



NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS

NAIC 2006 SUMMER NATIONAL MEETING

The National Association of Insurance Commissioners held their 2006 Summer National Meeting in Washington DC June 10-13. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

Executive Summary

- At their Executive and Plenary sessions, the Commissioners adopted two NAIC Resolutions and ten new or revised model regulations, including revisions to the Model Audit Rule to adopt certain provisions of Sarbanes-Oxley. (page 3)
- The Statutory Accounting Principles Working Group approved as final a new statutory accounting principle, SSAP 94, Accounting for Transferable State Tax Credits, and a new Issue Paper 128, Settlement Requirements for Intercompany Transactions, which would require specific due dates for intercompany receivables and nonadmission of amounts over ninety days past due. The working group also exposed for comment or added to its agenda several important issues: SSAP 95, Exchanges of Nonmonetary Assets, FASB FSPs on disclosures of other-than-temporary impairments of assets, consideration of FAS 123 (R) on share-based payments, proposed changes to accounting for guaranty fund assessments, and gain recognition on sale/leaseback transactions involving real estate. (pages 3-5)
- The Emerging Accounting Issues Working Group finalized three Interpretations including guidance on accounting for revenue from the sale of claims data. The working group also reached a tentative conclusion that the guidance in INT 02-21, Accounting for Prepaid LAE and Claim Adjustment Expenses, should apply to non-capitated managed care contracts. (pages 5-6)
- The NAIC/AICPA Working Group summarized the recently adopted changes to the Model Audit Rule noting that the effective date of all provisions was extended to 2010. The working group also reported on the status of the Implementation Guide to assist insurance companies in adopting the revisions to the Model Audit Rule, which is expected to be adopted as final later this year. (pages 6-8)
- During one of the more controversial, and well attended, meetings of the conference, the Valuation of Securities Task Force continued to discuss the classification of certain "new generation" hybrid securities that contain components of both debt and equity. At the conclusion of NAIC meeting, including additional discussion at the meeting of the Financial Condition Committee, the regulators voted to hold a special joint meeting of the Valuation of Securities and the Capital Adequacy Task Forces to consider whether these hybrid securities merit a lower RBC charge than the current 30% charge for common stock. (page 8-9)
- The Capital Adequacy Task Force approved a proposal from its Life RBC Working Group, effective for 2006, to expand C-3 Phase I interest testing to all companies that perform an asset adequacy analysis, over the objections of several interested parties. The P/C RBC Working Group heard a report from its

Catastrophe Subgroup regarding its progress on a project to determine the appropriate treatment of catastrophe risk. The Life Risk-Based Capital Working Group adopted changes to the 2006 RBC instructions regarding the treatment of the modco dividend liability in the total capital calculation for RBC. (pages 9-10)

- The Risk Assessment Working Group discussed adoption of the Revised Risk-Focused Guidance for inclusion in the NAIC *Financial Condition Examiners Handbook*, and agreed with the request of interested parties not to send the guidance to the Financial Condition Committee until September to allow additional time for the working group to resolve certain concerns of interested parties. The deferral should not delay the implementation of the guidance at January 1, 2007. (pages 10-11)
- The Blanks Working Group adopted 12 new proposals that revise the annual statements and instructions that affect 2006 and 2007 statements and exposed 23 new items for comment. New guidance adopted includes the clarification (approved under the emergency procedures) that the confidential filing referred to as the Actuarial Opinion Summary should not be filed with the regular Actuarial Opinion, nor should it be filed with the NAIC. (page 11)
- The Life Insurance and Annuities (A) Committee held its second public hearing on proposed amendments to the Viatical Settlement Model Act to address concerns about "investor-initiated life insurance." One proposal being considered by the committee is a prohibition on the settlement of a policy, with certain exceptions, within a specified period of time, such as five years. (page 12)
- The Life and Health Actuarial Task Force continued its work on the principles-based reserving project and has preliminarily concluded that the initial approach will be prospective only, which is a significant change. Progress has been made on interim proposals relative to the New Valuation Standards from the ACLI, and the task force voted to expose for comment revisions to Actuarial Guideline 38 and a proposed model regulation that would permit the use of preferred mortality tables for use in determining minimum reserve liabilities. The task force also exposed a revised version of VACARVM for comment that includes a revised effective date of December 31, 2007. (pages 12-13)
- At its meeting in Washington DC, the P/C Reinsurance Study Group reviewed the results of the 2005 filings of finite reinsurance interrogatories and agreed to an increase in the disclosure threshold from 3% to 5% of policyholders' surplus, ceded premium or ceded loss and loss adjustment expense. The study group also noted the release of the FASB's Invitation to Comment entitled Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting. The study group noted that it plans to comment to the FASB on this issue. (pages 14)
- In connection with its consideration of possible changes to U.S. collateral requirements, the Reinsurance Task Force adopted a motion that all interested parties group should focus "primarily" on the Rating Proposal from the Ad Hoc Reinsurance Regulatory Roundtable. The proposal would create an organization called the Reinsurer Rating Organization, which would rate the financial strength of reinsurers doing business in the United States. (page 14-15)

Executive Committee and Plenary

The Commissioners adopted the following new or revised models and white papers:

- Senior Protection in Annuity Transactions Model Regulation
- Life Insurance and Annuities Replacement Model Regulation
- Variable Annuity Model Regulation
- Health Policy Rate and Form Filing Model
- Reinsurance Intermediary Model Act
- Credit for Reinsurance Model Regulation
- Actuarial Guideline ABC - Project of Guaranteed Nonforfeiture Benefits under CARVM

Adoption of Revisions to the MAR

The commissioners adopted the proposed changes to the Model Audit Rule to incorporate for insurers best practices from Sarbanes-Oxley on governance, audit committees and internal control. The commissioner from Virginia, which chairs the NAIC/AICPA Working Group, noted that the process to consider provisions from Sarbanes-Oxley was an open one which lasted more than three years and included at least six official Exposure Drafts, fifteen meetings at NAIC National conferences, seventeen conference calls and six interim meetings. The vote to adopt the revisions was nearly unanimous, with only Utah and a few other states voting no.

NAIC Resolution

During Executive and Plenary, the commissioners adopted two new resolutions after significant discussion: Resolution of the NAIC Calling for the Creation of a National Commission to Study the Issues Pertaining to the Nation's Health Care Crisis and make Recommendations and a Amended Resolution in Support of a Comprehensive Legislative Solution to the Problems Presented by Natural Catastrophic Exposure for the Benefit of all Americans.

Formation of Executive Working Group

The commissioners approved the formation of a new working group reporting directly to the

Executive Committee: Executive Working Group on Principles-Based Reserving and Charges. The working group will be chaired by North Dakota and Virginia.

Election of NAIC Secretary-Treasury

At their meeting in Washington, the Commissioners unanimously elected New Hampshire Insurance Commissioner Roger Sevigny as Secretary-Treasurer to replace the retiring former Secretary-Treasurer Eric Serna of New Mexico.

Broker Activities Task Force

The task force held a brief open session in Washington DC before going into a regulators-only session. During that time, the task force discussed that regulatory settlements had been reached in cases against Marsh & McLennan, Zurich, and Aon. Interested parties questioned whether the more extensive consumer protection disclosures were necessary. The task force requested that any concerns from interested parties be expressed in writing.

Financial Condition (E) Committee

As discussed below in the summary of the Valuation of Securities Task Force, the committee voted to have the task force and the Capital Adequacy Task Force hold a joint public hearing in July in New York to discuss the appropriate RBC charge for hybrid securities. The goal is to resolve this issue by Winter National Meeting.

Statutory Accounting Principles Working Group

Public Hearing

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

SSAP 94, Accounting for Transferable State Tax Credits

– The working group voted to adopt this SSAP as final. There were no comments during the public exposure period and the SSAP is effective December 31, 2006 with earlier adoption permitted. The guidance establishes that transferable state tax credits are classified as admitted assets and valued at cost, less any impairment.

Amendments to Appendix A-010 and SSAP 59, Credit Insurance – The working group voted to adopt changes to Appendix A-001, Minimum Reserve Standards for Individual and Group Health Insurance Contracts, to reflect recent changes to the model. Conforming changes are also proposed to SSAP 59. These changes were also approved by the Accident and Health Working Group. No comments were received during the public exposure period.

Issue Paper 128, Settlement Requirements for Intercompany Transactions, An Amendment to SSAP 25 – The working group exposed this new issue paper in March; it was drafted to address the lack of an aging requirement for receivables from affiliates and other related parties. At its meeting in Washington DC the working group adopted the issue paper and directed NAIC staff to draft an SSAP. The proposed effective date is for periods beginning on or after January 1, 2007; interested parties had asked that a later effective date be provided to allow insurers to draft amendments to intercompany agreements and regulators enough time to review the agreements. The working group did not extend the effective date but committed to reviewing the revised agreements on a timely basis. NAIC staff was also directed to consider adding guidance regarding the filing requirements with domiciliary states.

Review of New GAAP Guidance – The working group reached a final conclusion to reject the following newly issued U.S. GAAP guidance as not applicable to or inconsistent with statutory accounting:

- FAS 151, Inventory Costs, an amendment to ARB 43
- FAS 154, Accounting Changes and Corrections of Errors
- FIN 47, Accounting for Conditional Asset Retirement Obligations
- SOP 03-4, Reporting Financial Highlights and Schedule of Investments by Nonregistered Investment Partnerships
- FSP FAS 141/142-1

Disclosure of Supplemental Information within the Annual Audited Report – The working group voted to expose for comment a nonsubstantive change to SSAP 1 to refer to the annual statement instructions for life and health insurers to scope into the audited financial statements the Selected Financial Data. There is currently no reference in

any of the SSAPs to these required supplemental schedules.

Amendments to SSAP 1 and Appendix A-205 – The working group voted to adopt nonsubstantive changes for comment related to the disclosure requirements of the effect on risk-based capital when either a permitted practice or prescribed practice that differs from NAIC prescribed is used by a company.

The change also amends the example footnote in Appendix A-205, Illustrative Disclosure of Differences Between NAIC Statutory Accounting Practices and Procedures and Accounting Prescribed or Permitted by the State of Domicile.

In response to a comment from the chair of the Capital Adequacy Task Force that oversees RBC, the chair of the working group noted that this revision is disclosure only and does not pre-empt state regulatory authority.

Appendix A-588, Modified Guaranteed Life Insurance - The working group adopted as final an amendment to A-588 to document that although this model law has been deleted by the NAIC through its review of all current model laws and regulations, A-588 will be maintain in the Accounting Practices and Procedures Manual because of its reference in SSAP 80.

SAP Maintenance Agenda Discussion

All issues exposed for public comment have a comment deadline to NAIC staff of August 14, with a public hearing at the Fall National Meeting.

SSAP 95, Exchanges of Nonmonetary Assets, A Replacement of SSAP 28, Nonmonetary Assets – The working group exposed this new SSAP for comment, based on Issue Paper 128 of the same name. The guidance adopts FAS 153 on exchanges of nonmonetary assets with some modifications.

FASB FSP 115-1 and FAS 124-1, The Meaning of Other-than-Temporary Impairment and Its Application to Certain Investments – The working group voted to expose FSP 115-1 and FAS 124-1 for comment with respect to the OTTI disclosures. During the related discussion, it was noted that the valuation and impairment issue addressed in the GAAP guidance has not been ruled out for discussion but that will occur at a subsequent meeting. If the GAAP guidance is later rejected, it would be very helpful of the SAP Working Group to

enumerate how SAP differs from GAAP when determining and measuring impairment of these securities.

Proposed Appendix to SSAP 88 – The SSAP 88 Subgroup, formed to address implementation issues of SSAP 88, has met several times in nonpublic meetings since the Winter National Meeting and at the meeting of the working group, the subgroup's Implementation Questions and Answers was distributed and released for comment. The Q&A includes answers to 15 issues; many of the questions related to the audit requirement under various scenarios. One frequently asked question raised in part by the wording in paragraphs 8 and 18 of SSAP 88 is whether a GAAP audit at the holding company parent of the insurer meets the audit requirement of downstream subsidiaries of the insurer. The answer per the Implementation Guide is no; the audit must be performed at a level below the insurance company.

Consideration of FAS 123(R) Share-Based Payments - The working group voted to add this issue to its active agenda and directed NAIC staff to draft an issue paper to replace SSAP 13, Stock Options. No tentative conclusions were discussed during the meeting. However, the Form B prepared by NAIC staff includes the following: "NAIC staff considers the optionality of FAS 123 to be an additional reason by FAS 123 was rejected. FAS 123(R) now eliminates the optional accounting treatment by requiring recognition of compensation expense for all employee services received in share-based payment transactions using a fair-value-based method. As a result, this statement recognizes transactions that affect the issuer's reported financial condition and results of operations that previous guidance and guidance adopted in SSAP 13 fails to capture."

Modification to SSAP 35 for Property and Casualty Assessment – The working group briefly reviewed a Form A from interested parties to amend SSAP 35 which proposes that the accrual for assessments such as for guaranty funds be based on premiums as they as written using on assessments rates provided by the National Conference of Insurance Guaranty Funds. No conclusions were reached, but the working group formed a subgroup to hold additional discussions.

Accounting for gain or loss on sale of real estate included in a sale leaseback transaction - The working group is again addressing sale leaseback

accounting in SSAP 22. NAIC staff noted they have received many questions on the issue of whether the intent of SSAP 22 is to allow gain recognition when there is a sale leaseback of real estate. One regulator stated that he is comfortable in allowing gain recognition because the insurer has received the cash; however, the chair noted the working group needs to consider whether they should adopt a conclusion less conservative than GAAP. The working group added the issue to its active agenda and will discuss the issue again in September.

Report of the Bail Bond Subgroup - The subgroup reported that they have had two meetings to discuss how bail bond and immigration bond premiums should be accounted for and reported. The subgroup plans to hold additional meetings to consider whether the two products should have different accounting.

Referral from CATF on Intercompany Pooling - The working group agreed to address several issues posed by the Casualty Actuarial Task Force including the following:

- What is the interpretation of the definition intercompany pooling per SSAP 63?
- Is there a minimum amount of participation in the pool required?
- Does 100% cession to the pool with 0% participation qualify as intercompany pooling?
- Does the use of intercompany pooling allow for the exchange of surplus among companies without having to go through the dividend process?

INT 03-17 disclosure to SSAP 55 – The working group held a conference call with the Casualty Actuarial Task Force to discuss proposed changes to SSAP 55 to require disclosure of claims or losses related to extra contractual obligation lawsuits. During the conference call the groups agreed to withdraw the current Blanks proposal (2005-55BWG) and submit a revised proposal, probably sometime during the third quarter of 2006.

Emerging Accounting Issues Working Group

At its meeting in Washington DC, the working group reached a final consensus on the following issues:

INT 00-26, Amendment Resulting from the Issuance of FAS 153 – The working group adopted as final proposed changes to INT 00-26 to conform the guidance to FAS 153 from the current APB 29 guidance included in the INT.

INT 06-01, Accounting for Revenue as a Result of the Sale of Claims Data to a Pharmacy Benefits Manager – The working group revised its tentative consensus that this revenue to health entities should be classified as a reduction of claims expense: the new guidance requires such revenue to be classified as other income. The Form B notes that such claims data sold is used for pharmaceutical and medical research purposes and has been "scrubbed" of personal information.

INT 06-03, ETIF 04-6: Accounting for Stripping Costs Incurred during Production in the Mining Industry and INT 06-04, EITF 04-13: Accounting for Purchase and Sales of Inventory with the Same Counterparty – The working group confirmed its tentative conclusions as final to reject these two FASB EITFs as not applicable to statutory accounting.

The working group then discussed new and outstanding issues; all new and revised exposed issues have a comment deadline of August 14, 2006.

INT 06-02, Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) – The working group had previously reached a tentative conclusion that the accounting for investments in CAPCOs should be based on the accounting for the underlying investment, such as bond, common stock, preferred stock, limited partnership, etc. Such guidance is considered necessary since CAPCOs have been excluded from the scope of SSAP 94. At its meeting in Washington, the working group voted to add guidance related to the tax credits received by the entity. The INT was then re-exposed for comment.

EITF 04-7: Determining Whether an Interest in a Variable Interest in a Potential Variable Interest Entity - The working group reached a tentative consensus this EITF as not applicable to statutory accounting. Note that FIN 46, Variable Interested Entities, has been previously rejected by the SAP Working Group.

EITF 00-12: Accounting by an Investor for Stock-Based Compensation Granted to Employees of an Equity Method Investee - The working group voted

to expose as a tentative consensus adoption of this EITF with modifications.

Liability for Claim Adjustment Expenses for Managed Care Contracts under INT 02-21: Accounting for Prepaid LAE and Claim Adjustment Expenses - This INT was issued in 2002 and excluded all managed care contracts and that a separate INT would be issued to address those contracts. The Accident and Health Working Group recently recommended that INT 02-21 be applicable to non-capitated managed care contracts and that managed care contracts which include capitation payments should be excluded from INT 02-21. The EIAWG voted to expose that recommendation as its tentative consensus.

NAIC/AICPA Working Group

Final Adoption of the MAR

The working group began the meeting in Washington DC by reviewing activity with respect to the Model Audit Rule (MAR) by other committees since the March National Meeting. The chair noted that Financial Condition Committee had approved proposed changes to the MAR after a day long public hearing on May 11 and a follow up conference call on May 18. As discussed on page 3 of this Newsletter, the Commissioners adopted the changes to the MAR as final at their Executive and Plenary session bringing three years of work to completion.

Some significant changes to the MAR were made as a result of the public hearing last week and are as follows:

- The effective date for the Management Report on Internal Control over Financial Reporting was extended by one year to December 31, 2010.
- The premium thresholds that trigger the requirement for independent audit committee members was increased from \$100 million to \$300 million, based on "prior year calendar assumed and direct premiums." The threshold for a majority (more than 50%) of independent audit committee members increased to \$300 - \$500 million. The requirement for a supermajority of independent audit committee members was raised to \$500 million.

- The effective date for the revised audit committee requirements was extended to January 1, 2010. These include: (1) assignment of an audit committee to each legal entity, (2) requirement that audit committee members be members of the board of directors, and (3) requirement for independent audit committee members.
- The revised partner rotation requirements, which require the lead partner to rotate after five years of service in that capacity, and remain off the engagement for at least five consecutive years following, will be effective 2010 statutory audits and thereafter.

During the May 18 conference call, there was much discussion about state regulators having discretion to provide an exemption from certain requirements of the MAR. The committee ultimately voted to adopt the following wording: "Upon written application of any insurer, the commissioner may grant an exemption from compliance to any or all provisions of this regulation if the commissioner finds, upon review of the application, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer." To ensure that notice is provided to non-domiciliary insurance departments when an exemption is granted, the Financial Condition Committee adopted a referral to the Blanks Working Group that would require disclosure in the annual statement when a company has obtained an exemption.

There are two important provisions in the adopted MAR that merit additional discussion. The MAR introduces the concept of "group of insurers" which is more than one affiliated insurers that may be considered as a group for purposes of assessing the effectiveness of internal controls. In addition, one audit committee may oversee the accounting and financial reporting of the group of insurers. In those instances, a separate management report on internal controls and separate audit committee would be not required for each legal entity insurance company. However, the premium thresholds for these requirements would still apply at the legal entity insurance company. This effectively would reduce the number of insurance companies to which the new requirements will apply since the thresholds apply at the individual, not group, level.

The changes to the MAR also introduce a new concept called "SOX Compliant Entity," which is defined as follows:

"SOX Compliant Entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002: (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934); (ii) the Audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

Sox Complaint Entities and any wholly-owned subsidiaries of a "Sox Compliant Entity" would be deemed exempt from any MAR separate company requirements, including the audit committee requirements, as any such insurer would be substantially in compliance by virtue of its status under Sox. In addition, for purposes of the Management Report of Internal Control Over Financial Reporting, a "Sox Compliant Entity" may file its parent's Section 404 Report and an addendum stating that "those internal controls of the insurer or Group of insurers having a material impact on the preparation of the insurer's or Group of insurers' audited statutory financial statements were included in the scope of the Section 404 Report."

Implementation Guide

After a review of important recent events, the regulators then had a short meeting of the Title IV Subgroup, which is working with interested parties to complete the Implementation Guide for the MAR. The Implementation Guide is being developed to assist insurers and regulators in understanding and implementing the changes required by the MAR. Significant guidance was made on the Implementation Guide during a day-long meeting on May 23 in Philadelphia and both substantive and non-substantive changes were integrated into the Guide. At its meeting in Washington, the chair of the subgroup delineated the timetable for the summer: NAIC staff will "take back" the Implementation Guide currently being edited by interested parties and make minor, mostly conforming, edits. A revised draft will be distributed to interested parties by June 30. A conference call of the subgroup and the

NAIC/AICPA Working Group is scheduled for July 24 during which the Guide will be exposed for a 30 day comment period. The working group anticipates approving the Guide for review by its parent Financial Condition Committee at the Fall National Meeting with final approval at the Winter National Meeting.

Maintenance Process

The working group noted that at its next meeting it will begin discussing "next steps" since adoption of revisions to the MAR, including the process to maintain the requirements, consideration of an index for inflation for the premium threshold and the annual review process of the appropriateness of the premium threshold number. The working group also noted that NAIC staff will be drafting a letter to states that require the current MAR by adoption of the annual statement instructions. Since the new revisions to the MAR will not be incorporated into the annual statement instructions, the letter will remind those states that they will need to adopt the revisions by regulation or law.

Update from the AICPA

The working group heard a short update on AICPA projects that may affect state insurance regulators. A representative from the AICPA noted that the Auditing Standards Board recently issued Statement on Auditing Standard No. 112, Communication of Internal Control Matters. SAS 112 replaces SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit*. This SAS is effective for periods ending on or after December 15, 2006. Note that SAS 60 is adopted in the current MAR as the standard for reporting on internal controls to state insurance departments.

Valuation of Securities Task Force

At the 2006 Summer National Meeting, the Valuation of Securities (VOS) Task Force held a standing room only meeting to discuss the classification of certain "new generation" hybrid securities that contain components of both debt and equity (a more detailed discussion as to the types of securities being referred to as hybrid securities is available at the following link: http://www.naic.org/documents/svo_ReportOfSVO_ClassDeterminationsNum1.pdf). A majority of the ninety minute meeting was consumed by this issue.

In the past, insurance companies classified these hybrid securities as debt due to their generally high rating by Moody's and/or S&P (often A3 or A-, respectively) and accordingly, were assigned a NAIC 1 rating. Being rated by an approved rating agency resulted in the securities being exempted from filing with the Securities Valuation Office (SVO).

In the fall of 2005, the New York State Department of Insurance instructed an insurer to file one of these securities with the SVO. In March 2006, the SVO concluded that the security should be classified as common stock by the ten insurance companies owning the investment. The most significant impact of the SVO's decision was on the insurance companies' Risk-Based Capital (RBC) computation, as investments in common stock are assessed a significantly higher RBC charge than investments in debt securities (for life insurers the charge is .4% for NAIC 1 rated debt compared to 22.5% to 45% for common stock, depending on the weighted average beta of the common stock portfolio). As the insurance companies classified the securities as debt for RBC purposes when they were purchased (i.e., they did not contemplate the higher charge and therefore likely did not purchase the security understanding they would be classified as common stock), interested parties (including investment banking firms) have questioned the proper treatment of the securities on a go-forward basis.

At the meeting, the VOS Task Force discussed whether investments in these hybrid securities should be classified as common stock for RBC purposes or whether to provide a grandfathering provision for all hybrid securities purchased prior to the meeting. Ultimately, the VOS Task Force agreed to (1) discuss the issue in further detail on a conference call in the future and (2) "hold in abeyance" any new ratings of hybrid securities until the issue is resolved later this summer.

However, the Financial Condition (E) Committee, the parent committee of the VOS Task Force, reversed the decision, allowing the Securities Valuation Office to continue to determine and release the classification for these hybrid securities (i.e., the process of the SVO will not be interrupted). One marketplace participant believed that the decision reached by the committee introduces "regulatory event risk" into the market, as the value of a specific security may immediately

decrease after the publishing of an unfavorable classification decision by the SVO.

Additionally, the committee requested that the VOS Task Force and the Capital Adequacy Task Force continue to discuss the issue and make a recommendation as to the proper treatment of hybrid securities for RBC purposes (such as lowering the RBC charge). A public hearing in New York is expected to be held in July, with subsequent conference calls, to resolve the issue in time for year-end 2006 Annual Statement filings.

Many interested parties expressed the concern that insurance companies will have to put a "hold" on buying hybrid securities until the issue is resolved, due to the current uncertainty of the securities' impact on RBC. On June 14th, the SVO released its classification decisions on eight additional securities. A summary of those decisions is available on the NAIC's website: http://www.naic.org/documents/SVO_ReportOfSVOCClassDeterminationNum2.pdf

In addition to the discussion on hybrid securities, at the Summer National Meeting, the VOS Task Force agreed to the following:

- To reconstitute the Invested Asset Working Group in order to review a number of issues currently before the VOS Task Force.
- To recommend to the Investment Schedules Subgroup that foreign exposure should be uniform across the states and the definition of foreign investment contained in the Defined Limits version of the NAIC Invest of Insurers Model Act be adopted.

Other topics on the agenda not addressed but which will be discussed at a future conference call include proposed accounting and impairment guidance for SSAP 43 on principal-protected structured securities and a report from the Derivatives Market Study Group, which held a lengthy conference call on May 18.

Capital Adequacy Task Force

As discussed below, the task force adopted a proposal to expand C-3 Phase I interest testing to all companies that perform the asset adequacy analysis, over the objections of several interested parties and trade associations.

The task force heard an update from the C-3 Phase II Results Subgroup, which has developed a "plan of attack" for reviewing companies. Five companies had been selected for a more detailed review. No final timeline for completion of the project was decided upon. A more detailed report is expected at the Fall National Meeting.

Life Risk-Based Capital Working Group

Expansion of C-3 Phase I

The Life Risk Based Capital Working Group voted to adopt changes that would expand C-3 Phase I interest testing to apply to all companies that are currently required performing asset adequacy analysis for some annuities and single premium whole life type policies. The change will be effective for year end 2006. Under prior RBC requirements, only companies who fail one of two tests regarding interest rate risk or capital levels are required to do the C-3 Phase I cash flow testing. The ACLI continued to ask regulators what problems they are seeing that they are trying to address with this additional requirement and appeared unsatisfied with the regulator's answer. Others from industry questioned why the Life RBC Working Group would consider passing this change without first understanding the impact of the change. Despite these objections, working group unanimously adopted these changes. Interested parties again raised these objections at the Capital Adequacy Task Force meeting the next day, but again, no change was made.

ModCo Dividend Liability

The working group adopted changes to the 2006 RBC instructions regarding the treatment of the modco dividend liability in the total capital calculation for RBC. More permanent changes, to be effective for 2007, were exposed during an interim conference call and the exposure period for these changes is still open. The 2007 changes will be addressed either during a future call or at the Fall National Meeting.

C-3 Phase II Update

The working group adopted changes to the Life RBC instructions for 2006 to clarify and correct some of the implementation problems that companies experienced in 2005.

C-3 Phase III

A brief report was made by the Academy indicating that work has progressed on a life insurance version of the C-3 stochastic analysis requirements and that a framework is expected to be completed

by year-end 2006. An interesting discussion took place regarding LHATF's decision to apply PBA for reserves for new business only while RBC requirements typically are applied to an entire block of in force business.

Other Items

The working group voted to request the Capital Adequacy Task Force to add a new charge to the working group agenda. The new item was to review the cap, floor and scenario generator for the current C-3 Phase 1 calculation as well as the current interest rate risk factors. The working group was also asked to increase the priority of its current charge regarding unauthorized reinsurance.

P/C Risk-Based Capital Working Group

The working group met in Washington DC and approved revised loss reserve factors for the 2006 formula, which are updated annually. The working group also heard a report on the results of the 2005 RBC filing. No adverse trends were noted for P/C companies, and the percentage of companies at an action level has decreased slightly. However, it was also noted that a significant number of companies at action levels (twenty-three companies) are risk retention groups.

The working group also met via conference call on March 28 to review the progress of the Catastrophe Risk Subgroup, which is evaluating the possibility of developing an RBC charge for catastrophe risk and using catastrophe modeling to develop the RBC charge. The chair of the subgroup has noted that CAT risk is the "one major risk that is not being explicitly or effectively factored into the RBC formula."

The subgroup has asked the P/C RBC Committee of the AAA to accomplish the following: 1) report to the subgroup on the catastrophe risk charges included in the capital requirements of other countries and those used by rating agencies and 2) recommend a procedure to remove the CAT loss and premium from the current RBC formula so that the CAT risk is not double counted in the formula.

The chair of the subgroup summarized the anticipated project plan:

- The subgroup must decide which risks should have RBC charges risks, which risks would be

included in a second phase and which risks do not need to be included.

- The subgroup will also need to evaluate whether modeling will work to develop the charges and
- If modeling will work, how to incorporate the CAT risk charges into the formula

The meeting ended by discussion of the immediate next steps which are to wait for the AAA report discussed above, discuss observations on the suitability of various models and alternative approaches to validating the models.

Risk Assessment Working Group

Since the 2006 Spring National Meeting, the working group met via conference call for two meetings. The following summarizes the significant conclusions reached and the current status of issues being deliberated by the working group:

Revised Risk-Focused Guidance for Inclusion in the NAIC *Financial Condition Examiners Handbook*

The working group discussed whether to adopt the Revised Risk-Focused Guidance for inclusion in the NAIC *Financial Condition Examiners Handbook*. The working group agreed with the request of interested parties not to send the guidance to the Financial Condition (E) Committee for another quarter in order for the working group to resolve certain concerns of interested parties on the proposed guidance. In discussing the next steps, the working group agreed that the Handbook Revisions Subgroup would conduct an open interim meeting in order to allow interested parties an opportunity to further comment on their outstanding issues. Additionally, the working group discussed that its intent and desire is to adopt the revised risk-focused surveillance during the third quarter of 2006; therefore, the deferral should not delay the January 1, 2007 effective date of the guidance.

Accreditation and Transition Recommendations for the Revised Risk-Focused Guidance

The working group discussed four recommendations from the Implementation Subgroup on accreditation and transition. The working group agreed to defer consideration of these recommendations until the Fall National Meeting. Specifically, the Implementation Subgroup recommended that the working group:

- Convey that the proposed risk-focused surveillance process revisions are significant when communicating these changes to the Financial Regulation Standards and Accreditation (F) Committee.
- Not request a waiver of procedure to accelerate the accreditation timeline to require the use of the revised risk-focused surveillance process.
- Allow states to utilize the approach as soon as the approach is initially adopted by the working group, the Financial Condition Committee, and Executive and Plenary.
- Include the Risk-Focused Surveillance Process within the 2007 Release of the NAIC *Financial Condition Examiners Handbook* and the Folio View compact disk.

The working also received reports from the following subgroups:

Implementation Subgroup - Since the Spring National Meeting, the Implementation Subgroup conducted two conference calls to discuss the implementation recommendations and comments received from the interested parties related to the implementation of the revised risk-focused guidance. The Implementation Subgroup also discussed its development of a comprehensive training program and proposed revisions to the Accreditation Review Team Guidelines to reflect the revised risk-focused examination guidance.

Blanks Working Group

The working group adopted twelve blanks proposals and exposed twenty-three new items for comment. The comment period ends August 10, 2006. The adopted proposals include the following, which are effective for year-end 2006 unless other stated.

- To change the bar codes used to identify hardcopy amendments in order to assure that the official hard copy of the annual and quarterly statements agree with the data available to regulators electronically.
- To modify the state pages to identify Medicare premium exempt from state tax; it is effective the first quarter of 2007.

- To update the instructions and the Life, Health & Annuity Guaranty Association Model Act Assessment Base Reconciliation Exhibit to allow for data capture of fee income associated with variable contracts with guarantees.
- To remove FE implications for surplus debentures and to clarify the Other Asset category on Schedule BA and the related AVR reporting; it is effective the first quarter of 2007.
- To add new codes to the existing options for the foreign code column of the investment schedules for Canadian securities issued in the U.S. and denominated in U.S dollars, Canadian securities denominated in any other foreign currency, and U.S. securities issued in U.S. but denominated in any foreign currency other than Canadian; it is effective the first quarter of 2007.
- To clarify that the fair value column of the investment schedules for loan-backed securities should be obtained from the SVO price, an exchange price, other service price, or as assigned by the reporting entity after considering the definition of fair value included in the Glossary of the *Accounting Practices and Procedures Manual*
- To add a new supplemental filing for the Medicare Part D coverage.
- To change the reporting of tax on unrealized gains or losses on the surplus reconciliation for Life, Accident, & Health, and Fraternal annual statements, quarterly statements, and instructions to be compliant with the provisions in SSAP 10, Income Taxes; it is effective the first quarter of 2007.
- To delete the reference to valuation allowance for bonds in Schedule D in the annual statement, quarterly statement, and instructions; it is effective the first quarter of 2007.
- To clarify that the confidential filing referred to as the Actuarial Opinion Summary should not be filed with the regular Actuarial Opinion, nor should it be filed with the NAIC (this proposal was not previously exposed for comment, but was added to the working group's agenda under its emergency procedures).

The proposal to modify the Schedule P Interrogatories for new disclosure of extra contractual obligation lawsuits was withdrawn by the sponsor. Additionally, the working group agreed that the guidance for preparers of financial statements currently located in the NAIC's Public Directive should be moved into the NAIC Annual Statement Instructions (a blanks proposal will be drafted in the future to make the changes).

All Blanks proposals, both adopted and exposed for comment, can be viewed at the NAIC's webpage for the Blanks Working Group.

Life Insurance and Annuities (A) Committee

The committee spent most of its meeting in Washington DC discussing comments on proposed amendments to the Viatical Settlement Model Act. This was in addition to the all day meeting in New York held May 3. The committee has a charge to consider changes to the Viatical Model in response to concerns about "investor-initiated life insurance." The May 3rd meeting was a public hearing on "Premium Financing of Life Insurance, Life Settlements and the Relationship with State Insurable Interest Laws" and the attendance greatly exceeded the size of hearing room. The hearing included six panels of speakers representing life insurers, life insurance agents and advisors, life settlement companies, premium financing companies and consumer representatives. Many representatives opposing the concept of investor-initiated life insurance call such policies STOLI: stranger-owned life insurance.

During the meeting in New York, one working group member (Commissioner Koken of PA) summarized that the issue is determining which arrangements are legitimate, such as life settlements, and should be permitted to continue, and which arrangements are not legitimate, such as STOLI transactions and should be prohibited. The difficult part is determining where to "draw the line."

During the same meeting, the chair of the working group, Commissioner Poolman of ND, suggested that the committee consider revising the Viatical Model to prohibit the settlement of a policy, with certain exceptions, within a specified period of time perhaps as long as five years.

At its meeting in Washington, the committee heard many speakers who commented on amendments to the Viatical Settlement Model Act proposed by the ACLI. All the speakers suggested changes to the ACLI proposed of "viatical settlement contract" which is a very detailed definition and includes six specific policies or agreements that would not be considered a viatical settlement contract. No conclusions were reached, but Commissioner Poolman stated that the committee is still considering a five year "moratorium" on policy settlement.

Life and Health Actuarial Task Force (LHATF)

Report of the AAA Life Reserves Work Group
The American Academy of Actuaries' Life Reserve Working Group made a presentation regarding their work on principles-based reserve requirements for life insurance products. As a result of this presentation, LHATF decided for this current draft that the Academy should continue with the gross premium valuation ("GPV") method for the deterministic reserves, but to move to the greatest present value of accumulated deficiencies ("GPVAD") method for the stochastic reserves. This is a major change and will require additional work on the part of the Academy, especially with regard to their modeling efforts. LHATF also voted unanimously to expose for comment the June versions of the model regulation and the three draft actuarial guidelines with a note regarding the inclusion of the GPVAD method. In addition, LHATF has preliminarily decided that the initial approach for principle-based life reserves will be prospective only but indicated that retroactive application on in force policies at some point in the future would be considered.

Although on several occasions during their presentation, the Academy made it clear that they are confident meeting their target of completing their work by the end of this year, at least two regulators expressed their opinion that this is not a realistic expectation.

Report from the Various Academy Principles-Based Work Groups

Nine different Academy Work Groups made presentations regarding their work on a Principles-Based Approach ("PBA") to reserves. Areas discussed included reinsurance, standards for stochastic modeling, economic scenarios, annuities other than variable annuities, peer review and long-term care application. There were no

specific decisions made regarding these presentations.

Interim Proposals Relative to New Valuation Standards from ACLI

Significant progress was made on this initiative since the March meeting during interim conference calls and discussions at this meeting. At the conclusion of their discussions, LHATF voted to expose for comment revisions to Actuarial Guideline 38 and a proposed model regulation that would permit the use of preferred mortality tables for use in determining minimum reserve liabilities. The proposed revisions to AG 38 include a provision that would allow the application of lapse rates in reserve formulas for calculating reserves for secondary guarantees only. Also included in the draft model regulation is a recommendation from New York to require companies using the preferred mortality tables to contribute mortality data to future industry mortality studies.

Update on an Interim Table for Preferred and Standard Mortality Classes from Joint SOA-AAA Project Oversight Task Force

A report was made by the joint task force updating LHATF on the progress of developing a new valuation mortality table which will include multiple preferred underwriting categories. The group expects to complete their study in early 2007. The current presentation focused on how a company's underwriting practices will be used in the development of various preferred mortality tables.

Report from the Academy's SVL2 Work Group
LHATF's SVL2 subgroup is working on new language to the standard valuation law ("SVL") to support Principles-Based Approach (PBA) reserves. One of the components of these revisions is the introduction of a valuation manual which would contain reserve instructions for calculating PBA reserves. This approach would allow changes to the valuation manual to be adopted without changing the SVL. Changes to the SVL often take years to implement.

LHATF asked the ACLI to work with the Texas regulator to develop the new SVL language based on each of their proposals. When the regulator from New York reminded the task force that they had submitted a proposed SVL in December, New York was also asked to participate in the process.

LHATF noted that the Executive Committee of the NAIC has formed the Principles Based Regulation Working Group to be led by Commissioners Jim

Poolman (ND) and Alfred Gross (VA). LHATF is unsure how this new working group will interact with LHATF's efforts on PBA reserves.

Reserves for Variable Annuities (Actuarial Guideline VACARVM)

LHATF voted to expose for comments changes in the proposed AG VACARVM. This current exposure draft contains a CTE level of 75 which the Academy believes produces excessive reserves and will likely exceed total capital requirements in many cases. After some debate, the option value floor also remained in the current proposal.

Although LHATF still fully expects to adopt AG VACARVM in September, they changed the effective date in the current proposal to December 31, 2007 with little debate. Previously, it appeared that LHATF was working on a schedule that would have this guidance in place for year end 2006.

Reinsurance Reserve Credit

This issue first surfaced at the Spring National LHATF meeting and it appeared it was headed for quick adoption by LHATF until interested parties convinced most LHATF members that this issue needed further study. The issue involves the ceding on a coinsurance basis, where the coinsurance premiums are paid annually, of a block of term insurance business where premiums are paid more frequently than annually. Typically, the business in question has net premiums that exceed gross premiums. Under some interpretations of statutory accounting guidance, the direct company sets up a net deferred premium asset that is greater than the annual gross premiums ceded to the reinsurer, thereby creating a temporary increase in surplus. A conference call will be scheduled to discuss this topic. LHATF asked the ACLI to provide real company data on the proposed changes.

Study of Feasibility of Electronic Filings of all Actuarial Certifications

Regulators are looking at requiring all actuarial certifications, including certifications required by Actuarial Guidelines and other regulatory reporting requirements, be submitted electronically. No progress was reported.

Accident and Health Working Group

Premium Deficiency Reserves

After spending several quarters struggling to develop a consensus on deficiency reserves, the working group adopted changes to the Health

Reserve Guidance Manual regarding deficiency reserves and has now completed this charge. The changes to the Health Reserve Guidance Manual include a more detailed definition of deficiency reserves (including the specific deficiency reserve calculation), specified lines of business for grouping contracts to test for premium deficiencies and revised documentation requirements.

Alternatives to Individual Medical Rate Regulation

A productive discussion took place on this long standing issue regarding rate spiraling that occurs on closed blocks of individual medical business. Although many issues were discussed, no solutions were presented. The working group expects to have a specific written proposal in the near future.

Accounting for Prepaid Loss and Claims Adjustment Expenses

The working group has made technical corrections to the Health Reserve Guidance Manual after a request from the Emerging Accounting Issues Working Group to review the differences in the guidance manual to INT 02-21 regarding accounting for prepaid loss adjustment and claim adjustment expenses. INT 02-21 exempts managed care companies from the guidance in that interpretation and the working group has recommended that INT 02-21 be modified to remove that exemption for non-capitated managed care contracts. The working group does not plan to release the Health Reserve Guidance Manual until after INT 02-21 is revised.

P/C Reinsurance Study Group

Debrief on New Finite Reinsurance Disclosures

The majority of the study group's meeting was devoted to discussion of finite reinsurance disclosures and attestation first filed in 2006. NAIC staff gave a detailed presentation analyzing the results of the information filed. NAIC staff noted that 11% of P/C insurers responded to one or more interrogatories. The study noted that the overall effect on finite reinsurance transactions is approximately 7% of industry surplus but 31% of the surplus of those that reported. The study also noted that the difference in the number of companies reporting using the current materiality threshold of 3% compared to 5% is only 14 companies. At the request of interested parties, the study group increased the reporting threshold to 5% of policyholders' surplus, ceded premium or ceded loss and loss adjustment expense.

The chair of the P/C Reinsurance Study Group Interested Persons gave comments on changes they would like to see; the most critical one to them is a request to remove the requirement to include the information in the footnotes to the audited financial statements. Many interested parties believe the information included in the interrogatories is difficult to audit due to the judgment involved in accumulating the information. No change was made to the requirement, which was originally required for 2005 but deferred to 2006 at the request of interested parties. Additional discussion will occur at a subsequent meeting.

The study group also agreed to remove "any risk" from "any risk and positive or negative underwriting result" from Interrogatory 9.1. The study group and interested persons did not complete its discussion of the interrogatories and will hold a conference call in the near future.

Other Projects of the Study Group

Included on the agenda but not discussed due to lack of time are several other important projects. At its upcoming interim meeting, the study group will review a Form A that proposes an amendment to SSAP 62 to require that allocation agreements for multiple cedent reinsurance agreement be writing and have fair terms. The study group also plans to review and comment on the FASB's recently issued Invitation to Comment entitled Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting. A regulator from New York noted that the FASB paper "goes beyond" the bifurcation paper drafted by New York last year because it scopes in insurance contracts in addition to reinsurance contracts. Another issue on the agenda for the next meeting is discussion of a proposal from the Wisconsin Department of Insurance to clarify the SSAP 62 guidance on amortization of "excess" ceding commissions, i.e. pro rata over the effective period of the reinsurance agreement in proportion to the amount of coverage provided under the reinsurance contract. This proposal was not exposed for comment due to lack of time.

Reinsurance Task Force

The task force devoted its entire two hour meeting to continuing discussions of the charge of the task force to "develop alternatives to the current reinsurance regulatory framework, including the use of collateral within the U.S. and abroad.

Consider approaches that account for reinsurers' financial strength regardless of domicile, i.e. state or country." The task force has been asked to present a final proposal by the 2006 Winter National Meeting in December.

The task force heard a long presentation from its Interested Parties group that has been working on providing alternatives to the current reinsurance regulatory framework. The chairs of the interested parties group emphasized that unanimous approval or even consensus had not been reached on any proposal. The group has been working to develop "Core Principles and Standards" such as a single regulator for reinsurance, protection of the solvency of ceding companies, and principles-based regulation.

The task force also heard from the Ceding Insurers Interested Parties Group which has reviewed the above core principles and expressed objections to those principles compared to their guiding principles.

As the meeting started to run over, the task force adopted a motion that all interested parties group should focus "primarily" on the Rating Proposal from the Ad Hoc Reinsurance Regulatory Roundtable. This was a surprise move to many interested parties by the task force since the Rating Proposal had not been discussed during this meeting or other recent meetings. It would create an organization called the Reinsurer Rating Organization, which would rate the financial strength of reinsurers doing business in the United States. Collateral for reinsurance ceded may still be required but it is assumed it would be less than the current requirements.

International Accounting Standards Working Group

At its meeting in Washington, the working group discussed the following issues.

Insurance Contracts Phase II Developments

The working group heard an update on the status of the Insurance Contracts Phase II project at the International Accounting Standards Board (IASB). Specifically, the working group was informed that IASB has concluded the following:

- Discretionary participation features are not liabilities until the insurer has an unconditional

obligation that compels it to transfer economic benefits to current and future policyholders.

- Risk margins are intended to convey information about uncertainty.
- Measurement of insurance and reinsurance (ceded and assumed) liabilities should be at its current exist value (profit at inception is not prohibited).
- Payments that must be made to retain guaranteed insurability should be recognized as a customer relationship intangible asset.
- Measurement of an insurance liability should include changes attributable to a change in the company's own credit.

IAIS Insurance Contracts Subcommittee

The subcommittee of the International Association of Insurance Supervisors (IAIS) issued its second paper on Liabilities in May of 2006.

IASB Discussion Papers

The IASB previously released a Discussion Papers for comment entitled *Measurement Bases for Financial Reporting - Measurement on Initial Recognition*. During May 2006, the IAIS submitted a comment letter to the IASB on the Discussion Paper.

International Solvency Initiatives Working Group

At its meeting in Washington, the working group discussed the following issues.

IAIS Structure and ALM Papers

The International Association of Insurance Supervisors (IAIS) issued the following papers for comment:

- Draft paper entitled *Common Structure for the Assessment of Insurer Solvency* in May 2006. The paper proposes a consistent, reliable and transparent approach to the assessment of insurer insolvency. Comments are due by the end of July.
- Draft paper entitled *Asset Liability Management* in May 2006. The paper provides additional background on some aspects of asset liability management (ALM) not covered in detail in the *IAIS Supervisory*

Standard on Asset Liability Management.
Comments are due by the end of July.

Other

The working group then had a discussion on the principles regarding the discounting of non-life reserves. No decisions were reached.

Casualty Actuarial Task Force

The task force adopted a response to the Emerging Accounting Issues Working Group's referral concerning the financial reporting of legal costs. The response notes that there are situations where the task force believes the legal costs should be coded as losses rather than as loss adjustment expenses, particularly where the only policy coverage is for reimbursement of the insured's legal expenses.

Exposure drafts on the Actuarial Standard of Practice on Unpaid Claim Estimates and on Actuarial Qualification Standards will be discussed on a future conference call.

The status of numerous Subgroup activities was provided:

- The Extended Loss and Loss Adjustment Expense Reserves Subgroup submitted a proposed revision to the Schedule P Interrogatory for DDR Reserves. The task force will discuss the proposal on the next call.
- The Workers' Compensation Large Deductible Subgroup is expecting a response from the American Academy of Actuaries (AAA) soon and expects to have a proposal to the task force this summer.
- The Intercompany Pooling Subgroup is awaiting a response from the SAP Working Group (which is discussed in the summary of that meeting above)
- The task force received a response from the AAA related to the potential role of the actuary in the enhanced risk-focused surveillance process.
- The International Subgroup will discuss the discounting of reserves for non-life insurance and the European Commission's Solvency II.

The task force decided not to propose to require the Statement of Actuarial Opinion to be included in the bound copy of the Annual Statement, due to

timing issues for Appointed Actuaries. They also decided against starting a project concerning premium deficiency reserves. They discussed the need to provide additional communication regarding Actuarial Opinion Summary guidance and state annual statement checklists, but decided to handle this on an individual situation basis.

Financial Regulation Standards and Accreditation Committee

At Washington DC, the Financial Regulation Standards and Accreditation Committee discussed the following:

Update on Insurer Receivership Model Act

The committee was notified that it will receive proposed revisions to the Insurer Receivership Model Act for consideration in March 2007 from the Receivership Law and Intergovernmental Working Group of the Financial Condition (E) Committee.

Recommendations from the Financial Examination Modernization Working Group

The committee adopted the recommendations and related revisions received from the Financial Examination Modernization Working Group of the Financial Condition Committee. Specifically, the recommendations included revisions to the Review Team Guidelines to clarify the statutory examination requirements when coordinated examinations are conducted, statutory examination requirements when companies are under some sort of insurance department supervision, the definition of full and limited scope examinations, and the calculation of examination timeliness statistics. The revisions will be effective January 1, 2007.

Revisions to the Procedure for Adoption of Additional Model Laws, Regulations or Standards for Accreditation

The committee agreed to expose for comment for a 30-day period the NAIC staff revisions to the *Procedure for the Adoption of Additional Model Laws, Regulations or Standards for Accreditation*. The revisions clarify the guidance related to the length and timing of the exposure period and the process for determining when a provision should be required for accreditation.

Consumer Protections Working Group

The working group received a presentation on the NAIC's consumer portal proposal. The new consumer portal will be www.InsureInfo.org. In

summary, the presentation addressed how the portal is different from existing state Web sites and the NAIC Web site. The presentation also covered why a portal is needed, where the NAIC is in the development of the portal and future goals of the portal.

The working group adopted the following recommendation from the Complaint Handling and Reporting Standards Working Group. The display of aggregate counts of consumer complaints and the calculation of a company's complaint ratio on the Consumer Information Source (CIS) should include complaints that have both justified and unjustified codes. Those complaints that have only an unjustified code should be excluded from the aggregate complaint count and complaint ratio calculation.

The working group received a draft document entitled "Best Practices for Writing Required Information Disclosure Standards." This document covers the reason for information disclosure, improving the effectiveness of information disclosure, when information disclosures may not be effective and guidelines for increased comprehension of disclosures. The working group will continue to work on this project for further discussion at the Fall National Meeting.

Finally, the working group recognized the three consumer alerts focusing on flood, storm preparedness and fraud related to natural catastrophes. NAIC staff requested the working group to submit additional ideas for future alerts.

Class Action Litigation Working Group

The working group learned that the long-awaited study by the RAND Institute for Civil Justice on class action litigation in regulated industries was still undergoing editing in the peer review process. It is expected that the report will be available for distribution prior to the Fall National Meeting.

The working group heard a presentation on the need for states to enact legislation that provides the insurance regulator with an opportunity to be heard before a court rules on a case where the insurer is subject to regulatory requirements. A model law developed by the American Legislative Exchange Council (ALEC) Civil Justice Task Force was presented. The model requires the trial court to hear and rule on all pending pleas asserting that the regulator has either exclusive or primary

jurisdiction over a matter or that a party has failed to exhaust administrative remedies.

A consumer representative provided a rebuttal to the arguments made by proponents of the model law. The representative contended that court actions are more transparent than most regulatory proceedings. He also cautioned insurance regulators that class action litigation could be very labor intensive. He was concerned that if insurance regulators intended to adjudicate class actions at the administrative level, additional resources would be necessary. He was critical of the ALEC proposal, as he believed it was unnecessary and would serve to limit options for consumers by prohibiting class actions when the regulator has either exclusive or primary jurisdiction over a particular matter. The working group will consider developing a model law over the summer months.

The working group also heard from an interested party on mortgage impairment products. It was suggested that most of the discussion on mortgage impairment products relates to a monoline requirement for writing title insurance business. While there have been no class actions to date, there is a potential for them to occur. Also pertinent to the working group is the use of administrative remedies in lieu of going directly to the courts.

Risk Retention Group Task Force

The task force continued its discussion of which accreditation standards should apply to risk retention groups. In Washington, the task force held a second discussion of the applicability of the accreditation standard regarding capital and surplus, noting that the primary unresolved issue with this standard is whether the RBC model law, or something substantially similar, should be applicable to captive risk retention groups (RRGs). The task force received a summary explanation of the RBC formula and then engaged in extensive further discussion as to the applicability of whether RBC should apply to RRGs. The task force decided that this topic will be discussed further in a subsequent conference call.

The task force then discussed the accreditation standard regarding holding company systems. This standard requires that state law should contain the NAIC Model Holding Company Systems Act or an act substantially similar and an accredited Department should have adopted the NAIC's model regulation relating to this law. The primary issue related to this standard is that much of the model act is triggered by whether there is a

controlling member as defined in the model law. In some instances, captive RRGs deal with a large number of individual policyholders so that no one person may exercise control and thus, they are typically not a part of a holding company system. Some, however, are controlled by a small number of policyholders, and some may be controlled by a management contract.

The task force is waiting to receive a report from the Corporate Governance Subgroup of the Risk Retention Working Group regarding similar control issues with the model act. Prior to that report being received, the task force decided to conduct a limited survey of its own members to find out which task force members currently require holding company-related filings or any other related information. (That subgroup is working to develop basic corporate governance standards that should apply to risk retention groups.)

The task force had an initial discussion on the standard regarding risk limitation. This standard requires that state law should prescribe the maximum net amount of risk to be retained by a property and liability company for an individual risk based upon the company's capital and surplus. This limitation should be no larger than 10% of the company's capital and surplus. There was discussion regarding this limitation and various considerations specific to RRGs. One task force member opposed applying this standard, while another member suggested a phase-in approach for RRGs. The task force will discuss this standard further in subsequent conference calls.

The task force concluded with a short discussion on the standard regarding reinsurance ceded. This standard requires adoption of the Credit for Reinsurance Model Law and Regulation, or substantially similar language. This discussion indicated that the standard should generally apply to RRGs, with some minor modification.

Financial Examination Modernization Working Group

- The working group continued discussion of exceptions to the 18-month timeliness accreditation standard, which generally requires a report of examination must be filed no later than 18 months after the "as of" date. The working group decided that a few additional revisions were needed and that a conference call would be held prior to the Fall

National Meeting in order to adopt the recommendation.

Additionally, the working group agreed to expose for a 45 day comment period proposed revisions to the *NAIC Financial Regulation and Accreditation Program - Review Team Guidelines* relating to the review and reliance on another state's workpapers. In addition, the working group will hold an interim conference call to discuss necessary revisions to the guidance on reporting examination progress and findings in the *NAIC Financial Condition Examiners Handbook* based on the revised definitions of full-scope and limited-scope exams.

Financial Examiners Handbook Technical Group

At its meeting in Washington DC, the technical group adopted revisions to the *NAIC Financial Condition Examiners Handbook* (the "Handbook") in response to the final implementation rules of the USA PATRIOT ACT. The rules require anti-money laundering programs for all insurers who sell or underwrite "covered products" as defined in the final implementation rules. The Handbook revisions instruct the examiner to contact the appropriate federal regulator if it appears that an anti-money laundering program is not in place when it should be.

The regulators also adopted revisions to Exhibit K: Sample Letters of Representation of the Handbook to incorporate representations on information technology (IT) systems within the management representation letter. The technical group then received a status update on revisions to the Handbook revisions drafted by the Risk Assessment Working Group.

Examination Oversight Task Force

During its meeting at the 2006 Summer National Meeting, the Exam Oversight Task Force received reports from the following working or technical groups:

Audit Software Working Group - The Audit Software Working Group met on May 2-3, 2006 and agreed to (1) expose a "template" which will provide insurers an expectation of what baseline electronic information will be requested during an examination, (2) expose revisions to Exhibit C: Evaluation of Controls in Information Systems Questionnaire (ISQ) included within the *NAIC Financial Condition Examiners Handbook*, and to

create new documents and tools to replace the current ISQ with a more complete "IT Examination Process."

The task force then discussed the report from the Government Accountability Office (GAO) entitled *Insurance Sector Preparedness* and agreed to discuss with the Financial Condition Committee whether to add the following to its 2006 charges:

"Review and consider the recommendations set forth in the GAO Report: Insurance Sector Preparedness pertaining to 1) the review of insurer's business continuity capabilities, including the placement of business continuity with the examination guidelines and the minimum recovery time objectives for certain insurance services and 2) the review of insurer's outsourcing of critical functions."

Advisory Organization Examination Protocol Working Group

The working group is considering how best to determine when statistical agent examinations should be scheduled and how to coordinate that activity with states most interested.

The working group also discussed a need to expand the Statistical Agent Examination chapter and possibly include within it examinations of advisory rating organizations. Many elements of examinations for insurance companies would not be included in examinations of statistical agents or advisory rating organizations. The working group requested regulators and interested parties to provide suggestions for improving the Statistical Agent Examination chapter to NAIC staff. These suggestions would be reviewed for recommending possible changes.

The working group then discussed the need to provide market conduct examiners with special training as to how to perform a statistical agent and/or advisory rating organization examination. It was noted that specific guidelines for such training should include gaining knowledge about various data systems.

Disaster Reporting Working Group

The working group noted that nine comment letter responses were received regarding the coordinated disaster reporting initiative. Based

upon the comments received, the working group noted that it understands and appreciates the importance of confidentiality of information collected from the insurance industry. However over the past several years, the NAIC has played a key role in data collection efforts of the regulators in several important areas, including collection of confidential data. The state insurance regulators are willing to have the NAIC enter into any necessary agreements with the states regarding the safeguarding of confidentiality. Additionally, the working group will consider encouraging all states to adopt the confidentiality provisions in the 1999 version of the NAIC Model Examination Law, which clarifies existing protection for information collected and allows for the NAIC to directly obtain confidential information while assisting a state. The chair also directed NAIC staff to contact the SEC to address regulations for public companies that could impact confidentiality.

The working group noted that advance preparation and notice are key in coming up with an efficient and timely disaster data collection mechanism, both for regulators and insurers, and highlighted some suggestions received in the comment letter responses: for example, to clearly define the trigger, data elements, timing and frequency, and duration of data reporting categories. In terms of triggers, the working group discussed suggestions for possible triggers to initiate a disaster reporting effort. Initially, the discretion of the relevant commissioners appeared to be the most probable trigger. Timing and frequency were also discussed at length.

The working group discussed possible data elements for reporting, as well as the concept that some data elements would be added through the duration of the reporting cycle when such information was more easily available. The chair asked working group members to provide suggestions to NAIC staff by July 7, 2006, for any items they wish to include in the framework. A conference call will be scheduled shortly after the deadline.

National Treatment and Coordination Working Group

The working group is continuing its work on the Company Licensing Best Practices Handbook and the development of a Company Licensing Model Act with uniform standard requirements for company licensing. Discussion included the need

to continue working on best practices regarding processes and timeliness of processing company licensing applications.

The working group previously determined it would work on the two most challenging topics for the Company Licensing Model Act: uniform lines of business and uniform capital requirements. Recent discussions have resulted in two options for uniform lines of business: broad categories of business with annual statement lines of business mapped to those categories and the annual statement lines of business alone. It was noted that these proposals are designed for standard life/health/annuity (including fraternal) and property/casualty companies, and not, at this time, health maintenance organizations. The working group plans to further consider these two options and other suggestions, including a possible survey of the states and will hold further conference calls once direction is received regarding its charges.

The next National Meeting of the NAIC will be held in St. Louis on September 9-12, 2006. We welcome your comments regarding issues raised in this newsletter. Please give your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC

Meeting Notes editor: Jean Connolly, Managing Director, PricewaterhouseCoopers LLP, BP America Building, 27th Floor, 200 Public Square, Cleveland, Ohio, 44114-2301 — (216) 875-3239 or jean.connolly@us.pwc.com.

Disclaimer

Since a variety of viewpoints and issues are discussed at task force and committee meetings taking place at the NAIC meetings, and because not all task forces and committees provide copies of agenda material to industry observers at the meetings, it is often difficult to characterize all of the conclusions reached. The items included in this Newsletter may differ from the formal task force or committee meeting minutes. In addition, the NAIC operates through a hierarchy of subcommittees, task forces and committees. Decisions of a task force may be modified or overturned at a later meeting of the appropriate higher-level committee. Although we make every effort to accurately report the results of meetings we observe and to follow issues through to their conclusion at senior committee level, no assurance can be given that the items reported on in this Newsletter represent the ultimate decisions of the NAIC. Final actions of the NAIC are taken only by the entire membership of the NAIC meeting in Plenary session.