, and inconsistent and unclear application of the Premium Allocation Approach (PPA). Interested parties also expressed concern with the proposed symmetry of treatment between ceding companies and reinsurers, which they considered would not always reflect the reality of reinsurance transactions.

The key points with respect to each of the IASB's questions summarized in the NAIC's document are as follows:

### Question 1: Adjusting the contractual service margin

The NAIC is concerned by the asymmetric treatment of losses when rebuilding the contractual service margin. More generally, the NAIC continues to support the FASB's single margin approach in preference to the IASB's approach. The proposed ability to unlock the Contractual Service Margin in the IASB's ED received support in general from the NAIC and interested parties, who noted that that an inability to unlock margins would likely lead to results that fail to express the economic reality of the underlying business.

### Question 2: Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

The NAIC considers the IASB's drafting to be unclear in this area, in particular in respect to application to universal life and variable products. Further, the document considers the proposed requirement to bifurcate policies to be complex and of questionable cost/benefit.

### Question 3: Presentation of insurance contract revenue and expenses

The NAIC considers the IASB's proposed presentation to be unclear, unlikely to be widely understood, and to bear limited relation to current concepts of earned premium. The NAIC is also concerned by the asymmetrical treatment of ceding commissions (netted against reinsurance premium) and direct premium, which is presented gross under the premium allocation approach. Interested parties agreed in Indianapolis that the presentation

proposals would not provide meaningful information, and also noted that the differences between the IASB and FASB approaches would likely lead to differing earnings patterns between the two standards.

Question 4: Interest expense in profit or loss

The NAIC views the IASB's proposals, which it considers would require insurers to maintain yield curves at original recognition at an individual policy level as part of policy data, to be extremely complex, and to be unlikely to justify the cost to implement. The document also notes that interaction with the more granular definition of a portfolio contained in the standards may be a source of further complexity. Interested parties also noted that increased disaggregation may lead to greater recognition of onerous contracts, which may result in increased accounting-driven volatility. The NAIC recognized in its discussions with interested parties that substantially different issues arise on this question with respect to P&C and life insurance.

Question 5: Effective date and transition

The NAIC considers the IASB's current proposed approach to transition to be an improvement over previous proposals. Interested parties in Indianapolis raised concerns with the proposed measurement of the margin on transition, while recognizing that the current ED is a substantial improvement over the IASB's original proposals.

Question 6: The likely effects of a standard for insurance contracts

The NAIC's overall view on the proposed standard is that its complexity means that its benefits are unlikely to justify its cost. Interested parties in Indianapolis agreed with this view, noting that the level of complexity in the standard must be justified by its benefits.

Question 7: Clarity of drafting

The NAIC considers the drafting of the proposed standard and its intent to be highly unclear.

Other NAIC and interested party views

The NAIC views the one year safe harbor for P&C insurers not to discount to require either expansion or guidance on materiality. The NAIC's document notes that the impact of discounting is unlikely to be material for a number of years in a low interest rate environment, and therefore suggests that the length of the safe harbor may vary according to the interest rate environment.

The working group also heard comments from interested parties on the appropriateness of probabilistic-based reserving for P&C contracts in general, and the proposed changes to onerous contracts requirements, which the working group heard would lead to non-comparability between insurers by requiring onerous contracts to be recognized based on expected future costs. Interested parties also raised a lack of clarity in the IASB's proposed treatment of mutual entity obligations towards policyholders treated/not treated as equity-like obligations. Finally, interested parties raised concerns with the proposed approach to accounting for acquisition costs.

## **International Insurance Relations Committee**

The committee met by conference call in August, followed by an in-person meeting in Indianapolis.

*Topics relating to financial stability and ComFrame were discussed by several committees, task forces and working groups at the Summer National Meeting. All discussions in relation to these topics are summarized in this section of this newsletter.*

Financial Stability and Global Systemically Important Insurers (G-SIIs)

A substantial part of the committee's discussions at the Summer National Meeting were focused on financial stability and the associated recent activities of the Financial Stability Board (FSB) and the IAIS. The committee heard that the IAIS published in July its assessment methodology and policy measures to be applied to G-SIIs, which were endorsed by the FSB. Further, the committee heard that the FSB has identified an initial list of nine G-SIIs, including 3 U.S. insurers,<sup>1</sup> and that reinsurer designations are expected next summer. The policy measures include requirements for recovery and resolution planning, enhanced group-wide supervision, and higher loss absorption requirements (HLA). However, the committee also heard that neither the policy measures nor the G-SII designations are binding on any particular regulator, and that authority to designate systemically important insurers in the U.S. is held by the Financial Stability Oversight Council (FSOC), which has also started to exercise these

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<sup>1</sup> For analysis of the policy measures, their impact for the firms designated, and future developments for G-SIIs, U.S. non-bank SIFIs and the wider insurance industry, see PwC's July 2013 *Regulatory Brief Systemically important insurers: Global follows US lead*, available at <http://pwc.to/1dJf63M>.

powers domestically to commence the designation of U.S. insurers as non-bank SIFIs.

The committee heard that the NAIC had expressed concern with the FSB's designations, with Commissioner Thomas Leonardi (CT) issuing a public statement on behalf of the NAIC questioning the sufficiency of the analysis to identify the designated G-SIFIs. The NAIC and state regulators are involved in the IAIS's process, and the Federal Reserve Board, the Department of the Treasury and the SEC are members of the FSB. However, the committee heard that the NAIC had no visibility of any information that the FSB may have used to make its designations, beyond the relative ranking of insurers prepared by the IAIS. The committee heard that the NAIC did not consider this relative ranking to be sufficient to designate individual insurers, and that it had therefore called for a comprehensive study to be carried out comparing the proposed G-SIFIs with systemically important banks, to compare the risks posed by the most systemically important insurers with the risks posed by the most systemically important banks. The committee noted that designating insurers as systemically risky where they do not actually pose systemic risk, itself carries the risk of creating "too big to fail" insurers, and reiterated its view that traditional insurance business does not give rise to systemic risk.

The Financial Stability Task Force also discussed the insurer designations, and heard that the NAIC had also questioned the FSOC's insurer designations, in particular the suggested "run-like" scenarios that had formed part of its rationale. The NAIC considers these to represent a misunderstanding of the insurance business model and the regulation of insurers.

The committee discussed two principal areas of the IAIS' policy measures: firstly, the proposed "backstop" capital requirements, which will form the basis of HLA requirements, and secondly, the proposed "comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a quantitative capital standard," for which the IAIS has been asked to prepare a workplan by October 2013. As discussed further below, the IAIS' policy measures are not clear on whether this refers to ComFrame, or whether ComFrame would satisfy the proposal. However, at its meeting in Indianapolis, committee members noted the potential for overlap between ComFrame and the IAIS' work in relation to G-SIFIs. These two projects of the IAIS have so far been distinct, but both committee members and interested parties

expressed concern about the risk that policy measures applicable to G-SIFIs may ultimately influence requirements being prepared by the IAIS for wider application in the insurance industry. The committee heard that discussions are ongoing at the IAIS on the potential overlap, but that it is not clear currently what the final outcome may be, nor who the ultimate decision maker(s) may be.

Other interested party concerns expressed to the committee at the Summer National Meeting included the potential for Dodd-Frank to apply "bank-centric" capital standards to insurers, and more generally the need for requirements applicable to insurers to be tailored to the insurance industry and business model. Further, interested parties questioned the purpose and noted the potential for uneven application of capital standards. Interested parties also renewed their call for the IAIS' and FSB's processes to be opened to observation and consultation. However, the committee heard that the IAIS has no current plans to consult on its workplan for the comprehensive, group-wide supervisory and regulatory framework. The committee noted its agreement with interested parties on many of the issues raised.

While not discussed at the Summer National Meeting, the FSB also released its report *Peer Review of the United States* in late August. The review was conducted following the 2010 FSAP review of the U.S., and recognized substantial developments to U.S. regulation since the FSAP. However, the report also found the U.S. regulatory system to be "complex and fragmented," and made a number of recommendations, including a greater role for federal regulatory bodies including the FSOC and the FIO.

Following the release of the FSB's report, Commissioner Thomas Leonardi (CT), chair of the committee, made several public comments supporting the NAIC and the U.S. state-based insurance regulatory system. Commissioner Leonardi suggested that the FSB's report dismissed the strengths of U.S. state-based regulation, and that the FSB did not have a sufficient understanding of the U.S. state-based system and the activities of state regulators. However, the Department of the Treasury, which is a member of the FSB, welcomed the independent evaluation provided by the report, noting its agreement that the establishment of the FSOC, OFR and FIO are important steps to enhance the stability of the financial system.

### ComFrame

The committee also devoted significant time in Indianapolis to discussion of ComFrame. The committee heard that the IAIS is currently working on an updated draft of ComFrame, which it intends to consider and release for a 60-day comment period at the IAIS' 2013 Annual Conference, scheduled October 16-19 in Taipei. The committee also heard that the IAIS's Field Testing Task Force (FTTF) is continuing to work on the planned field testing phase of ComFrame, and is developing questionnaires covering the various aspects of ComFrame. The committee heard that field testing will evaluate the effectiveness and assess the cost-benefit of ComFrame, and that the first questionnaire, which will consider the "backstop" capital requirement proposed by the IAIS in relation to its policy measures for G-SIIs (as discussed above) in addition to ComFrame elements, is expected to be issued in March 2014. ComFrame areas that were identified in Indianapolis as key topics for the questionnaires include valuation, confidentiality and the role of the group-wide supervisor. The regulators further heard that field testing is expected to be completed in 2017 to 2018.

The committee heard that the IAIS is seeking U.S. participation in field testing. However, both committee members and interested parties raised the perceived current lack of clarity on the field testing process and content, and the consequent difficulty of planning resources, as a potential barrier to participation. The committee heard that the FTTF is currently in the early stages of planning field testing, but that it is sensitive to the time commitment that will be required by volunteer regulators and insurance groups.

Interested parties also expressed concern about the lack of opportunity for observer or public input into the ComFrame development process, particularly given the substantial policy changes and redrafting work currently taking place at the IAIS, for example around the ComFrame Adjusted Pro-Forma Balance Sheet (CAPFBS), which is no longer expected to form part of the valuation framework. Interested parties also noted the IAIS's current work on revisions to ICP 23: Group-wide Supervision, which is also expected to have an impact on ComFrame once completed. These concerns were shared by committee members, who the committee heard had previously called on the IAIS to open the process.

The committee also discussed the potential implications of the IAIS' and FSB's G-SII work for ComFrame, and both committee members and

interested parties highlighted what they saw as an apparent connection between the "comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a quantitative capital standard," being proposed as part of the IAIS's G-SII measures, and ComFrame. The committee discussed the potential influence that the G-SII workstream may have on critical ComFrame issues such as the role of the group supervisor and the role of group capital in the framework, and interested parties at the meetings of both the committee and the Group Solvency Issues Working Group also questioned the value of the expected upcoming ComFrame consultation, given the expectation that key issues consulted on may later be redeveloped in any case, for example to incorporate changes to ICP 23 made after the IAIS' Annual Conference in October. Further, and in common with the Group Solvency Issues Working Group, above, the committee discussed the future role of the IAIS more generally, and whether its role on the FSB may ultimately impair its independence as a standard-setting organization, in addition to the risk to its independence posed by pressure from the FSB towards specific conclusions on topics such as capital and the role of the group supervisor. The committee also discussed the risk of a disconnect between the IAIS' ongoing work on ComFrame, and the best practices for group supervision that regulators are developing meanwhile through colleges of supervisors.

At its meeting in Indianapolis, the committee also discussed and adopted a position paper on ComFrame, intended to articulate in a summary form U.S. state insurance regulators' views on ComFrame, and to serve as a guide for regulators at meetings of the IAIS. The committee heard comments from interested parties on the points of view expressed in the document, including its proposed use of the accounting and valuation bases set out in the IASB's and FASB's insurance contracts exposure drafts for ComFrame testing purposes. The committee heard that this is not intended to imply usage of any specific drafts of the EDs, but to encourage ComFrame testing to leverage work that insurers are expected already to be carrying out to prepare for implementation of the proposed new accounting standards. The committee also heard that the view expressed is not reflective of any conclusions on the future of statutory accounting, and further that the NAIC would still support the use of statutory accounting for ComFrame purposes for insurers not required to apply U.S. GAAP, for example mutual insurers.

The International Solvency and Accounting Standards Working Group also discussed ComFrame at its meeting in Indianapolis, and heard comments from interested parties expressing concern with the proposed use of the valuation bases set out in the EDs, as expressed in the position paper. Interested parties noted that variations exist in accounting and valuation frameworks internationally, and that IAIGs may be disadvantaged by the application of an additional and different valuation framework by ComFrame. The International Solvency and Accounting Standards Working Group also discussed and agreed to support the use of the amortized cost valuation basis for ComFrame field testing, which it heard is currently expected to require market-consistent (fair) valuation.

The position paper is otherwise broadly consistent with the NAIC's previously expressed positions on ComFrame.

#### Supervision of Branches

On its August conference call, the committee discussed and agreed to submit to the IAIS its comments on the IAIS' *Issues Paper on Supervision of Cross-Border Operations through Branches*, which was released in July for a one-month comment period. The NAIC's comments proposed some updates intended to clarify points in the paper and to provide a more balanced view. More generally, both the committee and interested parties agreed that the paper has improved from previous versions, and contains less of an anti-branch bias than previously. However, the committee noted that it still hopes for further improvement to the paper.

The NAIC continues to stress its view that it supervises branches and subsidiaries in largely the same manner, and does not see a regulatory basis for preferring one organizational structure over the other, with advantages and disadvantages of both branches and subsidiaries. The committee also continues to question the need for the issues paper to have been prepared at all.

Interested parties also expressed concerns to the committee about recommendations made in the current draft of the issues paper for more work to be carried out by the IAIS on branches. Interested parties noted that they do not consider further work to be necessary, given the work already carried out to prepare the issues paper, and that parameters should at least be placed around what any further work might entail, including preserving optionality over form of operation, cost-benefit analysis, neutrality, empirical foundation, and consideration

of other forms of operation, such as subsidiaries and joint ventures.

#### EU-U.S. Dialogue Project

The committee heard that the EU-U.S. Dialogue Project is ongoing, with a recent meeting held in Frankfurt. The committee heard that reinsurance remains a priority for the Dialogue Project, and that a public forum in Washington D.C. is planned on December 14, to coincide with the NAIC's Fall National Meeting.

#### Joint Forum

The committee heard that the Joint Forum has released for comment its papers on point of sale disclosures and longevity risk transfer markets, each for a two-month comment period. Both papers have cross-sectoral perspectives. The committee heard that the longevity risk transfer markets paper recommends that policymakers establish an explicit capital requirement for longevity risk. The NAIC plans to respond to both documents.

## **Financial Stability Task Force**

The task force met in Indianapolis, and discussed systemically important insurers and the work of the IAIS, FSB and FSOC. These discussions are summarized under the International Insurance Relations Committee, above.

The task force also discussed the FSOC's 2013 Annual Report, which was published in April 2013 and is intended to describe significant financial market and regulatory developments, analyze potential emerging threats, and make recommendations to enhance U.S. financial markets, promote market discipline and maintain investor confidence. The committee heard that the report discusses the risk of prolonged low interest rates for insurance companies, and recommends that supervisors ensure that stress testing carried out by insurers captures interest rate risks.

The task force also heard presentations on resolution planning, which discussed lessons learned from current resolution plan filers in the banking industry, and risks posed by the interest rate environment, which discussed regulatory tools used to monitor interest rate risk.

## Government Relations Leadership Council

At the Summer National Meeting, the council heard a presentation from MetLife on its alternative capital proposal for non-bank systemically important financial institutions (SIFIs) and thrift holding companies. In its presentation, MetLife again emphasized that traditional life insurance generally does not pose systemic risk. It is MetLife's belief that naming a handful of insurers as SIFIs is not the best approach to regulating potentially systemic activities. On the basis that bank-centric capital frameworks are inappropriate to measure the risks of an insurance company, MetLife evaluated alternatives to the Basel framework and developed an "aggregated activities-based approach" which supports group supervision, uses a consolidated measure of capital, and captures all entities. MetLife's proposed capital model involves three steps: (1) sum the available and required capital for insurance entities and other subsidiaries (i.e. asset management), (2) adjust for holding company leverage by calculating the net asset balance of the unconsolidated holding company, and (3) determine capital ratio by subtracting the net asset balance of the unconsolidated holding company from the sum of available and required capital.

The council discussed comments to its draft letter to the U.S. Department of Labor, U.S. Department of Health and Human Services, and U.S. Department of Treasury concerning fixed indemnity insurance. The letter is in response to the issuance of "ACA Implementation FAQ #11." Question number 7 which relates to circumstances under which fixed indemnity (or hospital indemnity) plans are to be considered "excepted benefits" under the Public Health Service Act, and therefore exempt from the provisions of the Affordable Care Act. Since adoption of the Health Insurance Portability and Accountability Act of 1996, fixed indemnity and hospital indemnity plans have been classified as "excepted benefits" in the Public Health Service Act. In "ACA Implementation FAQ #11" the answer to question number 7 states that coverage with variable fixed amounts based on type of service does not meet the definition of a hospital or other fixed indemnity insurance and is not considered "excepted benefits" under the Public Health Service Act. In the letter, the council expressed concerns noting that immediately requiring modifications to these plans in order to retain excepted benefit status would unnecessarily strip consumers of their coverage options. The letter also states that the NAIC believes fixed indemnity coverage with variable fixed amounts based on service type could provide important options for consumers as supplemental coverage. The letter

requests for the departments to reconsider its position regarding this matter. After reviewing proposed changes to the draft letter, the council adopted the issuance of the letter.

## Captive and Special Purpose Vehicle Use Subgroup

The subgroup met via conference call June 6 and adopted its white paper with very few changes from the previous draft. The most significant change was the deletion of the following sentence: "due to changes made to AG 38 by the NAIC in 2012, the use of captives and SPVs should no longer be needed for universal life with secondary guaranty transactions but it's possible there may be some remaining AXXX issues that have not been addressed."

The white paper includes recommendations in the following seven areas:

1. Accounting Considerations
2. Confidentiality
3. Access to Alternative Markets
4. International Association of Insurance Supervisors Insurance Core Principles, Standards and Guidance
5. Enhancements to the Credit for Reinsurance Model Act and the Credit for Reinsurance Model Regulation
6. Disclosure and Transparency, and
7. Financial Analysis Handbook Guidance

Consistent with prior drafts, the subgroup did not reach a consensus related to transparency and disclosure, i.e. how much information related to commercially-owned captives and SPVs would be made publicly available. This issue will be considered by the PBR Implementation Task Force.

The subgroup's parent, Financial Condition Committee, adopted the white paper July 17 and its recommendations to the PBR Implementation Task Force and the Reinsurance Task Force as discussed in those summaries. One regulator noted that the first priority should be for additional disclosures by the ceding companies in their annual statements.

Also on its July 17<sup>th</sup> call, the regulators adopted, after extensive discussion, the following new charges related to captives for work by the Financial Analysis Working Group.

- Perform analytical reviews of transactions (occurring on or after a date as determined by the NAIC membership) by nationally significant U.S. life insurers to reinsure XXX and/or AXXX

reserves with affiliated captives, special purpose vehicles (SPVs), or any other U.S. entities that are subject to different solvency regulatory requirements than the ceding life insurers, to preserve the effectiveness and uniformity of the solvency regulatory system.

- For such transactions entered into and approved prior to this date and still in place, collect specified data in order to provide regulatory insight into the prevalence and significance of these transactions throughout the industry.
- Provide recommendations to the domiciliary state regulator to address company-specific concerns and to the PBR Implementation Task Force to address issues and concerns regarding the solvency regulatory system.

During the committee's discussion, two regulators commented that the intent and/or outcome of the proposed charges would be usurping states' ability to approve new captive transactions. The chair noted several times that the process will be voluntary and that the Financial Analysis Working Group will not have approval authority over any transaction. States will not be required to bring transactions to the Financial Analysis Working Group but will be encouraged to do so as part of a peer review and additional feedback. All meetings of the Financial Analysis Working Group are confidential and closed to non-regulators. The chair of FAWG, Steve Johnson of Pennsylvania, committed to performing reviews timely so as to not slow down approval of the transactions by the domiciliary states. He also noted the working group will reach out to captive experts, as necessary.

Other groups in addition to the NAIC are continuing to study captives. In June, the New York State Department of Financial Services published a 23-page paper entitled *Shining a Light on Shadow Insurance - A Little-known Loophole That Puts Insurance Policyholders and Taxpayers at Greater Risk*, which advocates an "immediate national moratorium" on the approval of all new captive transactions until a "complete and a fuller picture" of such transactions emerge. The Federal Insurance Office is also studying captives.

## Reinsurance Task Force

The task force met via conference call in June and August and again in Indianapolis and discussed the following topics.

### Qualified Jurisdictions

The bulk of the task force's efforts this spring and summer have been to finalize the *NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions* document. The task force released two exposure drafts this spring and summer (March 29 and June 27) and received a total of 21 comment letters on the two drafts with many of the same parties commenting on both drafts. Changes made to the draft Process since the Spring National Meeting related primarily to application of the expedited review procedures, enforcement of U.S. judgments and confidentiality protections.

With respect to the expedited review procedures, the task force added a section on consideration of extending the expedited review procedure to other potential Qualified Jurisdictions (i.e. in addition to Bermuda, Germany, Switzerland and the UK) provided that certain conditions are met. These include a report to the Qualified Jurisdiction Working Group confirming that a state has completed a full review of the jurisdiction in accordance with procedures set forth in Evaluation Methodology and that the state completes the full review and lists the jurisdiction as a Qualified Jurisdiction within 60 days of the NAIC's adoption of the Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions.

With respect to the U.S. judgment comments, the task force added the following to Section F, Enforcement of Final US Judgments: "the Qualified Jurisdiction Working Group will monitor the enforcement of final U.S. judgments and the Qualified Jurisdiction is requested to notify the NAIC of any developments in this area."

On the important issue of information sharing and confidentiality, the draft Process was revised as follows:

The NAIC does not intend to review confidential company-specific information in this process, and has focused the procedure on reviewing publicly available information. No confidential company-specific company information shall be disclosed or disseminated during the course of the jurisdiction's evaluation unless specifically requested, subject to appropriate confidentiality safeguards addressed in a preliminary confidentiality and information sharing agreement. If no such agreement is executed or the jurisdiction is unable to enter into such an agreement under its regulatory authority, the NAIC will not accept any confidential company-specific information.

At its August 8<sup>th</sup> conference call the task force adopted its Process for Developing and Maintaining the List of Qualified Jurisdictions document, which was adopted by Executive Committee and Plenary at the Summer National Meeting.

At the Summer National Meeting the working group discussed next steps in implementing the adopted Process. The task force has formed the Qualified Jurisdiction Working Group which will be chaired by California; the working group will begin discussion of a uniform effective date for the four Conditional Qualified Jurisdictions.

#### Reinsurance Modernization Implementation

The task force heard an update on the adoption of the revised credit for reinsurance models by the states. The number of states which have adopted the revised models is now 18, an increase of seven since the Spring National Meeting, and which represents 53% of U.S. direct premium. Five additional states have action under consideration.

#### Reinsurance FAWG

The task force also heard an update from its Reinsurance Financial Analysis Working Group, which purpose is to provide advisory support to states in the review of reinsurance collateral reduction applications. The working group's chair discussed the process for reviewing the reinsurers which have already been certified by Connecticut, Florida and New York, noting their goal of certifying the 29 reinsurers by year-end with a January 1, 2014 effective date for a uniform implementation. All meetings of this working group are regulators only.

#### Referrals from Captives and SPV Subgroup

The task force briefly discussed the referrals below that resulted from the Captives and SPV White Paper. The task force will begin work on these issues in future meetings.

- The task force should consider re-evaluating the Special Purpose Reinsurance Vehicle Model Act (#789), and updating it as necessary to reflect alternative markets solutions acceptable to state insurance regulators, to ensure there is a uniform framework for the implementation of alternative market solutions.
- The task force should monitor ongoing developments of IAIS principles, standards and guidance, and consider, if appropriate, enhancements to the U.S. captive and SPV regulatory framework in preparation for future International Monetary Fund/World Bank Financial Sector Assessment Program reviews.

- The task force should consider studying the effects of, and potential limits on, the variability in qualified LOCs or any other security that might not provide the intended protections provided within the Credit for Reinsurance Model Law and Model Regulation (#785 and #786).

#### Other Projects

The task force briefly discussed other projects it will be resuming discussion of shortly: collection of undisputed reinsurance recoverable balances held by ceding insurance companies in receivership and concerns related to a perceived increase in loss limiting features in finite risk reinsurance transactions.

## **NAIC/AICPA Working Group**

The working group met via conference call April 29 and August 14 and discussed the following topics.

#### Changes to Statutory Audit Opinions

The working group heard a presentation from the AICPA on changes to the statutory audit opinion that were effective for 2012 financial statements as a result of the Auditing Standards Board's clarity project which included special purpose financial statements. Significant changes included the addition of headings to the opinion, a new separate paragraph section explaining the basis for the qualified, adverse or disclaimer opinion and other changes to make the opinions easier to read and understand.

#### CPA Workpaper Issues

The working group discussed a survey done by the NAIC with regard to issues that arise on financial examinations related to the use of independent CPA workpapers, many of which relate to the PDF format in which most workpapers are provided. The working group will work with AICPA representatives to develop possible solutions.

#### Testing of Schedule P

The working group discussed a proposal from the AICPA on the possible elimination of the separate testing of Part 1 of Schedule P as it may duplicate other work done in connection with statutory audits. The working group asked for a more detailed proposal from the AICPA for discussion at a future meeting.

## Blanks Working Group

The working group held a conference call on June 13<sup>th</sup> adopting fourteen blanks proposals as final. The more significant proposals effective for 2013 annual statement reporting include:

- Modified annual statement instructions to reflect reporting of preferred stock Exchange Traded Funds as preferred stock. (2013-01BWG)
- Added two categories to Schedule BA for joint ventures, partnerships and limited liability companies with characteristics of mortgage loans (affiliated and unaffiliated). (2013-02BWG)
- Added illustrations to Note 23, Reinsurance, for the certified reinsurer disclosure for those entities downgraded or subject to revocation of certified reinsurer status. (2013-04BWG)
- Modified instruction for Note 23F(1), to provide additional information with regard to retroactive reinsurance. (2013-07BWG)
- Modified Schedule F in the P/C and Title blank to provide more clarity of reporting. (2013-08BWG)
- Added a new exhibit and related instructions to Health Annual Statement as Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued. (2013-12BWG)
- Modified the disclosures in Note 5, Investments, to reflect the changes to SSAP 37, Mortgage Loans related to the credit quality of mortgage loans. (2013-14BWG)
- Modified the current Interrogatory Question 1 in the Separate Accounts Blank General Interrogatories and add additional sub-questions to the interrogatories regarding seed money, other fees and expenses, and other surplus. (2013-15BWG)
- Modified the instructions and illustrations for Note 21C to reflect disclosure changes for restricted assets (see SAP Working Group summary for further discussion). (2013-16BWG)
- Modified the instructions and illustration for Note 9 to clarify the disclosure regarding the impact of tax-planning strategies on adjusted gross deferred tax assets and net admitted deferred tax assets. (2013-18BWG)

- Modified the instructions for the AVR to reflect elimination of the Mortgage Experience Adjustment Factor used to adjust factors for certain lines. The same lines on the blank will be modified to reflect the new specific factors. (2013-19BWG)

The working group deferred consideration of four proposals on the June conference call, including proposals that would:

- Eliminate the requirement to file the Reinsurance Attestation Supplement and Exceptions to Reinsurance Attestation Supplement and related instructions (2013-03BWG). These supplements were added several years ago when finite reinsurance contracts were prevalent in the industry. The proposal was deferred at the request of the Reinsurance Task Force, until the task force completes its related work with the Financial Analysis Working Group. The proposed effective date of this item is year-end 2014.
- Modify Schedule F to (a) develop and report the Provision for Overdue Reinsurance by reinsurer rather than in aggregate, and (b) clarify certain aspects of the schedule (2013-09BWG). The proposal was referred to the SAP Working Group, as the working group is currently considering a similar issue with respect to presentation and calculation of the Schedule F penalty.
- Add new lines to Schedules F and S to identify reinsurance ceded to affiliated captive insurance companies, and modify instructions to define which entities should be reported on the new lines (2013-11BWG). Interested parties expressed concern that the captive affiliate definition was too broad and would include certain traditional non-U.S. reinsurance affiliates. The working group agreed to revisit the definition, which was exposed for public comment on a July 25 conference call and subsequently adopted on its August 6 conference call. This change will be effective for 2013 annual statements.
- Add instructions and illustrations for new disclosure to Note 5, Investments for Working Capital Finance Investments (2013-13BWG). The proposal was deferred as the SAP Working Group has not finalized its consideration of the item. The proposal was re-exposed at the Summer National Meeting for a public comment period which ends November 17.

A new proposal which would modify the Supplemental Compensation Exhibit and add instructions to facilitate the collection of additional detail on the nature of compensation paid to top executives and directors (2013-20BWG) was exposed in June for a public comment period which ended July 24. At the Summer National Meeting, the working group adopted the proposal, despite interested party requests to defer its consideration because of the pending draft model of corporate governance reporting. Interested parties requested that the two projects be considered concurrently. The proposal was subsequently deferred by the Accounting Practices and Procedures Task Force and referred back to the working group to give further consideration to the interested parties' request. The sponsors of the proposal recommend a 2014 effective date.

A proposal to add an electronic-only disclosure of the cyber-security contact to the Jurat page of the annual statement (2013-21BWG) was exposed for public comment on the July 25 conference call. The proposal was adopted as final on the August 6 conference call.

In addition to the re-exposed proposal (2013-13BWG), two new blanks proposals were exposed for comment at the Summer National Meeting. The new proposals include a request to modify the illustrations and instructions for Note 5 and Note 11 to facilitate improved reporting of Federal Home Loan Banks investments (2013-23BWG). The public comment period for this proposal ends September 13.

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

### Contingent Deferred Annuities Referrals

The committee met by conference call August 6 and in Indianapolis. During the August conference call, the committee discussed and exposed for comment two documents related to the Contingent Deferred Annuity Working Group's report and recommendations submitted to the committee at the Spring National Meeting. One document includes NAIC staff suggested referrals to the various NAIC groups with the appropriate subject matter expertise to work on the issues identified by the working group in its report and the other document includes NAIC staff draft proposed charges for those groups to accompany the referrals. The CDA Working Group recommendations included proposed extensive

projects related to the financial regulation of CDAs and state filing and other requirements for CDAs.

At the Summer National Meeting, the committee discussed comments received and approved revisions to the proposed charges for NAIC groups. Comments on the proposed revisions are due September 10.

### Annuity Disclosure Guideline

In Indianapolis, the committee exposed a proposed guideline amendment to the Annuity Disclosure Model Regulation (#245). The proposed guideline amendment is intended to address a possible issue with a provision in the model that may conflict with the National Securities Markets Improvement Act of 1996. The comment period ends September 16.

## Life Actuarial Task Force

### **PBR Valuation Manual**

#### Aggregate Margins

LATF received a report from the Aggregate Margin Subgroup in conjunction with the AAA Aggregate Margin Task Force (AMTF). The AMTF was formed to assist LATF in evaluating the pros and cons of replacing the individual margin approach with an aggregate margin approach and to recommend a specific aggregate margin approach. The AMTF considered various approaches, focusing on goals of developing an aggregate margin approach that provides adequate policyholder protection, covers all material policy risks, is practical to implement, auditable and reasonably transparent. The approaches considered included a percentage add-on, confidence interval and cost of capital alternatives.

Ultimately, the AMTF recommended a cost of capital approach based on the concept that margins for uncertainty should reflect the cost of holding capital to support the underlying risks being valued. Advantages of this approach include adequate policyholder protections through liability transfer, consistency with global market views on risk margins, and the ability to leverage existing frameworks for determining capital. Disadvantages include added complexity and the inability to directly quantify sufficiency of margin in a runoff scenario. The AMTF also recommended continued consideration of the confidence interval approach given similar pros and cons to the cost of capital approach. The AMTF recommended implementation using a Representative Scenarios Approach, whereby a small number of scenarios are developed to reflect adverse experience for primary risks. This approach provides for consideration of all material risks as well as correlation among risks, is reasonably

practical and transparent. The full report can be found on the NAIC website.

LATF must now consider whether to adopt an aggregate margin approach. If adopted, additional work will be needed to define implementation details, perform "field testing" with actual company data and coordinate with other PBR work such as life mortality tables and VM-22.

#### Valuation Manual Amendments

LATF continued discussion of several Valuation Manual amendment proposals. Amendment proposals exposed for a 30-day comment period included clarifications regarding treatment of due premiums in expected future cash flows when calculating deterministic and stochastic reserves, and inclusion of individually underwritten certificates under group life insurance. A third amendment proposal exposed for comment provides for an extended transition period for small companies. The transition period would be extended from three years to five years for small companies, defined as having direct life insurance premium less than \$500 million per year and direct first-year premium less than \$50 million.

During an interim conference call and at this meeting, LATF discussed proposed amendments from the AAA Life Reserves Work Group that set forth a change in the way the pre-tax investment maintenance reserve is reflected in the deterministic reserve and a direct iteration method to calculating the deterministic reserve. The proposed changes simplify the calculations and, in theory, produce results equivalent to those prescribed in the current draft of the Valuation Manual. Discussion also clarified that the direct iteration method is being proposed as an alternative, not a replacement, for the deterministic reserve calculation. LATF requested numerical examples of the direct iteration method to better understand how the reserves develop and auditability. No vote was taken and discussion will continue on an interim conference call.

LATF also discussed a proposed amendment regarding the treatment of letters of credit in the reserve calculations. The proposal suggests that LOCs be included in starting assets, and that LOC fees be treated as expenses in projected cash flows. Regulators were not comfortable with this proposal and discussion will continue on an interim conference call.

LATF adopted a previously exposed amendment proposal clarifying the treatment of policy loan cash flows in the deterministic and stochastic reserve calculations.

#### VM-22 Fixed Annuity PBR

LATF received reports from both the VM-22 Subgroup and the AAA Annuity Reserve Work Group on activity related to development of a PBR methodology for non-variable annuities. The two groups presented a proposed methodology, comparisons to current requirements and comparisons to features in VM-20 and VM-21 (AG43). Objectives of the proposed methodology include decreased complexity from VM-20 and VM-21, increased auditability, consideration of key risks inherent in current product designs and sufficient flexibility to accommodate new product features. The proposed methodology sets the reserve equal to the greater of a "Floor Reserve" and a "Modeled Reserve," where the floor reserve is expected to generate results comparable to current CARVM requirements while the modeled reserve is scenario-based.

The floor reserve introduces the concept of "Listed Benefits" for purposes of qualifying additional benefits (e.g. GLIBs, annuitizations) for consideration in the valuation. Floor reserves would be defined as the greater of the cash value, reserves including listed benefits (alpha) and reserves excluding listed benefits (beta). Prescribed dynamic lapse rates would be applied in determining every Integrated Benefit Stream, and such lapse rates would reflect in-the-moneyness adjustments. The modeled reserve is expected to be based on a small number of scenarios reflecting on critical risks, using experience assumptions for items within a company's control and prescribed assumptions for all other items. An aggregate margin would also be incorporated in the modeled reserve. Resulting reserves would be subject to asset adequacy analysis, and the need for additional scenario testing is under consideration.

The Kansas Insurance Department is conducting a field test of the practicality of the proposed approach. Work is underway to test the calculations for a variety of products based on information submitted by two companies. There will be an interim call to report on progress prior to the Fall National Meeting.

#### Standard Nonforfeiture Law and Low Interest Environment Considerations

At the Spring National Meeting and again in Indianapolis, LATF discussed a proposed amendment to floor the maximum nonforfeiture interest rate at 4%, the rate used to demonstrate that a life insurance contract meets the requirements of IRC Section 7702 to qualify as life insurance for

federal tax purposes. Currently, the maximum nonforfeiture rate, as with the valuation interest rate for reserves, is a dynamic formula based on the Moody's Corporate Average Yields. Without such a floor, the potential exists for the state nonforfeiture interest rates to drop below 4%, whereby traditional life insurance contracts would fail to comply with IRS requirements for favorable tax treatment. Changes are required in both the Valuation Manual and the Standard Nonforfeiture Law for Life Insurance (#808). At the Spring National Meeting, LATF requested approval from the Life Insurance and Annuities Committee and the Executive Committee and Plenary to open the model law for change, but the request has not yet been approved. Once the request is approved, it is not clear whether LATF will quickly adopt the changes since discussions did not yield consensus on the need for this change. However, since the Moody's Corporate Average Yields have recently increased, there may not be an issue unless rates decline further.

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

LATF discussed a motion to consider adjustments, modifications or clarifications to AG33 to address Guaranteed Living Income Benefit (GLIB) reserving. Currently, the prescribed methodology implicitly requires a 100% benefit utilization assumption and industry and some regulators believe this to be too conservative. The potential modification to AG33 could be as simple as consideration of the appropriate utilization rate, and does not preclude use of AG43 methodology as a solution. The motion failed 4-1 with 5 members abstaining. It was not clear whether LATF will have any future discussion or consideration of this matter.

#### **C-3 Phase 2/AG 43 Subgroup**

This subgroup is charged with developing more consistency between RBC's C-3 Phase 2 and AG 43 reserves. The subgroup held interim conference calls to hear and discuss a report from the AAA C-3 Phase II RBC/AG-43 Work Group on equity return calibration criteria, to discuss AG43 amendment proposal forms previously submitted by New York regulators and currently before the subgroup, and to continue discussion of the definition of "in the money" (ITM) and "lapse".

The New York proposals address equity market volatility as reflected in the standard scenario and policyholder behavior for deep ITM guarantees, and would generally make the prescribed assumptions for these items more conservative. Discussion of the proposed changes, including a comment letter submitted by the ACLI, identified inconsistencies in the definitions of ITM and lapses. The

inconsistencies stem from differences in the definition of the ITM benefit (i.e. a benefit base or present value of the guarantee) relative to the account value, and from inclusion in lapses of instances where policyholders obtain a benefit that exceeds the cash surrender value. The inconsistencies create challenges in the comparison of experience to assumptions and in the evaluation of results. The subgroup plans to work with companies to ensure a common understanding of the relevant definitions, and this item will be addressed in the upcoming annual New York Special Considerations Letter.

The primary objective of the AAA presentation on equity return calibration criteria was to determine if the addition of post-2003 data (i.e., inclusive of the recent financial crisis) would materially change the calibration criteria. The report suggests that the current scenario model fits the historical data extremely well even over longer periods of time, and that the addition of post-2003 data would result in only minor changes to the calibration criteria. The AAA suggested if a change is deemed necessary, there should be a defined process established regarding the data to be included and how updates will be addressed, particularly considering the amount of work involved in developing and testing the criteria.

The subgroup plans to present proposals on these items to LATF later in 2013 or early 2014, in time for 2014 implementation.

#### **Valuation Mortality Tables**

LATF received a report from the Society of Actuaries (SOA) & AAA Joint Project Oversight Group on the status of work related to development of a 2014 Valuation Basic Table (VBT), 2014 Commissioners Standard Ordinary (CSO) table and Guaranteed Issue/Simplified Issue/Preneed (GI/SI/PN) mortality tables. The 2014 VBT gender distinct and smoker status tables are being finalized and a report to LATF is anticipated by the end of September, with a recommendation to expose the draft tables for comment. Relative to the CSO table, the group is compiling analysis on the history and purpose of margins and how they might differ between net-premium reserves and determination of nonforfeiture values as compared to gross premium reserves or principles-based reserves, but the recommendations are contingent upon the decision regarding aggregate or individual margins on assumptions in VM-20. Work on the GI/SI/PN tables continues and the group anticipates presenting these tables in early October.

### **Nonforfeiture Modernization**

LATF received an update from the AAA Nonforfeiture Modernization Working Group. Recently, this working group has been focused on providing input to support the Kansas field test of the proposed methodology for Principles Based Reserves for fixed (non-variable) deferred annuities. The working group was asked by the Kansas representative to provide comments on the considerations involved in the determination of nonforfeiture values for fixed deferred annuities, with and without guaranteed lifetime income benefits (GLIBs), under the Gross Premium Nonforfeiture Method approach proposed in the AAA Working Group's August, 2011 Report. The AAA Working Group concluded that required nonforfeiture amounts for fixed deferred annuities with no riders or GLIBs may be determined using a generalized retrospective approach, but identified several issues related to the determination of nonforfeiture values for GLIBs, including challenges with retrospective measurement of anticipated risks, the basis for a separately identifiable nonforfeiture value and the method of calculation. In upcoming reports to LATF and Kansas, the AAA Working Group will provide the relevant observations and recommendations with respect to determination of nonforfeiture values under PBR for both types of products.

### **Experience Reporting**

The LATF Experience Reporting Subgroup presented a case statement supporting mandatory expense data reporting to enable regulators to benchmark expense data and to establish a consistent basis for comparability. The statement discusses the need for expense information, alternative approaches for collecting the relevant information and advantages and disadvantages of mandatory data collection. The group asserts that the benefits outweigh the costs associated with the data collection and proposes testing the process on a pilot basis prior to implementation. The case statement has been exposed for comment for a period of 60 days.

### **Actuarial Opinion and Memorandum Regulation Communication Group**

LATF heard a report from the AAA Actuarial Opinion and Memorandum (AOM) Regulation Communication Group. This discussion group is focused on opening lines of communication between regulatory actuaries and appointed actuaries in order to improve practice and understanding. Three distinct subgroups including both regulatory and company actuaries have met at least monthly to discuss consolidation and standardization of AOMs, communication of assumptions and enhanced

Regulatory Asset Adequacy Issues Summary (RAAIS), and addition of links in the AOMs for key issues; this latter subgroup is developing a Word template for this purpose. The discussion subgroup will provide input to the AAA workgroup updating the 2004 Asset Adequacy Analysis Practice Note. Also, discussion forums to address this topic specifically as it relates to Universal Life with Secondary Guarantees/AG38 and Variable Annuities/AG43 will be held at the September 2013 Valuation Actuary Symposium (VAS).

LATF received referrals from the Corporate Governance Working Group to incorporate into regulation a requirement for life insurance entity appointed actuaries to present the full actuarial report to the board of directors on an annual basis, consistent with the requirements for appointed actuaries of health and property/casualty entities. LATF will make a request to its parent committee that the Actuarial Opinion and Memorandum Regulation (AOMR) be opened to include this requirement.

### **IIPRC Report**

The Interstate Insurance Product Regulation Commission provided LATF with an update on recent activities including work to address comments on the recently exposed standards for incidental guaranteed minimum death benefits on non-variable annuities and group term life accelerated death benefits. The commission also discussed the proposed framework for its report on Uniform Standards currently subject to five-year review. The report will distinguish recommendations between clarification, substantive and technical changes, each of which are compiled from suggestions or issues in the comments or raised by the IIPRC Office in conjunction with the product filing review process.

### **Generally Recognized Expense Table**

The SOA Committee on Life Insurance Company Expenses presented analysis to assist LATF in considering for adoption the recommended 2014 GRET factors. The proposed factors vary by distribution channel, consistent with the current factors, and reflect reductions for most distribution channels. Factors for Branch Office, Multiline and "Other" channels show increases. LATF voted to expose the 2014 GRET factors for a period of 30 days. Typically, GRET exposures get few if any comments. We expect that the exposed GRET table will be adopted later this year for use in 2014.

### **Joint Qualified Actuary Subgroup**

In December 2012, LATF, HATF and the Casualty Actuarial and Statistical Task Force formed the Joint Qualified Actuary Subgroup (A/B/C) to develop recommendations on (1) a uniform definition of “qualified actuary” for life, health and P&C Appointed Actuaries signing prescribed Statements of Actuarial Opinion, identifying any differences that should remain between lines of business and a uniform definition of “qualified actuary” for other regulatory areas (e.g. rate filings, hearings), and (2) a definition of inappropriate or unprofessional actuarial work and a process for regulatory and/or professional organizations’ actions. Following an open session at the Spring National Meeting, the subgroup held several conference calls to discuss the charges, record observations and compile recommendations. The result of this activity and dialogue is a Discussion Draft documenting the subgroup’s considerations and recommendations or requests for more direction. At this meeting, the subgroup submitted the Discussion Draft to LATF (and separately to HATF and CASTF) for exposure.

The Discussion Draft presents considerations regarding the definition of “qualified actuary” and options for strengthening the definition. The Joint Subgroup failed to reach consensus on any meaningful recommendations. The subgroup did reach consensus relative to potential revisions in the definition of an Appointed Actuary, including disclosure elements that would increase the transparency of the appointed actuary’s qualifications, but seeks more direction relative to the definition of a qualified actuary for other regulatory areas. With regard to the second charge, the Discussion Draft addresses the definition of inappropriate or unprofessional actuarial work, presents both measured and more substantial regulatory actions in response to such work, as well as means of implementing such actions, but does not make specific recommendations due to a lack of consensus on the issues.

The Discussion Draft has been exposed for comment through September 27 and is available on the NAIC’s website.

### **Emerging Actuarial Issues Working Group**

The Emerging Actuarial Issues Working Group was formed by the NAIC to address implementation issues resulting from the revision to AG 38 for universal life products with secondary guarantees. Since the Spring National Meeting, the working group held interim conference calls to discuss interpretive responses to questions submitted by

practitioners. During these meetings, the working group adopted previously exposed interpretations and voted to expose responses to pending questions. Recent interpretations addressed the applicability of negative results in section 8E, use of the Alternative Reserves Methodology in section 8D(b) and the basis for application of the deterministic reserve under 8D(a). The working group also discussed questions for which responses have not yet been exposed, and will continue to hold conference calls to finalize responses to questions still under consideration. Submitted questions, exposed responses and adopted interpretations are available on the NAIC website.

### **Health Insurance and Managed Care Committee**

The committee met by conference call May 14, June 27, August 8, and in Indianapolis and discussed the following topics.

#### Coordination of Benefits Model Regulation (#120)

The committee adopted amendments to the Coordination of Benefits Model Regulation (#120) that address issues related to medical benefits coverage in certain automobile contracts and extend the dependent coverage to age 26 as provided in Section 2714 of the federal Public Health Services Act. The model revisions were adopted by Executive Committee and Plenary at the Summer National Meeting.

#### Frequently Asked Questions About Healthcare Reform

The committee adopted a Frequently Asked Questions document developed by the Consumer Information Subgroup. The FAQ provides guidance on the federal Affordable Care Act for use by state insurance department staff as they begin to receive the anticipated influx of consumer calls regarding health insurance exchanges and general ACA implementation. Two documents accompany the FAQ: 1) the flow chart; and 2) the uniform glossary of health insurance terms. The uniform glossary is the final version adopted by the U.S. Department of Health and Human Services. The flow chart is not intended to be used as an eligibility tool and is intended to provide a general overview of the best place for consumers to learn more about coverage options that will be available after full implementation of ACA. Later, the Executive Committee and Plenary adopted the FAQ and attachments at the Summer National Meeting.

### Health Care Reform Guidance Papers

The committee adopted three guidance papers developed by the Health Care Reform Regulatory Alternatives Working Group:

- State Decisions: Federally Facilitated Exchange States
- ACA Impact on State Regulatory Authority: Qualified Health Plans, and
- ACA Impact on State Regulatory Authority: Health Plans Outside Exchanges.

### Individual Market Health Insurance Coverage Model Regulation

The committee heard an update from the Regulatory Framework Task Force on its exposed Individual Market Health Insurance Coverage Model Regulation, which is to be a companion to the Individual Market Health Insurance Coverage Model Act (#36). The task force heard comments and anticipates distributing a revised draft for comment by late September.

## **Health Actuarial Task Force**

### Long Term Care

The LTC Actuarial Working Group received a status report from the AAA State LTC Principle-Based Work Group, which is developing and testing a model to examine the impact of stochastic analysis under a principles-based approach to LTC reserve valuation. The current prototype models mortality, morbidity and lapse risks on a stochastic basis, but resource constraints have stalled progress on reflecting stochastic interest rates. Work on the model was to be completed by the end of 2014, but resource constraints have delayed progress and a report is not expected for another 12-18 months. Regulators are concerned that they will need to propose a methodology for principles-based reserves for LTC without the support of the AAA, and encouraged the use of consultants to help complete this work. The subgroup will investigate this option.

The AAA LTC Credibility Monograph Work Group presented an update on its work to establish the applicability of credibility procedures to LTC insurance and to establish the importance of incorporating credibility into LTC-related actuarial work. A draft monograph is expected to be submitted in January 2014.

The AAA Long-Term Care Terminations Work Group reported on its work to provide analysis of LTC termination, voluntary lapse and mortality experience. Companies have been targeted for

solicitation of data and results of the study are expected to be reported sometime in 2014.

The Long-Term Care Pricing Subgroup of the LTC Actuarial Working Group reported progress on charges from the Senior Issues Task Force to (1) make recommendations regarding the actuarial aspects of a proposed bulletin for states regarding approval of LTC rate increases and (2) review revisions to the LTC Model Act (#640) and LTC Model Regulation (#641) to improve rate stability standards. The subgroup reached consensus on recommendations regarding the bulletin, but struggled to reach consensus on the recommended changes to the Model Act and Regulation. As such, the LTC Work Group directed the subgroup to continue work on the modifications and withheld presenting the changes for HATF to deliver to the Senior Issues Task Force.

### Cancer Claim Cost Table

The task force received a report from the joint AAA & SOA Cancer Claim Cost Table Work Group on the development of a new cancer morbidity table. The new table would replace the 1985 tables which are outdated and which many companies no longer use in favor of their own experience. Following identification of problems with the data submissions from 12 submitting entities, the data aggregator went back to each submitting entity for revisions. The aggregator plans to have usable data to the work group by the end of 2013, but given these early issues the work group is hesitant about the data quality and anticipates development of a proposed valuation table to be delayed beyond 2014. In the meantime, the workgroup approved the incidence and exposure calculations the data collector will use to synthesize the data.

### Group Long-Term Disability Work Group

The task force received a progress report from the AAA Group Long-Term Disability Work Group regarding implementation of the 2012 Group LTD table into valuation standards. Proposed revisions to the LTD model regulation and a new actuarial guideline were exposed for comment between November 2012 and May 2013, and at this meeting the work group presented revised materials with modified language to address the comments. The modifications suggest the table will be effective October 1, 2014 at the earliest but by October 1, 2016 at the latest. The submitted materials were re-exposed for a 3-week period.

## Separate Account Risk Working Group

The working group held a conference call June 5 to review comments on its draft Non-Variable, Insulated Product Characteristics/ Proposed Recommendations document, which had been exposed for comment January 9. The document summarizes information regarding product attributes and characteristics for non-variable, insulated products, with a goal to “establish an expert view without considering the existing requirements of models or state laws and regulations.” The draft paper segregates the products into five groups and recommends for three of the groups, Grouping A (Market Value Adjusted Annuities and Modified Guaranteed Annuities), Grouping B (Flexible Premium Deferred Annuities, Deferred Annuities, Fixed Annuities, Fixed Income and Fixed Credited Interest Rate) and Grouping E (Single Premium Annuities, Experience Rated Contracts and Non-Experience Rated Contracts), that these products (and products with different names, but similar characteristics) should not be insulated from general account claims.

The working group received 100 pages of comment letters from nine trade associations and other interested parties; most commenters disagreed with the exposed product characteristics and conclusions. The ACLI suggested that an alternative approach would be to “make use of a set of basic principles that ... should be applied in assessing the use of insulation of assets within separate accounts.” The Committee of Annuity Insurers emphasized its belief that no significant problems have been detected that would lead to a requirement for non-insulation. Other commenters made similar points.

At the conclusion of the call, the chair requested a regulator-only call to discuss the comments received, including whether to expand the focus of the group to some of the additional questions that have arisen as a result of the discussions, such as why noninsulated products are included in some separate accounts and whether they are subject to general account provisions such as asset adequacy and nonforfeiture requirements. The next public call of the working group may be scheduled for early fall.

## Financial Regulation Standards and Accreditation Committee

The committee met in Indianapolis and took the following actions:

### Revisions to Documents Required for Accreditation

The committee adopted three significant revisions made to the Financial Condition Examiners Handbook relating to prospective risk assessment, issue/risk tracking template, and IT reviews of small companies. The revisions were exposed at the Spring National Meeting and no comments were received.

### Revisions to the Review Team Guidelines

The committee discussed the proposed revisions to the Review Team Guidelines to incorporate the significant 2012 amendments made to the Financial Condition Examiners Handbook and exposed the proposal for a 30-day comment period.

The committee discussed a referral from the Group Solvency Issues Working Group that includes proposed revisions to the Review Team Guidelines regarding performance and documentation of the annual holding company assessment. The revisions better reflect the different expectations for lead states and other domestic states as it pertains to the holding company analysis, including appropriate steps for the lead state to take in communicating the results of the holding company analysis to other states. The committee exposed the proposal for a 30-day comment period.

### Revisions to the Business Transacted with Producer Controlled Property/Casualty Insurer Act (#325)

The committee adopted revisions to this model, noting that the revisions remove the exemption of risk retention groups chartered as captives from the definition of licensed insurer effective January 1, 2014. The revisions were exposed at the Spring National Meeting and no comments were received.

### Own Risk Solvency Assessment Model Act (#505)

The committee re-exposed the ORSA Model Act as a possible addition to the accreditation standards for a one-year comment period.

### Insurance Holding Company System Regulatory Act and Model Regulation (#440, #450)

The committee adopted the 2010 revisions to the Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation as an update to the accreditation standards effective January 1, 2016.

### Revisions to Part A: Correction Action Standard

The committee discussed a referral from the Corporate Governance Working Group requesting for Section 4B(10) of the Model Regulation to Define Standards and Commissioner’s Authority for Companies Deemed to be in a Hazardous Financial Condition (#385), to be added to the list of critical elements required to be adopted as part of the NAIC Accreditation Standard for Corrective Action.

Section 4B(10) allows the commissioner, upon a finding of hazardous operation, to issue an order requiring the insurer to correct corporate governance practice deficiencies. This element represents the strongest, most specific authority available to a commissioner to require correction of corporate governance deficiencies and has been identified as critical to the effective regulation of an insurer's corporate governance. The committee exposed the proposal for a 30-day comment period.

#### Revisions to Part A: Standards for RRGs

The committee discussed a referral from the Risk Retention Group Task Force relating to a requirement for RRGs in Part A to audit the Note 1 reconciliation of surplus from generally accepted accounting principles to statutory accounting principles. Regulators of captive RRGs have expressed concern regarding the reconciliation in the audited financial report, noting that in order to audit the reconciliation, the auditors must perform additional procedures at an additional cost to the RRG. The concerns are auditor's costs and additional record keeping by the RRG that may be required by the auditors. The task force recommended that the committee remove the requirement that the reconciliation be part of the audited financial statements. The unaudited reconciliation will be provided to non-domestic regulators in Note 1 of the annual statement. The committee exposed the proposal for a 30-day comment period.

### **Annuity Disclosure Working Group**

In Indianapolis, the working group reviewed electronic versions of the recently revised Buyer's Guides for Deferred Annuities. Three versions of the Buyer's Guide will be available, a fixed annuity guide, a variable annuity guide and a combined guide. The NAIC has not decided how the electronic versions of the guides will be distributed; however the working group noted that the goal is to distribute the guides as broadly as possible. The guides are likely to be available on the NAIC website and state websites, as well as, consumer and industry association websites.

The "bound" hardcopy versions of the Buyer's Guides were previously adopted at the Spring National Meeting and are required to be distributed to consumers by agents under the revised Annuity Disclosure Model Regulation (#245) and are intended to allow consumers to make a more informed purchase decision. The working group discussed issues involving the timing of transition from the prior version of the bound guide to the

current versions, including issues involving states that have adopted the prior version of the Annuity Disclosure Model Regulation, which includes the prior buyer's guide as an appendix. Currently, only Iowa has adopted a requirement for the variable annuities guide to be provided to prospective annuity buyers. Iowa indicated a likely transition date to the new guide of January 1, 2014.

Having completed its charge, the working group agreed to recommend that the Life Insurance and Annuities Committee disband the working group. In its later session, the committee approved the motion to disband. It is expected that the committee will oversee remaining transition issues.

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

The task force held conference calls May 14, May 21, and June 11, and met in Indianapolis. During the conference calls, the task force discussed the CAS proposed revisions to the Statement of Principles Regarding Property and Casualty Insurance Ratemaking. On June 5, the task force submitted its comment letter to CAS, noting concerns regarding the elimination of standards language from the existing principles prior to release of proposed revisions, and the shift in emphasis from loss-based ratemaking principles to principles that include subjective market driven ratemaking. The proposed revisions introduce two additional factors, competition and market maximization, in the standard cost-based principle model, which will result in a shift in the pricing model and ultimately, have a major impact on the industry.

The task force discussed a referral from the Corporate Governance Working Group requesting for language contained in the Actuarial Opinion and Memorandum Regulation Model Law (#822) be considered for inclusion in the Property and Casualty Actuarial Opinion Model Law (#745). This mater was referred to the Appointed Actuary Opinion Subgroup.

At the Summer National Meeting, the task force discussed proposed revisions to the annual statement instructions regarding Schedule P, which address retrospective changes to pooling agreements impacting prior accident years. After hearing comments, the task force requested NAIC staff to make updates, after which the task force plans to expose the proposal on its next conference call.

The task force discussed and exposed the Joint Qualified Actuary Subgroup's draft discussion paper that provides a recommendation on the definition of

an actuary qualified to serve as appointed actuary. The recommendation is based on additional public disclosures as opposed to establishing a costly and cumbersome licensing or qualification review process. The subgroup is requesting that each of its parent task force reassess membership requirements. The task forces have also been asked to consider whether they wish to move ahead with the subgroup's recommended definition and whether they wish to pursue a measured approach or substantial regulatory action in assessing inappropriate or unprofessional actuarial work. The subgroup acknowledged that because each parent task force reports to a different committee, it is possible the result could be significantly different decisions and direction. The subgroup believes it is in the interest of all involved to have consistency in direction as much as possible. The comment period ends September 27.

The task force also exposed the Regulatory Guidance on Property and Casualty Statutory Statements of Actuarial Opinion for the Year 2013 and the Regulatory Guidance on the Property and Casualty Actuarial Opinion Summary for the Year 2013. The comment period ends September 30.

## **Terrorism Insurance Implementation Working Group**

The working group met in Indianapolis to discuss a July 16<sup>th</sup> Federal Register notice in which the Federal Insurance Office requested comments on many issues related to terrorism insurance, including the effects of the potential termination of Terrorism Risk Insurance Act (TRIA) which is set to expire on December 31, 2014. Specific comments are requested on the availability and affordability of insurance for terrorism risk in the United States, as well as, suggested revisions or modifications to TRIA, if it were to continue beyond 2014, which would promote the availability and affordability of terrorism insurance in the future. Comments on the Federal Register notice are due by September 16. The working group reported that the Government Relations Leadership Council planned to consider a resolution in support of the reauthorization of TRIA, which was subsequently adopted by the council.

The working group heard a presentation from Risk Management Solutions titled "Terrorism Risk Modeling and the Case for TRIA." The presenter discussed RMS' analysis of past terrorism acts and attempts, including 9/11 and the Boston Marathon bombings. The discussion also included the role of counter-terrorism efforts in the prevention of such acts. The following observations were made which argue for the necessity of TRIA:

- Unlike natural catastrophes, there is no intrinsic finite limit to the magnitude of losses from a terrorist attack.
- Terrorists have the ambition to inflict the maximum loss, and deliberately target properties in major cities with very high insured value.
- A successful terrorist attack will only happen if counter-terrorism efforts fail; thus, terrorism insurance in the U.S. and Western Europe is essentially insurance against counter-terrorism failure.

Industry representatives advised the working group of concerns with upcoming policy renewals if TRIA is not extended.

## **Climate Change and Global Warming Working Group**

The working group discussed the recent work of its two subgroups. The Impact of Climate Exam Subgroup was charged with addressing issues that may be encountered in a financial condition examination and developed enhancements to the Financial Condition Examiners Handbook which were subsequently adopted by the Financial Examiners Handbook Working Group for the 2013 Handbook.

The Impact of Climate Disclosure Survey Subgroup evaluated whether modifications were needed to the NAIC Climate Risk Disclosure Survey (Climate Survey). The subgroup subsequently determined that the questions should remain consistent to develop a baseline of data. Additionally, the administration of the Climate Survey is being conducted through a multi-state effort, consisting of California, Washington, New York, Minnesota, and Connecticut for 2013. In future years, the working group will supervise the administration of the multi-state survey, as the subgroups were disbanded at the Summer National Meeting.

## **Mortgage Guaranty Insurance Working Group**

The working group held a conference call on June 24 and met in Indianapolis. During the conference call, the working group discussed two options available to the working group regarding its charge. The first option is to replace the existing Mortgage Guaranty Insurers Model Act (#630) with a model guideline. The second option is to make changes to the existing model. It was noted that most states do not regulate mortgage guaranty insurers. Given the recent crisis in the housing industry and high visibility of

mortgage guaranty insurance, the working group voted to amend the model to ensure uniformity in regulation. The working group discussed comments regarding the Request for Model Law Development and adopted it; the request received final approval by the Executive and Plenary Committee on July 26.

During the conference call, the working group continued its discussion on the Concepts List of Potential Regulatory Changes. The working group adopted changes which removed items that did not receive sufficient support following the public comment period; one such item removed related to the creation of an FDIC-like government entity as a backstop where premiums are paid in over an entire business cycle. A representative from the Center for Economic Justice emphasized that the identification of the problems that led to the mortgage insurance crisis needs to be better identified, and that insurance regulators and the regulatory process are not addressing the issue if some sort of blame is not assigned to the risk management process of mortgage insurers. The chair responded that this issue will be better identified and addressed as the working group makes progress in revising the model.

During the conference call, the working group heard an update from the industry regarding the development and design of a new capital model for mortgage guaranty insurers. A group of active mortgage insurers have engaged an actuarial firm to assist in developing a uniform standard. This standard would be applied across the industry to assess the financial soundness of mortgage insurers. The project has two phases: phase one is discussion of various approaches that can be undertaken and phase two entails the use of industry data to build the standard. Phase one was completed in July which involved proposing a framework and methodology for a capital model. It is expected that when the project moves into the second phase, the mortgage insurers will engage the stakeholders to share preliminary results and obtain feedback. Stakeholders include members of the working group, insurance departments, Federal Housing Finance Agency (FHFA), government-sponsored enterprises, and bank regulators.

At the Summer National Meeting, the working group heard a presentation on the progress of the development of the industry capital model, which "core design principles" are that it would possess increased risk and premium sensitivity, be forward looking, comprehensive and adaptable. The goal is to have the industry capital model distributed to the working group during the 2014 Spring National Meeting, at which time the working group can

discuss the appropriateness of the capital model or approve it for use in the amended model act. Concurrently, discussions will be held with individual companies and their domiciliary states on the impact of the proposed capital model and its back-testing performance.

In Indianapolis, the working group also discussed other work on the new model law. Wisconsin has been assigned work on investments limitations, underwriting and quality assurance; Arizona will address dividend limitations, contingency reserve requirements and release, maintaining capital requirements, and loss reserve estimates; North Carolina has been assigned rescission rights and responsibilities; Pennsylvania will address mandatory reinsurance, and New York has committed to work on geographic concentration. The working group hopes to have a draft of the proposed model law for public comment shortly after the Summer National Meeting.

In Indianapolis, the NAIC staff reported that the FHFA is working to develop its own standards, while the Government Accountability Office has begun its own analysis of the industry. The FHFA plans to formulate eligibility standards for mortgage insurers, including developing standard terms, definitions and industry standard data reporting protocols. On August 20, the Joint Forum of the International Association of Insurance Supervisors, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions issued its report "Mortgage insurance: market structure, underwriting cycle and policy implications," which lists recommendations for policymakers and supervisors to consider in reducing the likelihood of mortgage insurance stress and failure.

After the public meeting the working group met in closed session with FHFA, but the chair assured interested parties that no policy decisions would be made during the closed session.

## **Title Insurance Task Force**

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

### Title Insurance Escrow Theft White Paper

The Title Insurance Escrow Theft White Paper Subgroup met by conference call May 9, June 12, and August 7. During the conference calls, the subgroup discussed in detail comments received on drafts of the Title Escrow Theft and Title Insurance Fraud Whitepaper. The purpose of the whitepaper is to raise awareness and serve as a tool for regulators

to research methods for combating and preventing escrow theft, title insurance premium theft and other forms of fraud associated with title insurance and closing services. The whitepaper stresses that there is not a single solution to the problem for any particular jurisdiction and as such, a variety of methods are identified. The 26-page whitepaper presents considerations for regulators, title underwriters, title agency and closing service owners as potential tools and methods to address escrow theft. The whitepaper also discusses considerations for mitigating escrow theft once a theft has occurred. During the August 7 conference call, the subgroup adopted the revised whitepaper. The task force will schedule a conference call to consider adoption of the whitepaper later this fall.

#### Title Insurance Risk-Based Capital

The Title RBC Subgroup met by conference call June 20 and August 15, and heard a presentation by a financial analysis company. It was noted that virtually all title underwriter insolvencies were related to theft, escrow theft, shortages or defalcations as opposed to claims or exposure related to the marketability of title to real property. Thus, a focus on various aspects of balance sheet integrity is not believed to be the solution to title underwriter insolvencies. Rather, the solution to the solvency issue may likely be the minimization and mitigation of theft, escrow theft, shortages, or defalcations, which is likely to involve enhanced agency licensing requirements that may include a minimum liquid net worth requirement.

The subgroup also discussed results of a recent survey that questioned respondents regarding risks in a variety of categories, requested feedback on methods to reduce risks and monitor financial strength, and questioned respondents regarding accreditation requirements. A total of 26 responses were received, of which 20 were from regulators. Both regulators and industry viewed volatility of the real estate market and agent defalcations as high risks. Regarding methods for reducing risks, development and implementation of Title RBC was viewed moderately importance by regulators and low importance by industry. Additionally, the enactment of capital requirements and usefulness of financial analysis solvency tools were viewed fairly important by regulators and low importance by industry. Very few industry respondents favored accreditation and none of the industry respondents supported development of Title RBC while two-thirds of the regulators favored creation of Title RBC.

The subgroup reviewed industry comments received in the survey and discussed one fundamental concern, which is the lack of uniform reserve

requirements. At present, there is no consensus on reserve requirements and it would take an exhaustive study and lengthy implementation process to accomplish this goal, i.e., first having the NAIC develop the uniform reserve standards and then getting the respective state legislatures to pass enabling language. As evidenced by the fact that very few states have adopted the NAIC Title Insurer Model Act, which has been in place for over 15 years, it is doubtful that the necessary number of states would ever legislate the changes to qualify the reserve requirements as accreditation standards.

In its report to the task force, the subgroup confirmed that it does not, at this time, believe it should move forward with the development of RBC standards for title insurers. The subgroup wishes to explore the possibility of creating financial analysis solvency tools applicable to title insurers, such as IRIS and FAST ratios. The subgroup sees value in obtaining a better understanding of the various state-specific reserve standards for title insurers and in potentially making reserve standards more uniform. The subgroup will consult with the Title Insurance Financial Reporting Working Group regarding this matter.

#### Title Guaranty Fund

The Title Insurance Guaranty Fund Working Group met by conference call August 15 to discuss work on a model guideline to assist states considering a guaranty fund. Two draft options were developed by the NAIC staff. The first draft is a stand-alone title insurance guaranty association model guideline and the second draft expands the existing Property and Casualty Guaranty Association Model Act to include title insurance. The working group solicited comments, noting that no written comments were received. A working group member commented that the second option would be less costly administratively. The working group extended the comment period to September 18 pursuant to a request from a trade organization. The working group will discuss comments during a conference call on October 7.

### **Risk Retention Group Task Force**

The task force continues to assess whether, and if so, how changes to the NAIC Financial Regulation Standards and Accreditation Program should apply to risk retention groups (RRGs) and their affiliates. The task force held three interim conference calls and met in Indianapolis. The applicability of following model regulations was discussed during these meetings.

2006 Revisions to the Risk-Based Capital for Insurers Model Act (#312)

The 2006 revisions to this model act, which become effective for accreditation effective January 1, 2014, incorporate a new trend test for P&C insurers. The task force confirmed that the trend test is required to be included as part of the state's adoption of RBC for RRGs.

2008 Revisions to the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385)

This model regulation is already applicable to RRGs under current accreditation standards, however, the applicability of 2008 revisions to the model regulation have not previously been discussed by the task force. The revisions relate to the definition of hazardous financial condition in the federal Liability Risk Retention Act of 1986. Industry representatives requested a 30-day period to provide written comment on the applicability of the revisions to RRGs. The task force agreed with this request; the comment period deadline is September 30.

2010 Revisions to the Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450)

Following extensive discussion of all significant elements of the Regulatory Act and Model Regulation, the task force has reached preliminary agreement that all elements should be applicable to RRGs for accreditation purposes. However, certain elements received more significant consideration, including examination authority, Form F filings on enterprise risk and confidentiality.

The task force will consider adoption of its recommendation to the Financial Regulation Standards and Accreditation Committee with respect to the applicability of the Regulatory Act and Model Regulation for accreditation purposes as applicable to RRGs on its next conference call. The 2010 revisions to the Regulatory Act and Model Regulation would be applicable for accreditation purposes, effective January 1, 2016.

2011 Revisions to the Credit for Reinsurance Model Act (#785) and the Credit for Reinsurance Model Regulation (#786)

The task force discussed necessary modifications to the Accreditation Interlineations to conform to changes adopted in 2010 by the Accreditation Committee with respect to the applicability of the Credit for Reinsurance Model Law and Model Regulation to RRGs. The revision clarifies that "an RRG's cedants as of January 1, 2011, are grandfathered in as acceptable without meeting the requirements in the Reinsurance Guidelines. The

requirements in the Reinsurance Guidelines should be used for new cedants with which business is placed after January 1, 2011."

In Indianapolis, the Financial Regulation Standards and Accreditation Committee adopted the task force's recommendation to update Part A Credit for Reinsurance Ceded Standard.

Risk Management and Own Risk and Solvency Assessment Model Act (#505)

The task force sent a comment letter to the Financial Regulation Standards and Accreditation Committee stating that the Risk Management and Own Risk and Solvency Assessment Model Act should be applicable to RRGs, stipulating that if a state does not have any captive RRGs that are above the threshold amounts, the state should not be required to adopt the model law or regulation with respect to RRGs for accreditation purposes.

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The next National Meeting of the NAIC will be held in Washington DC December 15-18. We welcome your comments regarding issues raised in this newsletter. Please provide your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor at [jean.connolly@us.pwc.com](mailto:jean.connolly@us.pwc.com).

**Disclaimer**

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

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

## ***Additional information***

If you would like additional information, please contact:

Jean Connolly  
Managing Director, National  
Professional Services Group  
Tel: 1 440 893 0010  
jean.connolly@us.pwc.com

## **PwC's Insurance Practice Leaders**

Bob Sands  
Insurance Practice Leader  
Tel: 1 267 330 4480  
robert.m.sands@us.pwc.com

Paul McDonnell  
Insurance Advisory Co-leader  
Tel: 1 646 471 2072  
paul.h.mcdonnell@us.pwc.com

James Yoder  
Insurance Advisory Co-leader  
Tel: 1 312 298 3462  
james.r.yoder@us.pwc.com

David Schenck  
Insurance Tax Leader  
Tel: 1 202 346 5235  
david.a.schenck@us.pwc.com

[www.pwc.com/us/en/insurance](http://www.pwc.com/us/en/insurance)

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