



NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS

NAIC 2004 FALL NATIONAL MEETING

The National Association of Insurance Commissioners held their 2004 Fall National Meeting September 11-14, 2004 in Anchorage. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

Executive Summary

- The NAIC held a special election at their meeting in Anchorage to elect new officers as a result of the departure of former NAIC President Ernst Csiszar. Commissioners from Pennsylvania, Oregon and Maine were elected officers. (page 3)
- The Financial Condition (E) Committee continued work on their project to address the “proliferation” of permitted practices granted to insurance companies. At their meeting in Anchorage, the committee exposed proposed language that requires the domiciliary regulator to notify other state insurance departments when the regulator grants a permitted practice to a domiciled company. (page 3)
- The Statutory Accounting Principles Working Group approved the exposure of three new proposed standards: Issue Paper 124, Treatment of Cash Flows when Quantifying Changes in Valuation and Impairments, An Amendment to SSAP 43, Loan-Backed and Structured Securities, Issue Paper 125, Accounting for Investments in Low Income Housing Tax Credits Property Investments, and Issue Paper 126, Accounting for Transferable State Tax Credits. The working group also voted to expose for comment inclusion of FASB Staff Positions (FSPs) in the Statutory Hierarchy. (page 4)
- The Emerging Accounting Issues Working Group finalized six Interpretations including guidance on syndicated letters of credit. They also issued a tentative consensus on nine issues, including adoption of the FASB’s guidance in FSP106-2 on the Medicare Modernization Act and interpretive guidance on Actuarial Guideline XXXVIII. (page 7)
- Since the Summer National Meeting, the NAIC/AICPA Working Group and its new subgroups have met many times, the result of which are proposed amendments to the April 13th Exposure Draft of a revised Model Audit Law to adopt certain provisions of Sarbanes-Oxley. The revisions relate to auditor independence, auditor rotation and the cooling off period before an audit partner can be employed by his former client. Work on Title IV issues of SOX, including Section 404, will not resume until other issues are resolved, including audit committee requirements. The chair of the working group noted in Anchorage that an effective date of the proposed changes of December 31, 2006 may not be feasible. (page 8)
- The newly formed Tax Policy Task Force met for the first time at a National Meeting to discuss tax issues affecting the insurance industry. Input from interested parties is being actively sought. (page 11)

- The Capital Adequacy Task Force re-exposed a revised C-3 Phase II proposal for variable annuities with guaranteed benefits, with an effective date of year-end 2005. The task force also adopted the bond factors for investments in preferred stock for the P/C and Health RBC formulas and exposed for comment a dual trend test for the P/C RBC formula that has a trigger based on both the RBC formula result and a company's combined ratio. (page 12)
- The Valuation of Securities Task Force deferred their expected vote on filing alternatives for unrated securities until later this month to ensure all members can participate. The proposal would exempt certain unrated securities for filing with the SVO. (page 13)
- The Blanks Working Group adopted eleven proposals for changes to the annual statement and instructions that are effective for 2005 and exposed thirteen new or revised proposals for comment. Included in the adopted proposals are significantly revised instructions for statutory MD&A. A proposal to require additional disclosures on corporate codes of ethics and audit committee financial experts (from Sections 406 and 407 of the Sarbanes-Oxley Act) that had been exposed at the last meeting was deferred to allow re-consideration by the NAIC/AICPA Working Group. (page 14)
- The Consumer Protection Working Group concluded that all annual and quarterly statement information and supplementary filings (except confidential information) should be available to consumers at no cost via the NAIC's Consumer Information Source database. (page 15)
- After significant debate, the Credit Scoring Working Group adopted its revised Insurance Credit Scoring Regulatory Best Practices report. (page 15)
- The Life and Health Actuarial Task Force exposed for comment a newly revised draft of Actuarial Guideline VACARVM – CARVM for Variable Annuities Redefined and also exposed four documents as part of their consideration of issues raised by industry and regulators with respect to Actuarial Guideline XXXVIII and reserving methodologies that may lessen the effect of AG 38. (page 16)
- The Reinsurance Task Force moved forward with a project to consider amendments to the Reinsurance Intermediary Model Act to address issues raised by a reinsurance arbitrator. (page 19)
- The Market Conditions Working Group approved their revised Medical Malpractice Insurance Report: A Study of Market Conditions and Potential Solutions to the Recent Crisis, which was also adopted by the Commissioners at their Executive and Plenary sessions. The report calls for additional data gathering to determine why costs are increasing so significantly. (page 19)
- The Casualty Actuarial Task Force has nearly completed its Regulatory Guidance on Property Casualty Statutory Actuarial Opinions, which will be distributed to all chief examiners. They also heard a status report from the American Academy of Actuaries that is developing guidance for actuaries to be used to implement the 2004 audit requirement to communicate with management and the auditor on significant data for purposes of the actuarial opinion. (page 20)

Special Election of NAIC Officers

As a result of the resignation of Director Ernst Csiszar from the South Carolina Department of Insurance and as President of the NAIC, the NAIC held a special election to elect officers to complete the 2004 year. Commissioner Diane Koken of Pennsylvania was elected President; Oregon Insurance Administrator Joel Ario was elected Vice President, and Maine's Superintendent of Insurance, Alessandro Iuppa was elected Secretary-Treasurer. The officers will serve for the remaining three months of 2004, and will likely run unopposed for re-election for 2005. That election will occur at the Winter National Meeting.

Executive Committee

The Commissioners at their Executive and Plenary session adopted, after very extensive debate and a vote of 31-20, the NCOIL Market Surveillance Model Law. They also adopted the Medical Malpractice Report drafted by the Property and Casualty (C) Committee.

The Commissioners also approved the election of the Northern Mariana Islands as a Member of the NAIC, which is a Commonwealth of the United States located in Northern Pacific Ocean.

In their continuing "model law review" the commissioners voted to delete 13 models that are considered out of date, no longer needed, or that have not been adopted by many states. Included in the deleted models is the Fronting Disclosure and Regulation Act.

NAIC/Industry Liaison Committee

The committee discussed the new proposed discussion draft of the federal State Modernization and Regulatory Transparency (SMART) legislation. NAIC members discussed the process the NAIC membership used to engage in debate in Washington D.C. and outlined major themes that have emerged as part of the NAIC Roadmap and the SMART legislation.

Industry representatives were then given an opportunity to brief the committee on their respective viewpoints and goals. Issues raised,

amongst others, included state regulation and rate regulation. Industry and regulators agreed the issues were complex and that any federal legislation needs to balance many competing needs.

Also heard were brief updates on several state modernization initiatives that correspond to issues included in the SMART legislation. Progress has been made both on the Interstate Compact implementation in the states and the development of product standards.

The committee then discussed the notion of doing background checks and fingerprinting of company directors and officers. At present only producers and agents are subject to these checks. The NAIC is to follow up as to how this process could be implemented.

A report on the Life Insurance Industry Homeland Security Preparedness and Critical Infrastructure Protection was provided to the committee. The report highlighted a summary of the significant participation of the life insurance industry contributing to Homeland Security preparedness and to protection of critical infrastructure, which contributes overall to business continuity assurances.

Financial Condition (E) Committee

At their meeting in San Francisco, the chair addressed a new issue being undertaken by the committee at the request of then-NAIC President Ernst Csiszar related to the "proliferation" of the granting of permitted practices to nationally significant companies. The goal of the project is to make commissioners aware of the issue and consider actions that should be taken. Since the Summer National Meeting, the Committee held two interim conference calls to discuss the issue. The chair of the working group, Commissioner McCarty of Florida, emphasized the following: the issue is not a technical accounting issue, but a communication procedure among states and that the guidance will apply only to new permitted practices, not those already discussed in a previously filed annual statement. The commissioner also noted, in response to a question, that he is aware of actual examples in

which the approval of permitted practices has created solvency problems.

As a result of discussion during the conference calls, at their meeting in Anchorage the committee exposed the following revision to the Preamble of the Accounting Practices and Procedures Manual for a forty-five day comment period:

In instances where a domiciliary state intends to approve a permitted practice that has not been previously disclosed within the NAIC Annual Statement, the domiciliary state regulator must provide notice and disclose the nature of the permitted practice, as well as the cumulative effects of permitted practices with all other approved permitted practices currently in effect for that insurer in the domiciliary state, to all other states in which the insurer is licensed, prior to granting final approval of the permitted practice (Notice). Notice from the domiciliary state regulator must disclose the effect of the permitted practice on both a legal entity and on all parent and affiliated United States insurance companies, if applicable. The Notice should clearly describe the permitted practice, identify any affected financial statement account(s), and quantify the impact to each financial statement account affected. The impact may be determined by comparing the financial statement prepared in accordance with SAP and the financial statement incorporating the proposed permitted practice.

No domiciliary state regulator shall grant a permitted practice unless notice herein is provided at least 30 days in advance of such approval and such shorter period without an explanation for the shorter period, but never less than 15 days. The granting of a permitted practice by the domiciliary state regulator does not preempt or in any way limit any individual state's legislative and regulatory authority.

The committee will schedule a public hearing for November to receive comments on the draft, and anticipates adopting a final proposal by year-end. The committee also noted that it is their intention to develop report specifications to track approved permitted practices through an Annual Statement disclosure. The chair of the committee also recognized that they need to draft language that

specifies the actions that may be taken if a state does not comply with the above policies.

Statutory Accounting Principles Working Group

Public Hearing

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

SSAP 90, Accounting for the Impairment or Disposal of Real Estate – The working group held a conference call on June 30th to further consider the treatment of home office property with respect to the requirement for recoverability testing. A revised SSAP was exposed for comment after the conference call and would require all companies with home office property to perform a recoverability test of the property occupied by the company. At their meeting in Anchorage, the working group, after long debate, again revised SSAP 90 to require a recoverability analysis only when the “financial condition of the reporting entity is such that its ability to continue in the insurance business is in question.” The final public hearing will be held in December, and the SSAP will still be effective January 1, 2005.

Consideration of the AICPA SOP 01-5, Amendments to Specific AICPA Pronouncements for Changes Related to NAIC Codification – The working group adopted as final the proposed changes to SSAP 1 to require a company to disclose certain information when it would have triggered an RBC action level if it had not used a permitted accounting practice granted by the state of domicile.

Accounting for Sale-Leaseback Transactions Involving Real Estate under SSAP 22, Leases – The working adopted the proposed nonsubstantive changes to SSAP 22, paragraphs 10, 11, 13, 16 and 26e to resolve an apparent conflict with GAAP literature adopted by SSAP 22. The issue relates to the gain recognition on sale/leaseback transactions of real estate.

Rebuttable Presumption of Control for Joint Ventures, Partnerships, and Limited Liability Companies – The working group adopted the proposed revisions to SSAP 48 to make the control

provisions for joint ventures, partnerships and LLCs consistent with the presumption of control guidance for SCA entities in the newly adopted SSAP 88.

Changes to Appendix A-001– Investments of Reporting Entities – The working group adopted nonsubstantive changes to Appendix A-001 to match the Annual Statement Blanks changes for 2005.

Exchange Traded Funds – The working group adopted nonsubstantive changes to SSAP 30 to reflect guidance already adopted for the SVO's Purposes and Procedures Manual on exchange traded funds. ETFs meeting the SVO definition qualify for bond treatment.

SAP Maintenance Agenda Discussion

All issues exposed for public comment have a comment deadline to NAIC staff of November 8th with a public hearing at the Winter National Meeting.

Accounting for Investments in Low Income Housing Tax Credits Property Investments – The working group approved Issue Paper 125 for comment and directed staff to draft the related SSAP for exposure this fall. The issue paper requires such investments to be carried at the lower of amortized cost or fair value, which is a change to the current requirement of the use of the equity accounting. Several interested parties spoke at the meeting; they are pleased with the conclusion to use lower of amortized cost or fair value but have concerns in three areas: 1) amortization to investment income instead of realized gain/loss treatment, 2) balance sheet gross up of the commitment to provide future investment, and 3) a proposed effective date of December 31, 2004. The working group encouraged interested parties to submit their comments in writing. The issue paper should be posted to the NAIC's website shortly.

Accounting for Transferable State Tax Credits – The working group approved the exposure of Issue Paper 126. The proposed guidance provides for such tax credits to be recorded and carried at cost, subject to an admissibility test. The issue paper also includes an implementation guide on sample journal entries. The issue paper should be posted to the NAIC's website shortly.

Proposed Amendment to SSAP 43 for Valuing Impairments – The working group exposed for comment Issue Paper 124 and the related SSAP 92, Treatment of Cash Flows when Quantifying Changes in Valuation and Impairments, An Amendment to SSAP 43, Loan-Backed and Structured Securities. The proposed revisions to SSAP 43 requires the use of discounted cash flows when calculating new prepayment assumptions related to changes in valuation and impairment of loan-back and structured securities. The effect of this change could be material for some entities. The proposed effective date is January 1, 2005.

New Adoptions, Deletions and Amendments to New Model Laws and Actuarial Guidelines During 2003 – Based on NAIC staff's review of decisions reached on guidance during 2003, the working group exposed nonsubstantive changes to three models law in Appendix A of the Accounting Practices and Procedures Manual. Those changes are: adding Model Law 818, Determining Reserve Liabilities for Credit Life Insurance Model Regulation; deleting Model Law 825, Guideline Concerning the Commissioners' Annuity Reserve Valuation Method, since there is adequate guidance in the Actuarial Guidelines adopted in Appendix C; and revising Model Law 10, Health Insurance Reserves Model Regulation to reflect changes adopted by the Accident and Health Working Group. All other changes to model laws during the year were not deemed necessary for changes to the APP Manual.

Change in Disclosure Requirements for Asbestos and Environmental Claims and LAE – The working group exposed for comment proposed changes to the disclosure requirements of SSAP 55 to require disclosure of asbestos and environmental claims on a direct, assumed and net basis. The previous requirement was for disclosure on a "gross" basis.

Statutory Adjustment in par. 9 in SSAP 88 – The working group exposed nonsubstantive amendments to SSAP 88 to reflect two additional adjustments when nonadmitting assets for statutory adjustments to audited U.S. GAAP. EDP equipment and software per SSAP 16 and SSAP 79 would now be required adjustments, which the working group stated was their original intent.

Clarification and Reporting Guidance for Financial Instruments Used to Hedge Options Embedded in Variable Annuity Contracts – This issue, brought to the NAIC by a consulting actuary, arises as a result of the new reserving methodology for variable annuity products with guaranteed minimum death benefits and guaranteed living benefits guidance that will be effective December 31, 2005. The Form A identifies issues related to accounting, reserving, recognition of hedging gains and losses, AVR, IMR and annual statement reporting. The working group voted to refer the issues to the Life and Health Actuarial Task Force with a recommendation that a subgroup be formed with members from both LHATF and the SAP Working Group.

Applicability of New GAAP Disclosures Prior to NAIC Consideration – During 2004, the NAIC has had significant discussion regarding new GAAP disclosures that, under generally accepted auditing standards, are to be included in the audited SAP financial statements although such disclosures have not yet being addressed by the NAIC. (Such disclosures are required by Interpretation 12 of SAS 62, Special Reports.)

In advance of the Fall National Meeting, Industry Interested Parties had prepared a Form A to address this conflict which proposed that “all new finalized GAAP accounting pronouncements be considered immediately rejected for statutory accounting until such time that the NAIC through its deliberations formally accepts the new accounting pronouncements as adopted for statutory accounting and reporting.” At the meeting in Anchorage, representatives from interested parties asked that the Form A be deferred until the Winter National Meeting so that interested parties could further refine the proposal.

Disclosure of the Benefit Obligation for Non-vested Employees – The working group exposed for comment a proposed change to SSAP 89, par. 11b to require the disclosure of both the accumulated benefit obligation and projected benefit obligation for non-vested employees.

Placement of FASB Staff Positions (FSPs) in the NAIC Hierarchy – The working group voted to expose for comment a proposed change to the Statutory Hierarchy in the Preamble to the APP Manual to clarify that “Board-Directed” FASB Staff

Positions are NAIC Level 1 guidance and FSPs issued by FASB staff are NAIC Level 5 guidance.

Definition of Affiliate and Control in SSAP 25 – The working group exposed nonsubstantive changes to SSAP 25, Related Party Transactions, to include the rebuttable presumption of control that has been included in the newly adopted SSAP 88, Investments in SCA Entities.

Incorporation of SSAP 18 Changes into SSAP 91 – The working group agreed to nonsubstantive changes to the newly adopted SSAP 91 to reflect previously revised language in SSAP 18 on the classification of investment income in securities lending transactions.

Accrual of a liability for nonvested, nonqualified benefits prior to retirement when there is no longer a substantial risk of forfeiture – The working group exposed for comment a proposed amendment to SSAP 89, par. 16(d) to integrate guidance from INT 01-17 (which was nullified by SSAP 89). The guidance requires the liability to be recorded using guidance from FAS 87 when there is no longer a substantial risk of forfeiture.

Pension Illustrations – The working group directed the subgroup to meet shortly to develop and expose pension illustrations for comment, if possible prior to the Winter National Meeting.

SSAP 41 Redraft – At the Summer National Meeting, the working group approved the formation of a subgroup to address six specific issues related to surplus notes and to substantively rewrite SSAP 41. At their meeting in Anchorage, the working group noted that no substantive work has been done on the project; they still need additional regulatory and industry volunteers to provide input. The subgroup is also considering whether the issues raised will necessitate a substantive re-write of SSAP 41 or that nonsubstantive changes will be sufficient. Interested volunteers for the subgroup should contact NAIC staff.

Life Reinsurance Reserve Credits – During their June 30th conference call the working group referred to the Life and Health Actuarial Task Force an issue drafted by industry interested parties on the appropriate reinsurance credit given the guidance in SSAP 61 on separate calculations for proportionate

and nonproportionate reinsurance. In a memo dated August 4th from the chair of the working group to the chair of LHATF, input from the task force was asked for the following issues:

- Is the reinsurance contract [described in the Form B] outside the definitions in SSAP 61?
- Is it appropriate for reinsurance credits to be taken for types of life reinsurance contracts not described in SSAP 61?
- What type of reinsurance credit, if any, should be allowed for this specific type of reinsurance contract?
- Based on answers to the above, does SSAP 61 need amendment?

Emerging Accounting Issues

Working Group

The working group finalized the following six tentative Interpretations as final in Anchorage:

INT 02-09, A-785 and Syndicated Letters of Credit –

The working group confirmed their tentative consensus as final that syndicated letters of credit are consistent with Appendix A-785, Credit for Reinsurance because such letters of credit have been determined to be the legal equivalent of multiple letters of credit separately issued.

INT 03-17, Classification of Bad Faith Expenses –

The working group adopted a final consensus that with respect to SSAP 55, Unpaid Claims, as follows: 1) claims-related extra contractual obligations (ECO) and bad faith adjustment expenses are to be included in “Adjusting and Other” loss adjustment expenses per SSAP 55, par. 5.c.ii, 2) claims-related ECO and bad faith losses should be included in losses but disclosed separately in a note to the financial statements, and 3) this guidance applies to both direct and assumed obligations and to all lines of business.

INT 04-05, Clarification of SSAP No. 5 Guidance on when a Judgment is Deemed Rendered –

The working group adopted as a final consensus that a judgment is considered “rendered” (as discussed in SSAP 5, paragraph 9) when a court, enters a verdict, notwithstanding any outstanding motions or the possibility of an appeal.

INT 04-06, EITF 02-13: Deferred Income Tax Considerations in Applying the Goodwill Impairment Test in FASB Statement No. 142 – The working group concluded that this EITF should be rejected since the EITF is based on FAS 141 and FAS 142, which have been rejected by statutory accounting.

INT 04-07, EITF 02-15, Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are within the Scope of FASB Statement No. 84 – This EITF provides guidance on the application of FASB Statement 84 when an offer for consideration in excess of original conversion terms is made by the debt holder rather than the debtor. The working group adopted the position of EITF 02-15 as an interpretation of SSAP 15, Debt and Holding Company Obligations.

INT 04-08, EITF 02-17: Recognition of Customer Relationship Intangible Assets Acquired in a Business Combination – The working group concluded that this EITF should be rejected since the EITF is also based on FAS 141 and FAS 142, which have been rejected by statutory accounting.

The working group then addressed new Form Bs and reached the following decisions. Tentative conclusions reached were exposed for comment through November 8th:

EITF 02-18, Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition – The working group adopted the consensus of the EITF, but with a modification to exclude reference to the concept of control.

EITF 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, an Expansion of INT 02-07: Definition of Phrase “Other Than Temporary” – The working group decided to defer any discussion of this controversial EITF until after the FASB issues guidance through the issuance of two Board-Directed FSPs (FASB Staff Positions) that will provide implementation guidance for the EITF position and delay the effective date of par. 16 of EITF 03-01. (The GAAP guidance is still expected to be effective for year-end 2004.) Note that the conclusion to defer action differs from the original NAIC staff recommendation in the Form B that was posted to the NAIC’s website as advance meeting

material as a result of the FASB's meeting on September 8th.

EITF 03-5, Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software – The working group reached a tentative consensus to adopt the position of the EITF that includes the non-software items within the scope of SOP 97-2, and for statutory purposes, SSAP 81.

EITF 03-07, Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock (Instrument C of Issue No. 90-19) – The working group adopted as a tentative consensus of this EITF, which is a clarification of EITF 90-19, which was adopted by SSAP 15.

Actuarial Guideline XXXVIII: The Application of the Valuation of Life Insurance Policies Model Regulation – After long debate, with insurers on both sides of the issue speaking, the working group exposed for comment a tentative consensus proposed by two large mutual life insurers. The issue relates to whether clarifying guidance is needed on reserving for "shadow account" policies. The tentative consensus was developed by the New York Insurance Department; however, the consensus exposed for comment differs from that exposed by the Life and Health Actuarial Task Force at their meeting in Anchorage. (See additional discussion on page 16 for the task force's consideration of the issue.) EAIWG also referred the tentative consensus to LHATF for their review.

Impact of Medicare Modernization Act on Postretirement Benefits – Recognizing that guidance is needed on this issue for this year-end, the working group issued a tentative consensus to adopt the FASB's guidance in FSP 106-2 on accounting for the effect on the OPEB liability as a result of the Medicare Modernization Act. The working group emphasized that consideration of this FSP should not be considered precedent setting with respect to future consideration of other FASB FSPs.

Modification to INT 01-31: Assets Pledged as Collateral –The working group adopted this recommendation to update INT 01-31 to reflect that

its guidance is still in effect after the adoption of SSAP 91 on transfer of assets. The INT currently states that its consensus is subject to amendment subject to completion of SSAP 91.

EITF 02-11, Accounting for Reverse Spinoffs – This issue has been referred to the EAIWG's APB 29 Subgroup for their consideration.

The working group reached a tentative consensus to reject the following FASB EITF consensuses as "rarely" or not applicable to statutory accounting:

- EITF 03-02: Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities
- EITF 03-06: Participating Securities and the Two-class Method under FASB Statement No. 128
- Sales Incentives Offered to Resellers of Merchandise by Vendors as Discussed in EITF 02-16 and EITF 03-10

NAIC/AICPA Working Group

Consideration of Sarbanes-Oxley

Interest in the working group's project to consider which requirements of Sarbanes-Oxley should be applicable to insurance companies remains, understandably, very high.

At their short meeting in Anchorage, the working group received reports from its newly formed Title II and Title III Subgroups, and approved the minutes from those meetings. The working group had little discussion of Title IV of Sarbanes-Oxley, which includes Section 404. The chair of the working group noted that while the working group had set December 31, 2006 as the earliest effective date of any new guidance, he acknowledged that a 2006 implementation date may not be feasible.

During the same meeting, the working group representative from Pennsylvania stated that he believes the central issue is that "there currently is no certification of internal controls [to the NAIC] by management." He believes that the NAIC should consider pursuing a requirement for management to attest as to the quality of its controls irrespective of the NAIC's Sarbanes-Oxley considerations. Some observers view this approach as the path forward.

In the following paragraphs below is an update of other discussions held by the working group prior to their meeting in Anchorage. The working group held an interim four-hour meeting in Atlanta on July 27th.

Development of the agenda for the interim meeting was led by industry interested parties. The first item on the agenda was "identification of deficiencies in the current regulatory framework," which discussion was led by the regulators in the working group.

Industry interested parties believe articulation of such deficiencies is critical to substantiating the need to adopt portions of Sarbanes-Oxley in addition to other existing regulatory requirements such as risk-based capital, etc. The chair of the working group gave some prepared comments on the need for improved corporate governance and internal controls over financial reporting, which were consistent with the comments that he gave at two previous meetings. The chair focused on his belief that regulators currently do not receive enough information on the quality of internal accounting controls and therefore, regulators do not have the ability to rely on the financial information generated by companies. If regulators had additional evidence to rely on controls, such as management's assessment of internal controls and the related auditor's attest report on such assessment, then insurance regulators could significantly reduce financial examinations and focus on other high risk areas in an insurance company. No other "regulatory deficiencies" were identified by the working group.

The meeting then moved to a presentation of a draft grid developed by interested parties entitled "Comparison of State Insurance Financial Reporting and Regulation with SEC Registrant Financial Reporting and Regulation." A representative from interested parties stated that the goal of the grid is to demonstrate that insurance companies are more highly regulated than non-insurance SEC registrants. Several members of the working group conceded this point but noted that all regulatory controls depend on high quality historical financial information to be effective, and consequently, they believe, regulators need some type of Section 404 report to obtain that comfort.

Much of the remainder of the meeting was spent hearing presentations from three large insurers

which have either early adopted Section 404 of Sarbanes Oxley (Met Life) or are in the process of adoption for 2004 (Allstate and The Hartford). All of the presenters made the point that the process to adopt 404 in terms of internal hours spent and external costs is very extensive. Two of the three companies noted that their estimate of total internal hours is approximately 100,000 to adopt Section 404 at the consolidated level. The representative from Met Life stated that the cost to adopt 404 for each legal entity would be a very significant, if not impossible activity.

The working group then discussed "next steps." Together with interested parties, the working group agreed to form two subgroups to address Title II (Sections 201 to 209 of SOX, which includes the requirements for CPA rotation, pre-approval of services performed by auditors and prohibited services), and Title III (Sections 301 to 309 of SOX, which includes the independent audit committee requirements. Title IV, which includes the controversial Section 404, will continue to be discussed at the higher subgroup level after the Title II and Title III issues are resolved.

Final comments at the meeting in Atlanta were from several regulators including the representative from New York, who stated that interested parties will need to demonstrate how the regulators will "get comfort" on internal controls at the legal entity level when internal control testing is done at the consolidated level. This may indicate that some members of the working group are stepping back from the tentative conclusion reached in their exposure draft of revisions in the Model Audit Rule in which the Section 404 testing would be permitted at the holding company level when "insurers within this group share common systems and controls over financial reporting."

After the meeting in Atlanta, the Title II and Title III Subgroups met several times. Using the April 13th draft of proposed revisions to the Model Audit Rule as the starting point for their discussions, the Title II Subgroup reached the following tentative conclusions:

- Services prohibited to be performed the company's auditor will be the same as those under Sarbanes-Oxley, except that companies with less than \$100 million in premium may

apply for an exemption. The exemption is not automatic.

- Required rotation for the audit partner will be the same as Sarbanes-Oxley (five years on and five off) with the same exemption discussed above.
- The “cooling off period” for employment of independent CPAs by their clients applies only to the “partner involved in the audit and anyone who helps set the scope or reviews others work on the audit.”

The Title III Subgroup approved an Action Plan drafted by industry interested parties. The steps of the Action Plan are as follows:

- Identify and review all relevant SEC guidance and pronouncements (see SEC attachments) regarding Title III and any other related guidance (e.g., FDIC)
- Assess the appropriateness or alternatives of incorporating existing SEC guidance within regulatory framework as well as new SEC guidance
- Conduct survey/review of existing state laws/regulations governing audit committees and ability to mandate forfeiture of bonuses/profits
- Review all public hearing letters and comments

The subgroup asked that interested parties work on the action plan and propose recommendations, including proposed language to amend the April 13th exposure draft of revisions to the Model Audit Law to adopt Sarbanes-Oxley. A conference call will be scheduled for the last week in September or first week in October.

During several of the subgroup’s conference calls this summer, they discussed the requirement in the April 13th Exposure Draft of the proposed revisions to the Model Audit Law for independent audit committees for insurance entities. The subgroup was receptive to several suggestions from interested parties to allow a minority number of non-independent audit committees, even possibly to include company management. The chair of the

subgroup stated the audit committee should not include the “individual responsible for financial reporting” and that the CFO should not lead the audit committee. The subgroup also recognized the need to define the term “independent audit committee member.”

International Accounting Standards Working Group

The working group adopted the interim conference call minutes which were held on August 17th and September 1st. The first conference call dealt with the International Accounting Subcommittee Futures Liability Measurement Project. The working group considered the preferred parameters of an insurance contract liability measurement model based on specific assumptions and will communicate the themes to the International Accounting Standards Board. Items considered and discussed included amongst others: a company’s own credit worthiness as an element of liability measurement; determination of market value in respect of an observed market is not always possible; and discounting and deferred acquisition costs should be eliminated. The conference call held on September 1st dealt with the draft comment letter prepared to the International Accounting Standards Board regarding credit insurance and their conclusion of the inappropriateness of the inclusion of credit insurance in IAS 39, *Financial Instruments: Recognition and Measurement*.

The working group proceeded to discuss the IASB’s progress towards Phase II of the Insurance Contracts Standard. It was reported that educational sessions had been held to become familiar with key recognition and measurement issues which need to be resolved prior to moving the project forward. The IASB have also set up an Insurance Consultation Working Group to deal with the issues surrounding the fair value measurement of the insurance contracts. Members of the committee include actuaries, regulators and industry specialists. NAIC staff (Rob Esson) was granted a seat as an observer of this group.

The working group then adopted the comment letter to the IASB regarding credit insurance (discussed on the September 1st conference call). The comment letter drafted to the IASB highlights that credit insurance is not similar to financial guarantee

insurance and should not be included in the scope of IAS 39 but should rather form part of the scope of IFRS 4, *Insurance Contracts*.

The working group is currently drafting a comment letter in response to the IASB's financial instrument exposure draft ED 7, *Financial Instrument Disclosures*. Once drafted, the working group will schedule a conference call to discuss the draft comment letter.

The working group received an update from the International Association of Insurance Supervisors (IAIS) Accounting Subcommittee on the Future Liabilities Measurement Project. The committee met in Atlanta on August 26-27. Specific items discussed included amongst others: deferral and matching vs. asset/liability methodologies; own credit worthiness as an element of liability measurement; top down vs. bottom up calculations of liabilities, including initial recognition; and renewal rights and discounting.

Tax Policy Task Force

The initial meeting of this newly formed task force was a public hearing held on August 12-13th. The purpose of the hearing was to receive comments regarding tax issues affecting the insurance industry. Items discussed at the public hearing were as follows:

- Tax issues related to securitizations
- Impact of Federal tax policy on the ability of the property/casualty insurers to prepare for and pay claims caused by catastrophic natural disasters
- State premium and retaliatory tax.

The chair of the task force began the Fall National Meeting by describing their goals, which are designed to address and be responsive to tax issues of the insurance industry. The chair communicated that industry input is being requested, and that the task force has no "hidden agenda."

The task force then asked for interested parties to provide input. Issues discussed included the following:

- A representative from industry described potential tax issues surrounding Investor Owned

Life Insurance where 3rd party investors purchase an annuity/life policy on wealthy individuals through a charity. The industry representative's belief is that participating charities' tax exempt status could be in jeopardy as the products are designed to take advantage of charitable interest tax laws and that Congress may legislate this to eventually do away with the tax benefits.

- A representative from the property/casualty industry described concerns over the inconsistencies between the NAIC and the IRS in establishing reserve levels. The representative's belief is that the NAIC encourages having more reserves, while the IRS allows less reserves. Therefore, the IRS often will charge insurance companies with interest and penalties for the effects of trueing up reserves in subsequent years.

Terrorism Insurance Implementation Working Group

The working group received an update of the quarterly activities of the working group and NAIC staff activities related to the implementation of the Terrorism Risk Insurance Act of 2002 (TRIA). On May 18, 2004, Commissioner Donna Lee Williams testified on behalf of the NAIC before the Senate Committee on Banking, Housing and Urban Affairs. She received a follow-up letter from Senator Shelby requesting additional information regarding the exclusion of group life insurers from TRIA coverage. Commissioner Williams responded to Senator Shelby via letter that group life insurers had asked not to be included in the original bill. Only later did they discover that catastrophe reinsurance was less available to them and much more expensive; however they must retain much of the risk of loss themselves.

The NAIC has not taken a formal position on whether group life insurers should be included in TRIA or another form of federal backstop. However, it is believed that most regulators would advise that group life insurers should be included in the extension of TRIA. The Commissioner noted in her letter that the working group is ready to work with Congress to address this important issue.

The working group noted that the Treasury has published a final rule on its claim procedures that was published in the *Federal Register* on June 29th. In addition, the Treasury published a final rule on litigation management that was published in the *Federal Register* on July 28th.

Risk Assessment Working Group

The working group presented a status report on proposed revisions to the *NAIC Financial Condition Examiners Handbook* that were recommendations of RAWG. The working group held an interim meeting in Chicago and made the following revisions:

- The working group prepared a revised outline of the Handbook to reorganize its sections to be more in accordance with the seven phases of the examination process identified by RAWG.
- They decided to expand the guidance provided in each area of the examination process and to develop a repository of operational procedures designed to enable examiners to review an insurer's prospective risk.
- The working group decided to separate the Specific Risk Analysis (SRA) documents into different sections and incorporate them into each respective examination phase.
- The working group decided to clarify that the Risk Assessment Graph is an optional tool rather than a required component of the risk assessment process.
- They decided that the assignment of numeric ratings for the Probability of Occurrence and the Magnitude of Impact components included in the Risk Assessment Matrix would also be optional.

The revisions made to the Handbook were exposed for a 45-day comment period. An interim meeting will be held to discuss the comments received on the draft. Additionally, the working group committed to developing a Risk Assessment Best Practices Supplement, containing insurance department best practices on risk assessment and risk assessment best practices for insurers. The working group requested input from interested parties.

Capital Adequacy Task Force

The task force met several times since the Summer National Meeting. At their June 28th conference call, the regulators adopted, as expected, revised RBC factors for preferred stock that make the factors equivalent to those for bonds for both the P/C and Health RBC calculations. (The revised factors for the Life RBC calculation had been adopted at the Summer National Meeting.) The working group also exposed for comment the AAA Long-Term Care Report for 45 days.

The task force held a two-day meeting in August, the purpose of which was for the regulators to gain a better understanding of the issues related to the C-3 Phase II proposal for variable annuities. At that meeting, the working group heard several presentations and then reviewed comment letters on the revised proposal that had been exposed at the Summer National Meeting. The comment letters had been summarized into a list of 17 issues, which were discussed at length during the two-day meeting.

As a result of comments received, the C-3 Phase II proposal was revised (now dated September 2004). The task force voted unanimously to expose for a 45-day comment period the following: the September 2004 and November 2003 C-3 Phase II Reports of the American Academy of Actuaries, New York's redraft of a Standard Scenario requirement proposal, and the New York report clarifying "prudent best estimate." The revised proposal would still be effective for year-end 2005. The task force will hold a conference call later this fall after the end of the comment period.

The task force received a report from AAA outlining a dual trend test for the P/C RBC formula, which consists of specific ranges for both RBC and combined ratios, and then voted to expose the proposal for a 60-day comment period. The trend test includes the proposal that any insurer failing the trend test would be placed in Company Action Level. The task force noted that they recognize the RBC Model will need to be revised once a trend test is adopted.

The trend test works as follows: a company is "flagged" when 1) RBC ratio is between 200%-300% and the current year combined ratio greater than

120%, 2) RBC ratio is between 300%-350% and the combined ratio is greater than 134% or 3) RBC ratio is above 350%.

The task force noted that during the summer they adopted via email vote the revised 2004 Life RBC instructions for guaranteed indexed annuity products.

The task force then received updates to the June 2004 AAA Long-Term Care Report, and noted they will schedule a conference call to discuss the proposal at length at that time. The task force also reported that they will have a separate conference call to address several outstanding issues on removing the C-3 Phase I exemption, unauthorized reinsurance and the modified coinsurance dividend liability adjustment.

Valuation of Securities Task Force

The task force reported the current status of their projects as follows:

Filing Alternatives for Unrated Securities

In 2003, New York introduced a proposal asking the task force to consider whether there were alternatives to the security by security approach to credit assessments of securities not rated by a NRSRO or the SVO. The industry's Authorized Investment Designation (AID) proposal was received at the Summer National Meeting to exempt certain unrated securities, certified as qualified by a state insurance department, from filing with the SVO. Since the Summer National Meeting, the task force held a conference call on September 2nd to discuss comments and issues associated the AID proposal.

Proponents of the proposal argue that the SVO should utilize the controls by insurance companies on rating securities not rated by a NRSRO to cut SVO costs and budgets. Opponents argue that there is nothing wrong with the current system and that the impact financially on the SVO would be minimal.

At the Fall National Meeting, a vote whether to consider the proposal any further was deferred until all members of the task force can participate. A conference call will be scheduled the week of September 20th to take the vote.

RSAT Proposal

The task force voted to receive and expose for a 45-day comment period an SVO staff proposal to have Short Term Replication Transactions continue to be filed with the SVO as they are derivatives. The industry argues that these investments are short-term investments and therefore do not need to be filed with the SVO.

Amendment to Part Eight of Policies and Procedures (P&P) Manual

The task force voted to receive and expose for a 45-day comment period new language for Part 8 of the P&P Manual on Subsidiary, Controlled and Affiliated Company Common Stock. The proposed changes are a result of the adoption of SSAP 88 by the Statutory Accounting Principals Working Group.

Principal Protected Notes

The task force is interested in the credit methodology used by the SVO in valuing Principal Protected Notes and whether that methodology is consistent with the P&P Manual. The chair will be providing members of the task force reports with reports from SVO staff on the credit methodology applied to Principal Protected Notes.

Additionally, the task force received a request for comments from the Blanks Working Group on a proposal submitted by New York to change Schedule BA Parts 1 & 2 to elicit more information on investments that are neither publicly traded nor rated by rating agencies.

Operational Efficiencies Working Group

Since the Summer National Meeting, the working group held three conference calls in August and September and met in Anchorage to report on the status of their current projects as follows:

Self-Certification Pilot Project

The working group reported that the self-certification pilot project still suffers from low filing volumes and is therefore not credible enough to report. The Association of Insurance Compliance Professionals (AICP) has offered to help publicize the program.

Suggested Changes to Operational Efficiency Tools

Since the Summer National Meeting, suggested changes received from regulators and interested parties were compiled, distributed to the working

group, and were voted on by the working group. The more significant changes made are as follows:

- SERFF sub-types of insurance codes were added for Medical Malpractice lines of business.
- The coding for auto coverage was broken down into more codes to emphasize basic auto coverage found in filings.

Checklists and the Product Filing Requirements Locators

The working group received the results of a survey by the AICP regarding the Property/Casualty and Life/Health checklists as well as the utilization of the Products Requirement Locator. The survey will be discussed at a later date on a conference call.

Product Filing Examiners Handbook

The working group was told that the NAIC staff has put together a draft outline of the Handbook and should have a rough draft by the 2005 Spring National Meeting.

Interstate Compact National Standards Working Group

The working group reviewed, discussed, and adopted thirteen new individual life and annuity product standards. Two additional standards on deferred annuity products were re-adopted with changes. Earlier this year, the working group adopted eight individual product standards.

The timeline for approving standards for the remaining product lines is the Winter National Meeting. The goal of the working group is to have 24 product standards by the end of the year.

Financial Examiners Handbook Technical Group

At the beginning of the meeting, the technical group adopted guidance for inclusion in the Handbook regarding *Statement on Auditing Standards (SAS) No. 70 – Service Organizations*. The revisions had been exposed for comment at the Summer National Meeting.

The group received an update on referrals received from the Examination Oversight Task Force relating

to the Statutory Financial Examination Process White Paper Recommendations Report. The technical group had in July 2004 formed two subgroups to address the five specific referrals. During the meeting the technical group voted to expose proposed revisions to the Handbook in response to the referral to “develop procedures for the utilization and monitoring of consultants and contract examiners.” The technical group is waiting to receive more information from the Examination Oversight Task Force before addressing the referrals relating to “increase the effectiveness of the examination planning process” and “develop enhanced training programs for examiners.”

Finally, the technical group received notification that updates had been made to the Specific Risk Analysis (SRAs) to reflect revisions to the Accounting Practices and Procedures Manual. Notification of changes to the SRAs will be posted to the NAIC website.

Insurance Securitization Working Group

The working group did not meet at the Fall National Meeting, but the minutes of the Casualty Actuarial Task Force note that the task force is continuing to review the instructions for Special Purpose Reinsurance Vehicles (Protected Cell Plans of Operation).

Blanks Working Group

The working group adopted eleven out of the fifteen proposed changes exposed for comment at the Summer National Meeting. Significant changes include the following:

- The 2004 AVR Preferred Stock factors were modified to be consistent with the risk-based capital factors adopted by the Capital Adequacy Task Force (Proposal 2004-33)
- The existing instructions for Management’s Discussion and Analysis were replaced with new instructions for year-end 2005 (Proposal 2004-21). Note this is the significantly revised proposal from the one withdrawn at the Blanks Task Force meeting in October 2003 that would have mirrored the MD&A requirements from Sarbanes-Oxley. The adopted proposal does

increase disclosures significantly compared to the current requirements.

- A general interrogatory was added to the 2005 health, fraternal, and title blanks related to real estate companies (Proposal 2004-25)

The proposal to modify the general interrogatories related to Sections 406 and 407 of Sarbanes-Oxley Act 2002 (Proposal 2004-32) was deferred to permit additional review by the NAIC/AICPA Working Group. The proposal to modify Schedule BA elicit more information on investments that are neither publicly traded nor rated by rating agencies for 2005 (Proposal 2004-34) was deferred to permit additional review by the Valuation of Securities Task Force.

The working group also voted to expose for comment thirteen new proposed changes to the Blanks and instructions. These proposals will be considered for final adoption at the Winter National Meeting. Significant items exposed for comment include the following:

- Modify the AVR and Schedule BA instructions to require separate disclosure of low income house tax credits. (Proposal 2004-39)
- Modify the instructions to Schedule BA to require disclosure of affiliated investments (Proposal 2004-46)

All Blanks proposals, both adopted and exposed for comment, can be viewed and printed from the NAIC's webpage for the Blanks Working Group at http://www.naic.org/frs/financial_statement_reporting/exposure_drafts.htm/

Consumer Protections Working Group

The working group began the meeting by receiving an update from the Blanks Ad Hoc Subgroup regarding consumer information sources. The subgroup recommended that all annual and quarterly filing information be provided free of charge through the internet in portable document (.pdf) format and should include all required filings and all Supplemental Filings, except for any held confidential such as the Risk-Based Capital report. Discussion ensued regarding the revenue stream which will be lost by the NAIC by not being able to provide hard copy information. The confidentiality of information provided was also discussed. The

working group concurred with the recommendations made by the subgroup.

The NAIC Information Systems Director reported on a feasibility study prepared for the creating of a system to track orphaned policies. Questions were raised with respect to data quality, policy, procedural and legal matters and the working group acknowledged that these issues would have to be further investigated and resolved before releasing the application proposed to the public. The working group moved to direct the NAIC staff to proceed with the inquiries and address the necessary questions.

Credit Scoring Working Group

The working group started the meeting in Anchorage by acknowledging comments received on the Credit Scoring Regulatory Best Practices Document from the Property Casualty Insurers Association of America (PCI) and American Insurance Association (AIA). Common concerns of the PCI and AIA included the absence of confidentiality language and the "sole factor" prohibition example presented in the document. The purpose of the document is to generally identify important regulatory issues and recommend best regulatory practices; identify best regulatory and uniform practices where the language of statute or regulation may require implementation or interpretation by the regulator; and provide recommendations to modify existing language of statute or regulations where such language no longer represents best regulatory practices.

The working group adopted the Best Practices Document after making modifications to the example contained in the section addressing the "Sole Factor Prohibition," which states that an insurer must consider other relevant factors, in addition to credit information, in the underwriting decision. The example provided in the Best Practices Document was modified to reflect this fact. This change was made after significant discussion and debate with consumer representatives.

Financial Regulation Standards and Accreditation Committee

The committee did not meet in Anchorage.

Life and Health Actuarial Task Force (LHATF)

At the opening of the LHATF session, it was announced that Leslie Jones, an actuarial regulator from South Carolina, has been appointed by both the Life Insurance and Annuities (A) and Health Insurance and Managed Care Committee (B) Committees to continue as chair of LHATF. As the result of the resignation of South Carolina insurance commissioner Ernie Csiszar as president of the NAIC, the position of chair of LHATF was briefly vacant.

Although LHATF did have a quorum at this meeting, with 10 members attending out of a current roster of 19, regulators seemed reluctant to put many issues to a vote, fearing that those votes would be overturned during subsequent meetings or calls when a larger majority of LHATF members were present.

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

Once again, the Academy's RBC working group provided to LHATF an informational update of the status of the RBC work. The RBC working group reported that they had attended a two-day interim meeting of the Capital Adequacy Task Force in Kansas City, which provided a "soup to nuts" review of the entire C-3 Phase II RBC project. The Academy noted that they still have a few concerns, including the standard scenario requirement, and they have sent a letter to the task force spelling out their concerns. The Academy expects the NAIC to adopt the RBC proposal at the Winter National Meeting for a 2005 effective date.

The Academy's VA Reserve working group then gave an update on their reserve work, which is following closely behind the RBC work. The Academy's report centered on revisions to the draft AG VACARVM. The new version of this AG now includes: (1) a description of four principles on which the reserve methodology is based, (2) a definition of "Clearly Defined Hedging Strategy," (3) certification requirements by the actuary and CFO regarding the company's Clearly Defined Hedging Strategy, and (4) a new appendix describing modeling requirements for hedges. In addition, the draft AG includes a provision allowing for a 3-year phase-in period.

New York then presented proposed revisions to the standard scenario, including changes to revenue amounts and lapse rates. It appeared that some of these changes were the result of conversations between the New York regulators and company representatives. The ACLI commented that it supports the use of the standard scenario, saying that a seriatim reserve calculation is needed for income tax purposes. The ACLI suggested that LHATF require the use of the applicable federal interest rate into the statutory reserve calculation to get maximum FIT benefits.

LHATF voted unanimously to expose for comment the revised AG CARVM with the revised standard scenario. As many as four conference calls are planned prior to the Winter National meeting on this topic.

Non-forfeiture Requirements for Individual Deferred Annuities

LHATF continues to work on a draft regulation to support the change in the Standard Non-forfeiture Law for Individual Annuities that was adopted in 2003. The draft regulation is intended to provide specific guidance on implementing the new dynamic non-forfeiture requirements for individual annuities.

The initial discussion centered on the premium bucket issue. Under a premium bucket approach, deposits received at different times under the same deferred annuity contract could have different minimum non-forfeiture rates. The current draft model regulation, which was exposed last quarter, did not contain this feature. That draft regulation required that all deposits received under the same contract have the same non-forfeiture rate. After hearing comments from regulators and interested parties, New York moved to add premium buckets to the current draft regulation, citing that such a provision promotes solvency. The motion passed by a vote of 5 to 4.

Next, the American Academy of Actuaries presented their report with changes to the draft model regulation. The changes from the prior draft appeared to be minor. However, the Academy will need to modify the draft regulation to include premium bucket language.

Lastly, LHATF voted to expose for comment draft Actuarial Guideline ABC, which focuses on the effects of the new annuity non-forfeiture requirements on CARVM reserves. The Academy and other interested parties indicated that they had suggestions for LHATF to consider. However, because of time constraints, these were deferred to subsequent conference calls.

Issues Relative to Actuarial Guideline XXXVIII

In the most well attended session of the two-day meeting, LHATF discussed possible revisions to AG 38, originally AXXX. LHATF continues to be concerned that there are actuaries who are developing strategies for designing shadow account products and reserving methodologies that lessen the impact of AG 38. At the Summer National Meeting, LHATF voted against making changes in AG 38, saying this was an enforcement issue and not a flaw in the Guideline. However, during an August conference call, some regulators provided convincing arguments that revisions to AG 38 were necessary and appropriate.

New York submitted a proposed revision to AG 38 for discussion. It should be noted that this was a different New York proposal than was submitted earlier in writing to the NAIC's Emerging Accounting Issues Working Group by two companies (which was exposed by EAIWG for comment at their meeting). The current New York proposal modifies Section 8 of AG 38 in order to "restore a level playing field for products with similar guarantees". New York's proposal is appealing in its simplicity; however, it has not been tested. New York was unable to answer some specific questions from other regulators regarding their proposal. Numerous representatives from insurance companies, including one who submitted a letter signed by ten companies, presented arguments both in support and against proposals to modify AG 38.

Another proposal was presented to LHATF for their consideration which included the use of an attained age level reserve methodology similar to that is used in AG 37. There was little time for discussion of this proposal.

Regulators present at this meeting were largely divided on the AG 38 issue, with the most vocal expressing views that AG 38 did not need

modification. No votes were taken by LHATF on which direction to take. Rather, the task force stated that they will study all proposals and would not necessarily rush to a solution. LHATF voted to expose for comments all current proposals. The four proposals under review are: (1) make no modifications and have states enforce the current AG 38 language, (2) New York's new proposed changes to AG 38, (3) the attained age level reserve proposal, and (4) add a stand-alone cash flow testing requirement to the current AG 38 requirements. Conference calls were scheduled to discuss this issue.

The Academy gave a report on the long-term solution to these types of issues. The Academy's goal is to develop a principles-based framework of reserving requirements by expanding the C-3 Phase II work to other product lines.

General Nonforfeiture Project and Possible Areas of Revision to the Standard Valuation Law

The Academy presented their Non-guaranteed Element Plans Blueprint Draft to address the management of non-guaranteed elements of insurance contracts. The Academy talked about a principles-based approach with accountability rather than the current rules-based approach with auditing. This project is in the very early stages. A conference call will be scheduled prior to the Winter National Meeting.

Previously, LHATF had asked the Academy to assemble a task force to study the feasibility of a new standard valuation law that will take a fresh global view of valuation requirements. The Academy reported on what it termed its "SVL 2" project. This is an enterprise risk management approach to reserves, where non-guaranteed elements are just a part of the equation. The Academy will present an update in December.

Recommendations to NAIC Models

As part of an NAIC-wide project to review all model laws and regulations for deletion or change, LHATF is currently studying the Interest Index Annuity Model Regulation and the Life and Health Reinsurance Model Regulation. LHATF feels that there needs to be consistency between model regulations for similar products, citing inconsistencies between the Modified Guaranty Annuity model regulation and the Variable Annuity

model regulation as an example. A conference call will be scheduled to discuss this.

International Valuation Topics

LHATF had been asked to provide comments on two issues: liability measurement under fair value accounting, and a global framework for insurer solvency. LHATF held separate calls to discuss these issues and sent preliminary reports to the requesting organizations with their high level conclusions. With regard to the fair value measurement of liabilities, LHATF mentioned that much has already been written by others on the issues surrounding this issue.

Update on Status of GRET Project

At the Summer National Meeting, LHATF voted to expose for comment the 2005 GRET factors provided by Society of Actuaries (SOA). Questions were raised during an interim call concerning unexplained fluctuations in some of the factors. The SOA committee wants to review the process that they will use for the 2006 GRET factors. LHATF did not adopt the proposed 2005 GRET factors, deferring any changes to the GRET factors until next year.

Accident and Health Working Group

Revisions to the Health Blank and the Life/Health Blank to Achieve Greater Consistency

The working group voted to adopt a new A&H Policy Experience Exhibit that will be used by all companies that issue health insurance, regardless of the type of statutory financial statement they file. LHATF will send a letter to the Casualty Actuarial Task Force suggesting they adopt a similar exhibit.

Premium Deficiency Reserves (formerly HMO/HMDI Reserves)

The Academy provided a preliminary report with examples showing the treatment of PDRs and gross premium valuations with respect to current statutory accounting principles, along with a list of concerns on how these requirements may vary from guidance provided in the NAIC Health Reserves Guidance Manual. Regulators agreed to give feedback to the Academy by October 15th and the Academy will provide a full report in December. In addition, the working group formed a subgroup to review the need for premium deficiency reserves.

Long-Term Care Working Group Issues Referral

The working group is reviewing changes to the NAIC Guidance Manual for Rating Aspects of the Long-Term Care Insurance Model Regulation. These changes were prompted by a 2003 request from the NAIC's Long-Term Care Working Group. There were numerous changes suggested, the most significant ones dealing with contingent benefits upon lapse for limited pay policies. The working group voted to expose the proposed changes for comment.

Medicare Supplement Refund Project

The working group is continuing to review actuarial issues associated with the Medicare Prescription Drug, Improvement and Modernization Act of 2003. Several reports were provided but no significant progress was apparent. A conference call is scheduled prior to the Winter National Meeting.

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

Another four hour presentation was made by the Academy detailing the models the Academy has developed to provide alternatives for rate filing guidance to the working group. Specifically, the models address rate increase alternatives associated with a closed block of business.

Market Analysis Working Group

The working group discussed suggested changes to the NAIC's Market Analysis Handbook suggested by the Housing Opportunities Made Equal (HOME), Center for Economic Justice (CEJ) and the Insurance Marketplace Standards Association (IMSA). The changes were incorporated into a discussion draft which is to be reviewed by the working group. Changes suggested by HOME focused on three methodologies to assess market conduct. They include: evaluation of the use of underwriting guidelines that restrict coverage on the basis of the age and market value of a home, the use of matched pair testing, and evaluation of rating territories to determine if certain demographic groups pay more for insurance products. The CEJ's comments focused on the importance of the use of underwriting guidelines in market analysis. The IMSA comments focused on language changes to the "best practice" reviews section of the handbook.

The group also discussed the agreed-upon integration of the NAIC's Market Conduct Examiners Handbook and NAIC's Market Analysis Handbook. The discussion at the Fall National Meeting focused on the creation of four volumes for Market Surveillance, which would focus on market analysis, the continuum of possible regulatory responses, baseline policy and procedure reviews, and collaborative efforts.

The Market Conduct Annual Statement Subgroup provided an update regarding the pilot project. The project has been well received by the states participating in the project and it was noted that other states are looking to join the project. After hearing comments from trade associations and consumer groups, the group successfully voted to transition the pilot project to the Market Conduct and Consumer Affairs (D) Committee for permanent continuation.

Finally, the working group received a report regarding the states' implementation of the Market Analysts Checklist. The checklist was designed to help states learn about Market Analysis and was adopted as part of the Market Analysis Handbook. NAIC staff reported that to ensure states were actively following the checklist; the NAIC membership adopted the Market Analyst's Scorecard that will be made public in December 2004. Since many of the suggested items for states to review are available in the NAIC databases, the NAIC volunteered to provide Company Listings for five major lines of business and to assist states in selecting companies for further analysis.

Reinsurance Task Force

The task force and its interested persons group continued their discussion of two proposals from interested parties to amend the Credit for Reinsurance Model Regulation. A representative from interested parties reported that their group has reached a consensus that revisions to Section 10(b)(14) of the model are appropriate, but that they have not reached a consensus on specific language. They believe changes are necessary to ensure that 1) trust assets intended to secure reinsurance recoverables are not seized by the rehabilitator or liquidator of the reinsurer/grantor, and 2) the valid reversionary interest of the reinsured/settler, after satisfaction of the

reinsurance contract obligation, is not overcome. The task force agreed to the suggestion for interested persons to form a subgroup to draft language that is responsive to the concerns above, and to have that proposal ready for the Winter National Meeting.

The task force also discussed amending the Model Law on Credit for Reinsurance and Credit for Reinsurance Model Regulation to allow the establishment of "working trusts," which would provide an "other form of security acceptable to the commissioner. The task force heard comments that many, but not all, reinsurers support the concept of working trusts. An initial draft of the proposal was distributed at the Summer National Meeting, and interested persons had hoped to have comments by this meeting; they promised to provide the task force with proposed amendments "soon."

The task force then had a brief discussion related to an issue first raised at the Summer National Meeting from a certified reinsurance arbitrator. He believes intermediaries too often refuse to cooperate in reinsurance arbitration proceedings. The chair of the interested persons group noted that the majority of interested persons believe there is a problem that should be addressed with amendments to the Reinsurance Intermediary Model Act, which they will be working on this fall. The task force noted that they had received several comment letters from reinsurance intermediaries, who disagree that a problem exists.

P/C Reinsurance Study Group

The study group did not meet in Anchorage or in an interim meeting since the Summer National Meeting. A meeting to continue discussions of the reinsurance accounting issues currently being considered by the study group is expected this fall.

Market Conditions Working Group

To begin the meeting, the working group was given a status report on its *Medical Malpractice Insurance Report: A Study of Market Conditions and Potential Solutions to the Recent Crisis*. Since the Summer National Meeting, the working group held two conference calls in July to discuss changes to the report as suggested by members of the working group and interested parties. Overall, most of the changes

made to the report were minor or editorial in nature. Significant items discussed and changes made to the report included the following:

- The working group and interested parties were very interested in how the report discussed the impact of investment income on medical malpractice prices. The report was revised to reflect that reduced investment income is an important factor, but not the most important factor in causing prices to increase.
- The working group changed references to California's law so that it would be useful to other states when reforming medical malpractice insurance and laws.

The report was adopted by the working group during a conference call held on July 23rd and by the commissioners at Executive Committee and Plenary at the Fall National Meeting. The primary conclusion of the report is that there is not enough data available to determine definitively why the cost of coverage is increasing to health care providers. The report recommends that the NAIC help states gather necessary data; however, the report makes no formal recommendations on tort reform.

The NAIC staff then asked the working group and interested parties for direction regarding its study of homeowners and property insurance. A representative from the Center of Economic Justice recommended that the study be focused on commercial multi-family dwellings. The working group was in favor of this recommendation, asking the staff to focus on availability/affordability issues, best practices of risk mitigation, and the differences between urban and non-urban markets.

Casualty Actuarial Task Force

The task force met via conference call in July and again in August due to the expected inability to have a quorum in Anchorage.

The task force noted that they are nearing completion of a Regulatory Guidance on Property Casualty Statutory Actuarial Opinions, which is expected to be distributed to all chief examiners. It includes a 10% bright line indicator, which is described as an outer boundary for when the potential for adverse reserve deviation should be

evaluated and materiality discussed. The task force expects to adopt the Regulatory Guidance document at their upcoming October 12th conference call.

The American Academy of Actuaries reported that they are working on providing guidance to actuaries with respect to the new requirement in the Model Audit Rule included in the 2004 Annual Statement Instructions. The new requirement calls for management, the auditor and actuary to communicate on what data the actuary considers "significant" for purposes of the actuary's opinion on loss reserves. If the data is not otherwise tested as part of the audit, an agreed-upon procedures report may be authorized by management and performed by the independent auditor. In those circumstances (which are not expected to be the norm), management and actuary would have to agree to the sufficiency of the procedures. The AAA will continue to work with the AICPA to address implementation issues.

The AAA also noted that they have recently met with the SEC and discussed several issues including loss reserve disclosures. Schedule P, Parts 1-4 were provided to the SEC.

Risk Retention Working Group

The working group met in Anchorage and agreed to form a Risk Retention Subgroup, which will study issues related to the financial oversight of RRGs. The subgroup will study whether RRGs formed as captives are included in the formal Financial Analysis Working Group process. The chair noted that a risk retention issue paper is being developed, but is not ready for release for comment.

The working group had a long discussion of the federal Liability Risk Retention Act and how a non-domestic state can regulate risk retention groups. The working group clarified that the non-domiciliary state regulator does have significant authority for financial solvency and enforcement under its Unfair Trade Practices Act and Unfair Claims Settlement Practices Act.

The next National Meeting of the NAIC will be held in New Orleans on December 4-7, 2004. 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, 27th Floor, 200 Public Square, Cleveland, Ohio, 44114-2301 — (440) 875-3239 or jean.connolly@us.pwc.com. Please provide any email change of address information to sandy.b.thurston@us.pwc.com.

Disclaimer

Since a variety of viewpoints and issues are discussed at task force and committee meetings taking place at the NAIC meetings, and because not all task forces and committees provide copies of

agenda material to industry observers at the meetings, it is often difficult to characterize all of the conclusions reached. The items included in this Newsletter may differ from the formal task force or committee meeting minutes. In addition, the NAIC operates through a hierarchy of subcommittees, task forces and committees. Decisions of a task force may be modified or overturned at a later meeting of the appropriate higher-level committee. Although we make every effort to accurately report the results of meetings we observe and to follow issues through to their conclusion at senior committee level, no assurance can be given that the items reported on in this Newsletter represent the ultimate decisions of the NAIC. Final actions of the NAIC are taken only by the entire membership of the NAIC meeting in Plenary session.