



# NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS

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## NAIC 2003 FALL NATIONAL MEETING

The National Association of Insurance Commissioners held their 2003 Fall National Meeting September 13-16, 2003 in Chicago. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. If questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

### Executive Summary

- The Statutory Accounting Principles Working Group finalized two issue papers, Issue Paper 121, Accounting for the Impairment or Disposal of Real Estate, and Issue Paper 123, Accounting for Pensions, a Replacement of SSAP 8, and directed NAIC staff to draft the related Statement on Statutory Accounting Principles. The working group hopes to adopt the new pension accounting guidance in December, effective for 2003. In August, the working group issued for final comments SSAP 88, Investments in SCA Entities, a Replacement of SSAP 46. (page 3)
- The Emerging Accounting Issues Working Group did not finalize any Interpretations in Chicago, but reached a tentative consensus on ten new issues and a revised tentative consensus on INT 03-03, Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee When a Qualified Opinion is Provided. The revised consensus will allow an admitted asset when a qualified audit opinion is issued in certain specific circumstances. (page 5)
- The NAIC/AICPA Working Group discussed a report entitled Comparison of the Sarbanes-Oxley Act of 2002 to the Current Provisions of the Model Rule Requiring Annual Audited Financial Reports. The working group plans to hold conference calls this fall to determine which provisions of Sarbanes-Oxley should be proposed for inclusion in the Model Audit Rule. (page 6)
- After hearing final comments on the issue, the Financial Condition (E) Committee finalized a proposal for permitting securities broker/dealers to be asset custodians. (page 7)
- The International Accounting Standards Working Group provided an update on their efforts to issue a comment letter to the International Accounting Standards Board on their Phase I Insurance Contracts Exposure Draft. (page 7)
- The Terrorism Insurance Implementation Working Group heard a presentation from the Deputy Director of the Office of Financial Institutions Policy on Treasury's work to assist the insurance industry in complying with the Terrorism Risk Insurance Act. (page 8)

- The Risk-Based Capital Task Force deferred adoption of the Life RBC Working Group's proposal on Modco related to the dividend liability in Total Adjusted Capital pending further discussion of objections raised by a life insurer. The Ad Hoc Subgroup of Risk-Based Capital Task Force discussed the avalanche of comments received that are opposed to the proposal released at the Summer National Meeting to increase the factor used in calculating the Authorized Control Level RBC for P/C companies from 50% to 75%. The task force did not officially withdraw the proposal, but will investigate alternative proposal such as adopting a trend test for P/C and health entities. The Life RBC Working Group gave an update of the progress of their C-3 Phase II project and adopted the AAA Modco Reinsurance proposal on asset concentration and bond size factors and "vanishing RBC" for 2004 RBC filings. (page 10)
- The Invested Assets Working Group directed the SVO to draft Purposes and Procedures Manual guidance for investments in exchange-traded fund securities ("iShares") that such investments should be classified as bonds on Schedule D. The working group will draft the related Blanks proposals. (page 12)
- The SVO Oversight Working Group reported that the NAIC has adopted the working group's proposal to exempt all NRSRO-rated "1" and "2" securities from filing with the SVO effective January 1, 2004. The working group continued to discuss regulator concerns with the remaining open proposal to restructure the SVO, i.e., exempting all NRSRO-rated, NAIC 3-6 equivalent securities. (page 13)
- The Blanks Task Force concluded that the certification required by NAIC officers on the Jurat page demands more accountability than the certifications required by the Sarbanes-Oxley Act, and therefore, no changes are required to the Jurat page. The task force announced that the NAIC has reinstated free access to its CIS webpage that provides financial information on insurance companies. However users must agree to terms of use and provide contact information. (page 15)
- The Life and Insurance and Annuities Committee reviewed final comments this summer on its Senior Protections in Annuity Transactions Model Regulation and adopted the model in August. The commissioners adopted the model at the Fall National Meeting. (page 18)
- The Life and Health Actuarial Task Force reached a short-term solution on the "dollar for dollar partial withdrawal" issue for variable annuity GMDB reserves by voting to expose for comment changes to Actuarial Guideline 34. The revisions include modified language that explicitly states that the actuary need not include a provision for future partial surrenders in calculating the AG 34 liability. (page 19)
- The Reinsurance Task Force received and will review the draft Model Regulation for List of Approved Reinsurers. This issue has been the subject of much debate in previous task force meetings (page 23)
- The P/C Reinsurance Study Group continued their discussion of intermediary clauses in reinsurance agreements and whether such clauses, which require the reinsurer to assume the credit risk of the intermediary, should be mandatory. The study group concluded the Reinsurance Task Force should make that decision and referred the issue to them. (page 24)
- The Market Conditions Working Group discussed their draft document Medical Malpractice Insurance: A Study in Market Conditions (page 24)

## Executive Committee

The Commissioners at their Executive and Plenary session adopted, among other new and revised models, the following:

- Insurance Fraud Prevention Act;
- Property and Casualty Actuarial Opinion Model Law
- Revisions to the Model Regulation Annual Audited Financial Reports on consideration of the Examiners Handbook
- Actuarial Guideline GICS: Guideline for the Valuation Rate of Interest for Funding Agreements and Guaranteed Interest Contracts (GICs) with Bail-Out Provisions
- Senior Protection in Annuity Transaction Model Regulation

The NAIC also adopted the proposal of the SVO Oversight Working Group to exempt NRSRO-rated, NAIC 1 and 2 equivalent securities. To offset the loss of revenue to the SVO for filing fees for these securities, industry officials agreed to a combination of additional fee-for-services and fee-assessments.

## Statutory Accounting Principles Working Group

### Public Hearing

Issue Paper 121, Accounting for the Impairment or Disposal of Real Estate – At the Summer National Meeting, the working group adopted significant amendments to the issue paper based on comments from interested parties and they re-exposed the paper for comments at the Fall National Meeting. At this meeting in Chicago, the only substantive comment received was that interested parties are still concerned with the organization of the Issue Paper. They believe that the Issue Paper should be a stand-alone document and not just refer to what has been modified from the GAAP standard (FAS 144). The working group agreed, but also directed staff to draft the related SSAP. Both the reorganized Issue Paper and the SSAP will be posted to the NAIC's website shortly.

Issue Paper 122, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – The working group briefly discussed detailed comments received from interested parties, which primarily ask for amendments to make IP 122 consistent with FAS 140 or consistent with existing statutory accounting. The working group deferred final adoption of the issue paper and referred the comments to its FAS 140 Subgroup for their review.

Issue Paper 123, Accounting for Pensions, A Replacement of SSAP 8 – At the Summer National Meeting, the working group directed staff to draft this issue paper, which became available July 28<sup>th</sup> on the NAIC's website. The conclusions in the Issue Paper are consistent with those discussed at the Summer National Meeting and include the following:

- Establishing an additional minimum pension liability and changes in the liability will be recorded as a component of unassigned funds, not the income statement
- If an intangible asset generated by the additional minimum liability is recognized, only that portion in excess of the unamortized incremental liability associated with the transition shall be nonadmitted. If an additional liability required to be recognized exceeds unrecognized prior service cost, the excess (which would represent a net loss not yet recognized as net periodic pension cost) shall be reported as a component of unassigned funds (surplus), net of any tax benefits that result from considering such losses as temporary differences for purposes of applying the provisions of SSAP 10, Income Taxes.
- Any intangible asset or prepaid expense, other than the intangible asset associated with the transition obligation recorded as of January 1, 2001, resulting from adoption of the new guidance is a nonadmitted asset

The proposed effective date is for years ending on or after December 31, 2003.

At the public hearing in Chicago, interested parties stated that they agree with the Issue Paper and asked only that the illustrative examples included in

FAS 87 be included in the final guidance. The working group did not agree with this suggestion; the acting chair stated that he is not yet certain that the FAS 87 examples are completely consistent with IP 123. He suggested that interested parties help clarify this with the working group. If that occurs, the guidance can be issued as an appendix in 2004.

Guidance not included in the Issue Paper, as some interested parties had hoped, is transition guidance that would allow those companies which had recorded an expense in the income statement for the additional minimum pension liability in 2002 but had a reduction in the AML in 2003, to record that reversal in the income statement in 2003. The acting chair of the working group noted that the working group had discussed this issue on two separate occasions, and they believe such transition is inconsistent with SSAP 3, Accounting Changes. That guidance requires accounting principle changes to be recorded as a component of surplus. The chair noted that interested parties will have another opportunity to comment during the SSAP comment period. The working group then adopted the Issue Paper as final and directed staff to draft the SSAP, which will be exposed shortly with a comment period deadline of November 18<sup>th</sup>.

Nonsubstantive changes to SSAP 70, Allocation of Expenses, to apply to health insurers – The working group adopted the proposed amendments to SSAP 70 after a brief discussion.

Modifications to Appendix A-440, Insurance Holding Companies – The working group adopted amendments to the A-440 to delete inapplicable references to quantitative limitations on investments in subsidiaries.

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

The working group took the following actions with respect to substantive issues. All issues exposed for public comment have a comment deadline to NAIC staff of November 18<sup>th</sup> (except for SSAP 88), with a public hearing at the Winter National Meeting.

SSAP 88, Investments in SCA Entities, a Replacement of SSAP 46 – The working group noted that SSAP 88 was released in late August with a comment period ending November 4<sup>th</sup>,

because the working group wants additional time to review the comments received. The SSAP has a proposed effective date of January 1, 2005 and includes the following requirements:

- The SSAP includes four categories of SCAs, three of which are similar to the SSAP 46 guidance plus a fourth category: foreign insurance SCA entities
- The SSAP includes the guidance from the Issue Paper of a “bright-line” 20% test for determining whether a noninsurance SCA should be valued at audited GAAP equity and adjusted to SAP.
- Foreign insurance SCAs are to be valued at audited U.S. GAAP adjusted for seven types of adjustments such as goodwill, nonadmitted assets, fair value adjustments on investments, etc.
- New guidance (ie not included in the Issue Paper) was added on investments in the preferred stock of SCAs and investments in surplus notes of SCAs.

Classification of Funding Agreements as Life Contracts, a Modification to SSAP 50 – The issue was referred from the Emerging Accounting Issues Working Group and addresses the classification of funding arrangements as life contracts versus deposit-type contracts. The working group exposed for comment an amendment proposed by the Virginia DOI to par. 20 of SSAP 50 that allows life insurance classification only for contracts “issued for the benefit of an identifiable individual or group of individuals containing a projected pricing structure with an effective purchase rate guarantee.” Contracts not meeting those requirements would be classified as deposit-type contracts.

AVR/IMR Treatment of Asset-Backed Securities – The Form A proposes IMR or AVR treatment, as applicable, for other-than-temporary impairments of asset-backed securities. SSAP 43 currently requires all such impairments to be recorded in IMR. The working group recognized this is a substantive change to SSAP 43, added the issue to its agenda and also referred it to the VOS Task Force for their consideration.

Accounting for Loan Agreements Issued by a State Guaranty Association – The working group exposed

for comment a proposed amendment to SSAP 21 to allow as an admitted asset loans to state guaranty associations.

Consideration of New Model Laws and Revisions to Existing Model Laws – Based on analysis done by NAIC staff, only one new model has potential accounting implications: Recognition of the 2001 CSO Mortality Table for Use in Determining Minimum Reserve Liabilities. After significant discussion of some of the issues, including the difficulty of adopting a model for the Accounting Manual that has both voluntary and mandatory adoption dates, the acting chair deferred action until consultation with the chair of the working group (who could not attend the meeting in Chicago).

Proposed Amendment to SSAP 2 to Classify Money Market Mutual Funds as Cash Equivalents – The working group again discussed this issue, and again referred it to the Invested Asset Working Group, this time with new concerns as to whether such investments are cash equivalents. The working group also exposed for comment a memo from NAIC staff.

Nontabular Discounting – The working group exposed for comment a memo and supporting documents from the Casualty Actuarial Task Force on whether nontabular discounting should be shown separately on the balance sheet as a contra-liability.

## **Emerging Accounting Issues Working Group**

The working group finalized no new Interpretations in Chicago but adopted the following with respect to tentative consensus discussed at previous meetings:

INT 03-03, Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee When a Qualified Opinion is Provided – The original tentative consensus required companies to nonadmit investments in entities when a qualified audit opinion was received on the investee. At the Summer National Meeting, the working group agreed to deferred final action while they explored with the AICPA and interested parties which specific types of qualified reports may be acceptable.

At the Fall National Meeting, the working group exposed for comment a revised tentative consensus that allows an admitted asset for investees with other than unqualified audit opinions, in certain circumstances. The revised guidance includes the following:

- If the audit opinion includes a qualification because of a scope limitation that has been quantified, the investment can be admitted, but adjusted to exclude the effect of the scope limitation.
- If the audit opinion is qualified or adverse because of a departure from GAAP that has been quantified, the investment can be admitted, but adjusted to exclude the effect of the departure from GAAP.
- Investments are nonadmitted if the audit report is a disclaimer of opinion or if the report indicates there is substantial doubt about the investee's ability to continue as a going concern.

The comment period deadline is November 18<sup>th</sup>.

INT 03-09, Accounting for Transferable State Tax Credits – The working group has concluded that its tentative consensus, that state premium tax credits should be recorded at cost and are admissible if they are reasonably expected to be realized in the current year or the subsequent accounting period, provides new guidance, and therefore, should be considered by the SAP Working Group. As a result, the working group rejected the tentative consensus. Interested parties will resubmit the issue on a Form A to the SAP Working Group at a future meeting.

The working group then discussed new issues, and reached a tentative consensus on ten new Form Bs, which will be exposed for comment on the NAIC's website. The comment period ends November 18<sup>th</sup>.

EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is with the Scope of FASB Statement No. 15 – The working group adopted the EITF's consensus as an interpretation of SSAP 36, Troubled Debt Restructuring.

AVR/IMR Treatment related to SSAP 43 – The working group agreed the proposed guidance in the Form B would be an amendment to SSAP 43 and not an interpretation, and referred the issue to the SAP Working Group. See further discussion in the meeting of that working group above.

Application of SSAP 68 with Receipt of a Capital Contribution – An interested party requested that SSAP 68 be interpreted, when an insurer receives the stock of another affiliated company as a capital contribution, to allow the transaction to be recorded as a purchase/business combination. This would allow goodwill to be recorded in certain circumstances. The working group concluded that a capital contribution does not meet the definition of purchase transaction, and therefore, SSAP 68 does not apply. No interpretation of SSAP 68 is deemed necessary.

Classification of Bad Faith Expenses – The tentative consensus is for such expenses to be classified as claim losses when they involve individual claims. Material amounts, such as those involving class action lawsuits, should be recorded as separate write-in liabilities. The working group also referred the issue to the Casualty Actuarial Task Force for their input.

Accounting for the Change in the Additional Minimum Pension Liability in SSAP 8 – The working group rejected this Form B because the issues are addressed in the transition guidance in Issue Paper 123. See further discussion above in the summary of the SAP Working Group meeting.

Included in the ten tentative consensuses are five FASB EITFs that were rejected as not applicable or inconsistent with statutory accounting, as follows:

- EITF 01-14: Income Statement Characterization of Reimbursements Received for “Out-of-Pocket” Expenses Incurred
- EITF 02-3: Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities
- EITF 02-6: Classification in the Statement of Cash Flows of Payments Made to Settle an Asset Retirement Obligation with the Scope of FASB Statement No. 143

- EITF 02-7: Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets
- EITF 02-8: Accounting for Options Granted to Employees in Unrestricted, Publicly Traded Shares of an Unrelated Entity

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

The working group heard a summary from NAIC staff on a report entitled Comparison of the Sarbanes-Oxley Act of 2002 (the Act) to the Current Provisions of the Model Rule Requiring Annual Audited Financial Reports. NAIC staff highlighted some of the requirements of the Act that differ from the requirements of the Model Audit Rule. Among the significant differences are the following:

- The Act requires the audit committee to pre-approve certain services performed by the independent auditor, and the Model Audit Rule does not.
- The Act requires rotation of the engagement partner (and certain other partners) every five years. The Model Audit Rule requires rotation after seven years, based on the former SEC requirements.
- The Act requires under Section 302 that the CEO and CFO make specified certifications; the Model Audit Rule does not require these certifications (although the Jurat Page does require the president, secretary, and treasurer to certify that the annual statement is a “full and true statement of all the assets and liabilities and of the condition and affairs of reporting entity”).
- The Act requires under Section 204 a report from the auditor to the audit committee covering specified topics. The Model Audit Rule does not require this.
- Under Section 404 of the Act there are extensive requirements for management’s assessment of internal controls. The Model Audit Rule does not contain any comparable requirement with respect to management. The rule does require that “significant deficiencies” noted in an audit (i.e. by the auditor), as described in SAS 60, Communication of Internal Control Structure

Matters Noted in an Audit, be communicated to the domiciliary insurance department.

The working group had a brief discussion of the report and concluded that they will hold a series of conference calls this fall to consider which provisions of the Act should be included in the Model Audit Rule. One regulator stated that he believes the requirements for audit committees should be included in the Model Insurance Company Holding System Regulatory Act

The working group then asked for comments from the AICPA on this topic. The chair of the AICPA/NAIC Task Force stated that the AICPA supports the requirements of Sarbanes-Oxley, and that the task force believes some of the Act's requirements are appropriate for inclusion in the Model Audit Rule. The task force is looking forward to providing technical input to the working group.

The working group then discussed an issue raised by a regulator of the willingness of a CPA firms to provide electronic copy of its workpapers to state insurance departments. States are requesting e-copies as one means of increasing reliance upon the work of the CPA and to reduce the cost of examinations to companies. The issue relates to two types of requests for electronic copies of workpapers: 1) in read-only (e.g. .pdf) format and 2) file format that can be manipulated, e.g. Excel and Word files. Most, but not all CPA firms, will provide read-only electronic copies. However, all the CPAs firms attending the meeting indicated their firms are not amenable to providing electronic workpaper files that can be altered for a number of reasons. The AICPA representatives agreed to discuss the issue internally and will report back to the working group at the Winter National Meeting,

At the close of the meeting a member of the working group suggested that additional information on corporate governance be obtained from four banking agencies, the OCC, the FDIC, the OTS and Board of Governors of the Federal Reserve. This request was added to the 2004 charges of the working group.

### **Financial Condition (E) Committee**

The task force reviewed comments received on the Issue Paper of the Custodian Assets Working

Group "Should Broker/Dealers be Allowed to Act as Custodians for Insurance Company Assets?" that had been exposed at the Summer National Meeting. After some further debate on the relative safety of brokers/dealers compared to currently permitted custodians (banks, trusts etc.), the recommendation was voted on and, by a narrow margin, the committee agreed to permit broker/dealers to act as authorized custodians. Therefore the Custodial Assets Working Group will continue to move forward in developing the necessary amendments to the model law, which will include establishing minimum standards for broker/dealer custodians.

### **International Accounting Standards Working Group**

During the summer and at their meeting in Chicago, the working group continued their work on a draft comment letter in response to the International Accounting Standards Board (IASB) Phase I Insurance Contracts Exposure Draft. The working group released the draft comment letter for comments at their August 27th conference call.

At this meeting, interested parties questioned the working group as to what happens if the IASB's current intended path (a fair value based system) is the end result. The working group indicated that they share the concerns of interested parties of issues that arise from a fair value based system, and as a result the working group is focused on ensuring that the IASB considers such concerns as part of the overall process. Representatives from ACLI indicated that they are working on a separate response letter to the IASB, but will share with their letter with this working group prior to sending it to the IASB.

Representatives from ACLI indicated to the working group that they, along with representatives of IAA, met with selected members of the IASB to discuss pertinent issues surrounding the inconsistent asset/liability measurement arising under a fair value system, when certain assets and liabilities have no readily determinable fair value.

As a sidenote, the working group indicated that the IASB's June 2003 decision to halt work on phase II is still in effect. While "behind the scenes meetings"

have been taking place between the IAIS Accounting Subcommittee and certain interested parties, no formal actions have taken place since June.

The final IASB development discussed by the working group was an IASB Exposure Draft of Proposed Amendments to IAS 39 - Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk. Comments on the Exposure Draft were requested by the working group no later than September 22 in order to coordinate getting a comprehensive comment letter to the IASB

### **Terrorism Insurance Implementation Working Group**

The working group commenced their meeting in Chicago with a presentation from representatives of the Treasury covering the structure of treasury responsible for implementing the Terrorism Risk Insurance Act (TRIA) of 2002, the status of the implementation and an overview of a survey that was going to be sent to select companies in the near future.

After briefly explaining how different parts of the Treasury interact, the Deputy Director for the Office of Financial Institutions Policy noted that to assist the insurance industry in complying with TRIA that (1) a February 28 interim final regulation had been issued, which set the groundwork for implementation by defining key terms used in the statute; and (2) an April 18 interim final regulation had been produced, to address issues associated with disclosure and the participation of residual market mechanisms under TRIA.

The Deputy Director then clarified that the TRIA Program expires on December 31, 2005, and that if a certified act of terrorism were committed prior to this date it would be covered under the Program. (It is the timing of the certified act of terrorism that is the key element). He believed confusion had arose around this issue because a provision in TRIA requires the Secretary to make a determination no later than September 1, 2004 on whether to extend the "make available" provision of TRIA into the third year of the Program.

The Deputy Director finished his presentation by noting that the Treasury is required to "assess the

effectiveness of the Program and the likely capacity of the P/C insurance industry to offer insurance for terrorism risk after termination of the Program, and the availability and affordability of such insurance," and TRIA requires that Treasury report to Congress no later than June 30, 2005 on the results of the evaluation of the Act's effectiveness. Therefore, he noted that surveys will be sent out in October, on a random selective basis to policyholders and insurers, designed to collect statistically meaningful data on such matters as the changes in insurance coverage purchased and premiums for terrorism risk covered by TRIA. In response to questions raised by interested parties he confirmed that the results of the survey would be confidential and that responses to the surveys were highly encouraged but not compulsory, but that this could change if response rates were disappointing.

One notable development during the quarter contained in the interim activities report for this working group was an acknowledgement of an announcement by the Treasury that group life insurers would not be included in TRIA as they believed that no there had been no appreciable reduction in the availability of group life insurance coverage for consumers.

### **USA Patriot Act Compliance Ad Hoc Task Force**

A member of the Treasury Department attended the meeting in Chicago to provide a status of the USA Patriot Act Regulations. She reported that the rules for implementing the Patriot Act for insurers are not yet finalized but she was optimistic that they could be finalized by the end of the year. Additional associated rules are expected to follow thereafter but with the exception of the customer identification rules, tagged with a potential first quarter 2004 issuance. The Treasury Department was not willing to speculate on the future issuance dates. Clarification was offered on the anticipated effective date of the rules, which would be six months after the issuance of the final rules.

The task force then returned to the discussion held at the Summer National Meeting with respect to whether the examinations should be done under a financial exam or a market conduct exam. It was concluded that they would be done under a financial exam for a number of different reasons including the

fact that these examiners were cognizant of, and able to utilize uniform examining standards, which is clearly optimal.

Finally, the task force, in responding to a question from an interested party regarding enforceability, noted that they believed states have a role in enforcement with respect to examining an insurer and making a report on the examination, but that they would have no direct authority with regards to compliance violations.

### **Federal Issues Discussion Working Group**

The working group discussed its primary issue for this fall, which is a renewed consideration of an issue that was originally addressed by the working group in 1998. At that time, the working group sent forth a resolution to the Insolvency Subcommittee supporting an amendment of 31 U.S.C. Section 3713 regarding the Federal government's priority as a creditor. The resolution urged Congress to exempt insurance insolvency proceedings from the statute that gives the Federal government certain preferences and rights as a creditor. It was the working group's belief that such an exemption to the statute was critical to preserving the states' ability to protect public (policyholder) interests under the McCarran-Ferguson Act. The resolution was adopted by the NAIC, but the NAIC never found a way to get the resolution in front of Congress.

In Chicago, the working group discussed the matter again. The working group continues to be concerned about scenarios whereby the federal government as a creditor of an insolvent insurance company could complicate insolvency proceedings. For instance, there is currently a perceived risk that the government would be able to place a credit claim against an insolvent company well after the majority of funds have been liquidated in preference to policyholder needs and expenses associated with administering the insolvency.

In consideration of this matter, the working group passed a motion to recommend that the Insolvency Task Force revisit this matter, and consider developing a new resolution to amend 31 U.S.C. Section 3713 to exempt insurance insolvency proceedings from federal creditor priority.

Having passed that motion, the working group moved on to discussing current issues regarding litigation involving insurance insolvencies being removed from state to federal jurisdiction. This is an ongoing issue that the working group monitors. The overriding concern is that if regulators are unable to get jurisdiction remanded to the state level after a case has been initially removed from state to federal jurisdiction, the regulators ability to facilitate the insolvency in the best interest of the policyholders may be impaired.

### **Risk Assessment Working Group**

The working group held an interim conference call in August to receive a report from the Federal Reserve System Joint Subgroup on Financial Issues. This subgroup was formed in 2000 by the Coordinating with Federal Regulators Working Group to discuss the components of risk arising from insurance activities with representatives from the Federal Reserve. The subgroup developed a report that mapped the risks inherent in banks and insurance companies. The report is to be used as reference material.

Interested parties submitted a comment letter on risk assessment confidentiality issues that were highlighted by the Information Sharing Working Group (ISWG). While the interested parties do not know the basis for the conclusions of the ISWG, they generally agreed that the examination process affords the best opportunity to ensure confidentiality. As the risk assessment framework and related tools are still being developed, interested parties will continue to monitor this project and will provide more meaningful comments at a future point.

The working group heard updates of activities of their subgroups as follows:

Risk Prioritization Subgroup – The subgroup continues to develop a nationwide prioritization system for use as part of the insurer profile. An objective, prototype system has been developed based principally on the current Minnesota system. Interested parties have not provided comments on the prioritization categories or the prototype system as detailed information on the analyses, calculations and framework is not yet available to the public.

Risk Assessment Development Subgroup – The subgroup has been working to develop a risk assessment framework and procedures. While the subgroup expected to have a draft report completed by August 15<sup>th</sup>, that did not occur. At this point, a draft report has been provided to the working group members with comments from regulators expected over the next two weeks. The draft, which still needs some clean up, will be exposed for public comment prior to the Winter National Meeting.

At the Fall National Meeting, the working group also held an executive session to discuss the work of the subgroups and the process to be used to solicit comments from interested parties.

### **Risk-Based Capital Task Force**

Significant discussion occurred at the meeting of the task force regarding the Life RBC Working Group's adoption of the Academy of Actuaries Modco proposal related to dividend liability in Total Adjusted Capital (TAC). The life insurer that objected to the proposal at the meeting of the working group raised the same objections at the meeting of the task force. As a result, the task force deferred final adoption of the proposal to allow the insurer "an opportunity to provide the AAA and the Life RBC Working Group with more specific and convincing information as to why this proposal should not be implemented for the 2004 Life RBC formula."

The task force then discussed a referral from the Statutory Accounting Practices Working Group. The working group had asked the task force to provide comments on their consideration of the AICPA SOP "Consideration of AICPA SOP 01-5, Amendments to Specific AICPA Pronouncements for Changes Related to NAIC Codification," which was effective for financial statements with years ending December 31, 2001 and thereafter. The guidance includes the requirement to disclose certain information when a company uses state permitted practices that differ from NAIC SAP. The SAP Working Group seeks an indication from the task force as to whether the task force supports the inclusion in the Accounting Practices and Procedures Manual a proposed required disclosure when a company would have triggered an RBC action level if it had not used a permitted practice. The task force will draft a response to the SAP

Working Group and hold a conference call to approve the verbiage. In the meantime, the task force agreed that the general consent is that such disclosure would not be appropriate because of the confidentiality provisions of the RBC Model Law.

### **Ad Hoc Subgroup of the Risk-Based Capital Task Force**

The vast majority of this subgroup meeting was devoted to fielding comments from interested parties in response to the subgroup's June proposal to consider increasing the RBC authorized control level (ACL) from the current 50% to 75% for property and casualty companies.

During the subgroup meeting, representatives from American Insurance Association (AIA) and Reinsurance Association of America (RAA) addressed the subgroup, summarizing a joint letter that they had sent to the subgroup shortly after the Summer National meeting. The letter evoked strong sentiment that moving the RBC ACL would be detrimental to the industry, emphasizing that a higher authorized control level would raise the cost of capital in an environment where pressure is already being placed on return on existing capital. The joint letter also suggested that other tools, such as IRIS and FAST ratios are better suited for monitoring solvency, and that the RBC system was truly established as a uniform minimum capital system, not a solvency monitoring tool.

Other comments included the belief that changing the RBC ACL is too broadly sweeping, and does not give any true insight regarding why companies are failing. While there is some uncertainty with respect to the exact impact raising the risk factor would have, the overriding concern is that healthy companies would be artificially forced into RBC action levels, and would then be penalized by the marketplace for being in those action levels. RAA also pointed to the fact that U.S. RBC is already two to four times higher than many foreign markets, which creates incentive for U.S. business to be pushed offshore to foreign reinsurers, which could exacerbate the problem.

Other interested parties gave similar comments, suggesting alternate strategies, such as trend testing, financial examinations, risk assessments, and audits of actuarial data may be more effective

means to identify troubled companies than changing the RBC authorized control level.

Having fielded interested parties' commentary regarding the 75% RBC factor, the subgroup's member from Pennsylvania reiterated his belief that more companies need to be brought into company action level, whether it be through raising the RBC risk factor, trend testing, or otherwise. In his estimation, bringing companies into the company action level quicker will allow regulators to more effectively mitigate larger future problems for those companies.

The subgroup used the last few moments of the meeting to formally request that the American Academy of Actuaries undertake a project to recommend possible RBC trend tests for both property and casualty and health companies, and to recommend potential changes to the Life RBC trend test that already exists. The merits of trend testing will be investigated, along with other viable ideas, as a potential alternative to a broad sweeping change in RBC factor levels. AAA agreed to undertake the project and present a preliminary report at the Winter National Meeting. The subgroup agreed to investigate alternate solutions, but fell short of officially withdrawing the possibility of increasing the RBC Risk Factor.

The meeting was adjourned without having time to discuss an agenda item related to focusing on operational risk as a potential indicator of troubled companies. This discussion was deferred to the Winter National Meeting.

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

The working group held two conference calls since the Summer National Meeting during which they discussed issues related to the guaranteed minimum death benefit alternative factor methodology, volatility inherent in the current C-3 phase II proposal, the modified coinsurance proposal, the workers' compensation carve-out proposal, and the treatment of long-term care business in the RBC formula. No formal action was taken on any of these matters, with further discussion planned for the Fall National Meeting.

The primary agenda item for their meeting in Chicago was the consideration of the

American Academy of Actuaries report on C-3 Phase II. AAA had originally made a recommendation related to capital standards for products with equity guarantee risk in December 2002, and has given update reports since. The AAA's current report encompasses the original proposal, along with all subsequent modifications. A representative from AAA highlighted the key changes in this report compared to prior reports.

- The report now excludes variable life insurance, but includes certain variable annuities, group annuities and insurance contracts that offer certain death benefit guarantees.
- Uses cash surrender value rather than a year-to-year projected "working reserve"
- Calibration standards have been changed to reflect a different historical period
- Starting assets have been changed to equal estimated statutory reserves
- Assumptions to develop the alternative method factors have been finalized
- For fixed account options, an interest rate component has been added for the guaranteed fund option to the equity risk

There is still work to be done on the proposal, including the further development of stochastic scenarios and factors. In order to make the end of 2004 deadline, any software changes necessary for the RBC formula diskette must be approved by December 31, 2003 and any factor and instruction changes must be finalized by June 2004. Despite the remaining work, the working group received the report by AAA "as is" and exposed it for comment. Final alternative factors, and modelling scenarios will be added to the report and received via conference call between the Fall and Winter Meetings, with a corresponding comment period

The working group then adopted the AAA Modco Reinsurance Proposal that had been exposed for comment at the June meetings. The proposal addresses concerns for the asset concentration factor, bond size factor and vanishing RBC as it relates to modco reinsurance with offshore entities.

No further discussion was held prior to adopting the report.

Discussion was warranted, however, regarding the AAA Modco proposal related to the adjustment to total adjusted capital for assumed dividend liability. The project was intended to align the modco dividend liability adjustment with the coinsurance dividend liability adjustment. The AAA proposal was originally exposed for comment in December of 2002, and in February 2003 a comment letter from a life insurer was received by the Academy urging further research on certain broader related issues before adoption of the proposal. The life insurer suggested that although the treatment between modco and coinsurance are now aligned under the AAA proposal, there is a possibility that BOTH adjustments should be changed further, and that the proposal does not address the "inadequate treatment for participating business and possibly specifically for closed blocks."

At the Fall National Meeting, the AAA stated that they still support their original recommendations, and presented their final report for adoption. They asked the working group whether they wanted to pursue the issues noted within the comment letter.

The working group chose to adopt the AAA report, but did ask AAA to start work on the broader scope project alluded to within the comment letter. Note that at the subsequent meeting of the RBC Task Force, the task force did not adopt the recommendations pending further discussion of the issues raised by the life insurer.

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

The working group briefly discussed their September 2<sup>nd</sup> conference call in which they had a spirited discussion of the issues surrounding the RBC Ad Hoc Subgroup's recent proposal to increase the Authorized Control Level to 75% from 50%. (The views expressed during this call were shared with the Ad Hoc Subgroup.) Some regulators believe there is a need for regulators to be able to detect problems in a more timely manner. Other regulators pointed to the difficulty the industry would have in raising the required capital under current market conditions, and the possibility that otherwise healthy companies would be tainted by failing the higher thresholds.

The working group heard a report from the American Academy of Actuaries on the treatment of reinsurance types A (non-proportional assumed property) and C (non-proportional assumed financial). The report addressed whether the RBC reserve and premium risk factors for Reinsurance A and Reinsurance C should be split. AAA recommended that no change be made to the factors at this time primarily due to the lack of known problems with the current application and the limited volume of Reinsurance C that any individual company writes.

The working group then received another AAA report, this one pertaining to the manner in which retroactive reinsurance is considered in the RBC calculation. Again, the AAA recommended no action be taken at this time, as there is not adequate information in the annual statement with respect to retroactive reinsurance to allow a reasonable basis for any adjustment to the RBC formula, and the relative volume of retroactive reinsurance reserves in industry is relatively low, and concentrated in a handful of companies. Note that the RBC formula does not allow any credit for reserves ceded under retroactive reinsurance agreements.

To close the meeting, the working group indicated that they will enlist AAA's help in investigating the potential need to adjust discount factors used in the RBC formula to take into account changes in investment yield and/or loss payout patterns since the original adoption of the RBC formula.

### **Health Organizations Risk-Based Capital**

The working group did not meet in Chicago, but held conference call in August, and discussed drafting a proposal to include a new line for aggregate write-ins for invested assets and receivables for securities in the Health RBC formula in response to an industry question regarding the reporting of derivatives. The working group also discussed a discrepancy in presentation of cash equivalents between the RBC formula and the Health Annual Statement blank. This matter was deferred to the RBC Task Force for resolution.

At that meeting, the task force requested that NAIC staff correct this inconsistency in the RBC formula.

## Invested Assets Working Group

Significant discussions continued at the Fall National Meeting regarding the proposal to file certain Schedule BA assets with the SVO. This proposal affects only Schedule BA assets with characteristics of fixed income securities and preferred stock instruments. Interested parties voiced their strong opposition for the overall proposal, arguing, as they have in previous meetings, that it does not address any existing issues or problems and that it has no regulatory purpose. Furthermore, this proposal will not have a material impact on many filers. The working group asked for further clarification on the impact to property and casualty companies and the impact to SVO revenue (i.e., number of filers). As the working group did not reach a consensus, an interim conference call will be held to further discuss the proposal.

Other matters discussed by the working group are outlined below:

iShares – iShares are exchange-traded fund securities with shares representing ownership interests in an underlying pool of bond securities. The chair of the working group prepared a letter dated July 28, 2003 that clarified the reporting of exchange-traded funds. In general, exchange-traded funds may be reported as a Schedule D bond if included on a predetermined list in the SVO Purposes and Procedures (P&P) Manual. If the instrument is not included on such list, an application must be filed with the SVO to determine proper classification. At the request of interested parties, the working group directed the SVO to draft an amendment to the P&P Manual and agreed to propose changes to the annual statement instructions and the blank that will be considered by the Blanks Task Force.

Accounting and RBC for low-income housing tax credit investments – The working group discussed the proposal from interested parties on accounting for low-income housing tax credit investments and related RBC factors. The proposal recommended amortized cost valuation and lower RBC factors for these limited partnership investments. After limited discussion, the working group adopted the proposal and will begin preparing response letters to the two

referring working groups, SAP Working Group and Life RBC Working Group.

## SVO Oversight Working Group

On an interim conference call, the working group continued its discussion of the proposed revisions to the SVO appeals process. At the Summer National Meeting, the only open issue (as identified by interested parties) related to the lack of written support outlining the basis for any appeal decision.

This matter was debated on the conference call as interested parties cited the need for transparency and appropriate guidance. However, despite industry opposition, the working group adopted the proposal without a provision to require the SVO to outline the basis for its conclusion. Only one amendment was made, which changes the 90-day limit on filing an appeal to 120 days.

At a subsequent meeting of the Valuation of Securities Task Force, the Texas DOI objected to the adoption citing concerns with time frames outlined in the proposal and the composition of the credit committee. The task force agreed to delay adoption of the proposal until Texas has an opportunity to share its specific concerns with the task force members. Texas noted that their concerns would not result in any substantive changes to the proposal. The task force still hopes to adopt the proposal at the Winter National Meeting.

At the Summer National Meeting, the working group asked regulators to provide comments on the long-term initiatives of the New York proposal to reform the SVO filing and rating process. In a memorandum dated August 26<sup>th</sup>, the chair of the working group summarized all regulator concerns with the third initiative, which calls for an SVO filing exemption for all securities with an NRSRO rating equivalent to an NAIC 3, 4, 5 or 6 designation. The concerns are as follows:

- Reliance will be placed on third party designations for riskier and more volatile securities.
- NRSROs differ in their interpretation of impaired securities and securities could be overstated with strict reliance on NRSRO ratings.

- Without SVO filings, the SVO may be unable to value securities (NAIC equivalent 3-6 for property and casualty companies; NAIC 6 for life companies).

The working group has asked regulators to consider the issues and determine whether the concerns are valid and how to address such concerns. The working group plans to have interim conference calls on the issue and hopes to make a decision at the Winter National Meeting.

At the Fall National Meeting, the working group also discussed the following matters:

Dominion Bond Rating Agency Application to SVO – Dominion filed an application with the SVO to be added to the SVO's list of NRSROs. A cost-benefit analysis has been completed and discussions have been held with Dominion. A conference call will be held to discuss the resolution to this matter.

Proposed Amendments to SVO Purposes and Procedures (P&P) Manual – Amendments have been proposed to the P&P Manual that take into consideration changes made to the SVO filing and rating process. NAIC staff and industry representatives plan to work together in reviewing the proposed amendments with adoption expected in December 2003.

Proposed Agenda for the SVO Research Unit – The working group directed the SVO to provide a list of current projects and tasks. This list will be used as the basis for developing an annual agenda of the research unit. In the coming months, a draft agenda will be circulated for a 30-day comment period.

### **Rating Agency Working Group**

The working group its charges for 2004, which include the following:

- Actively monitor the SEC proposals to modify the current process used to designate rating agencies as nationally recognized statistical rating organizations (NRSRO). As revisions to the NRSRO designation or the established SEC process may significantly impact the practice of the SVO, the working group will timely communicate SEC revisions to the Financial

Condition Committee and key personnel of the SVO.

- Continue to advocate for increased confidential communication between the rating agencies and state insurance departments. The working group will continue to develop and propose possible suggestions to the rating agencies on how this communication could be developed while considering the rating agencies' concerns of independence and timely issue of ratings.
- Ascertain whether the rating agencies consider a troubled company's corrective action plan when rating an insurer and to what extent the plan influences the assessed rating. For rating agencies who do not currently use corrective action plans, the working group will strive to provide guidance on how corrective action plans can be utilized in a company's rating.

The working group recognized that other NAIC working groups, including the SVO Oversight Working Group and the Insurance Marketplace Standards Working Group, are involved with rating agencies. Furthermore, certain states are currently in discussions with rating agencies.

The working group received a concept release from the SEC entitled "Rating Agencies and the Use of Credit Ratings under the Federal Securities Laws." In response to an invitation to comment, the working group responded to the concept release in a letter dated July 28, 2003. This letter, which will be available on the NAIC website and answers several questions posed by the SEC. The working group has speculated that the SEC will hold a public hearing to address their concept release.

### **Examination Oversight Task Force**

#### Status of the Examination White Paper Recommendations

The task force has been studying since December 2002 the Statutory Financial Examinations White Paper "A Call for Change" submitted by seven trade associations. At their meeting in Chicago, the task force exposed for public comment their responses to the recommendations. Comments are due by October 30<sup>th</sup>. In addition, the task force has identified the respective NAIC group that should address and implement the recommendations. The

task force hopes to adopt the report at the Winter National Meeting.

### **Financial Examiners Handbook Technical Group**

At the Fall National Meeting, the technical group discussed proposed revisions to the Financial Examiners Handbook and other recommended changes to examination procedures. Each matter discussed at the meeting is summarized below:

- The technical group discussed proposed revisions to Exhibit M of the handbook, "Consideration of Fraud" which would incorporate the guidance of AICPA Statement of Auditing Standard (SAS) No. 99. The primary changes to the handbook relate to the reorganization of the fraud risk factors. Guidance will also be drafted to highlight the consideration of fraud in all facets of the examination process. The proposed revisions to Exhibit M will not be exposed for comment until the technical group receives observations and recommendations from the Ad Hoc Task Force on the USA Patriot Act.
- Revisions have been proposed to Exhibit C of the handbook, "Information Systems Questionnaire." These proposed revisions were recommended by the Audit Software Subgroup and represent specific changes to individual questions and scoping considerations in the questionnaire. The revisions have been exposed for a 30-day comment period.
- The technical group formed a subgroup to review the recommendations of the NAIC/AICPA Working Group regarding the Use of CPA Workpaper Survey. The recommendations were made by the individual subgroups of the NAIC/AICPA Working Group – Investments Subgroup, Consolidated Audits Subgroup, Intercompany Transactions Subgroup and Reinsurance Subgroup. These recommendations include general examination considerations as well as specific testing procedures that may be valuable to the examiner if completed by the CPA. The technical group is hoping to incorporate the recommendations into the 2004 handbook.

- A subgroup was formed to review proposed changes to the Investment Specific Risk Analysis of the handbook. These changes will update the handbook to address the revised filing requirements with the SVO (i.e., adoption of the two New York initiatives to enhance the SVO process) as well as changes required by SSAP 86. Interested parties may submit comments to NAIC staff.

The technical group then adopted their 2004 charges. Notable charges include the following: (1) develop guidance on corporate governance and communications with audit committees, and (2) update the handbook to address the use of SAS 70 reports in a statutory examination.

### **Insurance Securitization Working Group**

The working group had previously formed a subgroup to develop review procedures for a special purpose reinsurance vehicle ("Protected Cell Plan of Operation"). A draft was exposed at the Spring National Meeting, and comments have been received throughout the summer. The working group will be addressing such comments and have a revised draft of the Plan of Operation ready for the December meetings.

Next, the International Association of Insurance Supervisors Subgroup on Insurance Securitization briefly discussed its completed reports on Life and Non-Life securitizations. The Non-Life issues paper had been issued earlier, but the Life paper was first issued in June. Comments received on the Life paper since then have been considered and incorporated. Both papers will be presented to IAIS Technical Committee later this fall.

At the Summer National Meeting, after the working group received a presentation on various forms of insurance securitizations, the working group asked for commentary as to whether any changes to model laws or regulations seemed necessary to allow for these types of securitizations. At their meeting in Chicago, the working group indicated that they have not identified any such necessary revisions, and therefore does not presume there to be any known regulatory obstacles to such securitizations.

The final discussion point was a letter written by the NAIC to the U.S. General Accounting Office in response to the GAO's report "Catastrophe Insurance Risks: Status of Efforts to Securitize Natural Catastrophe and Terrorism Risk." The NAIC's response letter clarified that its desire is to encourage the development of alternative capacity, including securitizations, as long as they are properly structured in accordance with the NAIC's overriding mandate of consumer protection. The NAIC letter also conveyed its strong desire to encourage securitizations within the U.S. rather than having them done in offshore markets where they are much more difficult to monitor and regulate. Specifically with respect to securitizations of terrorism risk, the NAIC recognizes that such risks are difficult to securitize presently, but believes that the developing efforts to model and price such risks should allow for effective securitizations in the future.

### **Blanks Task Force**

The task force discussed the implications of the Sarbanes-Oxley Act on the current Jurat page requirements for certain certifications by the president, secretary and treasurer. The conclusion reached by the task force is that "NAIC language in the Jurat page and the Affidavit of Filing and Financial Statement Attestation is stronger, is more directly to the point of the content of the filing, and demands more accountability." The task force noted that they should review the titles of officers on the Jurat page to ensure they are requiring the appropriate officers to attest; i.e. the CEO, CFO and COO.

The task force then discussed an issue related to the adoption by some states of the Valuation of Life Insurance Policies Model Regulation (Regulation XXX). Because some states have adopted XXX (which generally requires higher reserves) and others states have not as of yet, some insurers are filing different annual statements in different states depending on whether that state has adopted Triple X. The chair of the task force asked for input from its members as to whether this is appropriate. NAIC staff had been unable to locate a prohibition against this practice (which is not new but has come to the attention of regulators because of Regulation XXX).

The task force member from Pennsylvania agreed that this practice is not new and that he does not object to this practice since his domiciled companies must file in accordance with domiciliary requirements. The Blanks Task Force decided to take no action on the issue at this time.

The task force chair updated its members and the audience on the status of public access to the NAIC's CIS website that previously provided free downloads of annual statement data in .pdf format. During the summer, the website charged \$10 per download for all users. Some regulators were concerned that users who previously had free access to insurance company information will now ask the states for this information at a cost to the states.

The CIS website is again now free of charge, but users must agree to comply with a terms of use agreement including that they "agree to use this data for personal, non-commercial use only and agree not to market, sell or otherwise commercially distribute this data without the prior written authorization of the NAIC." Users must also complete a "survey" with name, company name, mailing address, email address and phone number. Members of the task force are concerned that such requirements will significantly reduce use of the CIS website and will be looking for further direction from their parent committee on how to proceed.

The task force will hold their final annual Blanks Task Force meeting on October 13 in Charleston, SC. The results of that meeting will be summarized in our December Newsletter. After that meeting, the new procedures to address new proposals at the quarterly National meetings will begin.

### **Insurance Holding Company Working Group**

The working group held a short open session prior to entering executive session. During the open session, the working group discussed two areas of the NAIC's Regulatory Modernization Action Plan that will impact the scope of their efforts in the coming year. Specifically, within the NAIC's recent declaration of principles and goals reflecting their commitment to modernize insurance regulation are statements directly referencing the need to strengthen the coordination of financial exams

involving multiple jurisdictions, and creating efficiencies in the merger and acquisition process.

These objectives are formally stated in the NAIC's principles and goals statement as follows:

*Solvency Regulation* – “Deference to lead states ... state insurance regulators have recognized a need to more fully coordinate their regulatory efforts to share information proactively, maximize technological tools, and realize efficiencies in the conduct of solvency monitoring.”

*Change in Insurance Company Control* - “Streamline the process for approval of mergers and other changes of control.”

As both of these objectives will involve leveraging work in the lead state, focus at the holding company level will intuitively become the crucial components of regulatory exams and Form A procedures in the future. As such, activities of the working group will take on added importance.

The working group then went into executive session to discuss a survey of states with respect to coordinating financial exams and the Form A process.

### **Privacy Issues Working Group**

The working group did not meet in Chicago.

### **Consumer Protections Working Group**

Many written comments have been received regarding the working group's consideration of arbitration clauses in insurance contracts. The working group will be summarizing all comments over the course of the next month and anticipates holding an interim conference call to discuss the materials. The working group hopes to provide recommendations at the Winter National Meeting, which may include development of a model law.

At their meeting in Chicago, the working group heard an update from the Unauthorized Insurer Media Subgroup. The subgroup discussed the results of a survey to states regarding unauthorized insurers. Based on this survey, the subgroup noted that most unauthorized activity relates to health insurance and that a national media campaign

designed to educate consumers would be beneficial. The working group adopted the five recommendations of the subgroup to increase consumer awareness of such unauthorized insurers.

The working group also heard an update on the efforts of the Disclosures Subgroup. This subgroup, which was formed to research the effectiveness of disclosures to consumers, made a recommendation to solicit bids from national research firms and survey research centers. A qualitative approach based on discussions with consumer focus groups will be used to conduct the research. The research project will be designed to identify which disclosure elements are effective or ineffective, develop reasons for effectiveness or ineffectiveness and suggest ways to improve disclosures.

### **Credit Scoring Working Group**

The working group heard extensive comments from interested parties on both sides of the issue on the applicability of the “disparate impact standard” to insurance rating laws and which uses of credit reports are permissible. The key issue is whether insurance credit scores have a disparate impact on certain protected classes of people. The working group concluded they should get additional legal analysis from the NAIC before deciding whether to conduct a credit scoring study.

The working group discussed several options on determining the effects of credit scoring including ongoing compliance monitoring and information exchange, an NAIC study, collaborative market conduct exams, collaborative market analysis activities or an FTC study. NAIC staff will survey the states to determine their interest in doing a collaborative study or an NAIC study.

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

The only action taken by the committee during its short open meeting was to adopt their 2004 charges. All proposed charges, which relate to strengthening the Financial Regulation Standards and Accreditation Program, were adopted. The committee then met in closed session for several hours.

## **Information Sharing Working Group**

The working group opened the meeting with a status report on implementation efforts with respect to the Model Information Sharing and Confidentiality Agreement. As of this meeting date, 25 states have signed the Agreement, and 2 others have indicated that they intend to do so imminently. While one state has indicated that it feels precluded altogether from signing the Agreement due to conflicts with state law, several other states have indicated that wording changes, or amendments to the Agreement may be necessary before they could sign. The working group discussed the general nature of the concerns conveyed by states. One example noted by the working group is that while the Agreement calls for the return or destruction of any documents obtained via the Agreement, certain states' document retention laws would prohibit compliance with the Agreement in that regard. The working group agreed that any requests for modification to the Agreement by individual states ought to be considered by the entire working group. As such, NAIC staff will be responsible for receiving such requests, summarizing them, and addressing them with the working group via email.

In closing the open session, the working group indicated that its primary focus in executive session will be to discuss issues pertaining to information sharing among states and the NAIC. Particularly, if states share confidential information with the NAIC, does such information become subject to disclosure to third parties that otherwise would not have been able to get such information directly from the states.

## **Class Action Litigation Insurance Working Group**

The working group has been formed to determine the impact or potential impact of class action litigation on the authority of state insurance regulators. The working group will focus on class action litigation against insurers in areas that are regulated by insurance commissioners. The working group anticipates formulating a white paper and developing NAIC guidelines regarding legislation and amicus briefs. The working group will provide a report to NAIC members detailing their findings by December 2004.

At the Fall National Meeting, the working group met and reviewed the scope of their mandate; received a status report on a survey of insurance companies to be conducted by the RAND Institute for Civil Justice; discussed a law recently enacted in Texas that addresses the class action litigation process; discussed legislative proposals prepared by NCOIL, NAMI, and the American Legislative Exchange Council; and received an update on the current U.S. Senate Bill that addresses interstate class actions.

Significant discussion and debate at the Fall National Meeting focused on the jurisdiction of insurance regulators vs. courts, the use of administrative remedies and the legitimacy of class actions.

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

During an interim conference call, the committee adopted a revised Senior Protection in Annuity Transactions Model Regulation. The revisions contained within the Model Regulation are designed to give regulators the tools to work with an insurer to resolve a potential problem. The section that was subject to the most debate surrounded the revised requirements for an insurer to maintain a mechanism to supervise the various channels of distribution. The adopted language states that an insurer can work with a third party, such as a broker/dealer in that supervisory activity, but that the insurer is required to make a reasonable inquiry that the third party is following the required procedures and must check to determine that it is fulfilling its function.

Because the committee adopted the model prior to the Fall National meeting, Executive Committee and Plenary were able to consider the model at their meeting in Chicago, which the commissioners adopted.

## **Insurance Marketplace Standards Working Group**

During an August 12<sup>th</sup> conference call, the working group continued discussions of its white paper on recognition of best practices organizations such as National Commission on Quality Assurance and Insurance Marketplace Standards Association. There was spirited debate as to what extent a best practices organization's work product should be

utilized to supplement, reduce or replace the scope of regulatory examination. Ultimately it was agreed that such matters are not the focus of this working group. Rather it is the task of the working group to develop a white paper establishing guidelines for best practices organizations that seek to be recognized, or accredited, by regulators.

During the August conference call a newly drafted recommendations and conclusions section was submitted for addition to the white paper. The section consists of two separate but interrelated areas: standards that a best practices organization should meet to be eligible for regulatory recognition and the types of recognition currently enjoyed by best practices organizations.

At the Fall National Meeting, comments from the Center for Economic Justice related to the recently added recommendations and conclusions section of the white paper were recognized, and other interested parties indicated that they would like further opportunity to comment. As such, the working group agreed that it would not take formal action on the section at this meeting.

A draft summary of the working group's thoughts regarding to what degree states can and should delegate authority to outside service organizations was submitted for discussion. An initial template, which will be used to capture various states' current position on accreditation of service organizations, was also submitted for comment. Comments on these proposed additions to the white paper will be received at the next conference call.

Finally, the working group discussed its timeline to submit a completed white paper to the Life Insurance and Annuities (A) Committee, which they hope they can submit at the Winter National Meeting. To accomplish this, another conference call will be held to field comments on the three most recently added elements of the white paper; the full draft white paper will be distributed for comment, and the working group will hold a mid-November conference call to adopt the complete white paper.

### **Separate Accounts Working Group**

The working group did not meet in Chicago.

### **Life and Health Actuarial (Technical) Task Force (LHATF)**

LHATF generally allocates one and a half days to life and annuity issues and one-half day to health insurance issues. Since many industry actuaries who help support LHATF projects were attending the Society of Actuaries' Valuations Actuaries Symposium, a full day of this quarter's meeting was spent discussing A&H topics.

The most important discussion during this National meeting was that surrounding the variable annuity GMDB Dollar-for-Dollar issue. At the conclusion of this discussion, LHATF voted to expose revisions to Actuarial Guideline ("AG") 34. The revisions include: (1) modified language that explicitly states that the actuary need not include a provision for future partial surrenders in calculating the AG 34 liability, and (2) a requirement that companies perform a stand-alone asset adequacy analysis of the entire variable annuity contract if it includes a GMDB. See further discussion below.

#### Variable Annuity GMDB reserves

In an effort to resolve the reserving dilemma surrounding variable annuities containing a GMDB where the death benefit reduces dollar for dollar with reductions in the account value due to partial withdrawals, LHATF voted to expose changes to AG 34. The changes include specific language that projections of future utilization of partial withdrawal provisions are not required under this guideline, and a requirement that a separate stand-alone asset adequacy analysis for variable annuity contracts with GMDBs. This latter requirement is in addition to the stand-alone asset adequacy analysis already required under AG 39 for variable annuities with guaranteed minimum income benefits ("GMIB"). LHATF hopes to have this change adopted by the NAIC at the Winter National Meeting December 4<sup>th</sup>, effective for year-end 2003 financial statements. This is expected to be a temporary solution until the AAA completes its work on a stochastic reserve calculation model for variable annuities with GMDBs. GMIBs and other similar provisions.

As part of this lengthy discussion, LHATF rejected a joint proposal from California, Florida and New York that would require companies to use an annual partial withdrawal assumption of 20% anytime projected future GMDBs exceed the account value.

We are aware that New York may still be considering incorporating the 20% assumption requirement in its Regulation 151, and the Department is soliciting comments from interested parties.

#### Update on Life RBC C-3 Phase II Work and VA Reserves

The AAA's work group discussing reserve requirements for variable annuities with guaranteed benefits provided an update of their progress. Working closely with the RBC C-3 Phase II work group, the reserve work group is developing a recommendation for reserve requirements for these products that is consistent with the RBC recommendations. The AAA work group was looking for direction from LHATF regarding the form of the recommended guidance (law, regulation or guideline), the confidence level of the reserves and whether the guidance would apply to inforce business. LHATF generally preferred new guidance to be in the form of an actuarial guideline; however, other forms of guidance offered other attractive benefits. LHATF clearly indicated that historical inforce policies need to be included in the new guidance; otherwise the dollar-for-dollar issue is not solved for the long term. LHATF had no preference regarding the level of the conditional tail expectation.

#### Non-forfeiture Requirements for Individual Deferred Annuities

As a follow-up to the change in the Standard Non-forfeiture Law ("SNFL") for Individual Annuities adopted earlier this year, LHATF is now working on a possible regulation to support that change. The AAA presented a report on this issue, where they identify several items that need to be clarified through additional guidance. LHATF needs to address these items and will schedule a conference call prior to the December meetings to discuss.

#### General Nonforfeiture Project

LHATF was asked to provide additional guidance to the AAA group working on this project. Specifically, the AAA group asked that LHATF identify specific lines of business to be addressed by this project, whether they should focus on an objective equity-based pre-funding approach or rely upon comprehensive disclosures, how to treat non-guaranteed elements ("NGE"), and are there any

particular areas of the current non-forfeiture law that need special attention. In general, LHATF members favored starting with life insurance, leaned toward a disclosure approach, and stated a concern that they wanted to be certain that, once credited, NGE's couldn't be taken away. The task force reiterated that they believe every aspect of the current non-forfeiture law needs attention.

#### Possible Areas of Revision to the Standard Valuation Law

Of the many issues regarding the standard valuation law ("SVL") being considered for possible revision, the Certificate of Valuation requirement is the first one being addressed. NAIC staff conducted a survey of state insurance departments to determine the current use of these certifications. Although results varied, LHATF determined that the certificates of valuation are seldom used today. LHATF voted to expose for comments suggested revisions to the SVL that would eliminate the certificate of valuation requirements. Once adopted by the NAIC, changes in the SVL are estimated to take 3 to 5 years before implemented by all states.

The second topic to be reviewed by LHATF is deficiency reserves, in particular, whether they should still be required. A future conference call will be scheduled to discuss this issue.

#### Credit Life Insurance Valuation Mortality

LHATF adopted a model regulation for determining reserve liabilities for credit life insurance, specifically requiring the use of the 2001 CSO composite ultimate mortality table for credit life reserve requirements. LHATF also formed a sub-group to study a list of related credit life issues raised by industry representatives.

#### Request from Financial Analysis Handbook Working Group

LHATF was asked to comment on including certain reserve ratios in the Financial Examiners Handbook. LHATF's response will indicate that they believe the ratio tests are of limited value and that a thorough review of the actuarial opinion is the only effective method for determine the adequacy of the reserves.

## Accident and Health Working Group

### Long-Term Care Reserving Requirements

The working group voted to re-expose changes to the A&H reserve regulation to incorporate proposed modifications to active life reserve requirements for LTC insurance. The changes include the requirement to incorporate provisions for moderately adverse deviations in the morbidity assumption, a prohibition against the use of morbidity improvement factors, lower allowable lapse rates and a revision to the allowable mortality table for reserve calculations. The language prohibiting future morbidity improvement has been clarified to grandfather, with permission of the insurance commissioner, reserve calculations on existing business that already include a morbidity assumption incorporating future improvement. Industry representatives expressed some concern over what they considered to be extremely low allowable ultimate lapse rate assumptions and the proposed effective date of January 2005.

### Reserve Standards for Disability Income Insurance

The working group adopted revisions to the model A&H reserve regulation to clarify the allowable adjustments for a company's own experience to termination rates for disabled life reserves. Current language is ambiguous and has been interpreted in different ways. The new language clarifies that a company's own experience can only be used for termination rates applicable to periods within 2 years of disability, or for group policies, 5 years with permission of the commissioner.

### Reserves for Credit Disability

The working group adopted changes to the A&H reserve model regulation for credit disability insurance. The change clarifies in the model regulation that the section on unearned premium reserves does not pertain to single premium credit disability insurance.

### Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses

In December 2002, the Emerging Accounting Issues Working Group issued Interpretation 02-21 *Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses*. As a result of this, certain language in the Health Reserve Guidance Manual conflicts with INT 02-21. The working group voted to send a response to the

EAIWG with recommended changes to the Manual. However, the working group is requesting that the guidance be applied to both managed care contracts and indemnity contracts. Because there are currently no projects involving changes to the Manual, it is not clear when these clarifying changes will be made.

### Medicare Supplement Refund Project

This is a complicated issue affecting both federal standards for required premium refunds when benchmark loss ratio standards are not met and NAIC requirements for Medicare supplement products. The working group voted to expose a discussion draft of changes that they think need to be made to the federal Medicare supplement requirements. In addition, the work group is anxious for the American Academy of Actuaries to complete its work regarding benchmark target loss ratios.

### Medicare Supplement Automatic Claim Filing Fee

The working group has been asked by the Medicare Supplement Working Group to provide input regarding whether fees that companies charge for an automatic claim filing service should be considered as premium, particularly for the calculation of premium taxes or similar matters. Although slightly puzzled about being asked for advice regarding this issue, the A&HWG will send a response that states that they believe that this is not a clear issue in all states, but that the A&HWG believes that these fees should be considered premium.

### HMO/HMDI Reserves

The working group formed a subgroup to work on this project, which deals with the consistency between HMO, HMDI and life insurance company reserve requirements. The initial focus will be premium deficiency reserves.

### Update from the Academy's Health Insurance Rate Filing Task Force

The AAA will be conducting a web-cast on September 25<sup>th</sup> to regulators to present its findings. It wasn't clear if non-regulators were being invited to participate.

## Health Entities Working Group

A working group member reported on the activities of the Accident and Health Working Group, which has been working to improve consistency between the Health and Life, Accident & Health Annual Statements. Ultimately this work will extend to health business reported in the P/C blank as well. Specifically, the group intends to suggest amendments to the Accident and Health Policy Experience Exhibit in the Life and A&H blank. The proposed changes require more information on specific lines of health business and eliminate requirements that are viewed to be non-essential or that provide minimum value. The changes clarify the instructions for the exhibit, which should help companies to more accurately categorize their business. The working group will forward the proposal to the Blanks Task Force.

The working group accepted a report from the Health Liquidity Group of the American Academy of Actuaries. The report identifies potential ratios for use in testing liquidity of health entities. NAIC staff will now investigate the availability of information required for the ratios. The AAA will provide the formulas for the ratios. Upon completion of those tasks, the working group will revisit the report and decide which ratios they believe are predictive of liquidity problems.

The group discussed an inconsistency in the Actuarial Opinion and Memorandum Regulation relating to health entities. The problem arises because the AOMR defines items to be tested by the actuary based on the Life blank, yet some entities file the Health blank. One possible solution would be to develop a new model regulation for health actuarial opinions. However, not all health entities are subject to the HMO Model Act and this could lead to different inconsistencies. An AAA working group intends to prepare a paper on health actuarial opinion instructions.

The working group plans to forward two proposals to other groups. It plans to establish definitions and accounting treatment for risk revenue, or services provided to non-members. The group anticipates preparing a Form A for the Statutory Accounting Principles Working Group. The group also intends to draft amended instructions for proper reporting of all prescription drug arrangements, regardless of

whether they are subject to a separate prescription drug agreement or not. The amended instructions will be forwarded to the Blanks Task Force.

## Viatical Settlements Working Group

The working group spent the Fall National Meeting reviewing a revised draft of the Verification of Coverage form that is part of the appendices for the Viatical Settlements Model Regulation. No substantive changes were proposed. The purpose of the form is to provide a uniform method for viatical settlement providers to request information about policies from insurance companies. The information assists providers in deciding whether to make an offer on a policy and at what price. The working group also reviewed provider and broker reporting forms that will be attached to the Model Regulation.

Interested parties will be given a final opportunity to make comments on the Model Regulation during an interim call and it is anticipated that it will be adopted (as revised) at the Winter National Meeting.

## Market Analysis Working Group

### Market Conduct Annual Statement Subgroup

To begin the meeting, a representative from Alliance of American Insurers (AAI) presented a study of the cost to participating member companies for gathering data related to the property-casualty market conduct annual statement program in the nine designated pilot states. Results of study indicate that the eight responding companies' cost to gather the required data fell close to the range of \$10,000-\$25,000 dollars that a prior estimate had proposed. Companies' costs seemed to be dependent upon the number of states in which they file, but not on premium volume. The AAI study companies estimated that recurring efforts to complete the market study annual statement data elements would be approximately half of the first year effort.

With regards to the long-term schedule for the property-casualty market conduct annual statement project, the subgroup indicated that it hopes to complete the pilot program, and implement the project in time to be able to collect 2004 data from all companies in the spring of 2005.

Next, the subgroup discussed its August 27<sup>th</sup> conference call to clarify certain data elements to be included in the Life version of the market conduct annual statement. During that conference call, it was determined that all data related to group annuities, 1035 exchanges for non-cash life products, and surrender data for all non-cash individual life products would be eliminated from the market conduct annual statement.

Significant conversation was also held regarding using covered lives as a data element for group life products. Interested parties expressed extreme reservations regarding the ability of most companies to produce a reliable count for covered lives, or even certificates, on group life products. The subgroup agreed that premium volume will be used as the primary data element for pertinent ratios and comparisons rather than covered lives.

#### Market Analysis Handbook Subgroup

The group discussed the latest draft of the "Market Data Analysis Guide," issued in early September. The stated intent of the group is to develop a guide that includes step-by-step instructions on how to conduct analysis of markets, market disruptions and market conduct. The chairman asked specifically for commentary on Section III, containing instructions on how to conduct market analysis. For accurate analysis, it is critical that all participants in the process – companies, regulators and various industry groups – code consumer complaints consistently.

Interested party comments supported the direction of this draft, as it is getting much closer to the stated intent of being a how-to guide. An interest party representative asked if the market analysis timeframe in the guide was to be annual or quarterly or neither. A subgroup member responded that some elements of the process would be regular or periodic; for instance, certain financial analysis should be done soon after Annual Statement information is available. Other parts of the process will be used on an ad hoc basis in response to market disruptions or complaint trends. When it was suggested that calculating complaint ratio based on policies in force rather than premiums would yield better results, the chair agreed but said policy count information is not available. The important idea is to put as much information as

possible into the analysts examining the market and market conduct.

The group will continue to work on the draft and to accept comments from interested parties.

#### Collaborative Actions Subgroup

The subgroup met in executive session in Chicago and reported that discussions had focused on specific companies where states had reported multiple examinations in the NAIC Examination Tracking Systems (ETS). The goal was to determine if there were issues of common concern that could be examined on a collaborative basis to avoid duplicative regulatory efforts.

Finally, the working group received an update on the collaborative effort with respect to privacy examinations. Currently 18 states have agreed to join this effort with an anticipated 10-15 states still considering the program. The examination, which is in the form of a detailed questionnaire, will be sent by a third party contractor to 100 companies to determine their activities in protecting private information. It was noted that on receipt of the questionnaires if a specific company believed it had already been subjected to a thorough privacy examination (such as by the SEC) then they would be able to request that their results be examined with the potential for no further participation required. States have committed that for companies that complete this questionnaire, unless there is specific cause, they will not be subjected to another privacy examination for three years.

#### **Reinsurance Task Force**

As part of the NAIC's Model Law review process, the task force added to its 2004 list of charges the review of two: *Life and Health Reinsurance Agreements Model Regulation* and *Minimum Surplus as Regards Policyholders to Assume Property or Casualty Reinsurance*. Additionally, it agreed to monitor the European Union's reinsurance regulatory directive, review any resulting standards and compare the updated European regulatory framework for reinsurance to that used in the U.S. An old model that is no longer applicable was also rescinded: *ML #75 Reinsurance: A Model Act for Regulation of Reserves Ceded to Nonadmitted Reinsurers* (superseded by the *Credit for Reinsurance Model Law and Regulation*).

The task force chair established two new subgroups. The Enforceability of Foreign Judgments Subgroup will consider actions from other jurisdictions taken against U.S. insurers. The group had extensive discussion at an interim meeting about enforceability and determined that there is enough to consider to merit creation of the subgroup. The Jurisdictional Accounting Standards Subgroup will study non-U.S. accounting frameworks and identify specific differences. This second group will monitor activities related to International Accounting Standards and International Financial Reporting Standards.

Various jurisdictional subgroups reported on reinsurance regulation in Bermuda, Switzerland, France, Germany, and the United Kingdom. Some of the subgroups are in the process of obtaining responses to their reports from the applicable regulatory authorities. The Reinsurance Association of America issued a comment letter on the drafts dated July 31<sup>st</sup> that included a list of 12 questions it felt each subgroup should answer. The task force chair charged the subgroups with ensuring that their reports addressed these questions.

In other matters, the task force has received a significant amount of comments and letters from interested parties concerning reinsurance collateral requirements. An interested parties group submitted a draft of a Model Regulation For List of Approved Reinsurers, which the task force will review. The International Association of Insurance Supervisors shared its draft Standards on Supervision of Reinsurance, which it expects to finalize at its upcoming annual meeting in Singapore.

### **P/C Reinsurance Study Group**

The existence of a requirement to include a standard intermediary clause in reinsurance agreements differs across states. Such a clause requires the reinsurer to assume all of the credit risk of the intermediary related to payments to the intermediary. Some states have explicit statutes requiring such clauses in order for ceding companies to receive reinsurance credit. Others refer in their statutes to the Financial Examiners' Handbook, which also indicates the necessity of a clause. The list of required clauses in SSAP 62,

"Property and Casualty Reinsurance," (par. 8), however, does not include one for reinsurer intermediaries, and thus states whose statutes refer to the Accounting Practices and Procedures Manual do not have the requirement.

The study group considered several options to resolve the discrepancy and establish an intermediary clause as a requirement for reinsurance credit:

- create a reinsurance intermediary clause model law;
- amend the Financial Examiners' handbook;
- amend the Credit for Reinsurance model law

The group ultimately decided that the decision should be under the jurisdiction of the Reinsurance Task Force and agreed to send that group a letter.

The working group briefly discussed that the AICPA's Insurance Experts Panel has drafted an issues paper, soliciting views on emerging issues related to risk transfer in property/casualty contracts. The Expert's Panel will review the draft at its upcoming September meeting and decide whether to recommend to AcSEC's Planning Subcommittee that the paper be sent on to the FASB staff for their review and consideration. If that occurs, FASB staff will then decide whether the issues warrant consideration and resolution by an authoritative GAAP standard-setting body.

### **Market Conditions Working Group**

The working group discussed its draft document, *Medical Malpractice Insurance: A Study of Market Conditions*. The study concludes the primary driver of med mal rates is loss costs. The possible tools to control losses are caps or limitations on awards for noneconomic damages, informing juries of collateral sources of recovery and allowing periodic payments of future damages. Many, including regulators and interested parties, indicated they would forward comments to the working group in writing. Notable suggestions and comments on the draft include:

- Consider not just short-term solutions but also long-term solutions
- Include discussion of bad faith/excess of contract obligations claims.

- Consider conducting analysis of insolvent medical liability insurers for ideas.
- Include discussion of mediation, arbitration expert witness reform, alternative dispute resolution.
- Encourage stronger doctor self-policing efforts like medical review boards.
- Focus ratemaking prospectively, and not to recapture past losses.
- Consider Congressional recommendations made by the General Accounting Office.
- Assess impact of insolvencies, bankruptcies, withdrawals, reserve levels on decreased medical capacity.
- Include discussion of tradeoff between insurer solvency measures and consumer protection.

Missouri Insurance Department representatives indicated that analysis they conducted indicated results contrary to the working group draft; they concluded med mal claims are down. They feel the report is more about tort reform than insurance reform. The report does not itemize the data on which its conclusions and recommendations are based, and Missouri staff questioned whether that data would support those conclusions. The Missouri study involved collecting information on economic versus noneconomic awards, analysis of the effect of lowering caps on awards and evaluation of the unpredictable impact of loss adjustment expenses.

A consumer advocate made strong comments about the report, stating that it was very one-sided toward doctors and tort reform and had little to do with available, affordable coverage. He faults the discussion of higher claims costs leading to higher rates and reduced capacity, questioning why there is no discussion of the impact of poor investment management and inadequate pricing. He feels there is no evidence of the frequency of non-meritorious claims, while the report presumes such claims are numerous and problematic. The working group's conclusion that higher med mal rates lead to lower public access to healthcare contradicts the conclusions of the GAO report. The consumer advocate believes there are multiple factors affecting med mal rates, and the report's sole focus on claims costs is misleading. He recommended that the working group discuss non-economic factors, such as whether claim caps are disincentives to avoiding errors, and to look at claims over a longer

time period so a few claims do not skew the results.

The working group chair agreed to accept written comments and delay formal action on the draft at this time.

### **Joint Meeting of the Casualty Actuarial Task Force and the Actuarial Opinion Instructions Working Group**

To open the meeting, the Actuarial Opinion Instructions Working Group reviewed the events of its August 12th conference call. Discussion during the conference call focused primarily on "next steps" in relation to adoption of the working group's proposed Property and Casualty Actuarial Opinion Model Law. The Property and Casualty (C) Committee approved the proposed model law at the Summer National Meeting, and it was adopted by Executive Committee and Plenary in Chicago. The 2004 Annual Statement Instructions related to the model law would be presented to the Blanks Task Force in October 2003, and if passed as anticipated, would become effective for 2005.

The working group also discussed the process that will be necessary for getting the model law adopted as an accreditation standard. The immediate goal is to initiate action by presenting the issue to the Accreditation Committee for discussion at the 2004 Spring National Meeting.

Brief discussion was held regarding the newly formed subgroup of the Insurance Securitization Working Group that will be tasked with reviewing procedures for Special Purpose Reinsurance Vehicles, and Protected Cell Plans of Operation. The Casualty Actuarial Task Force will continue to participate in this new subgroup, and will be forward pertinent issues to the task force.

To close the meeting, the American Academy of Actuaries (AAA) was asked to address the task force regarding recent projects. AAA indicated that it is working on its annual compilation of property and casualty reserve laws, the Property Casualty Law Manual and has requested that states provide them with any pertinent updates to existing laws. The updated Manual is to be released during the fourth quarter of 2003.

On the international front, AAA indicated that it would be commenting on International Accounting Standards Board's Phase I proposal for Accounting for Insurance Contracts. Amongst other things, in AAA's opinion there appear to be conflicts between FAS113 and IAS' proposed accounting for reinsurance.

### **ERISA Working Group**

Final comments on the ERISA Handbook (*Health and Welfare plans Under the Employee Retirement Income Security Act: Guidelines for State and Federal Regulation*) are due in mid-October; the group plans to adopt at the Winter National meeting. Significant amendments to this draft include a new section on prevention of health and wealth plan scams, and example consumer and agent alerts. The chair stated there are gaps in the discussion of pursuing errors & omissions coverage, and asked for assistance from the working group and interested parties in completing this and any other open sections.

The working group heard a presentation on the Commonwealth Fund August 2003 Issue Brief *Health Insurance Scams: How Government is Responding and what Further Steps are Needed*. A representative of the Commonwealth Fund stated that in examining 4 national plans covering approximately 100,000 participants, they found \$85 million in unpaid bills with no assets to back that up. She discussed the analysis performed on Department of Labor's data collection on multiple employer welfare arrangements (MEWAs), which file Form M-1. For 545 filings, 60% claimed full coverage from licensed insurance companies, 35% claimed self-insurance, and 5% were licensed insurance companies. For that population of approximately 5 million members, that means roughly 1.8 million are self-insured. Further analysis needs to be done on the veracity of the claims of full insurance coverage. The representative asked for comments on the draft, which will be exposed to all states and ultimately the public.

### **Long Term Care Working Group**

The charge of this working group is to look at issues raised by various parties concerning the Long-Term Care Model and to look at other states'

long-term care insurance requirements for possible amendments to the NAIC model.

Subsequent to the Summer National Meeting, the working group participated in two interim conference calls to revisit an initial issue list with the result that 64 specific items were brought for discussion at the two meetings held in Chicago. After a prolonged debate surrounding the best way in which to address the items on the list, the working group concluded that it made sense to identify key issues that were central to long-term care regulation and to tackle these first. The interested parties agreed to this approach and at the working group's request prepared the following list of issues that they believed (and the working group concurred with) should be addressed as a priority:

- Access of services outside the domiciliary state;
- Specific definitional issues, or lack thereof;
- Policy flexibility – up and down-grade issues, changes to future services;
- Group insurance issues;
- Agent education and training issues; and
- Reporting requirements and dissemination of information from a consumer perspective.

As the first item on the list, the working group discussed the issues and potential conflicts surrounding the situation where a consumer buys a policy in one state and attempts to access the benefits in another state. A healthy debate followed with the working group finally concluding that this first issue should be addressed in two ways: (1) from a procedural perspective so that the model (section 6) contains language conveying "substantially similar" benefits to consumers if they move out of state; and (2) from a definitional standpoint redefining and updating some key terms in the model (section 5Q). Revised wording for both would be drafted and issued for comment.

Finally, the working group reviewed the response to the NAIC State Survey on Long-Term Care Insurance Rating Practices and Consumer Disclosure Amendments. It was noted that the results were positive with 17 states adopting the August 2000 rating practices and enhanced consumer disclosure amendments and a further 16 in the process of, or intending to, adopt the amendments. New York is the only significant state not considering adoption, as it already believes it

has a prior approval process for forms and rates similar to the suggested model.

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The next National Meeting of the NAIC will be held in Anaheim on December 6-9, 2003. We welcome your comments regarding issues raised in this newsletter.

Please give your comments to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor: Jean Connolly, PricewaterhouseCoopers LLP, BP America Building, 27<sup>th</sup> Floor, 200 Public Square, Cleveland, Ohio, 44114-2301 — (440) 875-3239 or [jean.connolly@us.pwcglobal.com](mailto:jean.connolly@us.pwcglobal.com). Please provide any email change of address information to [sandy.b.thurston@us.pwcglobal.com](mailto:sandy.b.thurston@us.pwcglobal.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.