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# ***NAIC Meeting Notes***

Global Insurance Industry Group, Americas

## **NAIC 2011 Fall National Meeting**

The National Association of Insurance Commissioner held its Fall National Meeting in Washington DC (National Harbor, MD) November 2-6. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

## Executive Summary

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- The NAIC adopted SSAP 101, Income Taxes as final, in addition to adoption of significant revisions to the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation. The NAIC also elected its 2012 Officers. (page 2)
- The NAIC will hold an Executive/Plenary call on November 22 to vote on a resolution sponsored by 22 states to "expeditiously consider legislation amending the MLR provisions of the PPACA in order to preserve the consumer access to agents and brokers." (page 3)
- The Financial Condition Committee discussed its new charge and subgroup, which will study insurers' use of captives and special purpose vehicles; the committee also reviewed comment letters from the exposure of a whitepaper from the LATF Separate Accounts Subgroup. (page 3)
- The Statutory Accounting Principles Working Group adopted clarifications to SSAP 5R to allow an exemption from liability recognition for guarantees to both wholly owned non-insurance and insurance entities. The working group re-exposed for comment proposed changes to SSAP 43R to reflect recent revisions adopted by the VOS Task Force and exposed an SSAP incorporating guidance from Issue Paper 141 on transfers of assets (FAS 166). (page 4)
- The Capital Adequacy Task received a written report from the ACLI on its commercial mortgage long term project and proposed an extension of the current factors for the MEAF through 2012; the task force also discussed an update from the American Academy of Actuaries that suggests use of a 0% -1% RBC charge for deferred tax assets now that SSAP 101 has been adopted. The C-1 Factor Review Subgroup has begun its work to study a recalibration of RBC C-1 risks. The Catastrophe Risk Subgroup resumed discussion of a proposed risk charge for hurricanes and earthquakes; catastrophe risk is viewed as the most significant risk not captured by an RBC formula. (page 7)
- Through frequent conference calls this summer and fall, the Group Solvency Issues Working Group met its aggressive goal of adoption of the ORSA Guidance Manual at the Fall National Meeting. The date of the first filing with the regulators has not been decided but 2013 or 2014 is expected to be the requirement. Next on the agenda for the working group is discussion of the legal vehicle through which to require the ORSA, e.g. through changes to the Holding Company Form B requirements. (page 10)
- The Corporate Governance Working Group continued work on its draft whitepaper *Existing US Corporate Governance Requirements*. (page 12)
- The International Accounting Standards Working Group had a detailed discussion of comments received by the IAIS on its Common Framework for the Supervision of Internationally Active Insurance Groups. The International Insurance Relations Committee heard an update from the Secretary General of the IAIS on activities of the IAIS' Financial Stability Board. (page 12)
- The Valuation of Securities Task adopted revisions to the modified FE process applicable to loan backed and structured securities (LBaSS) for 2011 year-end reporting; a flow chart and instructions developed to facilitate the reporting of LBaSS were exposed for a brief comment period. The task force also adopted 2011 year-end RMBS and CMBS modeling assumptions. The task force discussed proposed significant changes to its ARO policy. The Invested Assets Working Group continued its consideration of Working Capital Finance Notes. (page 14)
- The Reinsurance Task Force discussed a proposal to assist regulators in enforcing collection of undisputed reinsurance balances held by ceding companies in receivership. (page 16)
- The Blanks Working Group adopted one blanks proposal as final and exposed three new proposals for public comment. The working group also exposed for comment a Q&A document on Schedule Y, Part 1A. (page 16)
- The Financial Regulation Standards and Accreditation Committee approved 2010 revisions to the Financial Condition Examiners Handbook and 2008 revisions to the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition

as applicable for accreditation purposes. A proposal to approve the 2010 revisions to the Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation as applicable for accreditation purposes was exposed for public comment. (page 17)

- The Life Insurance and Annuities Committee had a lengthy discussion on contingent annuities and whether the product is an annuity or financial guaranty product. (page 17)
- The Life and Health Actuarial Task Force received an update on the progress of the impact testing of PBR and also had a very lengthy discussion of a proposed "interpretation" of AG 38 as it relates to universal life products with secondary

guarantees. This led to the formation by Executive Committee of a new working group who hopes to resolve the issue for 2011 financial statements. (page 18)

- The Climate Change and Global Warming Working Group discussed responses to the climate risk disclosure questionnaire and formed two new subgroups to study further climate changes issues for insurers. (page 21)
- The newly formed Social Media Working Group met in Washington DC to discuss its whitepaper *The Use of Social Media in Insurance*. (page 23)

## Executive Committee and Plenary

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### Election of Officers

The NAIC held its annual election of officers. The officers for 2012 are as follows: Commissioner Kevin McCarty of Florida was elected President, Commissioner James Donelon of Louisiana was chosen as President-Elect, North Dakota Commissioner Adam Hamm was chosen as Vice President, and Commissioner Monica Lindeen of Montana was elected Secretary-Treasurer.

### Adoption of New or Revised Models

The Commissioners unanimously adopted the following items which were the subject of public hearings and debate as they were considered by various groups of the NAIC:

- Amendments to the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation
- Statement of Statutory Accounting Principles 101—Income Taxes, A Replacement of SSAP 10R and SSAP 10.
- Model Guideline for Implementation of State Orderly Liquidation Authority
- Amendments to the Risk-Based Capital for Insurers Model Act regarding the life trend test and fraternal benefit societies

The unanimous adoption of the Credit for Reinsurance Models came after friendly amendments were proposed by the New Jersey

Insurance Commissioner. The amendments provide clarification to the notification requirements to other states where a state of domicile determines a foreign jurisdiction meets the definition of a qualifying jurisdiction.

At its earlier meeting, Executive Committee approved a model law development request for amendments to the NAIC Model Regulation, Recognizing a New Annuity Mortality Table for Use in Determining Liabilities for Annuities. It was noted that the annuity mortality table included in the current model regulation is from 2000.

## Health Care Reform

### Professional Health Ins. Advisors Task Force

Last December the Executive Committee formed this task force whose charge is to "work in an expedient manner to identify, analyze and recommend options to the Executive Committee for addressing the negative impacts on health insurance brokers/agents, insurance consumers and insurance markets, prior to and as a result of the Medical Loss Ratio (MLR) requirements" of PPACA. After months of data collection and analysis, the task force voted earlier this year to recommend that the NAIC endorse HR 1206, *Access to Professional Health Insurance Advisors Act of 2011*, which proposes removing the requirement to include brokers' commissions in the MLR calculation. However, the

task force has stated that they recognize that the "current political environment makes the prospects of enactment of this and other potential PPACA amendments uncertain at this time."

On November 22, Executive Committee and Plenary will hold a conference call to consider adoption by the NAIC of a proposed resolution sponsored by 22 states that resolves the following:

"Congress should expeditiously consider legislation amending the MLR provisions of the PPACA in order to preserve the consumer access to agents and brokers" and HHS should take immediate actions "to mitigate the adverse effects the MLR rule is having on the ability of insurance producers to serve the demands and needs of consumers and to more appropriately classify independent producer compensation in the final PPACA MLR rule. The potential options available to HHS include: (1) approving state MLR adjustment requests; (2) placing an immediate hold on implementation and enforcement of the MLR requirements relative to independent agent and broker compensation; and (3) considering the NAIC's finding that a significant portion of insurance producer activities are dedicated to consumer advocacy and service and therefore classifying an appropriate portion of producer compensation as a health care quality expense for purposes of Section 2718 of the PPACA."

#### MLR Quality Improvement Subgroup

The subgroup was recently established by the Health Insurance and Managed Care Committee at the request of the Health Reform Solvency Impact Subgroup. The subgroup is charged with the review of new quality improvement (QI) initiatives, as reported annually on the Supplemental Health Care Exhibit Allocation Report. The review process, as set out in the Supplemental Health Care Exhibit, will determine compliance with the quality improvement criteria, as provided in section 2717 of the Public Health Service Act and section 1311 of PPACA, and make recommendations to the Secretary of HHS for certifying inclusion or exclusion in the quality improvement expense category of the Supplemental Health Care Exhibit.

Qualifying QI activities are primarily designed to achieve the goals set out in sections 2717 and 1311 discussed above to (1) improve health outcomes including increasing the likelihood of desired outcomes compared to a baseline and reducing health disparities among specified populations; (2)

prevent hospital readmissions; (3) improve patient safety and reduce medical errors, lower infection and mortality rates; (4) increase wellness and promote health activities; or (5) enhance the use of health care data to improve quality, transparency, and outcomes.

The subgroup held its first session at the Fall National Meeting. The subgroup received an overview from NAIC staff on quality improvement entries submitted by insurers on the Supplemental Health Care Exhibit and heard a presentation on transitioning to ICD-10 for diagnosis classifications. The subgroup will hold interim conference calls to continue discussions of ICD-10 and to consider other QI initiatives.

## **Financial Condition Committee**

The committee met in Washington DC and discussed the following issues:

#### New Charge Related to Life and Health Captives

The committee briefly discussed its new charge from Executive Committee on insurance captives, which is as follows: "The Financial Condition Committee will study insurers' use of captives and special purpose vehicles to transfer 3rd party insurance risk in relation to existing state laws and regulations and establish appropriate regulatory requirements to address concerns identified in this study. The appropriate regulatory requirements may involve modifications to existing NAIC model laws and/or generation of a new NAIC model law."

The issue was raised by a New York Times article May 8th entitled *Seeking Business, States Loosen Insurance Rules*, which suggested that life insurers are not required to maintain the same level of reserves in a captive as they would have to in a traditional life insurer. The chair noted that consistency of captive regulation will be a goal of the regulators. The committee is forming a subgroup to study the issue, which will consist of two members each of the Financial Analysis Working Group, the Life Actuarial Task Force and the Reinsurance Task Force.

#### LATF Separate Accounts Subgroup

At its meeting September 19, the committee asked for feedback from interested parties on the draft report from the LATF Separate Accounts Subgroup, which raised concerns regarding the "growing trend" of life insurers to include non-unit linked products within the separate account. (These concerns have

also been raised by the committee's Separate Account Risk Working Group.) The committee received three comment letters from the chair of the Receivership and Insolvency Task Force and the Receivership Separate Accounts Working Group, the ACLI and the National Organization of Life and Health Insurance Guaranty Associations. The chair of the RITF and RSAWG asked that the committee and the LATF take no action on the paper since the topics addressed in the report are also being currently reviewed by the task force and working group. The ACLI urged the committee to "correct misstatements [in the paper] and to balance statements in the draft that suggest that separate accounts have been abused, that requirements are being avoided and that separate account products produce additional risk for the industry."

After some discussion the committee requested that the Receivership Separate Account Working Group consider the reporting needs for the current separate accounts mix of products and assets due to concerns with insulated and non-insulated products and assets. The regulators also requested that the Separate Account Risk Working Group compare the US GAAP definition and requirements for separate accounts to the statutory accounting requirements. The committee will then review that analysis to consider what should be allowed as insulated products. The committee will also requested that the Financial Condition Examiners Technical Group consider the current examination processes and procedures related to separate accounts to ensure that adequate consideration is being given to potential risks arising from these accounts.

## Statutory Accounting Principles Working Group

The working group met in Washington DC and discussed the following issues.

### Adoption of New Standards or Revisions to SSAPs

**SSAP 101, Income Taxes** - As discussed above, at the Fall National Meeting, SSAP 101 was unanimously adopted as final by the Executive Committee and Plenary with a January 1, 2012 effective date. However, there are still issues that may need clarification and NAIC staff is in the process of updating its Implementation Q&A with the assistance of a small group of industry representatives, which will hopefully resolve these issues and provide examples to ease implementation.

At its meeting in Washington DC, the working group chair stated that they expect the Q&A to be issued shortly for public comment (with an expected December 2 comment deadline). However, subsequent to the National Meeting, the timeline was revised with exposure scheduled for January 2012 with anticipated adoption in February.

**SSAP 5R Clarification** - In August, the working group exposed proposed changes to SSAP 5R, *Liabilities, Contingencies and Impairment of Assets*, which would have required liability recognition for guarantees made on behalf of wholly owned direct and indirect non-insurance subsidiaries. Many interested parties believed this was a change in intent from the adopted SSAP 5R.

During the Fall National Meeting, the working group adopted revisions to clarify the "wholly owned" subsidiary exclusion from the initial liability recognition requirement for guarantees and agreed that the initial liability requirement for guarantees excludes "guarantees made to/or on behalf of direct or indirect wholly owned insurance or non-insurance subsidiaries." The working group was convinced that there is no rationale for exempting just insurance subsidiaries. They also reiterated that the wholly owned exclusion does not include guarantees from one subsidiary to another.

In addition, although SSAP 101, Income Taxes, indicates that tax contingencies shall be computed in accordance with SSAP 5R with modifications, the working group concluded they should include such guidance directly in SSAP 5R and adopted revisions to incorporate that guidance.

**Adoption of Model 817** - The working group adopted a proposal to include Model 817, *Preneed Life Insurance Minimum Standards for Determining Reserve Liabilities and Nonforfeiture Values Model Regulation*, into Appendix A of the Accounting Practices and Procedures Manual.

**Rejected GAAP Guidance** - The working group voted to reject the following GAAP guidance as not applicable to statutory accounting:

- ASU 2010-24 - Health Care Entities, Presentation of Insurance Claims and Related Insurance Recoveries
- ASU 2010-26 - Financial Services - Insurance
- AICPA SoP 05-1: Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts



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

Items exposed for comment had a comment deadline of January 6 (unless otherwise stated). The SAP Working Group has scheduled a conference call for December 7 to discuss issues with an expedited comment period of December 2.

### **SSAP incorporating Issue Paper 141**

During its August 31 conference call, the working group voted to adopt Issue Paper 141, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, which would incorporate, with some significant modifications, FAS 166, *Accounting for Transfers of Financial Assets*. At its meeting in Washington DC the working group exposed for comment the related proposed SSAP, which reflects the recommendations from Issue Paper 141 and in addition adopts guidance from *ASU 2011-03 Transfers and Servicing, Reconsideration of Effective Control for Repurchase Agreements*. The working group noted that if adoption of this SSAP, which would supersede SSAP 91R, is delayed, it is proposed that the nonsubstantive revisions of adopting ASU 2011-03 will be reflected in SSAP 91R.

**SSAP 43R Issues** - At the Fall National Meeting, the proposed changes to the designation process in paragraphs 25 and 26 of SSAP 43R were re-exposed for comment. Only minor updates were proposed for paragraph 25. The re-exposed paragraph 26 has been revised to reflect the following methods: a) financial modeling; b) modified FE (which scope was updated by VOS Task Force) and c) all other. As discussed in the VOS Task Force summary, credit tenant loans and equipment trust certificates are now exempted from the Modified FE process for year-end 2011. SVO assigned designations are no longer modified by carrying value.

The proposed changes to clarify the definition of loan backed securities in paragraphs 2, 3, and 4, were deferred for discussion at the subgroup level beginning in the fourth quarter. Other changes in the SSAP such as updating the Q&A question 21, and deleting paragraph 46, were agreed to be re-exposed. The exposure deadline for all changes is December 2 to allow for year-end adoption.

In addition, the working group exposed a SSAP 43R flow chart to provide informal reporting guidance for year-end 2011. Subsequent to the Fall National

Meeting, the flow chart was revised based on early feedback and has been posted to the VOS TF webpage.

**Definition of Preferred Stock** - At the Spring National Meeting, the working group exposed for comment an explicit definition of preferred stock for use in SSAP 32. At the request of interested parties the working group revised the definition to be consistent with the SVO Manual definition and re-exposed it for comment.

At the Fall National Meeting, the revisions to define preferred stock as modified during the meeting were adopted with additional wording added to address interested parties' concerns about multiples classes or series of common stock.

**SSAP 102, Accounting for Pensions, and SSAP 92, Accounting for Postretirement Benefits Other than Pensions** - As discussed in our Summer Meeting Notes Newsletter, revisions to the implementation guidance for adopting these new standards were exposed for comment September 28. Comments are due by December 9. The effective date for both SSAPs is January 1, 2013.

### **SSAP 94- Transferable State Tax Credits**

During its August 31 conference call, the working group adopted proposed revisions, with minor clarifications, that allow entities that purchase or acquire tax credits that are subsequently non-transferable to reflect the credits as admitted assets if the domestic state law requires the credit to be used in that taxable year. SSAP 94 currently does not allow non-transferable credits as admitted assets. The working group directed staff to draft an Issue Paper and SSAP concurrently to incorporate these changes.

At the Fall National meeting, Issue Paper 145 and SSAP 94R to allow non-transferable state tax credits to be admitted assets if specific criteria are met were exposed simultaneously for an expedited comment period ending December 2.

**SSAP 100 Disclosures** - The working group had previously exposed for comment proposed revisions to SSAP 100 to clarify the Level 3 reconciliation disclosure requirements, which would require all transfers in and out of Level 3 to be included in the reconciliation. This would require disclosure of items that were acquired and disposed of during the same reporting period.

At the Fall National Meeting, interested parties commented that this disclosure is not meaningful, especially given the fact the same fair value may end up being disclosed for the transfer in and transfer out since company may use the fair value at the beginning of period or the end of the period (or the fair value the date of the transfer). The working group voted to expose revisions to limit the extent a security is included in the reconciliation as a transfer in/out to once on a quarterly basis. Many interested parties would prefer that no disclosure be required if the security is not included in the beginning of year or end of year balance (consistent with US GAAP). The exposure deadline is December 2.

Fund Demand Disclosures for Institutional Business - The goal of this project is enhanced disclosure of liquidity risk management of insurers; regulators and industry have agreed to base these disclosures on the New York liquidity survey questions. Due to the confidential nature of these disclosures, the working group exposed for comment proposed revisions to SSAP 1 to reference the stress liquidity templates (which have been recommended for inclusion in the Financial Condition Examiners Handbook) stating that reporting entities may be requested to complete such disclosures at any time, but that the information would not be required to be captured within the statutory financial statements. Deadline for exposure is December 2. However, consideration of adoption will not occur until the disclosure templates are included in the Examiners Handbook.

AVR/IMR Determinations through NAIC Designations - As the result of a referral from the Rating Agency Working Group, the SAP Working Group exposed a proposal to modify significantly the AVR and IMR rules to allow judgment in the allocation of AVR and IMR except when the NAIC designation changes by more than one rating during the holding period or if the security is rated NAIC 6 at any time. Interested parties had commented that before such changes should be considered that the NAIC should research the effectiveness of the current allocation methods and whether the process is not adequate for a particular asset class(es).

At the Fall National Meeting, the working group concluded that they do not believe any change is needed since the current process for AVR and IMR has not resulted in material solvency or accounting concerns.

SSAP 36 and ASU 2011-02, Receivables - A Creditors' Determination of Whether a Restructuring is a Troubles Debt Restructuring

At the Fall National Meeting the working group exposed nonsubstantive revisions to adopt guidance from ASU 2011-02 into SSAP 36 to provide additional guidance on whether a restructuring constitutes a troubled debt restructuring. The working group also recommended rejection of the troubled debt restructuring disclosures pertaining to financing receivables from ASU 2010-20 but proposed additional disclosures for creditors that pertain to all troubled debt restructuring.

SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers - At the Fall National Meeting the working group exposed for comment a proposed conclusion that the guidance in ASU 2011-06 be rejected for statutory accounting and instead proposed that SSAP 54 prescribe the accounting for the annual fee mandated by the Patient Protection and Affordable Care Act. These proposed SSAP 54 changes would require accrual of the annual fee on health insurers in 2013, instead of 2014 as required by ASU 2011-06.

Impact of Loss Portfolio Transfer on Provision of Reinsurance

- The working group discussed a proposal from a large P/C insurer which addresses situations where collection risk for third party reinsurance has been transferred and secured by the counterparty in a LPT, but where novation has not occurred. The proposal would allow the minimum reserve to be reduced in such situations. Regulators expressed views both pro and con on the issue, and the working group voted to exposed the proposal with the caveat that "they are not taking a position on this proposal, but to receive additional information." The issue will be discussed on a future conference call, along with a second proposal from the same insurer (that was not exposed for comment) that would allow any additional bad debt reserve to be unallocated to a specific reinsurer and be recorded through surplus not net income.

Derivatives and Hedging (Topic 815) - Scope Exceptions Related to Embedded Credit

Derivative (ASU 2010-11) - In ASU 2010-11, the FASB clarified that credit derivatives are to be separately recognized as embedded derivatives and have additional disclosure requirements. The working exposed revisions to SSAP 86 for the disclosure requirements for embedded credit derivatives within a financial instrument (including beneficial interests) that expose the holder to the possibility (however remote) to make future payments in the financial statements. They also

exposed revisions to SSAP 86 to adopt guidance from ASU 2010-11 that revises the seller of credit derivatives disclosures in 815-10-50-4K (already adopted for statutory) to clarify those disclosures do not apply to embedded derivatives features related to the transfer of credit risk that is only in the form of subordination of one financial instrument to another.

The working group also exposed for comment a proposal to reject all other revisions from ASU 2010-11, as embedded derivatives are not separately recognized as derivatives under SSAP 86 but incorporate revisions to SSAP 27 to ensure the embedded derivatives are included in the disclosures of financial instruments with off-balance-sheet risk.

**Pharmacy Rebates Under Medicare Part D Gap Discount** - The working group voted to add to its agenda the issue of whether additional guidance is needed for these type of rebates. NAIC staff will work with interested parties for a proposal at the Spring National Meeting.

#### **GAAP Guidance Rejected for SAP**

The working group voted to exposed for comment a proposal to reject the following recently issued GAAP guidance that applies to insurance entities:

- ASU 2011-07 - Bad Debts and Allowance for Doubtful Accounts (comment deadline is December 2)
- ASU 2011-05 - Comprehensive Income (Topic 220), Presentation of Comprehensive Income

## **Emerging Accounting Issues Working Group**

The working group voted to adopt a procedure to incorporate EAIWG interpretation guidance directly into the SSAPs instead of having the guidance as standalone INTs.

## **Capital Adequacy Task Force**

The working group at the Fall National Meeting and discussed the following issues:

#### **Commercial Mortgage Long Term Project**

The task force received a written report and short presentation from the ACLI on its proposed treatment of commercial mortgages within life RBC. The ACLI proposal is intended to replace the current, temporary RBC treatment, and suggests the categorization of mortgages based on objective

criteria and the use of risk factors to develop the RBC. Additional discussion will occur on future conference calls.

Recognizing the amount of work still remaining on the proposal (including public exposure), the working group agreed to expose for a 45 day comment period an option to extend the current, temporary treatment for a further year (through 2012) to provide more time to implement a long-term solution.

#### **AAA Deferred Tax Report**

The task force received a report from the American Academy of Actuaries on changes to its proposed RBC charge for deferred tax assets (DTA) in light of the adoption of SSAP 101. The report proposes applying a single charge rather than differentiating based on an insurer's ex-DTA RBC ratio, primarily since SSAP 101 eliminates DTA risk where the RBC ratio is below 200%. The task force discussed the differing risk of DTAs where they are recoverable from other group members rather than directly from the IRS, and also discussed whether the proposed charge (0% to 1%) should be higher, and agreed to defer further discussion of the changes to a conference call.

#### **RBC for Low Income Tax Housing Credits**

The task force discussed a proposal from the P/C RBC Working Group to apply the life RBC formula treatment for federal low-income housing tax credits (FLIHTCs) to P/C RBC and add similar treatment to both formulas for state low-income housing tax credit investments that are structured the same as the FLIHTCs. The current P/C RBC charge for FLIHTC investments is 23% before tax and 14.95% after tax and the life RBC charge is .14% for transactions guaranteed by an ARO-rated entity and 2.6% for all others (with no tax adjustment for either).

#### **RBC for Title Insurers**

The task force reviewed a request from the Title Insurance Task Force recommending that RBC be developed for title insurers because the lack of such a requirement represents a "hole in title insurance solvency standards." The task force will address the issue in a future conference call.

## **C-1 Factor Review Subgroup**

The newly formed C-1 Factor Review Subgroup is charged with reviewing the current C-1 Factors and delivering a recommendation for the new factors to the Capital Adequacy and Valuation of Securities



Task Forces. C-1 is the risk of assets' default of principal and interest or fluctuation in fair value used in the RBC calculation. The subgroup had several organizational meetings in October and also met at the Fall National meeting and discussed data and assumptions needed for the modeling that will be done, and the greater granularity that might be added to the RBC formula for bond categories and designations. Risks other than credit such as call, extension and duration will also be considered. Discussion around granularity centered on whether each asset class (e.g. corporate, municipal, and structured) should have a different C-1 factor depending on the modeling/historic default experience, or should different asset classes and ratings be mapped back to the six designations, depending on modeling/ historic defaults.

In order to complete this task, the subgroup may take the following steps:

1. Assess the work already done by the American Academy of Actuaries, the SVO and others.
2. Clarify where C-1 factors are used (e.g. bonds, derivatives, other).
3. Request a professional body (AAA and/or others) to review the C-1 factors. The subgroup will determine what the request includes, such as the level of granularity for ratings and the level of granularity for asset classes (such as corporate bonds, government bonds, municipal bonds, and loan-backed and structured securities) and asset subclasses (such as municipal general obligations and special revenue bonds, different types of loan-backed and structured security types, and industrial bonds by sector).
4. Determine what risks (other than credit) are sufficiently material and measurable that they should be incorporated into C-1 Factor (such as duration and correlation).
5. Determine which factors should be taken into account in C-1 (such as time horizon, premium/discount, tax impact/offsets, updates to mortgage factors, consistency in economic or other assumptions across asset classes, or risk offsets or risk management practices).

The subgroup plans to meet via conference call three more times in 2011 and has the aggressive goal of completing its work and proposing revised C-1 factors for 2012 RBC. The subgroup envisions revised factors would be applicable for the Life RBC formula but could be expanded to the other formulas.

## SMI RBC Subgroup

The subgroup met at the Fall National meeting and received a presentation on Canada's regulatory capital requirements for life insurers from the Office of the Superintendent of Financial Institutions (OSFI). The presentation detailed Canada's current and new insurance solvency frameworks. The presentation explained a new Total Asset Requirement (TAR), which will be equal to a best estimate of insurance plus other liabilities, in addition to solvency buffers for insurance and other risks. TAR is focused on the going concern assessment and the quality of capital, and will be required in addition to a second measure of capital adequacy, which will be the same as the currently required regulatory capital ratios. TAR is intended to be closely linked to IFRS to maintain a strong link to insurers' financial statements, and will be set at a confidence level of CTE 99%/VaR 99.5% over 1 year, with flexibility as to the exact measure used. OSFI also intends to allow companies to use their own internal models to determine supervisory targets, subject to approval, but will not start to implement this capability until beyond 2016.

The subgroup made no comment as to how it might use this information from the Canadian regulators, especially in light of the recent conclusion that the subgroup will be focusing on "incremental improvements" to the RBC formulas such as important and missing risks rather than a complete overhaul of the formulas.

The subgroup also reviewed a report on its activities to be presented to the Capital Adequacy Task Force, noting its work on the calibration of RBC, identification of missing risks and modifications to the RBC formula. The report also noted the subgroup's planned work on the re-evaluation of thresholds for action and control levels, which has not yet fully begun and will therefore remain on the subgroup's agenda.

The subgroup also received an update from the American Academy of Actuaries on its project to recommend improvements to the correlation/covariance methodologies used in RBC. The AAA update indicated that a general recommendation will be made towards the end of 2011, but that there is currently no timeframe for final completion.

Finally, the subgroup discussed future plans to continue the assessment of safety levels in US regulation, and noted that the question has been expanded from the calibration of RBC to consider the level of safety provided by the US regulatory system as a whole, including risk-focused examinations and the ORSA.

## Catastrophe Risk Subgroup

The subgroup held a public hearing at the Spring National Meeting to discuss catastrophe modeling but had not met since the summer of 2010 to discuss the draft formula in detail. The subgroup hopes to present a draft formula to P/C RBC Working Group in the spring of 2012 (after more than five years of deliberation). The subgroup also noted that catastrophe risk is considered by the NAIC to be the most significant risk not currently captured by an RBC formula.

At its meeting in Washington DC, the subgroup resumed discussion of the design of catastrophe risk charge. The proposal establishes that hurricane risk charge should equal the insurer's once-in-100 years modeled hurricane catastrophe losses using the insurer's property exposures applied in the model. Allowable models include the three principal commercially available models which are RMS, AIR and EQECAT. Model choices and key modeling parameter choices must match those used by the insurer in its own internal risk management process. Risk charge should be net of reinsurance and consideration to be given on whether models should use TVaR or VaR. The proposal also establishes that the hurricane contingent credit risk charge (for the risk of uncollectible reinsurance due to the catastrophe event) should equal 10% of the modeled ceded loss. A separate charge will be determined for the hurricane peril and for the earthquake peril. The charges for the hurricane and earthquake perils will be considered to be independent of each other, and independent of all other risks measured by the RBC formula. This means that they will each be subject to the covariance adjustment of the RBC formula. A charge will be calculated on a gross of reinsurance basis, and a negative charge or credit will also be determined based on the company's modeled anticipated ceded reinsurance.

At the meeting, interested parties proposed the use of a weighted average of models as opposed to an average of two or three models, and consequently the subgroup approved a change in language from simple average to the use of a combination of models. The subgroup discussed whether to require models to use TVaR rather than VaR. The subgroup also discussed whether the hurricane contingent

credit risk charge should be set at the proposed 10% of the modeled ceded loss. The subgroup was reminded that the Solvency Modernization Initiative had recognized a need to update this charge and had reached out to the subgroup. The proposed rate is pending review by the American Academy of Actuaries. Interested parties commented that the use of a range of rates may be appropriate. The subgroup ended the meeting noting that further discussion is needed; the next meeting of the subgroup has been scheduled for December 1.

## Health Risk-Based Capital Working Group

The working group held a conference call October 19 and discussed the following items:

### Treatment of MLR Rebate

The chair reported that a health entity had asked how the medical loss rebate should be treated for RBC purposes. An interested party noted that the SAP Working Group had recently concluded that such rebates are to be recorded as reduction of premiums and no changes to the RBC instructions should be required. NAIC staff will provide an example to demonstrate how it will work.

### Referrals to the AAA

The working group approved a referral to the American Academy of Actuaries to study two new issues: 1) whether there should be an RBC charge for insurers for high concentration in a business segment or large single contract and 2) whether underwriting losses and investment losses should continue to be considered independent risks or whether it should be considered in the covariance formula.

## Solvency Modernization Initiatives Task Force

As discussed in the next section, the task force unanimously adopted the Group Solvency Issues Working Group's ORSA Guidance Manual. The task force will continue to monitor implementation issues being addressed by the working group together with the Financial Condition Committee.

The task force then had an extensive discussion on how to communicate "regulatory successes" and other information about the US financial regulatory system to consumers, regulators, legislators, and federal parties both domestically and internationally. No specific conclusions were reached.

### CIWG presentation

The task force also heard a presentation from the Capital Initiatives Working Group whose charge is to "monitor activity and make recommendations concerning the modernizations of minimum regulatory standards in the US life insurance industry." Members of the CIWG are MassMutual, MetLife, New York Life, Northwestern Mutual, Prudential, the Reinsurance Group of America and State Farm. The CIWG re-iterated its position that Solvency II is not appropriate for the US because its "market consistent framework is not useful for life insurance business" because, among things, it results in significant volatility.

The CIWG has concluded that the current RBC framework works well but is suggesting a significant refinement that would allow companies to adjust minimum capital requirements after performing "stress testing" to capture material tail risk. Task force members asked several questions about the proposal and the CIWG agreed to come back the regulators with additional information.

## **Group Solvency Issues Working Group**

### Own Risk and Solvency Assessment (ORSA)

The working group's main focus has continued to be the Own Risk and Solvency Assessment (ORSA) Guidance Manual. The working group met three times by conference call to discuss the proposal during October and a revised manual was released for a two week public comment period on October 14. The working group also considered the results of its ERM Questionnaire, released following the ERM Symposium held in Jacksonville in July. All but 1 of the 11 respondents to the questionnaire had an ERM process in place, with four having or developing an ORSA, nine producing reporting on ERM, and two companies' developing ERM reporting. The working group noted that this helped confirm its understanding that most insurers currently have ERM and ERM reporting in place at some level.

Following the close of the comment period, the working group discussed the Guidance Manual at the Fall National Meeting, and adopted it unanimously with minor changes. The manual was also adopted by its parent committee, the SMI Task Force, a few days later.

Recent discussions on the ORSA requirement have covered two major issues; firstly the contents of the guidance manual itself, and secondly the legal

mechanism that will integrate the ORSA into US regulation. The contents of the Guidance Manual have received the majority of the attention and opportunity for industry input, via the CRO Council, over the year, which was reflected in general agreement between the working group and industry on the key features of the proposal. Changes to the wording of the proposal continued to be made on working group conference calls and at the National Meeting. However, these were primarily for clarification rather than changes to the substance of the requirements. The working group also discussed the future development of a glossary to clarify some of the terms in the manual.

There was far less consensus at the National Meeting on the legal mechanism. The working group had proposed to integrate the ORSA requirement into Form B of the Insurance Holding Company model, consistent with a survey of the states conducted by NAIC staff in which the consensus was for the use of Form B rather than examination authority. Draft Form B wording for the *Insurance Holding Company Model Regulation with Reporting Forms and Instructions (#440)* had been prepared by NAIC staff and released for a 7 day public comment period on October 21.

However, industry respondents to the draft wording raised strong objections to the proposed use of Form B, citing issues with differences between the application of the Holding Company Act and the proposed application of the ORSA requirement, and with the confidentiality of any information provided under Form B as compared to that provided under examination authority. Industry suggestions included the creation of a new reporting form for the ORSA, or inclusion of the requirement in the examination authority or the Model Audit Rule.

The working group recognised that further debate on the mechanism will be required and deferred adoption of the proposed Form B changes to allow further discussion on conference calls in the coming months. However, the working group remained supportive of the Form B proposals, and stated that the upcoming discussions would not introduce delay into the overall process for the implementation of the ORSA requirement, expected to be before the next IMF FSAP review of the US insurance solvency regime in 2014 (discussed in further detail below).

The working group also discussed the implementation of the new ORSA requirement at the Fall National Meeting, and reviewed a set of recommendations that it voted to provide to the

Financial Condition Committee, which will be responsible for planning the implementation. The recommendations include the following:

- An effective date for the receipt of the first ORSA summary report, ensuring that the US can receive credit for implementing the requirement during the 2014 FSAP, but allowing at least one year preparing. The working group also discussed the possibility for insurers to submit their ORSAs to regulators via oral presentations for the first round of submissions;
- The development of initial handbook guidance to assist examiners and analysts when reviewing ORSA summary reports;
- Uniform adoption and application of the requirements among states (the working group discussed the possibility that the ORSA would become an accreditation standard with a uniform implementation date);
- The planning of guidance and/or training for regulators, which the CRO Council has offered to help provide; and
- The creation of a pilot project in 2012, during which 5 to 10 undisclosed groups voluntarily submit an ORSA for review to allow regulators to provide high-level non-group specific feedback and, guidance prior to the effective date.

The Financial Condition Committee did not discuss the recommendations at the Fall National Meeting, and is next scheduled to meet at the Spring National Meeting but could hold a conference call before then to discuss.

Achieving international recognition for the US ORSA is a significant objective for the working group, both for the upcoming FSAP review of the US under ICP 16, Enterprise Risk Management, and for ongoing supervision. On its conference calls, the working group discussed its proposal to allow the recognition of group ORSAs prepared for overseas regulators where the relevant regulator has been assessed compliant with ICP 16 under the FSAP. The working group noted that Canada, Bermuda and Australia have so far indicated that they will accept the US ORSA, assuming a positive FSAP assessment against ICP 16. However, the working group heard that the EU will only accept a group ORSA where the US regulatory system is considered equivalent to Solvency II. The working group further heard about the NAIC's

strong objection to this position, and that it had referred the issue to the IAIS secretariat.

#### Holding company best practices

The working group continued work on its *Holding Company and Supervisory College Best Practices* document over the early fall, discussing and agreeing to changes proposed by Pennsylvania, Ohio and Wisconsin by conference call in October. The working group also discussed and agreed to consider the formation of a new NAIC working group to monitor and analyze holding companies, the preparation of holding company profile reports, and the delegation of all routine quarterly communications to the supervisory college, in order to build consistency and establish trust among regulators.

At the Fall National Meeting, the working group adopted the finalized document.

#### Other IAIS activities

The working group continues to be engaged with activities at the IAIS, including ComFrame, and received updates on its conference calls and at the National Meetings. Topics discussed by the working group included the thresholds for groups to be considered internationally active, the accounting framework for group regulatory reporting and the NAIC's involvement in IAIS groups modifying the IAIS's *Guidance Paper on the Treatment of Non-regulated Entities in Group-wide Supervision* and drafting an issues paper on the supervision of branches.

### **PBR Working Group**

The working group met at the Fall National Meeting, and heard a proposal from the ACLI concerning the verification of reserves determined under a principles-based approach.

The proposal, described as a "trust but verify" framework by the ACLI, would require independent review/audit of PBR assumptions and methods by a third party approved by the NAIC. Implementing the proposal would require standards to be developed for third parties to follow in performing the independent review, which the ACLI suggested should be based on the Actuarial Standard of Practice which has already been drafted by the Actuarial Standards Board. Perhaps the most controversial issue in the proposal would be allowing a company's independent auditor to perform this review. In previous discussions some regulators stated their view that the review should be done by actuarial firms engaged by the departments of



insurance. Companies believe use of the independent auditor will be more cost efficient.

The ACLI also called for recognition by regulators of the Practice Notes documented by the American Academy of Actuaries, in order to build consensus on good industry practices. Finally, the proposal referred to a recognized need for regulators to enhance resources, and suggested creation of a centralized actuarial resource to assist regulators during examinations and reserve reviews, which would also promote consistency across states.

The working group agreed to consider the ACLI's proposal for further discussion, indicating that it would also seek input from LATF.

## Corporate Governance Working Group

### US Corporate Governance Requirements

The working group's main priority continues to be its current review of corporate governance requirements in the US, which the working group discussed at an interim meeting and on a series of conference calls over the summer.

The working met at the Fall National Meeting, and discussed and released for comment an updated draft of its working paper, currently entitled *Existing US Corporate Governance Requirements*. The paper identifies existing US corporate governance requirements, standards and regulatory monitoring practices within the structure of the *United States Insurance Financial Solvency Framework* (Framework), and is available for public comment until December 5, following which the working group intends to meet by conference call to discuss comments and finalize the paper. The working group discussed the structure of the paper, noting that its alignment to the Framework, which is already well-accepted internationally, should help to facilitate international discussion of its contents.

On previous conference calls, the working group had received substantial comment from industry commentators on the purpose of the paper and its intended use. Industry representatives present at the Fall National Meeting noted that the paper was significantly improved from earlier drafts, but continued to express concern about the direction of the paper.

The working group also reviewed the new timeline for its corporate governance project, which it had adopted in September, and which concluded the working group agreed not to develop a model law or

principles regarding the duties of members of the board of directors given existing state laws covering these areas. The working group continues to be subject to the overall SMI deadline for policy-decisions to be made by the end of 2012, and noted that it intends to start a series of conference calls in January 2012, on which it will discuss potential gaps in the current US corporate governance structure. The working group is scheduled to complete this process ahead of the Spring National Meeting in March 2012, at which it is scheduled to discuss how to address the potential gaps.

### Insurance Core Principles

The working group also received an update on the activities of the IAIS' Governance and Compliance Subcommittee, which is currently carrying out a review of the new ICP 9, Supervisory Review and Reporting, following its adoption by the IAIS in October.

## International Solvency and Accounting Standards Working Group

### Insurance contracts project

The working group met by conference call on October 19 and again at the Fall National Meeting. At both meetings, the working group continued its discussions on the IASB's and FASB's joint insurance contracts project, and on its October 19 conference call agreed on viewpoints to feed into IAIS and IASB discussions.

One of the significant points discussed by the working group was a proposal to reduce income statement volatility through the use of Other Comprehensive Income (OCI). The working group agreed to support an approach proposed by the HUB global insurance group, referred to as a "current-current through OCI approach." The approach uses OCI for market movements on both the assets and liabilities side, and was noted by the working group as being similar to an IAIS approach which it had discussed at the Spring Meeting and which had previously been supported by the NAIC. At the Fall National Meeting, the working group heard that the Hub Group proposal had received broad support at both the IAIS and the IASB's Insurance Working Group (IWG), and some movement in the project now looks promising.

The working group also discussed and agreed its views on changes to the contract boundary definition proposed by the IASB, potential changes to the

premium allocation approach and accounting for reinsurance. These views were provided to the IAIS and IWG and were largely supported.

The working group also discussed the timing and likely future direction of the new standard, hearing that the IASB expects to make final decisions early in 2012, following which it will investigate points of difference with the FASB before most-likely re-exposing the draft standard. The working group heard that the IASB is also considering issuing a standard without full convergence with the FASB, an approach which the US does not support. The working group also received an update on industry feedback on the project, including encouragement for the IWG to spend a greater amount of time on non-life issues.

#### Financial instruments project

The working group also received an update on the financial instruments project, including the boards' ongoing work on impairment, in particular impairment for instruments classified as "performing well," and the need for discussion on the reintroduction of fair value through OCI, which the FASB intends to include in its classification and measurement standard, but which is not currently included in the IASB's IFRS 9.

#### ComFrame

At the Fall National Meeting, in common with several other working groups, the working group discussed the comments received by the IAIS in response to its public exposure of its Common Framework for the Supervision of Internationally Active Insurance Groups concept paper, reviewing an IAIS's summary of comments received.

Overall, the working groups reviewing the summary heard that there is broad recognition of the need for ComFrame and support for the structure. However, both members and observers commented on the need for greater clarity on the relationship between ComFrame and the ICPs and other regulatory systems, and on whether ComFrame is in effect introducing another layer of supervision. Commentators also felt that ComFrame is too focused on requirements for IAIGs rather than supervisors, and questioned the level of detail and prescription, and reporting requirements, which were generally felt to be too onerous. The roles of involved supervisors, including the group-wide supervisor, were also felt to be unclear. However, in some areas, the IAIS received a range of comments, in particular for the level of emphasis on solvency,

which some commentators considered too high and some considered too low.

Working group discussions at the Fall National Meeting indicated that the NAIC, which responded to the concept paper, was broadly sympathetic to the comments raised. A significant topic of discussion for all working groups was the emphasis that ComFrame places on capital, and whether it will require IAIGs to hold a formal group capital requirement. The NAIC does not support the concept of formal group capital requirements, viewing the US ORSA as a tool for the assessment of group capital, and indicated that the question would go for strategic direction to the IAIS executive committee, in which the US actively participates.

## **International Insurance Relations Committee**

The committee met at the Fall National Meeting, and received various updates on IAIS and other international activities. The committee heard an update on the activities of the newly formed IAIS Supervisory Forum, which had met three times since its creation to share supervisory experience on risk, trends, qualitative and quantitative supervisory methods and the impact of macroeconomic change, in addition to procedural matters including confidentiality. The forum is next due to meet at the end of 2011.

An update on the NAIC's current involvement in the IAIS's ICPs project was received at the International Regulatory Cooperation Working Group meeting, also held at the Fall National Meeting. The update covered the IAIS's current project to develop self-assessment templates for jurisdictions to use to assess ICP compliance, which the NAIC is currently developing for ICPs 1, 2 and 23, and which are expected to make the FSAP process more efficient.

The International Insurance Relations Committee also received an update from Yoshihiro Kawai, the Secretary General of the IAIS, on the activities of the IAIS Financial Stability Committee (FSC) and Financial Stability Board (FSB) in relation to the identification and supervision of Global Systemically Important Financial Institutions (G-SIFI). The committee heard that the FSC is soon to publish a concept paper covering the identification of systemically relevant institutions, albeit the FSC does not consider traditional insurance business to give rise to systemic risk.

The paper is also expected to stress the difference between banks and insurers, in particular the lower level of interlink age between insurers as compared to banks. The FSC is actively debating how the differences will affect the application of current SIFI banking concepts to insurers, but recognizes the banking methodologies considered by the G20 in November as an important reference, in particular those relating to shadow banking.

The committee heard that the FSC is currently analysing data and meeting monthly to debate policy measures around the methodology for the identification of insurance SIFIs (on which there is no current consensus), the intensity of supervision, capital requirements and the resolution regime.

Mr. Kawai noted that the dialogue would be opened to industry in the future once consensus has been reached among regulators, and that the identification of insurance SIFIs is currently expected to be by national supervisory authorities, with the agreement of the FSB and with a consultation process. Further details on the process are expected to be circulated in 2012. On a related issue, the IAIS released on November 15 a paper entitled *Insurance and Financial Stability* in which they conclude that there is "little conceptual reason" to consider the insurance industry a systemic risk to global economies unless insurers engage in significant non-insurance activities.

The committee also heard a presentation on insurance regulatory reform in Mexico, and received an update on the NAIC's discussions held with EIOPA in September, at which the NAIC exchanged information with European regulators on the US supervisory system. The NAIC and EIOPA are next scheduled to meet in April 2012, and consider regulatory cooperation between the US and Europe to be an important priority.

## Valuation of Securities Task Force

### 2011 Year-End RMBS & CMBS Modeling Assumptions

On its October 13 conference call, the task force adopted SVO staff recommendations for the macro-economic assumptions, scenarios and probability distributions to be used for the 2011 modeling of RMBS and CMBS. The treatment of RMBS and CMBS for 2011 year-end reporting will remain consistent with the 2010 approach. PIMCO Advisory and BlackRock Solutions will once again perform the

financial modeling for RMBS and CMBS, respectively.

### Regulatory Reviews Status for RMBS & CMBS

Since 2009, when RMBS was placed under regulatory review, the NR\* symbol has been used to identify modeled RMBS and CMBS securities. The NR\* symbol is reserved for securities which are under regulatory review. At its meeting in Washington DC, the task force voted to remove RMBS and CMBS securities from regulatory review status effective December 31, 2011. The NR\* symbol will be replaced by a new FM symbol, indicating that the securities rating designation is the result of financial modeling.

### Modified FE Reporting Process

In a September 13 vote, task force members narrowly defeated a motion which would have suspended the modified FE reporting process for 2011 for all SSAP 43R securities. Following the vote, the task force formed a Modified FE Subgroup to determine if certain revisions could be made to the modified FE process in order to build greater regulatory consensus for 2011 year-end reporting. In October the subgroup voted to remove the "staleness component" of the modified FE reporting process as rating agencies have already implemented detailed procedures to ensure all ratings are current. The subgroup also agreed that credit tenant loans, equipment trust certificates and any other security which is rated by the SVO should be excluded from the modified FE process. On October 13, following discussion of the subgroup recommendations, the task force unanimously adopted the proposed revisions to the modified FE process effective for 2011 year-end reporting. As a result, CTLs and ETCs may be classified as SSAP 43R securities in accordance with the revised definition of loan-backed or structured securities effective January 1, 2011, but they will be exempted from the Modified FE process for year-end 2011.

In Washington, DC, the task force discussed a proposed amendment to the Purposes and Procedures Manual that would provide analytical instructions for financially modeled and non-modeled securities subject to SSAP 43R. A flowchart developed by interested parties which visually depicts the reporting requirements for modeled and non-modeled structured securities subject to SSAP 43R was also discussed. Both the proposed amendments and flowchart were exposed for a ten-day comment period (which was subsequently revised and is posted to the VOS TF webpage).

The task force also discussed a proposal from the New York State Insurance Department to amend the modified FE guidance to clarify how insurers should adjust the breakpoints in the modified FE pricing matrix. The proposal, which would be effective for 2012 reporting, was exposed for a 60-day comment period.

### Working Capital Finance Notes

The task force's Invested Assets Working Group continued its consideration of an SVO staff proposal regarding the working capital financial notes (WCFN) program. The proposal would permit WCFN purchased in accordance with the SVO developed program to be recognized as invested assets. WCFN are created at the request of a business; a bank establishes programs which permit eligible suppliers to sell receivables to the bank. Under such programs the bank confirms the terms of the invoice with the obligor and verifies that there are no defenses to payment. Once confirmed, the payable is a legally binding obligation to pay a sum certain on a stated date to the bank or a note holder, such as an insurance company.

The IAWG has developed a work plan to address the following key questions before making concluding on the WCFN proposal:

- Is it an appropriate invested asset for insurers? Does it fit within the investment model laws?
- What are the minimum standards required for an insurer to participate in the WCFN program?
- Could minimum requirements be developed where it would be appropriate for any insurer to invest?
- How would WCFN be accounted for and reported?
- What is the appropriate RBC factor?

The working group is likely to solicit input from the SAPWG, CADTF and Blanks Working Group and will hold interim conference calls to continue its consideration of the WCFN proposal.

### NAIC Designation Recalibration Project

The task force continued its discussion of an SVO proposal that would shift from the current single NAIC designation framework to three separate frameworks: one each for corporate bonds, municipal bonds and asset-backed securities. The proposal would create new NAIC designation symbols and definitions, update historical default performance and create new RBC factors. The proposal reflects the work of the SVO in conjunction with the ACLI, the AAA, and other industry and

capital market representatives. The task force referred the proposal to the C-1 Factor Review Subgroup for its consideration.

### Update on Referrals from RAWG

The task force adopted a report to the Financial Condition Committee which informs the committee that the task force has substantially completed its work on the referrals from the Rating Agency Working Group, which was charged with conducting a comprehensive evaluation of state insurance regulatory use of NRSRO credit ratings. On April 7, 2010 RAWG referred several recommendations to the task force. The report summarizes various actions taken by the task force and SVO to address the referrals, including:

- Implementing the RMBS and CMBS financial modeling and the modified FE process for certain other structured securities
- Increasing the NAIC SVO capabilities for highly engineered securities
- Assessing the reliability of ratings by comparing the change in NRSRO ratings over a period of time to the actual performance.
- Identifying tools that could serve as an alternative or a supplement to credit ratings.
- Considering risks other than credit which are not captured in NRSRO ratings
- Proposing changes to the NAIC designation framework (Designations Recalibration Project)

### Money Market Funds

The task force adopted previously exposed revisions to the Purposes and Procedures Manual to reflect changes in the federal regulation governing money market funds and related changes in the methodology employed by the NRSROs to assign a credit rating to these funds.

### Consideration of New ARO

The task force discussed a request by Kroll Bond Rating Agency to be added to the NAIC ARO list. (It is currently an SEC-approved ARO.) Kroll does not meet the current ARO requirements as stipulated in the NAIC Purposes and Procedures Manual. However, some task force members expressed their views that the ARO policies and procedures are too restrictive. In order to enable competition it may be desirable to increase the number of AROs. A conference call will be held to discuss and expose a New York proposal which would revise the ARO policy and procedures.

Subsequent to the Fall National Meeting, in a somewhat surprising decision, the VOS Task Force



exposed for comment a proposal to change the SVO policy to allow all NRSROs to be considered NAIC Approved Rating Organizations. This proposal will be discussed at the task force's November 29th conference call.

## Reinsurance Task Force

### Credit for Reinsurance Models

The task force briefly noted that the proposed amendments to the Credit for Reinsurance Model Law (Model #785) and Model Regulation (#786) to incorporate key elements of the Reinsurance Regulatory Modernization Framework Proposal, which the task force had spent years working on, were scheduled for adoption by Executive Committee and Plenary at the Fall National Meeting. Such adoption occurred after discussion of several friendly amendments as discussed on page 3 of this Newsletter.

### Collection of Reinsurance Recoverable Balances

The task discussed a referral from the Financial Condition Committee and the Receivership and Insolvency Task Force for assistance in providing a recommendation for enforcement of the collection of undisputed balances held by ceding insurers in receivership. This could include consideration of a NAIC Model Law or Guideline so that states have additional authority to collect such balances. The RITF noted that some states have statutes that can be used to demand valid payment from "reluctant" reinsurers. The task force added this project to its 2012 charges and directed NAIC staff to study state laws on the issue and report back at the Spring National Meeting.

### IAIS Reinsurance Activities

The task force received an update from NAIC staff regarding the reinsurance activities of the International Association of Insurance Supervisors. A drafting group of the IAIS Reinsurance and Other Forms of Risk Transfer Subcommittee met November 7 to begin the process of updating the IAIS Guidance Paper on the Regulation and Supervision of Captive Insurers.

## Blanks Working Group

The working group adopted one blanks proposal, which was previously exposed during a September 7 conference call. The adopted proposal adds clarifying instruction to Schedule D, Part 1, Column 11, Book / Adjusted Carrying Value related to the exception provided by INT 01-25 for Treasury

Inflation Adjusted Securities. The proposal is effective for the 2012 annual statement. (Agenda item 2011-35BWG)

A previously exposed proposal (Agenda item 2011-36BWG) which would move retained asset account disclosures from Note 21H to Exhibit 7 was deferred and re-exposed for an additional comment period. The item was deferred as it was determined that certain disclosure information contained in Note 21H was inadvertently omitted from the proposed Exhibit 7.

Three new proposals were exposed for a public comment period which ends February. These proposals will be considered for adoption at the 2012 Spring National Meeting. The proposals would:

- Add a table to the instructions to the annual statement Notes to indicate which disclosures are data captured. Instructions would also be added to clarify that data captured electronically should be presented in a format consistent with the illustration. (Agenda item 2011-37BWG)
- Add instructions to the annual and quarterly blanks stating the need to report certain GAAP items that are inconsistent with SAP for reporting by captive risk retention groups utilizing US GAAP. (Agenda item 2011-38BWG)
- Modify the instructions and illustrations for Note 9A to reflect the disclosure requirements of the recently adopted SSAP 101, *Income Taxes*. (Agenda item 2011-39BWG)

All Blanks proposals, including those adopted and exposed for comment, can be viewed at the Blanks Working Group page on the NAIC's website.

The working group also exposed the following items for a public comment period ending December 2 so that guidance is effective for year-end 2011:

- A Q&A document developed by interested parties regarding Schedule Y, Part 1A. The document is intended to serve as unofficial guidance for 2011 annual reporting and is expected to be posted to the Blanks Working Group page on the NAIC's website.
- A flowchart which illustrates the reporting of SSAP 43R, *Loan-backed and Structured Securities* relating to the application of the Modified FE process. Similar to the Q&A document, the flowchart would serve as unofficial guidance for 2011 annual reporting

and expected to be posted to the Blanks Working Group page on the NAIC's website.

- A proposal to delete the "SM" suffix from Schedule D, Part 1 instructions. The "SM" suffix was added with the adoption of blanks proposal 2010-20BWG and the 2011 Spring National Meeting, however it has subsequently been determined that the suffix is not needed.

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

The committee met in Washington DC and took the following actions:

### Companies Deemed to be in Hazardous Financial Condition

The committee adopted for accreditation purposes the 2008 revisions to the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition. These revisions provide additional standards for consideration by the commissioner to determine whether the continued operation of any insurer might be deemed to be hazardous to its policyholders, creditors or the general public. These revisions were previously released for a one-year public comment period which ended December 31, 2010. There were no comments received, and there have been no further revisions to model regulation since 2008.

### Insurance Holding Company System Regulatory Act and Model Regulation

The committee discussed the 2010 revisions to the Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation which are to implement the "windows and walls" concepts of supervision of insurance holding company groups. A proposal to include these revisions within Part A: Laws and Regulations of accreditation standards was exposed for a thirty day public comment period. The committee will hold a conference call in December to consider comments and vote on the proposal.

### Revisions to Documents Required for Accreditation

Revisions made during 2010 to publications that are required for accreditation purposes (e.g., the Annual Statement Blanks and Instructions; Life and P/C RBC Formulas; the Purposes and Procedures Manual of the NAIC Securities Valuation Office; the Accounting Practices and Procedures Manual; and

the Financial Condition Examiners Handbook) were adopted by the committee at the Spring National Meeting as revised accreditation standards. At that time, the committee exposed one significant revision made to the Financial Condition Examiners Handbook for a thirty-day public comment period. That revision was for changes in the content and timing of the review of the examination planning memorandum. At the Fall National Meeting it was noted that no comments were received on this revision, accordingly it is effective immediately.

### Risk-Based Capital for RRGs

The committee received a referral from the Risk Retention Group Task Force which would require states that charter risk retention groups to adopt the Risk-Based Capital for Insurers Model Act for accreditation purposes. The referral was exposed for a thirty-day comment period.

## **Life Insurance and Annuities Committee**

The committee met in Washington DC and discussed the following issues:

### Joint Working Group on ULSGs

As discussed in detail in the LATF summary on page 19, "A" Committee will be part of a joint group with members of the Financial Condition Committee working to resolve the contentious issue of reserving for universal life policies with secondary guarantees.

### Contingent Annuities

The contingent annuity product has become the subject of recent discussions within the NAIC and in May 2011, the Life Actuarial Task Force referred this product to the attention of the committee via a memorandum. The memorandum indicated a need for a more robust discussion on whether the product is an annuity or a financial guaranty product, the need for the product, the risks it presents, any consumer issues, as well as reserving and capital considerations. Following that, the American Academy of Actuaries assembled a small group of qualified actuaries with a broad range of experience with contingent annuities and their related topics. AAA submitted a comment letter to the committee last month.

At the Washington DC meeting, the Academy and an insurer recommended that the NAIC classify a contingent annuity as an annuity and not as a financial risk product. AAA stated that its contingent annuities working group compared key risks and

benefits of a contingent annuity to those of the widely accepted variable annuities with guaranteed living withdrawal benefits. A contingent annuity is essentially a stand-alone guaranteed living withdrawal benefit. The AAA working group also looked at tax treatment, SEC treatment, nonforfeiture treatment, and state guaranty fund coverage to reach its conclusions.

Conversely, another insurer gave its view that the product is not an annuity and that the product could lead to reserve problems. Among the concerns from the insurer is the difficulty in measuring and managing the risk associated with the guaranty on a contingent annuity, which leads to difficulty in determining adequate reserving needed to support the product. It was also noted that in 2009, the New York Insurance Department concluded that contingent annuities are financial guaranty insurance under New York's adopted version of the Financial Guaranty Model Regulation. Six other states also maintain laws or regulations that follow the sections of the NAIC model relevant to New York's opinion: Alaska; California; Connecticut; Florida; Iowa; and Maryland. The discussion concluded by the committee voting to form a working group to study the new market of contingent annuities and similarly designed products from an actuarial and policy standpoint, as various parties in the industry diverge on how the product should be classified and if, indeed, they should be sold under existing statute or model law.

#### Abandoned and Unclaimed Property Update

Insurance department officials met in a regulators-only meeting to discuss the way in which life insurers use the Social Security Administration's Death Master File (DMF) to locate annuitants and beneficiaries of life insurance policies. There is significant concern amongst regulators that some life insurers may only be using the DMF to stop annuity payments, but not to pay life insurance benefits.

At last count, thirty-five states are investigating whether insurers are appropriately escheating unclaimed life insurance benefits to the state. Most recently, the New York Attorney General and Comptroller and the Minnesota Insurance Department announced their own investigations. It remains unclear how the NAIC will respond to this issue. Some regulators would like to see a model law that requires the escheat dormancy period to being at the date of death. Others are concerned that such an approach would harm beneficiaries (as the amount of time they have to claim a life insurance

benefit from the insurance company decreases). Further discussion is expected.

## **Life Actuarial Task Force (LATF)**

The majority of LATF's day and a half meeting was spent on two issues: the interpretation of AG 38 for UL products with secondary guarantees and Principle Based Reserves. LATF adopted a "statement" reflecting their interpretation of AG 38 as it applies to ULSG products. Subsequent to LATF's action, the Executive Committee formed a subgroup to "determine whether it is prudent and necessary to develop interim guidelines and/or tools to be utilized by regulators in evaluating reserves for these products and, if so, to promptly develop such interim guidelines and/or tools" On the PBR front, LATF received an update on the nearly completed PBR Impact Study and took other actions to further the progress of this important project as it nears completion, which is targeted for March 2012.

#### PBR Life VM-20 Impact Study

Towers Watson provided LATF with another update on the nearly completed impact testing project regarding VM-20 of PBR. Phase I of the study was designed to assess the impact of PBR on the US life insurance industry. Phase II was to evaluate documentation and reporting requirements and to assess the effectiveness of specific elements of the PBR methodology (e.g. sensitivity testing). While some issues that were identified during the study are still being researched, Towers Watson presented detailed findings and analysis from the Impact Study, which include the following:

- As expected, VM-20 methodology had the most significant impact on ULSG and level term insurance products.
- Surprisingly, VM-20 reserves for ULSG products were higher under VM-20 than under current statutory requirements. Towers is continuing to research this observation to better understand the unexpected results.
- Level term reserves were significantly lower under VM-20 than under current statutory requirements; this result was anticipated given the conservatism inherent in current statutory reserves under Regulation XXX.
- The mortality blending requirement under VM-20 appears to be adding a significant margin to the ending PRB reserve, particularly for term products. This observation is also being further

studied and may result in changes to the prescribed mortality assumption in VM-20.

- The stochastic and deterministic exclusion tests were effective in identifying products where stochastic reserve calculations are not necessary (e.g. traditional whole life).

Towers Watson expects to issue their final report to LATF by the end of November.

LATF is targeting March 2012 for adoption of the valuation manual. A legislative package including the revised standard valuation law and PBR related changes to the standard non-forfeiture law is targeted for submission to regulators in the summer/fall of 2012.

### Actuarial Guideline 38

Since the 2011 Spring National meeting, LATF has been actively researching a concern that reserves for some ULSG products were below statutory minimum requirements based on some regulators' interpretation of AG 38. Earlier this year, LATF passed a motion that was later rescinded calling for LATF to bring this issue to the attention of the Actuarial Board for Counseling and Discipline. During the summer of this year, LATF exposed a draft "Statement on Actuarial Guideline 38" which clarifies what regulators believe is the correct interpretation of AG 38 section 8, step 1, instructing companies to use the lowest schedule of minimum premiums the policyholder could pay to keep the guarantee in force. Many companies believe that the "statement" includes new reserving requirements.

LATF received eight comment letters from insurance companies and industry associations on the draft "statement." During this Fall National Meeting, LATF gave each commenter a chance to present their positions to the task force. Only one company was supportive of LATF's position as described in the draft statement. In the end, regulators were somewhat sympathetic with the companies' dilemma, especially after one company actuary described his process of going to his domiciliary state regulators in 2009 to describe the company's product features and their interpretation of the reserve requirements under AG 38. In addition, these products were targeted during a state exam which took place in 2011 and the examiners deemed the company's reserves to be appropriate.

This lengthy discussion of AG 38 lasted more than 4 hours. During this debate, an NAIC legal representative opined that, if adopted, the

"statement" would not be included in the Accounting Practices and Procedures Manual and therefore would carry no real authority other than the "force of persuasion." Still, LATF voted to adopt the statement with a few minor changes, which focuses their interpretation on a specific policy design identified by NY as being the most problematic.

Subsequent to LATF's action, Executive Committee formed a joint working group of commissioners to "determine whether it is prudent and necessary to develop interim guidelines and/or tools to be utilized by regulators in evaluating reserves for these products and, if so, to promptly develop such interim guidelines and/or tools." The group is expected to work expeditiously in developing conclusions to this issue which could affect year-end 2011 reserve requirements. The first meeting of the joint working group has not yet been announced. The working group is comprised of regulators from AK, CA, FL, IA, NY, NJ, TN, TX and VA.

### PBR - VM-20, Life Insurance

In other VM-20 developments, LATF spent considerable time discussing two alternatives for determining investment and reinvestment rates. Alternative 1, originally proposed by NY, is the more simplified approach of the two alternatives and produces the higher reserves of the two alternatives. Alternative 2 is the original approach proposed in VM-20 and its complicated structure may leave room for a compromise between the two versions. New York is expected to revise their proposed Alternative 1 methodology and resubmit it to LATF. Other areas of PBR and the VM are on target for completion by March 2012.

### Nonforfeiture Improvement

The Nonforfeiture Improvement Working Group of the American Academy of Actuaries presented a detailed report to LATF outlining its recommendations for improving nonforfeiture requirements in the United States. Among the Academy's recommendations are the following:

- Replace the current nonforfeiture mandates with a revised methodology,
- Require a retrospective methodology utilizing actual policy gross premiums and reflecting the funded portion of the risks in the policy,
- Have a consistent methodology between products including life and annuities,
- Develop enhanced methods for consumer information.



Without making a recommendation, the Academy questioned whether cash surrender values should be mandated in addition to other nonforfeiture benefits such as extended term or reduced paid-up insurance. The Academy recommended against using the current status of the insured in determining nonforfeiture benefits, which suggests that life settlement companies would continue to be able to offer more attractive benefits to terminally ill policyholders than standard nonforfeiture values. Regulators appeared to be in favor of the retrospective approach recommended by the Academy but were mixed on whether to allow the current status of the insured to be used in the calculation. Future conference calls will be scheduled as LATF continues with this charge that originated nearly a quarter of a century ago.

#### Mortality Tables

LATF received a report from a joint Society of Actuaries & Academy group regarding the status of two separate mortality table projects. For guaranteed issue, simplified issue and preneed products, data has been submitted from 18, 32 and 10 companies, respectively. Mortality analysis will begin in early 2012 with persistency analysis shortly thereafter. A first draft of the new tables is expected in late 2012.

Work on a new Valuation Basic Table to support PBR is underway. Originally, experience from 2002 through 2007 was collected for this purpose. However, with delays in PBR, data from 2007 through 2009 have been collected from 40 companies and is being included in the analysis. This additional information will greatly increase the amount of preferred underwriting experience data on which the new table will be based.

#### 2012 Annuity Mortality Table

LATF will request a charge from Executive Committee to develop a model regulation to support the 2012 Annuity Mortality Table to be used for payout annuities. The table was exposed following the Spring National Meeting.

#### Moody's Corporate Bond Index

NAIC staff informed LATF that once again Moody's is looking to charge the NAIC a significant fee in order to use its corporate bond index in dynamic valuation interest rate calculations. This issue resurfaces every few years and until now, the NAIC

been able to convince Moody's to allow limited use of their index without a fee. If a new arrangement cannot be reached, LATF may need to find an alternative index on which to base dynamic interest rate requirements.

#### Nonforfeiture Law

LATF briefly discussed the changes needed to the Standard Nonforfeiture Law to make it consistent with PBR requirements and the revised Valuation Manual. Their plan is to tie the non-forfeiture interest rates to the Valuation Manual. A conference call will be held for further discussion of this topic.

#### ACLI Proposed Framework to Verify Reserves

The ACLI made similar presentations to both LATF and the PBR Working Group suggesting a framework to verify reserves determined under PBR. The concern is that regulators face a difficult challenge ahead to determine if companies are compliant with the new statutory reserve requirements and that companies will need to finance these reviews. The ACLI's framework included four recommendations:

1. Independent 3rd part review/audit; the ACLI is suggesting the company's auditors carry out this task as a cost effective solution. The NAIC has previously rejected this type of solution citing their inability to rely on the work of firms not hired directly by the regulatory authority.
2. Develop Standards of Practice specific for the independent review
3. Centralized regulatory resources to foster consistent application of PRB reviews
4. Feedback of PBR Practices

The task force and PBR Working Group indicated that they will give consideration to the ACLI's proposal.

### **Health Actuarial Task Force**

#### Long Term Disability

The task force received an update from a joint Academy & SOA group that is developing a new LTD valuation table to replace the 1987 Commissioners Group Disability Table. The initial construction of the new table was completed and presented to the task force over the summer. Work is underway to develop and recommend a methodology for

incorporating a company's own experience into the termination rates used for valuation purposes, taking into account the credibility of the company's data. The work group also plans to develop and recommend margins for the valuation table. The group expects to make a final recommendation in March 2012.

#### Cancer Claim Cost

The task force received an update from a joint Academy & SOA group that is studying the possibility of replacing the 1985 cancer tables. A survey was conducted and 16 responses were received from 33 companies solicited. The survey results showed diversity of practice in use and application of the 1985 tables. Due to the inability to collect industry experience data for all cancer benefits, the work group will solicit experience data limited to incidence and hospitalization benefits. This data is expected to be much easier to compile and the task force hopes it will lead to higher voluntary responses to the data call which is expected to go out early next year after the completion of year-end valuation work. The project is expected to take 12 to 16 months to complete.

#### Long Term Care

The task force received a report regarding the development a new LTC valuation table. The group expects to have a first cut of the tables by the end of February 2012 and a draft recommendation by the end of June 2012.

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

The task force received an update from its Actuarial Opinion Subgroup, noting that the 2012 Proposed P/C Actuarial Opinion Instructions, 2011 Changes Made to the P/C Actuarial Opinion Summary Instructions, and 2012 Proposed Title Actuarial Opinion Summary Instructions were exposed for comment on September 9. The comment period ended October 10 and the task force received comments from the American Academy of Actuaries for the 2012 P/C Instructions. Although the task force views the changes as non-substantive, interested parties do not. Changes for the P/C Instructions relate to the actuarial report, focusing on the appointed actuary's relationship to the Company/Board including how and when the report is presented to the Board/Company officers as well as a reconciliation of the actuary's estimates to Schedule P broken out by segment and line of business.

AAA expressed concern over the proposed language in that the appointed actuary does not control, or necessarily know about, the distribution of the actuarial report to Company officials after it has been provided to management. AAA also commented on the challenges in splitting the actuarial analysis by segment as needed for the reconciliation to Schedule P, and was informed that the subgroup is not seeking segmentation by the actuary. However, companies would be required to allocate the reserves booked by segment which, when summed, should reconcile to the actuary's estimates. On the 2011 Changes, the task force received an informal comment from interested parties on the use of language referring to a central estimate vs. a point estimate. AAA reported that they have not yet responded with comments on the Title Instructions but anticipate similar comments as submitted for the P/C Instructions. As a result of comments received, the task force has deferred the proposed changes to the subgroup for additional review. There is a need for the Instructions to be finalized by February 2012. The task force anticipates discussing final revisions on its December 13 conference call.

The task force heard comments relating to self regulation of actuaries, primarily the experience from U.K., and discussion of a possible statute on the life actuarial side governing actuarial reports and certification of actuaries that would allow an insurance department not to accept the certified report of an actuary in certain circumstances. The task force agreed to continue discussion of this matter at a later time, after obtaining information on life actuarial statute, and with input from the Actuarial Standards Board and Actuarial Board of Counseling and Discipline.

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

#### Review of Climate Risk Disclosure Questionnaire Responses

The working group reviewed a summary of NAIC Climate Risk Disclosure Questionnaire responses. The summary was prepared by NAIC staff based on the results provided from seven (Maryland, Colorado, New Jersey, Puerto Rico, New Hampshire, Vermont and California) of the twenty-one jurisdictions that participated in the NAIC Climate Risk Disclosure Survey. Of the seven states that shared results, four implemented the survey as mandatory and three implemented the survey as voluntary. The working group noted that insurer

participation was low among those states that implemented the survey on a voluntary basis. The summary included responses from twenty-seven insurers, eighteen of which indicated that they have either a formal or informal comprehensive plan regarding climate change. Plans included reducing the insurer's carbon footprint by decreasing power consumption, promoting recycling and using paperless transactions. Thirteen of the respondents indicated that they include aspects of climate change in their risk management considerations, while ten respondents indicated they consider the impact of climate change on their investment portfolio.

At the Fall National Meeting, the working group heard a presentation from Ceres on insurer investments and climate change. The presentation included observations-based responses to the Climate Risk Disclosure Survey. Ceres' observations included the following:

- There is broad consensus among insurers that climate change will have an effect on extreme weather events.
- Property insurers tend to describe exposures or perils with more specificity than life insurers.
- The majority of insurers using catastrophe models do not seem to know how the models can or cannot be used to anticipate changing risk.
- In general, the industry is focusing on a narrow set of risks, with less attention to non-coastal extreme weather.
- Few insurers consider the risks and opportunities presented by climate change on their investment portfolios.

### New Subgroups

The working group formed two new subgroups and discussed their respective work plans.

The Impact of Climate Exam Subgroup will be chaired by Washington, and is charged with reviewing risk-focused examination questions for possible inclusion of specific questions regarding the impact of climate for inclusion in the 2013 Financial Condition Examiners Handbook. The subgroup's first meeting is scheduled for November 30.

The Impact of Climate Disclosure Survey Subgroup will be chaired by California, and is charged with modifying the NAIC Climate Risk Disclosure Survey to have greater financial emphasis. This subgroup will also review the United Nations Environment Programme Finance Initiative Survey: "Advancing the Role of the Insurance Industry in Climate

Change Adaptation" and consider possible approaches for US insurer participation.

## **Risk Retention Group Task Force**

At the 2011 Spring National Meeting, the task force exposed two proposals for public comment regarding the applicability of the risk-focused examination approach and the risk-based capital calculation to RRGs. These proposals were adopted by the task force on a May 10th conference call. The task force concluded that captive RRGs should not be exempt from the risk-focused examination approach (RFE), as the RFE is flexible enough to allow examiners to tailor the examination to fit the unique characteristics of captive RRGs.

The task force also concluded that the capital adequacy standard for RRGs should include the requirement for domestic regulators to enforce the Risk-Based Capital for Insurers Model Act. It was determined that while most captive RRGs report on a US GAAP basis, rather than SAP, the RBC calculation is still a meaningful measure for most RRGs. As a result, RRGs will be required to file annual RBC reports and captive states will need to adopt the RBC Model Act as applicable to RRGs. In limited circumstances, domestic regulators of RRGs could elect not to take regulatory action which would otherwise be required by the RBC Model Act. The adopted proposal was referred to the Financial Regulation Standards and Accreditation Committee for consideration as an accreditation standard, which exposed the proposal for comment.

### Risk-Focused Examination Tools

During its meeting in Washington DC, the task force discussed a list of interview questions for captive managers that examiners may use during the planning phase of risk-focused examinations. The questions were exposed for a thirty-day public comment period during a September 15th conference call. The questions cover areas such as the experience of staff members assigned to the captive, duties and responsibilities of the captive manager, the reporting structure, risk assessment and knowledge of fraud assessments. The task force referred the proposed interview questions to the Financial Examiners Handbook Technical Group. The task force also formed a subgroup which will discuss problems encountered and lessons learned by captive RRG states which have already performed risk-focused examinations of RRGs. The goal of the

subgroup is to develop best practices or tools which will create a more efficient examination process.

## Risk Retention Working Group

The working group met via conference call on October 3 to consider revisions to the notification requirements contained within the Model Risk Retention Act. The model currently requires that a risk retention group submit a copy of any revisions to its plan of operation to a non-chartering state at the same time that the revision is submitted to the commissioner of the chartering state. The working group discussed concerns that the chartering state may not approve the business plan change. Following this discussion, the working group agreed to amend the Model Risk Retention Act to clarify that a risk retention group shall submit a copy of any material revision to its plan of operations to non-chartering states within thirty days of the approval of such revisions by the commissioner of its chartering state, or if no such approval is required, within 30 days of filing.

## Social Media Working Group

As social media continues to become more prevalent in the marketplace, state regulators are taking notice. The newly formed Social Media Working Group met on November 3rd to discuss its draft whitepaper *The Use of Social Media in Insurance*. The goal of the working group is to develop guidelines for the proper use of social media and to instruct insurance companies on the "medium's benefits and limitations" in an effort to protect consumers. Ultimately, this whitepaper will be used as guidance for insurers when creating policies and addressing regulatory and compliance issues specific to social media.

In some instances, regulators are probing social media related-regulatory concerns through market conduct examinations and the monitoring of consumer complaints. These reviews stem from the potential regulatory and compliance infractions that can arise through a lack of supervision, monitoring and training for social media. For example, when an insurer is responsible for the content of a specific social media communication, the insurer is also responsible for complying with state record retention regulations relative to the subject communications. Regulators believe that insurers and producers should view social media as a form of advertising and, as such, should be sensitive to regulatory issues that arise from this type of external

communication. Specifically, regulatory guidance related to advertising and marketing, record retention, consumer privacy, and consumer complaints should be reviewed to ensure that their social media policy is consistent with regulatory objectives.

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The next National Meeting of the NAIC will be held in New Orleans March 3-6. 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 at [jean.connolly@us.pwc.com](mailto:jean.connolly@us.pwc.com).

## Disclaimer

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

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



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