



NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS

NAIC 2002 SPRING NATIONAL MEETING

The National Association of Insurance Commissioners held their 2002 Spring National meeting March 16-18, 2002 in Reno. 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 NAIC continued its detailed discussion of the effects of the terrorist attacks of September 11th on the insurance industry, the coverages that can (or cannot) be obtained, the permitted exclusions insurers can make in policies, and progress of any Federal backstop legislation. NAIC President Terri Vaughn has issued an NAIC statement on terrorism exclusions in life and health insurance coverages and expects such exclusions to be “limited,” but individual circumstances will vary by state. Exclusions are being seen in commercial property and casualty coverages. (pages 3-4)
- In its deliberations, the Statutory Accounting Principles Working Group reversed its position on requiring policy and service fees to be included in “premium income,” and approved the issuance of two new issue papers: Issue Paper 119, Capitalization Policy, and Issue Paper 120, Accounting for and Illustration of Foreign Currency Transactions and Translations. The working group also confirmed as final the consensus to reject three recently issued GAAP standards: FAS 141, FAS 142 and FAS 143. (pages 4-5)
- The Emerging Accounting Issues Working Group confirmed as final the tentative guidance on five interpretations, including whether disclosures are required for reinsurance trust funds of unauthorized reinsurers that are not fully funded by year-end. The working group reached a tentative consensus on seven new issues, including guidance on determining when assets are “other than temporarily impaired,” and the accounting for premiums paid on convertible zero coupon bonds. The working group did not reach a consensus on recording impairments on investments subject to FASB EITF 99-20 (retained beneficial interests). (pages 6-7)
- AICPA representatives provided comments to the NAIC/AICPA Working Group on how the accounting profession continues to work on improving the quality of audits, which includes the recent issuance of two new auditing standards and the release of a proposed revised standard on the consideration of fraud in a financial statement audit. (pages 7-8)
- The Life Risk-Based Working Group has been active in 2002 and has adopted several changes to the 2002 formula. Further consideration of a “look-through” proposal for Schedule BA assets will be made at the Summer National meeting. The Health Risk-Based Capital Group concluded that for purposes of the RBC calculation, incurred losses should not include premium deficiency reserves. (pages 8-9)
- The Invested Assets Working Group reached a consensus on four accounting/valuation issues referred to it by the Emerging Accounting Issues Working Group, of which three were adopted by the EAIWG. The

working group also exposed for comment a proposal for certain securities to be filed with the SVO for credit analysis. (pages 10-11)

- The Insurance Securitization Working Group received and exposed for comment a report from interested parties on the accounting treatment for index based insurance linked derivatives. The working group also heard a presentation on securitization transactions in the life insurance industry. (pages 11-12)
- The Insurance Holding Company Working Group received a final report from its Insurance Group Review Subgroup on detailed recommendations on the implementation of the recently adopted Framework for Insurance Holding Company Regulation. (page 12 and 13)
- The CARFRA Working Group began work on filing standards for individual variable annuity contracts and individual universal life insurance contracts. (page 13)
- The Functional Regulation Working Group and the NAIC/Industry Liaison separately discussed ways to address federal pre-exemption of states' powers. Both agreed that NAIC participation would be very helpful, such as the NAIC filing amicus briefs in support of states' rights to regulate its insurance companies. (pages 3 and 15)
- The Privacy Issues Working Group distributed and adopted "Informal Procedures for Consideration of Privacy Questions by NAIC Privacy Issues Working Group," which the working group will use in addressing privacy issues. The Privacy Notice Subgroup continues to develop sample wording of privacy notices to be sent to policyholders and consumers. (pages 16-17)
- The Risk Assessment Working Group presented their ambitious timetable to develop the detailed components of the Enhanced Regulatory Risk Assessment Framework and lay the groundwork for implementation of the newly developed risk assessment process. (page 17)
- The Financial Regulation Standards and Accreditation Task Force voted to expose for comment four proposed changes to the accreditation standards, including the change to the Actuarial Opinion and Memorandum Regulation which no longer allows opinions without asset adequacy analyses. (page 19)
- The Suitability Working Group has made significant progress since the Winter National meeting on their draft of the Suitability of Sales of Life Insurance and Annuities Model Regulation. After much discussion at their meeting in Reno, the working group approved additional revisions and voted to forward the current draft to their parent, Life Insurance and Annuities "A" Committee. (page 20)
- The Life and Health Actuarial (Technical) Task Force exposed two revised proposed Actuarial Guidelines, AG XYZ for products with secondary guarantees, and AG AXXX, which provides guidance on interpreting Regulation XXX. (pages 21-22)
- The newly formed Market Analysis Subgroup began discussion of an annual market data analysis process that would create a system to allow states to more effectively use their limited resources. The working group reviewed a "preliminary discussion draft" market conduct annual statement developed by a large life insurer. (page 23)
- The Actuarial Opinion Working Group continued its rapid progress in suggesting significant changes to the P/C Actuarial Opinion and Instructions. Interested parties have significant concerns about proposals to require disclosure of the actuary's best point estimate and/or reasonable range provisions within the publicly filed Actuarial Opinion and disclosure of the actuary's assessment of the likelihood for potential adverse deviation in any greater detail than is already required by existing Actuarial Standards of Practice. (page 25)

NAIC Agreement on Terrorism Exclusions

In a press release issued January 29th the NAIC noted that its members have come to an agreement on terrorism exclusions in filings by individual and group life, accident and health insurance entities. NAIC President Terri Vaughn made the following statement:

“It is the sense of the NAIC membership that terrorism exclusions are not necessary for individual life and health products and are generally not necessary to maintain a competitive market for group life and health products. They also may violate state law. However, we recognize that state laws vary in their authority and discretion. Further, there may be unique company circumstances in the group market that need to be considered on a case-by-case basis. We expect the need for these exceptions to be limited. “

Legal Issues Ad Hoc Group

The charge of this group of the Executive Committee is to address issues related to insurance policy terrorism exclusions that are being filed with state insurance departments. As a result of the policy statement on life and accident and health coverages, the ad hoc group is focusing on other insurance lines.

At the Spring National meeting, the group discussed lines of business that a few of its members felt had not been previously addressed, such as E&O, D&O, Glass, Workers Compensation Excess, and Commercial Auto insurance coverages.

To open the meeting, the working group solicited commentary from interested parties regarding these specific issues. There was no specific commentary from interested parties, or the working group itself in regard to E&O and D&O insurance. The following summarizes commentary made by interested parties regarding workers' compensation excess coverage, and commercial auto insurance:

Workers' Compensation Excess – certain interested parties indicated that if terrorism exclusions were not permitted for workers' compensation excess coverage, there would likely

be a capacity shortfall due to insurers exiting this particular segment in areas where the risk of terrorist activity is higher.

Commercial Auto – certain interested parties indicated that 21 states have already approved terrorism exclusions for commercial auto business.

Interested parties then enlisted the support of the working group in approaching certain states that have standard policy language for fire policies that does not include terrorism exclusions. It was noted that changing standard fire policy language within such states would require legislation, and as such, it would be beneficial for the NAIC to express its views in support of such legislation.

NAIC/Industry Liaison Committee

The liaison committee met in Reno and discussed several matters, including a federal “backstop” for terrorist acts, NAIC participation in class action lawsuits and measuring progress on regulatory modernization.

Lobbying continues for a federal backstop to cover acts of terrorism. Currently, industry representatives are looking to state governors to endorse non-partisan federal action.

Industry representatives urged additional participation or intervention by the NAIC in particular class action lawsuits. In certain of these lawsuits, and particularly multi-state cases, court actions appear to be undercutting state regulation. While there are no perceived weaknesses in NAIC actions to date, additional communication and earlier involvement would be beneficial. Enhancements to the NAIC Amicus Policy might also be advantageous.

The committee reviewed the objectives of regulatory modernization as outlined in the Statement of Intent. This encompasses speed to market initiatives, uniform company licensing, agent licensing initiatives and consumer protections. The committee will now focus on measuring progress to date for communication to the industry and the federal government.

Financial Services Modernization Task Force

The task force noted that at a recent hearing on terrorism insurance, the NAIC submitted a letter detailing the actions taken since the attacks on 9/11. At this point, the task force invited parties interested in testifying on the possible inclusion of group life insurance in the terrorism insurance discussion. Two representatives from the life insurance industry testified on the group life insurance issue related to terrorism, which is concentration of risk, and the increasing difficulty companies are having in obtaining catastrophic reinsurance. They testified that this fact pattern will result in underwriting decisions that may limit the availability of group life insurance. Both speakers were looking for support from the federal government in the form of a limit on catastrophic losses that would be incurred by an insurance company. The task force indicated that they would discuss the issue in further detail during executive session.

The developments related to a Federal Charter were briefly summarized for the task force. There are currently two bills that address the issue. The Senate bill calls for a National Insurance Office to be created under the Treasury Department. The NAIC model regulations would be the basis of the national regulation. Federal Charters would be made available and self-regulation would be allowed to some extent. Some key differences to current practice noted were that regulatory exams would be confidential and there would be no credit for reinsurance allowed. The House bill gives greater recognition to state licenses, as federal charters would not be offered. In this model, rate regulation would be left to the states and there would be no deference given to the U.S. GAAP accounting model.

Accounting Practices and Procedures Task Force

After receipt of the reports of their working groups, the task force discussed the NAIC's response to a February 18th article in Best Week entitled *Equity Analyst Outlines Six Bad Habits in Insurance Accounting*. The article details the "six bad habits" to which NAIC staff prepared responses to the analyst's observations, and concluded that the

points raised relate primarily to "investor reliance on flawed company announcements/projections rather than significant weaknesses in accounting practices." Therefore, staff does not recommend significant changes to the SAP model. The working group will not be issuing the staff memo as a formal response to the article, but New York insurance department representatives will be meeting with the author of the "six bad habits" shortly and will provide her a copy of the memo.

Statutory Accounting Principles Working Group

Public Hearing

The working group held a public hearing at the Spring National meeting on documents that had been exposed at previous meetings and reached the following conclusions:

SSAP 85, Claim Adjustment Expenses, an amendment to SSAP 55 – The purpose of this SSAP is to provide guidance as to what costs should be included as claim adjustment expenses on A&H contracts. The working group agreed to defer finalizing the SSAP so that the A&H Working Group can review certain issues raised by interested parties. Final adoption is expected at the Summer National meeting, with an effective date of January 1, 2003.

SSAP 53, P/C Premiums, proposed amendment to reflect finance and service fees as premium income – As a result of strong opposition from interested parties, the working group concluded they would not adopt this proposed change. Instead, proposed clarifying guidance to SSAP 53 to classify finance and service fees as other income was exposed for comment.

SSAP 68, Business Combinations and Goodwill, proposed nonsubstantive amendments – The working group adopted revisions to SSAP 68 to reject two recently issued GAAP standards, FAS 141, Business Combinations, and FAS 142, Goodwill and Other Intangible Assets.

SSAP 55, Unpaid Claims, proposed amendment to refer to the newly adopted Health Reserves Guidance Manual – The working group adopted this change to refer users to the Health Reserves Guidance Manual for further guidance for reserving

methodologies and assumptions used for individual and group A&H reserves.

Consideration of FAS 143, Accounting for Asset Retirement Obligations – This new GAAP standard was rejected as not applicable to statutory accounting.

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 May 20, with a public hearing at the Summer National meeting.

SSAP 3, Accounting Changes – The working group exposed for comment a clarification that corrections of errors to filed annual statements could result in the refiling of the effected annual statements.

SSAP 65, P/C Contracts and the elimination of the nontabular discounting – The working group discussed a proposed amendment to SSAP 65 to remove paragraphs 12a, 12b and 14b that provide guidance on nontabular discounting, which is NOT an NAIC prescribed accounting practice. The working group reached a consensus that such deletion seems appropriate, but they want to study the issue further, i.e. should this guidance be provided in the annual statement instructions or elsewhere so that states that prescribe or permit nontabular discounting will have guidance on rates to be used and disclosure requirements.

SSAP 36, Troubled Debt Restructuring, and the use of a valuation allowance for temporary impairments – Interested parties have drafted a Form A to request this issue for consideration, which was originally discussed at Emerging Accounting Issues Working Group. The request to allow impairments of mortgage loans to be recognized through valuation allowances (as allowed under GAAP) instead of realized losses was rejected by the working group.

SSAP 51, Life Contracts and SSAP 56, Separate Accounts and contracts with market value adjusted features – The working group exposed for comment nonsubstantive amendments to the two SSAPs and Appendix A255, Modified Guaranteed Annuities, and Appendix A588, Modified Guaranteed Life Insurance to clarify whether certain annuity

contracts are required to be held in separate accounts.

Issue Paper 117, Accounting by Insurance Enterprises for Demutualizations and MIHC Formations – The working group reported that they are still considering comments received and are working with interested parties to resolve open issues. Several of the comment letters disagreed with the proposed accounting for the policyholder dividend obligation, and that issue will continue to be discussed this spring. The working group expects to have a revised Issue Paper ready for exposure at the Summer National meeting.

Issue Paper 119, Capitalization Policy, an Amendment to SSAP 4, 19, 29, 73, 79 and 82 - The working group voted to expose this issue paper for comment, which requires insurance entities to establish a “predefined threshold” below which items are expensed (instead of capitalized).

Issue Paper 120 - Accounting for and Illustration of Foreign Currency Transactions and Translations, an Amendment to SSAP 23 – This issue paper was exposed for comment and provides guidance to address the numerous implementation questions that arose from the adoption of SSAP 23.

Issue Papers 119 and 120 were not available in Reno but have since been posted to the NAIC's website under Statutory Accounting.

SSAP 68, Treatment of Previously Established Goodwill in a Subsequent Merger

The working group previously approved the drafting of an issue paper related to a proposed amendment to SSAP 68, Business Combinations and Goodwill, related to the accounting for goodwill that arose from acquisitions when the related entities are subsequently merged. At this meeting the working group reported that they did not wish to proceed with the drafting of an issue paper as they believe the current accounting, requiring the writeoff of the goodwill in the merged entities, is the appropriate answer. After much discussion, interested parties convinced the working group to defer final consensus (i.e. not consider further discussion of the issue), and allow interested parties more time to develop support for their position for presentation at the Summer National meeting.

At the end of the meeting the working group briefly discussed a letter from the ACLI asking for relief from new disclosures to annual statements being required so close to year-end (as happened in December of 2001). The working group agreed to begin developing disclosure and annual statement instructions in conjunction with the issue paper development.

Emerging Accounting Issues Working Group

The working group confirmed the tentative consensus as final of the following INTs discussed at previous meetings:

INT 01-31, Assets Pledged as Collateral – Based on a recommendation for the Invested Assets Working Group, the working group concluded that assets under collateral agreements (excluding reinsurance collateral arrangements) are admitted assets until an uncured default occurs. This is interim guidance that will be reconsidered by the FAS 140 Subgroup of the SAP Working Group. (Also see further discussion in the summary of the IAWG meeting.)

INT 02-01 – Disclosure of the Departure from Appendix A-785, Credit for Reinsurance – The issue is whether deviations from state laws and NAIC requirements from full funding of trust accounts should be disclosed in the reconciliation of surplus from the state prescribed or permitted accounting to NAIC prescribed accounting. The working group concluded that such disclosure would not be necessary because A-785 does not provide guidance as to the timing of the full funding of the trust funds.

INT 02-02 – Recognition of Billings Made Prior to Effective Date of Contract – The working group concluded that an asset should not be recognized for billing policyholders in advance of the effective date of the contract.

INT 02-03 – Temporary Impairments that are Identified when Non-economic Modifications are made to the Contractual Terms of Commercial Loans – The working group concluded that the specific fact circumstances presented by interested

parties did not warrant temporary relief from the impairment guidelines of SSAP 36 and 37.

INT 02-04 – How an Assuming Reinsurer Should Account for the CRVM/CARVM Expense Allowances Belonging to the Assuming Company When the Ceding Company Holds the Assets Supporting the Full Account Balance in its Separate Accounts - The working group has concluded that the assuming company should record transfers to the separate account net of reinsurance.

The working group then addressed new and outstanding Form Bs and reached the following tentative conclusions. Forms Bs exposed for comment have a comment deadline of May 20 and will be posted shortly to the NAIC's website.

SSAP 43 and EITF 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets

– The working group reviewed the recommendation of the Invested Assets Working Group (which deliberated the issue for more than a year) to reject EITF 99-20 due to its inconsistency with the SAP model of the use of amortized cost for most bonds and undiscounted cash flows. The working group did not fully embrace that conclusion and asked interested parties and NAIC staff to report back in June with a comparison of impairments recognized in GAAP financial statements in 2001 under EITF 99-20 and impairments recognized under SSAP 43 in SAP financial statements. (Also see further discussion in the IAWG summary in the Newsletter.)

SSAP 26, Accounting for Convertible Bonds – The working group agreed with the recommendation of the Invested Assets Working Group that the premium paid of zero coupon bonds should be written off immediately at purchase.

Definition of "Other Than Temporary Impairments"

– Because of the multitude of questions received by NAIC staff and accounting firms on an interpretation of the term "other than temporary impairments" that is included in the invested asset SSAPs, the working group concluded that additional guidance would be helpful. The Form B addresses three questions:

- Does the NAIC believe that the phrase “other than temporary” impairments should be interpreted to mean “permanent”? Tentative consensus: No
- Is it appropriate for reporting entities, independent auditors or state examiners to apply predefined thresholds to the phrase “other than temporary”? Tentative consensus: No. The working group concluded that “rules of thumb,” such as fair value is 20% or more less than cost for six months, can be a first step in the analysis but management must use its judgement to determine the final assessment.
- When management determines that a write-down, accounted for as a realized loss, is necessary, how should the amount of the write-down be determined? Tentative consensus: the carrying value should be written down to its fair value using January 1, 2001 as the starting point for carrying value.

SSAP 62, Indemnity in Modeled Trigger Transactions – The working group adopted as its tentative consensus the recommendation of the P/C Reinsurance Study Group to not allow reinsurance accounting for such transactions.

SSAP 61 – Application of A-791 to YRT Reinsurance of Inforce Blocks of Business – The tentative consensus is to require such YRT agreements to apply the income statement deferral guidance applied to other reinsurance agreements of inforce blocks.

SSAP 62 – Syndicated Letters of Credit on Group Reinsurance Agreements – Consistent with the recommendation of the P/C Reinsurance Study Group, the working group concluded ceding companies may take credit for such LOCs when certain criteria are met.

SSAP 65 – Disclosure of A&E Exposures – The working group agreed with the proposed recommendation from one of the Big 5 accounting firms to require only two years of asbestos and environmental disclosures in the audited financial statements (but still require five years in the Annual Statement Notes.) NAIC staff expanded the Form B to clarify that the Annual Statement Notes and

the audited financial statement footnotes are not required to be identical.

SSAP 2, Reporting of Money Market Mutual Funds

– The working group agreed with the recommendation of the Invested Asset Working Group that current guidance is clear and no changes are necessary to the SSAP.

NAIC/AICPA Working Group

AICPA Projects

The working group received a report from AICPA representatives on AICPA projects that affect insurance regulators and the insurance industry. Those projects include the following:

Proposed Statement on Auditing Standards Consideration of Fraud in a Financial Statement Audit - An exposure draft of this proposed revision to auditing standards was recently released for comment. When finalized and adopted the standard will supercede SAS 82, and the AICPA indicates that it expects the standard will substantially change work performed by auditors with respect to fraud and improve the likelihood that auditors will detect material misstatements due to fraud. However, the SAS will not change the auditor’s responsibilities with respect to uncovering fraud.

Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards – This standard was issued in December 2001 and is effective for periods ending on or after December 31, 2001.

Statement on Auditing Standards No. 96, Audit Documentation – This standard was issued in January 2002 and is effective for periods ending on or after May 15, 2002.

Presentation to the working group

In response to a request from the NAIC/AICPA Working Group, an AICPA representative gave a short presentation on how the profession is working to continually improve the quality of audits. These initiatives include the following:

- The AICPA continues to work on the recommendations issued in 2001 by the Public Oversight Board’s Panel on Audit Effectiveness, which includes the issuance of SAS 95 and

SAS 96 and the proposed standard on the consideration of fraud all discussed above. The AICPA also recently issued a publication entitled *Impact of the Current Economic and Business Environment on Financial Reporting*, which is posted to the AICPA's website.

Through its Auditing Standards Board the AICPA will also be issuing guidance for company management and audit committees on new measures to deter fraud and issue a revised auditing standard on the review by auditors of quarterly financial statements.

- The AICPA supports Congress and the SEC in enacting recently exposed proposals such as the creation of a new private sector regulatory body for CPAs, new rules for corporate governance and specific SEC guidance on disclosures, such as FR-60 and FR-61, *Expanded MD&A Disclosures and Identification of Critical Accounting Policies*.
- The FASB will "fast track" a project on consolidation and reporting of special purpose entities.

Other Issues

The working group reviewed and exposed a report entitled "Examiners Reliance on CPA Workpapers," which summarized Virginia's concerns about transmittal letters from CPA firms that regulators receive when they request access to CPA workpapers. Some regulators believe that certain of the language in these letters may be interpreted to conflict with the Model Audit Rule's requirement for CPA to recognize regulators' reliance on the CPAs audits in the CPA Qualifications Letter.

Representatives of the AICPA stated that the wording of the language in the transmittal letters is in complete conformity with professional standards and that each third party requesting access to CPAs workpapers across all industries receives such letters from CPAs. The AICPA believes the language provides detail of what a financial statement audit entails and is not intended to restrict the regulator's reliance, only denote the limitations that may apply to each user intending to rely upon an audit. The AICPA will provide a formal response at the Summer National meeting.

Risk-Based Capital Task Force

During an interim conference call in February, the task force discussed a charge to the Chairs of each working group to update the task force on their groups' approach to addressing the "Wisconsin proposal" to re-calibrate the formulas. That letter requested review of the calculation of the Authorized Control Level Risk Based Capital, specifically the "50% factor" and whether 50% is the appropriate factor. However, due to the absence of the task force chairman, this item was deferred at the Spring National meeting.

The task force received a report from the American Academy of Actuaries that updates its 1999 comparison of the three RBC formulas. The updated report identifies where differences exist and seeks to explain why such differences are necessary.

Life Risk-Based Capital Working Group

Prior to the Spring National meeting, the working group held two conference calls. On their January, 2002 conference call, the working group adopted a number of "corrective" items affecting the 2002 Life RBC formulas.

During their February 28th conference call, the working group adopted a proposal to require life insurers to provide an RBC amount for affiliated health entity investments that are not required to submit the health RBC formula by their states of domicile. The working group will consider possible instruction changes to establish how indirect investments in Subsidiary, Controlled or Affiliated health entities that may or may not be subject to RBC should be handled.

Also during the February conference call, the working group adopted several proposals affecting the 2002 RBC instructions and formulas including 1) a C-3 cash flow testing exemption worksheet and 2) treatment, for RBC purposes, of Schedule BA affiliated investments in a manner that mimics the treatment for affiliated investments that are reported in Schedule D, Part 2, Section 2.

Finally, during the February call, the working group established an Ad Hoc Subgroup in order to move forward with the review of the life RBC formula as

requested in the "Wisconsin letter," which was raised at the Winter National meeting.

During the March meetings, the working group adopted a revision to the RBC formula instructions language in the Health Premiums section to clarify the mechanics of the formula pages for disability and long-term care insurance.

The working group deferred action on a look-through proposal for Schedule BA limited partnerships due to the need for clarifying language; however, the AAA did present recommendations regarding proper RBC treatment for such assets. The AAA concluded that there should be a "look-through" on rated limited partnership assets. If a limited partnership includes both rated and unrated assets, the unrated asset should not taint the whole partnership. The unrated asset should get a 30% RBC factor, but other related rated assets should still receive the "look through." In addition, if a Schedule BA asset contains a short position, then the asset is disqualified from the "look-through" provision and must use a 30% RBC factor. Further consideration to this proposal will be given by the working group upon the receipt of clarifying language from the AAA.

The working group also acted on three other reports from the AAA as follows:

- (1) Adopted proposed changes to certain language within the C-3 Interest Rate Risk section of the Life RBC instructions.
- (2) Received the C-3 Phase II recommendation to be exposed until May 1, 2002. This proposal on RBC treatment for variable products with guarantees would necessitate that insurers "stress test" the volatility of such products, and utilize the results of such tests to determine the appropriate RBC need.
- (3) Received the AAA's recommendations report on appropriate RBC treatment of Separate Accounts Guaranteeing and Index. Comments will be accepted until May 1st.

The working group approved a proposed format for a survey directed at companies' participation in the Federal Home Loan Bank MPF Program and exposure to other off-balance sheet risk and voted

to direct the NAIC to conduct the survey with responses due by May 1, 2002.

The AAA Long-Term Care Risk-Based Capital Subgroup presented a status report on its pending proposal on changes to RBC formulas for long-term care business. The AAA is currently testing its model using actual industry data, and expects to present a final proposal at the Summer National meeting. The working group accepted the status report for review. This same report was also given at the Health RBC Working Group meeting.

Property/Casualty Risk-Based Capital Working Group

The working group did not meet in Reno.

Health Organizations Risk-Based Capital Working Group

The working group reviewed a comment letter received from the Blue Cross/Blue Shield Association (BSBA) regarding RBC treatment for prescription drug programs. The letter seeks changes in Health RBC instructions related to the treatment of prescription drug benefits in the Underwriting Risk (H2) section of the RBC formula to clarify appropriate placement of prescription drug benefits within the formula. The working group approved a motion to have NAIC staff draft appropriate changes to the Health RBC instructions.

In a second letter to the working group, BSBA requested changes to the Health RBC instructions in order to clarify appropriate use of the "Guarantees for Affiliates" and "Contingent Liabilities" lines. The working group approved a motion to have NAIC staff draft appropriate changes to the Health RBC instructions.

The AAA presented an interim report on its study of certain asset-related elements of the RBC formula. Discussion during this meeting related primarily to contemplation of a covariance formula. In light of the pending change to Life RBC to bifurcate fixed income risk from equity investment risk, the AAA sees no theoretical justification for a covariance treatment that differs materially from the corresponding treatments in both Life RBC and P/C

RBC. Further discussion of the recommendations will be held at the Summer National meeting.

The working group addressed an inquiry from NAIC staff asking whether premium deficiency reserves should be included as part of incurred losses for purposes of RBC calculations. After discussion amongst the working group and interested parties, it was decided that for purposes of RBC, incurred losses should not include premium deficiency reserves, as such reserves address pricing concerns that are not contemplated in the RBC formula.

The working group Chairman suggested that a separate Ad Hoc Working Group not be formed to address the "Wisconsin letter" issues. Rather, the working group will monitor the developments of the Life Risk-Based Capital Ad Hoc Working Group, which has already been formed to address those issues.

Invested Assets Working Group

Since the 2001 Winter National meeting, the Invested Assets Working Group has met via conference calls on numerous occasions to provide recommendations to the Emerging Accounting Issues Working Group ("EAIWG") on the issues EAIWG requested input as discussed below.

SSAP 43 and EITF 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets

The working group will recommend to the EAIWG that EITF 99-20 not be adopted given that certain GAAP considerations underlying EITF 99-20 do not carry over to statutory accounting, i.e. the use of discounted versus undiscounted cash flows to determine impairment. However, the working group did suggest certain modifications to SSAP 43 to address the concerns of the working group regarding adequate guidance on non-mortgage backed structured securities (i.e., Collateralized Debt Obligations, Collateralized Loan Obligations, Collateralized Bond Obligations and other similar structured securities). These modifications are summarized below:

- Exclude residual interests from the scope of SSAP 43 with reference instead to SSAP 33

- Explicit reference to CDOs, CBOs and CLOs as loan-backed securities within the scope of SSAP 43
- Clarification that changes in cash flows can be due to changes in prepayment assumptions or for other causes
- Elimination of the "decline in fair value test" as a cause for an "other than temporary impairment"
- Recognition that write-downs are subject to either the requirements of the IMR or the AVR

At the meeting of EAIWG however, that working group did not fully embrace this recommendation. See that summary for further discussion.

Assets Pledged as Collateral

After review of example collateral agreements and discussion with the interested parties, the working group recommended that the EAIWG accept INT 01-31 on an interim basis until a full scale review can be conducted by the appropriate NAIC working groups. The NAIC working groups, including the RBC Working Groups, the Life and Health Actuarial Task Force and the Life Liquidity Risk Working Group, need to determine the appropriate way to address the risks to an insurer that pledges assets as collateral. The working group also recommended that the respective NAIC working groups address the lack of a regulatory framework for collateral-based transactions. Finally, the working group recommended that their report be distributed to the Chief Examiner in each state.

Convertible Bonds

This issue relates to accounting for premium paid on zero coupon convertible bonds that produce a negative yield. The working group recommended to the EAIWG that premium paid be written off immediately upon purchase. The working group rejected the recommendations of the interested parties, who supported amortized cost accounting for the premium using a "yield-to-worst" amortization period.

Other Issues

The EAIWG had also forwarded an issue to the working group relating to the reporting of money market funds under SSAP 2. At issue is whether money market funds should be reported as cash equivalents on Schedule E or as short-term investments on Schedule DA. An interested party

submitted a Form B to the EAIWG and requested clarification of existing guidance and recommended that guidance permit the reporting of money market funds as cash equivalents. The working group noted however, that existing guidance is not ambiguous on the treatment of money market funds. As a change to existing guidance would be required, the working group and the interested parties agreed that a Form A submission should be filed which will likely be referred to the Statutory Accounting Principles Working Group.

The working group then discussed the assignment of NAIC designations to debt and preferred stock issued by a Real Estate Investment Trust ("REIT") that is not rated by a Nationally Recognized Statistical Rating Organization. The SVO proposed an amendment to the P&P manual to permit the SVO to process unrated REIT securities. Historically, only rated REIT securities have been assigned an NAIC designation. The SVO has developed a methodology for processing these securities and concluded the office has sufficient expertise for this task. The revised SVO Purposes and Procedures language was exposed for comment through May 1st.

A proposal was also made by NAIC staff whereby certain Schedule BA assets would be filed with the SVO for credit analysis. This includes collateral loans and assets that have underlying characteristics of fixed income, preferred stock or common stock. Should an NAIC designation be assigned, the asset would then be reported on Schedule D. The proposal was exposed for comment through May 1st.

Other matters discussed by the working group included replication transactions and effective credit hedging transactions. The working group anticipates moving forward with a project to analyze risk reduction through the use of effective credit hedging techniques.

SVO Oversight Working Group

At the 2001 Winter National meeting, the American Council of Life Insurers had submitted a proposal to exempt certain highly rated securities with optionality from SVO filings in years subsequent to initial filing. Subsequent to the Winter National meeting, the working group distributed a survey to

chief examiners to obtain input from the states prior to deciding on an appropriate course of action. Responses were received from seventeen states. The working group determined that the survey was inconclusive and agreed to re-submit the survey to those states that hadn't responded. An interim conference call will then be scheduled to review survey results and determine next steps.

The working group discussed the treatment of long-term certificates of deposit and guaranteed investment contracts. The NAIC staff had previously raised questions regarding the filing requirements for such investments. The working group received reports from the SVO that outline accounting guidance on long-term certificates of deposit and guaranteed investment contracts and current SVO treatment. These two reports were exposed for comment through May 1st.

The working group adopted an amendment to the SVO's Purposes and Procedures Manual to clarify language related to the 5*/6* Rule in Part 4, Section 1(c). The revisions are intended to make the following point clear: insurance companies may report a security with the administrative symbol Z without incurring the penalty imposed by the 5*/6* rule if the insurer has reported the transaction to the SVO with all relevant documentation by the September 1 deadline but the SVO failed to process the security by year-end. The amendment will be incorporated into the July 1, 2002 P&P Manual.

Finally, the working group has expressed concern regarding the timely notification of deteriorating credit trends on securities. The SVO will respond to this concern by using SVO Monthly Research Reports to provide appropriate notification of such events.

Insurance Securitization Working Group

The working group adopted the March 5, 2002 minutes of the Exam Procedures Subgroup of the Financial Conditions (E) Committee. The subgroup discussed their role of developing the necessary modifications to the Examiners' Handbook regarding Protected Cells and Special Purposes Reinsurance Vehicles. The subgroup working on procedures for review of a plan of operation is planning on meeting during the second week of

April. During this meeting, the subgroup will discuss the format for guidance and the type of documents that need to be reviewed.

The working group received a report from interested parties on the accounting for index based insurance linked derivatives. The interested parties presented a final draft of the insurance securitization working group white paper, which presents the interested parties proposed statutory accounting guidance for such derivatives as well as regulatory concerns. The working group moved to receive the white paper and conduct a further analysis, accepting comments prior to the Summer National meeting.

An ACLI representative presented "Securitization and the Life Insurance Industry," which provided the ACLI's perspective on the benefits of life securitizations, the current state and the future of life securitizations, and the NAIC/regulator roles. Life securitization was defined as the sale of future streams of premiums and allowed expenses from an existing block of business to a special purpose vehicle. It may be done by itself or in conjunction with reinsurance. Life securitization may also take advantage of the transaction(s) contemplated by the NAIC Protected Cell Company Model Act.

The presentation highlighted that securitizations can reduce overall capital costs which could lead to lower premiums and better reserves as well as provide insurers with new sources of coverage and increased liquidity. The ACLI formed a Securitization Working Group in February 2002, with the goal to foster an environment for the growth and improvement of the life securitization market. The ACLI plans to hold a meeting to develop life securitization concepts by May 2002.

The working group received an update on the activities of the IAIS Subgroup on its Insurance Securitization meeting on February 25-26. The IAIS Subgroup heard from members of industry and regulators in order to provide education to the subgroup; the subgroup agreed to redraft the Insurance Securitization Issues Paper, which will be considered at the next IAIS Subgroup meeting in April 2002. A member of the European Commission agreed to draft a response to the recent IASC Draft Statement of Principals on insurance contracts.

Blanks Task Force

The task force discussed interim guidance developed by NAIC staff to address the "thousands" of annual statement preparation questions that staff received in the past few months. The questions related to implementation of the new accounting guidance and related changes to the 2001 Blanks. The document, Frequently Asked Questions (Q&A) & Schedule D Guidance, will be reviewed by the task force for possible inclusion in the annual statement instructions for future use. The document is currently posted to the NAIC's web site under Financial Reporting.

Annual Statement Instructions Working Group

The working group discussed proposed changes to the annual statement and its instructions, focusing on information that can be eliminated due to redundancy or no longer being useful. The working group agreed to the following proposals being forwarded to the Blanks Task Force for their consideration:

- Eliminate Schedule F in the Life and Health Blank
- Eliminate the use of exhibit numbers (due to frequent renumbering and resulting confusion)
- Eliminate Schedule DM and move its information to an interrogatory

An additional five "elimination" proposals will be presented at the Summer National meeting.

The working group also agreed to a proposal to add the instructions developed for the new investment disclosures from Appendix A-001, adopted as part of the Codification project, to the annual statement instructions.

Insurance Holding Company Working Group

As the working group moves to implement the Framework for Insurance Holding Company Regulation (as developed by the Insurance Company Review Subgroup), the working group will identify lead states for each insurance holding company group. Sixteen holding company groups have already been reviewed and a lead state was

identified for each. This process was relatively straightforward with constructive comments and feedback received from several states. Over 600 other holding company groups will now be reviewed. The working group strongly encourages feedback and expects to seek confirmation of lead state designations from the states in the second quarter of 2002. A database will capture all lead state assignments.

As noted at the 2001 Winter National meeting, the working group will begin a Form A Pilot project to assist in developing best practices surrounding coordination and communication on multi-state Form A filings. They have solicited the states for recently filed Form As that would be suitable for the pilot. Ideally, the working group would like to review 10-15 Form A filings during 2002.

Other matters discussed by the working group include the launch of a Form A filing database and a new I-site tool for global insurance analysis. The Form A filing database allows on-line entry of Form A data, provides query options to research Form A filings and allows regulators to monitor the status of Form A filings. State insurance regulators were also alerted to a new I-site tool offered by Thomson Financial Insurance Solutions that provides access to information and financial data on international insurers and merger and acquisition activity.

Insurance Group Review Subgroup

The subgroup reviewed, heard comments and subsequently issued their final report and recommendations regarding the implementation of the Framework for Insurance Holding Company Analysis. The subgroup identified four key areas for further research including:

- Necessity of additional guidance and the elimination of barriers to coordinated examinations and analysis
- Consideration of a database of holding companies and regulatory contacts
- Necessity for analytical tools for use in studying holding companies (which could potentially be a long-term project for the NAIC)

- Consideration of regular meetings among regulators to discuss their analysis of specific holding company systems.

At the meeting of their parent committee, Insurance Holding Company Working Group, the working group received the report and stated they will consider the recommendations at the Summer National meeting.

CARFRA Working Group

The Coordinated Advertising Rate and Form Review Authority (CARFRA) Working Group continues to work on adding products and states to the CARFRA program. Filing standards for individual variable annuity contracts and individual universal life insurance contracts are currently being developed. To date, one filing has been made and the working group reported that an effective process was demonstrated in the review of that filing. A second filing has been received and an appropriate review panel has been activated.

The working group then went into executive session to discuss moving the CARFRA program beyond the current limited launch states. They intend to investigate the use of an interstate compact concept for life and annuity products. This would provide for greater structural authority around the CARFRA program and increased recognition by the states.

The ACLI, having submitted a proposal on recommended improvements to the CARFRA program, offered to provide the working group with their previous work on interstate compacts. Additional information is available at the CARFRA website at www.carfra.org.

Improvements to State-Based Systems Working Group

The working group reviewed goals established at the Commissioners Conference for the Speed to Market Improvements to the working group for 2002. Highlights of the 2002 goals include speed to market with quality and review as well as meet the following standards for rate and policy form filings by December 1, 2002:

- 100% completed by 100 days
- 95% completed in 30 days
- 70% completed in 25 days
- 50% completed in 20 days

Additionally the following Subgroups were created in order to accomplish the goals set out to the working group: Review Standards Checklist Subgroup, Property & Casualty Product Uniformity Subgroup, SERFF Enhancements Subgroup, and the Filing Submission Uniformity/Metrics Subgroup.

Review Standards Checklist Subgroup

The subgroup is charged with identifying ways to improve the look and feel of the NAIC website, identify best practices for review standards checklists and to develop a uniform self-certification form. The subgroup discussed filing self-certification and the difficulty in enforcing self-certification.

SERFF Enhancements Subgroup

This subgroup is charged with identifying at least 3 enhancements that are needed to make review by states more efficient and effective and to identify and implement at least 3 enhancements needed to make SERFF a more value-added product for companies. The subgroup is anticipating asking states to look over a list of possible improvements and list the most significant improvements needed for SERFF. Currently 47 states are up and running on SERFF, with a total of 48 states expected by month-end.

National Treatment and Coordination Working Group

The mission of this working group is defined as identifying, coordinating and facilitating expeditious resolution of company licensing and expediting the review of pending acquisitions and mergers requiring multi-state approval.

The working group distributed and discussed its 2002 goals, which include:

- Conducting a corporate reorganization pilot project, whose focus is on the regulatory requirements involved after an approved merger or acquisition involving multiple reinsurers. Members of the working group agreed to utilize the developed forms and processes for

facilitating changes such as amending charters and by-laws and name changes as developed by the ALERT Subgroup.

- Eliminate 40% of the UCAA state specific deviations, of which the ALERT Subgroup has eliminated differences between the UCAA form and state specific requirements. Currently the ALERT Subgroup has identified less than 100 differences between the UCAA and state specific forms.
- Identify and evaluate obstacles to help ensure 90% of the company applications are acted upon by all states within 90 days by December 1, 2002. The working group has been charged with considering methods for identifying what obstacles, if any, tend to delay the application process.
- Eliminate the hard copy filing requirement of the UCAA form in 35 states where the electronic form is filed.
- Conduct a pilot on implementing streamlined company admissions. The ALERT Subgroup has already focused its efforts on identifying common requirements among all states.
- Eliminate the hard copy filing of annual statements for non-domestic companies in 35 states by December 1, 2002.

The working group received a report from the ALERT Subgroup detailing the results from their most recent meetings. The ALERT Subgroup heard a report from its State Specific Issues Technical Group which included a request for the NAIC to establish a state map on the UCAA system that would provide links the states' websites.

Coordinating with Federal Regulators Working Group

The working group received reports from its subgroups:

Subgroup on Financial Issues

The subgroup submitted for comment a revised draft document for its ongoing project to develop a matrix to map insurance risk into Federal Reserve banking

categories. The subgroup asked for final comments by April 15 in anticipation of submitting a final document for the subgroup's approval at the Summer National meeting.

Discussion was held regarding the potential future use of the document. The chair of the subgroup indicated that the Federal Reserve Board intends to use the final document as a training tool for regulators being exposed to insurance risk for the first time through their review of Financial Holding Company structures with insurance company subsidiaries. The NAIC itself will likely use the document for general educational purposes as well.

The subgroup also discussed development of a Health Insurance Product Risk Matrix and the American Academy of Actuaries agreed to assist with this project. This matrix will specify characteristics in product risk that are unique to managed care and/or indemnity organizations.

Troubled Companies Subgroup

The subgroup has been meeting with the Federal Reserve Board (FRB) to discuss the insurance supervision and liquidation process, as well as compare and contrast NAIC and FRB early warning systems. The subgroup has also revised the Troubled Company Handbook, and distributed to Federal Regulators.

After the subgroup reports, the working group adopted the final format for a Bank-Insurer Affiliation survey, and resolved that the individual states be charged with distributing the survey to their domestic insurance companies. In general, the survey seeks to identify insurance companies that are affiliated with regulated "financial holding companies," banks, thrifts, or securities firms.

Finally, the working group provided an updated listing of the states that have fully executed Regulatory Cooperation Agreements with Federal Banking Agencies. Currently, 32 states have executed the agreement with the Office of the Comptroller of the Currency, 45 states with the Office of Thrift Supervision, 36 states with the Federal Deposit Insurance Corporation, and 14 states with the Federal Reserve Board. The working group intends to perform a survey of states that have not yet executed such agreements.

Functional Regulation Working Group

The working group discussed the West Virginia Pre-emption Opinion from the Office of the Comptroller of the Currency (OCC). The OCC concluded that Federal law pre-empts some of the provisions of the West Virginia Insurance Sales Consumer Protection Act that apply to national banks based upon the interpretation that the clauses did not meet the safe harbor requirements of GLBA.

Since the Winter National meeting, the working group held a conference call and determined that the best way to proceed is for the NAIC to participate in a lawsuit brought by the agents and brokers by filing an amicus brief in support of the agents' contentions. The agents' position is that the OCC has no jurisdiction to declare state laws invalid, and that in the event that the OCC does have the authority, the agents maintain that the OCC did not apply the standards in GLBA correctly. The amicus brief will discuss how to define the pre-emption standards. The due date is April 3 and a draft should be completed shortly.

The Patriot Act Bulletin was discussed and adopted by the working group. The purpose of the Bulletin is to advise regulated persons or entities of new responsibilities under the Act. In particular, all financial institutions will be required to establish anti-money laundering programs by April 24, 2002, and the Secretary of the Treasury will be required to adopt minimum standards for financial institutions regarding the identity of customers that open accounts or purchase policies.

Comments on the Act were received from interested parties. An interested party noted that as written, the Act allows companies to notify prospective employers of financial misdealing in recommendation letters only applies to depository institutions. A request was made to extend the protection for such disclosure to all financial institutions. A representative of the Treasury Department noted that additional work needs to be completed in order to generalize the vocabulary to all financial institutions in a number of instances throughout the Act.

Another topic addressed by the working group was issues related to title insurance. Specifically under discussion was the effect of GLBA and the impact

on an agent in a sales capacity rather than in an underwriting capacity. Tennessee and Kansas both discussed the issues that they had experienced in relation to GLBA pre-empting the control of business statutes currently on the books that limit the amount of affiliated business sales. It was determined that a subcommittee would be formed to identify and review these title insurance issues in further detail.

Privacy Issues Working Group

The working group distributed and adopted the "Informal Procedures for Consideration of Privacy Questions by NAIC Privacy Issues Working Group." It was noted that this document does not in any way limit the ability of interested parties to comment on Q&A's that have been previously exposed for comment.

Two pending Q&A issues were discussed. The "Group Issue" which addresses when licensees are required to provide privacy notices to plan sponsors and individual contractholders was discussed, but was not adopted as presented. At issue is the intent of the regulators to require that individual group members receive privacy notices in the event that the group policyholder does not receive a notice. It was determined that the Q&A as currently written does not make this intent clear. The working group will work to redraft the section to ensure that the original intent is clearly defined.

The second Q&A issue clarifies the scope of the agent exemption in the NAIC Privacy Model Regulation. The working group determined that the agent exemption applies at the time of the initial placement of a policy. It does not apply, however, when an agent shops a policy for renewal. The working group decided to redraft the section discussing whether agents are required to comply with the information collection policies and the confidentiality and security policies of each insurer for whom they act as agent.

The working group discussed and approved the "Standards for Safeguarding Customer Information Model Regulation." This model regulation is in response to GLBA and will be sent to Executive Committee for approval.

As discussed in more detail below, the Privacy Notice Content subgroup reported that they have drafted sample language for privacy notices. Additionally, the idea of a consumer education bulletin was discussed in order to ensure that consumers had a reasonable expectation of the type of information they should receive.

Privacy Notice Subgroup

At the direction of the Privacy Issues Working Group, the subgroup is working to develop sample wording of privacy notices to be sent to policyholders and consumers. In drafting these sample disclosures, the subgroup adhered to the following parameters: (1) the subgroup will work within existing regulation, (2) the samples will include a series of alternative notices, (3) the subgroup will maintain flexibility and recognize the varying requirements for each state, (4) the subgroup will work to simplify language and develop a clear and inviting format, (5) work products will include a bulletin or circular letter that presents the alternative notices, a white paper that explains the privacy issue and a consumer education piece that describes privacy notices and consumer rights, and (6) companies that change the notices being used may not change their privacy policies (i.e., opt-in vs. opt-out)

The subgroup distributed a preliminary draft of sample notices for purposes of discussion and review by the subgroup and interested parties, which were drafted by a group of regulators, interested party representatives, consumer representatives, agent representatives and NAIC staff. Note that the sample notices included in the draft have not been adequately reviewed to determine whether they fully comply with state privacy laws and other privacy regulations. The preliminary draft was exposed for comment through April 19. After receiving all comments, the subgroup expects to meet in early May before providing a second draft at the Summer National meeting.

Consumer Protections Working Group

The working group adopted a resolution to act upon a list of proposed refinements to the recently deployed Consumer Information Source (CIS) computer website. The working group hopes to act

aggressively in completing these refinements by December 21, 2002. The proposed refinements include:

- Adding a disclaimer to the website indicating that the CIS is a work in progress, with individual states currently compiling and reporting complaint data to CIS in different manners. As such, in addition to utilizing CIS, users are encouraged to contact their state insurance department directly in order to determine the most up-to-date complaints information for their state. The disclaimer will emphasize that CIS is just one of many potential sources of information available to consumers.
- Investigating the validity of data in instances where “0” complaints are reported by individual companies within individual states. While “0” complaints may logically arise when a company does not write business in a particular state, there are instances where “0” complaints are reported by companies with significant business in a particular state.
- Assessing feasibility of using two years of complaint data within the CIS index rather than one year

In a separate motion, the working group agreed that states should report all complaints for use in CIS, regardless of ultimate resolution, until the Data Subgroup can determine if it is feasible to bifurcate, within the CIS index, “justified” complaints from complaints for which it is determined that a company did nothing illegal. After receiving a report from the Data subgroup, the working group will pursue additional input regarding the appropriateness of including all claims within the CIS index. Interested parties have consistently expressed a high level of concern in utilizing “non-justified” claims within the CIS index.

The working group then enlisted commentary on a previously released report on the effectiveness of insurance disclosures. This report has been posted to the NAIC website. Interested parties urgently requested that the working group work towards funding a research project to assess whether insurance disclosures are, in fact, giving consumers sufficient information to make educated insurance

decisions. The working group agreed to discuss the issue further.

Risk Assessment Working Group

The working group adopted a proposed 2002 work plan that outlines the steps and timelines as the working group develops the detailed components of the Enhanced Regulatory Risk Assessment Framework and lays the groundwork for implementation of the risk assessment process. This work plan will be revised during the year as issues arise. The primary steps in the work plan are as follows:

- Develop risk assessment form (risk matrix) by June 2002
- Plan a pilot examination to begin in September 2002
- Revise CPA Checklist by September 2002
- Develop insurer profile and handbook guidance by December 2002
- Develop a priority system for insurers by December 2002
- Discuss and prepare a report on confidentiality by September 2002
- Develop best practices for risk management by December 2002
- Plan a meeting with the AICPA at the Summer National meeting
- Revise examination and planning procedures based on results of pilot by January 2003
- Coordinate interaction between the risk assessment examination and financial analysis function by March 2003

As the working group moves toward developing the detailed components of a risk assessment framework, two risk matrix proposals were provided by the states of New York and Ohio. Several comment letters have been received on these two proposals and additional comments were received at the Spring National meeting. The working group would like to have more deliberation and guidance on these proposals and is also willing to consider other options or methodologies. An interim meeting will be scheduled in May. The working group also intends to discuss the risk assessment framework with Canadian and Great Britain regulators as these countries have recently migrated to a risk assessment approach.

Confidentiality Issues Subgroup

This subgroup of the Risk Assessment Working Group was formed to address confidentiality concerns of regulators and interested parties as they relate to the Enhanced Regulatory Risk Assessment Framework. Confidentiality issues need to be resolved prior to incorporating risk assessment techniques into the regulatory process. Major issues identified thus far include the following:

- Contemplate how risk assessment results can be shared among the states and with federal and international regulators
- Make recommendations as to the format of statutory examination reports
- Determine which states will evaluate an insurer group's risk management program when it has several companies domiciled in various states
- Analyze the amount of information that should be in the public domain as it relates to insurance regulation
- Consider the trade-off between disclosure and transparency, and
- Contemplate the need for penalties for the disclosure of non-public material information

These issues were summarized in a memo from the state of Connecticut. Interested parties responded to the Connecticut memo offering their comments on each of the respective issues. Some preliminary conclusions and other key observations are noted below:

- Risk assessment should be incorporated into the planning phase of an examination
- Current confidentiality laws are not standardized and several states do not have laws protecting financial analysis reviews. It may be advantageous to use a confidential management report to convey findings of the risk assessment process; this report could be shared with states having adequate confidentiality safeguards

- Information sharing agreements would be necessary to ensure confidentiality with federal regulators and international supervisors
- Lead states would be identified to complete the risk assessment for insurance groups with companies domiciled in multiple states
- Penalties for disclosure of non-public material information should be incorporated into the regulatory framework
- Interested parties would oppose both the use of consultants to perform the risk assessment and would oppose state regulators making risk management recommendations to insurers based on their experience with other companies

The subgroup intends to develop an action plan that will address all confidentiality issues identified by the subgroup and the interested parties. This action plan will be submitted to the Confidentiality Working Group that reports to the Executive Committee.

Examination White Paper Focus Group

The focus group of the Risk Assessment Working Group met to discuss comment letters received and the next steps to be taken in developing recommendations in a report form. Key comments supported by the focus group obtained from state surveys, consensus at previous meetings, and comment letters are summarized as follows:

- Zone examinations need to be significantly modified or eliminated, as the additional cost is significant compared to the resulting benefits.
- A uniform rating process should be established within the examination structure, as this would allow regulators to deploy resources to areas assessed as being higher risk. The Risk Assessment Working Group is currently addressing this issue.
- The guidance on the "retesting" of work performed by the insurer's independent auditors in the Examiners Handbook should be revised. This most likely would be a reduction of the current 20% re-performance standard currently in place.

- The focus group is supportive of the work being done by the Risk Assessment Working Group on the role of risk assessment in the solvency monitoring process.
- Improve efficiency, and in some cases lower the cost, of examinations by improving communication among regulators and auditors.
- Establish better training for staff performing the regulatory examinations.

The focus group plans to work on revising their recommendations between now and April, at which time the report will be exposed for the required 30-day period. It is hoped that final recommendations will be approved at the Summer National meeting.

The focus group concluded that three focus subgroups should be formed to meet the aggressive schedule outlined by the group. These focus subgroups will address the topics of cost, coordination with CPAs, and training and will consist of regulators as well as industry and AICPA representatives.

Financial Regulation Standards and Accreditation Committee

The committee met to discuss whether new accreditation standards contain substantive changes that therefore should be exposed for further comment. The committee voted to expose the following accreditation standards, which include changes from the previously adopted accreditation standards:

- Revisions to the Model Regulation to Permit the Use of Clearing Corporations and Federal Reserve Book-Entry System by Insurance Companies and the Revisions to the Financial Condition Examiners Handbook

The significant change is the requirement of notification if a custodial relationship is terminated or if a custodial balance is reduced to \$0. This is generally anticipated to be a reporting requirement for banks.

- Revisions to the Ceded Reinsurance Model Regulation and the Reinsurance Intermediary Model Act

New language has been incorporated into the Credit for Reinsurance Model Regulation that allows financial statement credit to be given for multi-beneficiary trust funds that are funded using letters of credit. The Reinsurance Intermediary Model Act was updated for changes resulting from GLBA.

- Revisions to the Actuarial Opinion Model Memorandum and Regulation

Companies will now be required to use a "Section 8" actuarial opinion as Sections 6 and 7 opinions have been eliminated, i.e. opinions not including an asset adequacy analysis. At this time there is no estimate as to the number of companies this may impact; however, it is anticipated that it would generally be the smaller companies that will be affected by this change.

The committee discussed minor proposed revisions to the Communication with States Standards confidentiality provisions that would standardize the language in all model laws and approved the language for review by Executive and Plenary.

International Accounting Standards Working Group

The working group discussed the status of the International Accounting Standards Board's Insurance Contracts Project. An IASB steering committee is developing a Draft Statement of Principles regarding insurance accounting and is posting individual chapters to the IASB web site as they are finalized. To date, eleven of thirteen chapters are available on the web site. The IASB will continue discussions on the Draft Statement of Principles, and tentatively plans to issue an exposure draft in late 2002.

The working group also received reports from interested parties with respect to the IASB's efforts to "clean-up" its core standards in preparation for use by the European Union. European Parliament has endorsed a proposal that all European Union

companies listed on a regular market report in accordance with a single set of accounting standards by 2005.

Members of the working group also noted that the IASC Board of Trustees has recently enacted changes to its constitution that will now allow the NAIC to attend meetings of the International Financial Reporting Interpretations Committee, thus giving the NAIC more direct access and input regarding IASB activity. The NAIC Executive Committee has approved a budget for the working group to become involved in this regard.

Suitability Working Group

The working group continues to work on the Life Insurance and Annuities Suitability Model Act and Model Regulation. As discussed at the Winter National meeting, the working group has made revisions to reflect the consensus. These changes, as well as those suggested in the four comment letters received, were discussed at these meetings in relation to the Model Act and Model Regulation.

After much debate, all references to “accredited investor” and “sophisticated purchaser” were stricken from the model regulation. It was determined that the language was originally intended to exempt those investors that did not require the protection that could be offered by this regulation, such as institutional investors. However, the accredited investor and sophisticated purchaser language that was added did not accomplish this objective. At issue was the fact that while an investor may be represented by an attorney or a CPA, the insurance agent was still the expert in this situation and should be held accountable for his or her sales recommendations.

Another area of discussion centered on the “work site” exemption as presented in Section 4F. It was noted that a similar exemption was included in the Small Face Amount Act as approved by the Life Insurance and Annuities “A” Committee. The working group voted to replace 4F as currently written with the language proposed by the ACLI that mirrors the Small Face Amount Act work site exemption.

Other noteworthy changes included the following:

- Language was added to guidance on sampling to emphasize that company oversight does not require reviewing every third party transaction.
- NASD language was added which indicates that a NASD review system currently in place may be deemed to be adequate for the purposes of this regulation; however, the commissioner has the authority to make the final determination.
- The effective date after passage of the model act and regulation was extended from 6 months to 18 months at the request of industry, as implementation is expected to be time consuming.

The working group voted to send the Model Regulation and Act to its parent committee, the “A” Committee for their consideration.

AVR/IMR Working Group

The interested parties continue to assess the impact of codification on AVR/IMR. No further changes to the AVR/IMR calculations were identified. However, through the course of discussion, the working group raised questions on the AVR treatment of replication transactions and deferred tax assets. Additionally, the working group forewarned that evolving discussions regarding the accounting treatment of collateralized obligations may impact the AVR calculation. The interested parties intend to take each of these questions and comments into consideration in their review.

Work continues to progress on a review of AVR factors aimed at determining the adequacy of factors based on experience. A similar review is being conducted on RBC factors and efforts are being coordinated. To date, the interested parties have obtained experience data compiled by rating agencies and determined the underpinnings used in originally establishing the factors.

The working group then discussed the “Blue Book,” which is intended to supplement AVR/IMR instructions and includes current and historical AVR/IMR guidance along with a question and answer section. The interested parties, who continue to work on an updated Blue Book, provided the working group with a very preliminary draft of the document. Using this draft, the working group

discussed the organization of the Blue Book and agreed that any historical guidance should be included as an appendix or attachment to the document.

Life Liquidity Risk Working Group

The working group is working to complete their public disclosure recommendation, the last remaining issue in their charge. This disclosure will likely require information to be provided in future annual or quarterly statements. The regulators considered two prototype disclosure requirements: one with relatively detailed disclosure by product type, and the other less detailed requirement that was proposed by industry. After much discussion, regulators opted for the less detailed version but with a limited amount of additional information. Regulators are expected to work with industry to develop a final version for adoption in June. If completed, it is not expected that the working group would require future meetings.

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

Because of budgetary issues, New York and New Mexico did not send representatives to this meeting. Since New Mexico chairs LHATF, the assistant chair from Arkansas ran the meetings. As a result, the meeting included regularly going around the table to ask each regulator to comment on specific topics, which was quite informative for the audience members.

The Fall National meetings have been rescheduled to start on Monday afternoon, September 9th in order to observe the Rosh Hashanah holiday. Normally LHATF meets during the two days immediately prior to the start of the NAIC meetings. In September, LHATF will meet on Monday afternoon and Tuesday. However, since many regulators will need to attend other meetings at the same time, a limited agenda for LHATF has been proposed for the Fall meeting.

Development of the New CSO Mortality Table

The American Academy of Actuaries has not completed their work at this time. They had expected to have their work done in plenty of time to present the new CSO mortality tables in June.

Other groups, such as the CSO Implementation Group, need to have the Academy's final tables before completing their work. It appears that the earliest the new mortality will be adopted by LHATF would be at the 2002 Fall National meeting, which could presumably be adopted by the NAIC in December.

A significant amount of work was completed on the CSO Mortality Table Model Regulation.

Discussions on deficiency reserves were lengthy and non-conclusive. LHATF requested that the Academy provide a recommendation on deficiency reserves at the June meeting. It is anticipated by regulators that the Academy will recommend an x-factor approach similar to what is in the Regulation XXX deficiency reserve requirements.

New York had made proposals regarding (1) the requirement of a Section 8 opinion if the 2001 CSO tables are used to report reserves, and (2) the requirement that companies using the 2001 CSO table for reserves be required to submit mortality data to the Society of Actuaries' mortality studies. Regulators generally favored the first but not the second proposal. However, since New York was not in attendance, neither proposal was voted on.

Additional discussions took place regarding gender-blended tables. Although the model valuation law does not allow the use of gender-blended tables for reserves, some states permit their use. Regulators are considering allowing companies the option of using simplified techniques to create these blended tables and not have specific gender-blended tables promulgated by regulation.

Non-forfeiture for Products with Secondary Guarantees

Proposed Actuarial Guideline XYZ will require the calculation of minimum non-forfeiture values for products with secondary guarantees that are the greater of those calculated under current requirements and additional values defined in the AG. The additional values would be calculated using cost of insurance rates that are consistent with the minimum premium requirements of the secondary guarantee. Industry representatives consider the guideline unnecessary and very costly to implement while providing policyholders only limited additional cash values. One industry representative testified that it would cost his

company "at least 7 figures" in systems modifications and product re-filing costs.

While regulators appear to have a strong dislike for secondary guarantees, they acknowledge that the need for this Guideline is not pressing. Regulators are still split on the need for this guideline. During recent conference calls, regulators agreed to make this AG optional at the state level. This would leave it up to the commissioner in each state as to whether that state should "adopt" the requirements of the guideline. The problem with this approach is that AGs are seldom adopted at the state level. No legislative or regulatory action is required for AGs. They are often referenced during examinations of life insurance companies or with other dealings with state regulators. The other issue with making this requirement optional is that it goes against the NAIC's goal of uniform regulations among states. When polled, the majority of the regulators indicated that they thought their state would not "adopt" this AG, if passed. In spite of this, LHATF voted to re-expose the revised version of the AG with the intention to adopt in June.

Variable Annuities with Guaranteed Living Benefits

Discussions continue regarding the retrospective reserve floor to be included in Actuarial Guideline MMMM. New York (and Connecticut) made some substantial last-minute proposed changes to the existing draft that appeared to trouble some regulators and the Academy. Since New York was not present at this meeting, a meaningful discussion did not take place. The Academy offered to discuss New York's concerns during an upcoming conference call. Many regulators agree that although the proposed AG MMMM is not perfect, they think it is adequate for their needs and are anxious to complete this project.

Issues Pertaining to Regulation XXX

LHATF discussed relatively minor changes to the proposed AG AXXX. This guideline is meant to clarify how certain products should be reserved for under Reg. XXX. The Academy presented some numerical examples that demonstrated no unusual reserving results under the requirements of AG AXXX. LHATF voted to expose the most recent draft once more with the intent of adoption by LHATF in Summer National meeting.

General Non-forfeiture Project

LHATF has been asked to recommend a permanent revision to the non-forfeiture requirements for individual annuities. With interest rates at fairly low levels, it has been noted that certain short-term annuity products have disappeared from the marketplace because of the underlying 3% non-forfeiture requirement. It was also noted that the NAIC is working with all states to make a temporary change in the individual annuity non-forfeiture requirements to reduce the interest rate from 3% to 1.5% through July 2004, at which time it would revert to the 3% requirement in the current law. Since this is a revision to the non-forfeiture law, state legislative action would be required to implement.

Because of the July 2004 expiration of the temporary relief, LHATF needs to fast track this part of the non-forfeiture project. In addition, LHATF needs to decide whether it should focus on the interest rate requirement only or look at the entire individual annuity non-forfeiture requirements. A brainstorming call has been scheduled for the last week in March to begin work on this project.

Possible Areas of Revision to the Standard Valuation Law

The Academy is continuing its work at looking at various alternatives including the use of simplified reserve requirements in conjunction with RBC requirements. They requested an hour of time in June to present their initial conclusions. In addition, the ACLI continues to push for LHATF to consider a revision to the Standard Valuation Law that would allow for a single actuarial opinion for all states based on the domiciliary state. The current ACLI proposal is narrower than the previous proposal in that it would only apply to the asset adequacy analysis. Regulators are skeptical as to how this would work but did remain open to exploring this at future meetings.

Reserves for GICs with Bailout Provisions

LHATF received no comments from regulators or industry with regard to this draft AG. LHATF voted to expose the current version with the intention to adopt in June.

Accident and Health Working Group

HMO/HMDI Reserves

Regulators, companies and other interested parties were requested to provide input into areas where inconsistencies were identified. Only two responses were received. One response from the Academy identified 3 areas with some inconsistencies: (1) treatment of premium deficiency reserves and gross premium valuations, (2) items to be included or excluded from unpaid claims liabilities, and (3) claim liability and claim reserve differences in SSAP 54 and SSAP 55. None of these were viewed to be significant. No controversial findings are expected as the subgroups plans to conclude their research by June.

Health Insurance Reserves Model Regulation

An issue was raised at the last meeting by an actuary from the Maine Insurance Department regarding disability claim reserves. Current requirements allow for companies to use their own claim experience, if credible, for claims less than 2 years old, or for group policies, 5 years with permission of the commissioner. The question raised is whether the regulation allows companies to use their own experience for periods after 2 or 5 years when calculating claim reserves for claims within the 2 or 5 year period.

Industry representatives testified that the language is clear in the model regulation and that no additional research is needed. They interpret the regulation to allow for a company's own experience for all future periods as long as the claim is still within 2 years of its incurred date (or within 5 years for group policies.) Regulators still want to poll companies to determine what current common practice is.

Credit A&H Reserves

SSAP 59, dealing with Credit Life and A&H reserves, allows three choices for calculating Credit A&H unearned premium reserves: the rule of 78, pro rata or the actuarial method. Many companies use the mean of the rule of 78 and pro rata, even though that is not one of the acceptable methods. The working group approved a motion to recommend a change in SSAP 59 to allow the use of the mean calculation, which will be forwarded to the SAP Working Group.

Rate Adequacy – Long Term Care Guidance Manual

This manual is being developed to assist regulators in dealing with LTC rate increases under the new LTC rate regulation. Several parties recommended some relatively detailed changes although none were particularly significant. A revised draft will be presented during an upcoming conference call. A June adoption is possible.

Long Term Care Reserving Requirements

A letter from a leading consulting firm to the A&HWG suggested that current LTC reserving requirements result in LTC reserve levels that are higher than necessary to maintain conservative statutory reserves for these products. The author of the letter was not in attendance so no discussions took place. Regulators did not seem interested in pursuing this issue.

Market Analysis Subgroup

This newly formed subgroup will be discussing ways in which to develop an annual market data analysis process that would create a system to allow for states to more effectively target resources on companies creating the greatest risk of harm to consumers. This could include the development and use of a "Market Conduct Annual Statement." A "preliminary discussion draft annual statement" was distributed at this first meeting of the subgroup, which will be used as a starting point for discussions.

The subgroup discussed the approach of work to meet its end product, which included identifying issues by the Summer National meeting, system design and construction by the Fall National meeting, implementation by the Winter/Spring National meetings and final results and measurement by the 2003 Summer National meeting. The subgroup also discussed the specific work plan of the subgroup, which identified auto and homeowners claims for P/C lines and underwriting, administration and death claims for life insurance and annuities as being given the first priorities.

Reinsurance Task Force

The task force held a "public forum" on the Availability and Affordability of Terrorism

Reinsurance on January 17, 2002. The purpose of the public forum was to gather evidence of the economic impact of the lack of terrorism reinsurance coverage and discuss regulatory response to any identified market disruptions. The public forum also discussed the availability and affordability of terrorism reinsurance from the primary life company perspective. Approximately 60% of America's workforce has group life insurance through their employer; there is no statutory requirement to force employers to provide coverage to their employees. The Intermediary Panel discussed issues and concerns facing insurance and reinsurance producers/brokers and the types of terrorism coverages currently being offered to the commercial market. Coverage for risks valued at less than \$500 million is currently available at an increased price. However coverage for risks greater than \$500 million is more difficult to obtain and can even reach five percent of the total insured value of the structure. With respect to the price of reinsurance coverage post-September 11th, the public forum discussed that the one area that has changed most dramatically is the amount of coverage that can be placed. The public forum also heard issues and concerns identified by industry analysts where between 23-32% of the global reinsurance industry capital was destroyed by the attacks of September 11th. S&P indicated that it might ask companies to allocate more capital to specifically address the terrorism coverage.

The task force received an update on the International Association of Insurance Supervisors Reinsurance Subcommittee's Mandate. The subcommittee's mandates are to:

- Finalize the "Draft Principles on Minimum Requirements for Supervision of Reinsurers by the Summer of 2002.
- Develop and recommend an IAIS standard on best practices on the supervision of reinsurers
- Promote and encourage training on supervisory issues related to reinsurance

The task force heard a report from interested persons concerning collateral requirements for reinsurance coverage using a working trust of credit for retrocessions. The interested parties, primarily US and alien reinsurance company representatives (on opposite sides of the issues) discussed the following:

- The Reinsurance Association of America report on "Alien Reinsurance in the U.S. Market – 2000 Data" which indicates that alien reinsurers comprise an increasing percentage of U.S. ceded reinsurance marketplace. The interested persons group agreed to continue to discuss the implications of the RAA report at its next meeting.
- An interested party representing alien reinsurance presented a proposal to recommend a reduction in the amount of required collateral to less than 100% when certain specific criteria are met. The consensus of the working group is that these and other technical issues need to be further addressed in much more detail
- The concept of amending the model law to permit the multiple beneficiary trust to be used as a "working trust" was discussed. The consensus of the interested persons that this area required further discussion of the issue.
- The interested persons will review the IAIS Draft Principles on Minimum Requirements for Supervision of Reinsurers and discuss the draft principles and present comments on them back to the task force at its Summer National meeting.

P/C Reinsurance Study Group

The study group received a report from its industry resource group which considered whether reinsurance accounting should be allowed for modeled trigger securitizations when there is a high correlation between the model and the actual losses of a company. The consensus of the resource group was that on the basis of the information provided in the Form B, the model trigger securitization does not meet indemnification as required by SSAP 62 and on that basis, is not eligible for reinsurance accounting. As a result the study group recommended that the modeled trigger transactions be evaluated as securitization transactions rather than reinsurance transactions. This recommendation was sent to the Emerging Accounting Issues Working Group.

The study group also received a report from the resource group concerning accounting for multiple cedant reinsurance contracts. The resource group

concluded that multiple cedant reinsurance contracts should be accounted for by cedants such that (a) the total amount of reinsurance recoverable claimed by the cedants does not exceed the amount of limit available under the multiple cedant reinsurance contract and (b) the reinsurance recoverable amounts should not be reallocated among the cedants after a cedant has filed a financial statement. Further, the resource group suggested increasing the annual statement disclosures to provide regulators more information about current multiple ceded reinsurance contracts. The study group will review these suggestions for more detailed annual statement interrogatories and revisit the disclosures at the Summer National meeting.

The resource group is currently reviewing a draft white paper entitled, "Reserve Guarantees and Related Reinsurance in a Business Combination," and will present their consensus views at the Summer National meeting. This white paper is in response to the interested parties' request to again consider allowing prospective reinsurance accounting for such reinsurance contracts. This treatment is allowed under GAAP but not SAP.

The study group received a report from its resource group regarding the accounting for finite risk reinsurance contracts. The resource group discussed whether additional statutory financial statement disclosures are necessary in light of the article written by Fitch entitled, "Insurance Losses Could 'Disappear' From Industry Totals." The article indicates that some insurers may be understating their exposure to loss from September 11th because of the effect of finite reinsurance contracts. The resource group concluded that within the Fitch Report it is difficult to determine US versus non-US reinsurers in the study group. The research group looked at the US reinsurers and concluded that with respect to risk transfer, under US SAP and GAAP standards there is no distinction between finite and non-finite reinsurance contracts. The resource group concluded that there is currently adequate financial statement disclosures in place for US regulators to evaluate the liabilities of US licensed insurers and reinsurers, and that nothing is contained in the Fitch report that would require additional statutory financial statement disclosures.

Casualty Actuarial Task Force

The task force addressed a prior internal technical question regarding the 2001 Statement of Actuarial Opinion regarding reporting of retroactive reinsurance reserves under the write-in item labeled "Retroactive reinsurance ceded or assumed." The task force clarified that the intention was to require an opinion only on the liability reported for assumed retroactive reinsurance reserves.

Upon a motion, the working group approved the reactivation of a previously existing subgroup focused upon insurance securitizations. The initial mission of the subgroup will be to assist, from an actuarial perspective, a new subgroup of the Insurance Securitization Working Group, which is reviewing procedures related to Protected Cell and Special Purpose Reinsurance Vehicles. The reformed subgroup of the task force would also be able to provide commentary on a recent white paper submitted to the Insurance Securitization Working Groups regarding hedging effectiveness.

After discussion with regulators and other interested parties, it was agreed that the recent NAIC/AICPA working group prohibition of indemnifications in audit engagement letters for insurance companies should be extended to actuarial engagement letters as well. The task force will draft proposed language to this effect, with the assistance of the AAA, and convey such language to the Actuarial Opinion Instructions Working Group for review.

Actuarial Opinion Instructions Working Group

This working group was formed to discuss structural changes that will be necessary to the Property/Casualty Actuarial Opinion as a result of Codification and other recent guidance.

During a January 2002 conference call, the working group discussed specific instances of insurer difficulties and whether the Statement of Actuarial Opinion was or could have been helpful in alerting regulators to the insurer's problems. The working group also reviewed results of a survey sent to member states of the Examination Oversight Task Force regarding the usefulness of the Opinion.

In a February conference call, the working group agreed to a basic structure, with exhibits, for the Opinion and its Instructions. The working group agreed that the Scope of the Opinion should not be expanded to require the appointed actuary to opine on each line of business separately, and that the Opinion should have a high level of consistency with Actuarial Standard of Practice (ASOP) 36.

The working group also discussed, without definitive conclusion, the following potential revisions to the Opinion: (1) disclosure of reliance on others in forming the Opinion, with a general feeling that disclosure should be required regarding reliance on others for reserves on pools and associations, (2) increasing the level of underlying loss data verification, (3) potential regulatory definition of materiality standards, (4) requiring a range of reasonable estimates and/or a point estimate, (5) premium deficiency reserves, and (6) confidentiality for the actuarial report

During its March 12 conference call, the working group reviewed and commented on the first draft of the revised instructions for the Property/Casualty Statement of Actuarial Opinion. Significant discussion regarding the first draft included further consideration of the definition of a "qualified actuary," ongoing commentary on appropriate disclosure of standards of materiality, and disclosure of potential volatility in reserves.

During their meetings in Reno, the working group distributed a redlined version of the proposed Opinion Instructions. The working group first discussed, amongst themselves, their own remaining commentary on the draft document. The attention of the working group was focused on the ramifications of using verbiage such as "material" and "remote" and "reasonable" within the Instructions, noting concern for potentially diverse interpretation of such terms amongst certifying actuaries.

The working group then opened the floor for discussion. The American Academy of Actuaries and other interested parties noted a high level of concern if the final revised Opinion Instructions document were to include required disclosure of the actuary's best point estimate and/or reasonable range provisions within the publicly filed Actuarial Opinion, or disclosure of the actuary's assessment of the likelihood for potential adverse deviation in

any greater detail than is already required by existing ASOPs. Interested parties also expressed concern for the verbiage in the current draft regarding IRIS ratio results.

During the discussions in Reno, considerable attention was given to the concept of strengthening the requirements for testing underlying loss data that is relied upon by the opining actuary. Proposed solutions include requiring the actuary to test data directly, or ensuring that external auditors' work on claims data is sufficient to meet the proposed standards for testing of actuarial data.

Interested parties provided further commentary on the feasibility of including range disclosure within the Opinion Exhibits, considering that actuaries often use multiple methodologies leading to multiple potential ranges.

The working group requested that interested parties submit their comments by April 2nd. The working group will consider such commentary, and continue their own review of the draft document during an April 9th conference call. The objective of the working group will be to finalize the revised Opinion Instructions in time for adoption by the Casualty Actuarial Task Force and the Blanks Task Force the Summer National meeting, which is a very aggressive timetable considering the significance of the proposed changes.

Underwriting and Reinsurance Pools Working Group

The working group met only in executive (closed) session in Reno. However, a summary of that meeting was made available at the Financial Condition (E) Committee and is further summarized herein.

The working group discussed regulator and staff comments related to a report entitled Regulation of Voluntary Accident & Health and Property & Casualty Underwriting and Reinsurance Pools. This report addressed and/or recommends the working group's positions on two primary issues:

- (1) evaluation of how pools' financial condition is monitored and whether any changes are needed, and

- (2) whether the accounting guidance for pools within the current Accounting Practices and Procedures manual is adequate.

The working group is not ready yet to expose this report, but they have reached a consensus on many of its recommendations. The working group will hold an interim conference call this spring with hopes of issuing the report for public review and comment by Summer National meeting.

Managed Care Organizations Working Group

During its two meetings at the Spring National meeting and two interim conference calls this winter, the working group continued its efforts toward revising the Health Maintenance Organization Model Act (HMO Model Act). Sections of the both the Draft Proposal on Downstream Risk and the draft model were reviewed and discussed by the working group with further discussions slated for future conference calls. The following tentative conclusions were reached:

- Registration of risk bearing entities - The working group discussed section 2A of the draft model, which requires that all risk bearing entities register annually with the commissioner. The working group agreed that some states may want to consider an exemption from the registration requirements for a provider group that enters a mutually exclusive contract with a traditional dedicated group model HMO.
- Enforcement against risk bearing entities – The working group agreed that it was not necessary for the commissioner to take action against an HMO if the risk bearing entity does not comply with the act because the draft proposal imposes procedural requirements only.
- The working group agreed to maintain the definition of “discontinuance” in the section regarding open enrollments and replacement coverage to ensure that the section relates to HMO insolvency situations only.
- The working group directed NAIC staff to review the NAIC Model Law on Examinations to

determine what provisions in this section, if any, could be eliminated by cross-referencing that model.

During these meetings, the working group reviewed recommendations from interested parties and written comments from the Blue Cross/Blue Shield Association. Due to time constraints, Sections 25-43 were not discussed during the Spring National meeting and were tabled for a future conference call.

The next National meeting of the NAIC will be held in Philadelphia June 8-11. 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.pwcglobal.com. Please provide any email change of address information to 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.