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NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS

NAIC 2010 SPRING NATIONAL MEETING

The National Association of Insurance Commissioners held its 2010 Spring National Meeting in Denver March 24-28. 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

- During the final session in Denver, the Commissioners overturned their previously adopted mandatory Insurer Climate Risk Disclosure Survey and replaced it with a voluntary, confidential survey. (page 3)

- The NAIC held a special session on systemic risk in insurance; a report from the Geneva Association has concluded that core insurance activities do not pose systemic risk to financial stability and was not the source of the current financial crisis. (page 3)

- Various working groups and committees discussed the recent adoption of Federal health care reform, the Patient Protection and Affordable Care Act. (page 3)

- The Financial Condition Committee finalized its paper on The United States Insurance Financial Solvency Framework which will be used by the Solvency Modernization Initiative Task Force in its work. The committee received the final report of its Rating Agency Working Group, *Evaluating the Risks Associated with NAIC Reliance on NRSRO Credit Ratings*. (page 4)

- In early 2010, the Statutory Accounting Principles Working Group finalized its SSAP 43R Q&A Implementation Guide; in Denver the working group released new or revised proposed guidance on guarantees (SSAP 5R), securities lending (SSAP 91R), and prospective-based guaranty fund assessments (Issue paper 143/ SSAP 35R). The working group announced the formation of the DTA Subgroup and the FAS 166/FAS 167 Subgroup, whose work will begin shortly. (page 5)

- The Emerging Accounting Issues Working Group reached a tentative consensus on accounting for the North Carolina Beach Plan, which would require equity interests that are not expected to be recovered to be written off to miscellaneous expense. (page 7)

- The Blanks Working Group adopted ten blanks proposals as final and exposed twelve new proposals for comment. The working group will hold an interim meeting June 21 to stay on track with 2010 proposals. (page 8)

- The NAIC/AICPA Working Group updated its survey on the states' progress of adopting the revised Model Audit Rule (MAR), noting that forty-nine jurisdictions have now adopted revised laws or regulations. The working group also directed staff to draft proposed disclosures modeled on the new SEC compensation disclosures in Rule 33-9089 as a starting point for discussion during an upcoming interim conference call. (page 9)

- The Valuation of Securities Task Force adopted a recommendation to extend through 2010, the 2009 short-term approach for rating residential mortgage-backed securities and adopted a recommendation that would change the approach for rating other structured securities, including commercial mortgage-backed securities beginning with the year-end 2010 annual statement. The task force discussed the techniques used by the SVO to determine fair value. The task force also released two SVO proposals for public comment, one of which would clarify the NAIC policy on the use by insurers of NAIC ratings designations as rating triggers in private agreements. The Invested Assets Working Group continued its efforts to develop a disclosure framework for investment risks other than credit and to develop a fixed income security risk-focused framework. (page 10)

- To the surprise of some interested parties, the Capital Adequacy Task Force exposed for comment a proposal to increase the base factor for mortgage loans from 2.6% to 4% for the 2010 RBC filings. The task force also adopted a recommendation to make Health RBC an accreditation standard. The Life RBC Working Group continued progress on its derivatives risk mitigation proposal, but realized it won't be completed for 2010 RBC; the working group also received an updated long-term mortgage loan proposal from the ACLI for discussion. The P/C Risk-Based Capital Working Group exposed an updated underwriting risk charge study which recommends an increase to the reinsurance lines of 15% for 2010, for the third year in a row. (page 12)

- The Life and Health Actuarial Task continues to make significant progress on its Valuation Manual; with strenuous effort, the task force believes it is on target to complete the manual by the extended August deadline. Some interested parties expressed concern that the PBR project is significantly moving away from being purely "principles-based." (page 15)

- The Life Insurance and Annuities Committee adopted, as final, revisions to the Suitability in Annuity Transactions Model Regulation. The committee also discussed its new charge to consider "stranger originated/owned annuities and how these transactions may interact with insurable interest laws and the impact of this activity on consumers." (page 17)

- The Solvency Modernization Initiative Task Force held a two day interim meeting in March to discuss the future of solvency regulation through its solvency modernization initiative. Significant progress has been made by the task force's Group Solvency Issues Working Group on its proposed revisions to holding company model law to reflect concerns in a group supervision setting. The Corporate Governance Working Group is working to outline high-level corporate governance principles. (page 19)

- The recently formed Title Insurance Task Force met to discuss its mission to study issues related to title insurers and title insurance producers, including the possible development of risk-based capital and other early warning tools for title companies. (page 23)

New National Meeting Schedule

This meeting marked the first under the NAIC's new triannual schedule; while the next national meeting is not until August, many working groups will be holding conference calls and in-person interim meetings to stay on target with 2010 goals and charges.

Executive Committee and Plenary

In a surprising turn of events, the Commissioners voted 27-22 to overturn the previously adopted Insurer Climate Risk Disclosure Survey and adopt a revised disclosure survey dated March 28. The revisions include making the survey confidential and the survey is to be filed only with the domiciliary regulator "at the discretion of each state." The survey adopted at Plenary in March 2009 was mandatory for insurers with premiums in excess of $500 million and the results would have been made publically available. The NAIC will work with participating states to develop a public report that provides information related to insurers' responses in the aggregate. The revised survey has been posted to the NAIC's website.

The NAIC will be reaching out to states the week of April 5 to determine their plans, which could possibly include states requiring the survey from non-domiciled companies.

The commissioners also adopted the following items, which were the subject of extensive public hearings as the proposals were being debated by the various groups of the NAIC:

- Amendments to the Suitability in Annuity Transaction Model Regulation (#275)
- Actuarial Guideline XLIII-CARVM for Variable Annuities (which was effective for 2009 financial statements in most states)
- Guideline Amendments to the Uniform Health Carrier External Review Model Act (#76)
- NAIC White Paper Alternative Mechanisms for Troubled Companies
- Guideline for Notice of Protection Provided by [State] Life and Health Insurance Guaranty Association

Special Session on Systemic Risk and Insurance

The International Insurance Relations Leadership Group held a special session in Denver entitled *Systemic Risk and Insurance: Industry Analysis of Insurance and Financial Stability*, a special report of the Geneva Association of Systemic Risk Working Group. According to its literature, the Geneva Association is an "international "think tank" for strategically important insurance and risk management issues."

The report concludes that core insurance and reinsurance activities do not pose any systemic risk and were not the source of the current financial crisis. For example, the report compares insured catastrophe losses for the period of 1970-2008, showing a total loss of $155 billion, to the cost of bank failures for the same period, which cost $1.7 trillion. The report notes that two non-core activities could be "systemically relevant": derivatives trading on non-insurance balance sheets including credit default swaps and mismanagement of short-term funding through commercial paper or securities lending.

The Geneva Association recommends five steps to strengthen insurance regulation:

- Implement comprehensive, integrated and principles-based supervision of insurance groups

- Strengthen liquidity risk management

- Improve regulation of financial guarantee insurance

- Establish "macro-prudential monitoring bodies" to monitor macro-economic risks in the financial services sector

- Strengthen risk management practices

Health Care Reform

Various working groups and committees discussed the recent adoption of health care reform, the Patient Protection and Affordable Care Act (H.R. 3590). The chair of the Health Insurance and Managed Care Committee noted that industry and regulators should not underestimate the amount of work it will take by all parties to implement the new law. The committee then heard comments from interested parties on their thoughts on the most pressing implementation concerns including the definition of and methodology for "medical loss ratio," changes that will be required Medicare supplement plans, NAIC assistance to states on rate and form filing requirements, state regulation of self funded plans, and many others. The NAIC plans to draft FAQs for states to post to their web sites and will also assist in data collection.

The Accident and Health Working Group was asked to free up time on its agenda for future work related to the adoption of health care inform. In addition, the Financial Condition Committee formed a new group, the Health Reform Solvency Impact Subgroup, whose charge is to "assess the solvency impacts/concerns for health insurers" as a result of the recently passed health care reform and recommend charges for the appropriate groups to address these concerns.

Principles-Based Reserving Working Group

The working group did not meet this winter or in Denver. A conference call is scheduled for April 14.

Financial Condition Committee

U.S. Insurance Solvency Framework
The committee met via conference call February 19 and adopted the Solvency Framework exposed in November. The 31 page Framework paper includes discussion of the seven U.S. Insurance Financial Solvency Core Principles: 1) Regulatory Reporting, Disclosure and Transparency, 2) Off-site Monitoring and Analysis, 3) On-Site Risk-focused Examinations, 4) Reserves, Capital Adequacy and Solvency, 5) Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities, 6) Preventive and Corrective Measures, Including Enforcement, and 7) Exiting the Market and Receivership. The Framework is available on the NAIC's website at http://www.naic.org/documents/committees_e_us_solvency_framework.pdf

Basel Committee on Banking Supervision
The Financial Condition Committee has become aware of a proposed "consultative document" from a Basel Committee that has caused some to be concerned that one of its recommendations "could have a negative effect on the liquidity of share of insurance companies" by non-admitting certain holdings in financial institutions for purposes of determining bank capital levels. Comments are due to the Basel Committee by April 16. The full proposal is available at http://www.bis.org/publ/bcbs164.pdf (page 32).

The committee received reports from its working groups; the actions of groups not meeting in Denver are summarized below.

Separate Account Risk Charge Working Group
This newly formed working group held its first meeting via conference call on March 15. NAIC staff reviewed that the genesis of the charge to study the need for new regulatory requirements for risks assumed by the general account in support of individual separate account products was the project that resulted in recently adopted revisions to SSAP 56, Separate Accounts, to require additional disclosures.

Staff noted that currently there is a risk charge requirement for certain specific group contracts in the Separate Accounts Funding Guaranteed Minimum Benefits under Group Contract Model Regulation (#200) but no similar risk charge is required for other group contracts or any individual contracts. The working group then discussed a possible plan of action to address the issue of risk charges in insulated and non-insulated separate accounts. This will include review of Model #200 discussed above, the Model Variable Contract Law (#260), a New York statute similar to this model law and discussion of the possible need for a new model for individual products similar to Model #200. A conference call will be scheduled for later in April to continue the discussion.

Rating Agency Working Group
The working group held a public hearing via conference call March 17 to review final comments on its report *Evaluating the Risks Associated with NAIC Reliance on NRSRO Credit Ratings* that had been exposed for comment at the Winter National Meeting. The chair noted that the working group and staff had reviewed all the comment letters received and had made numerous changes to the report to address the comments.

The final document, adopted by the working group during its conference call, has three primary recommendations as follows:

- Regulators should explore how reliance on ARO ratings can be reduced when evaluating new, structured or alternative asset classes by introducing alternative ways to measure risk
- Consider alternatives for regulators' assessment of investment risk, including expansion of the role of the SVO, and

- When considering continuing use of ratings in insurance regulation, the NAIC should consider steps taken by NRSROs to implement recommended structural reforms. (The report then details ten suggested reforms.)

In Denver, the committee considered, but did not adopt the report as final. The committee will hold an April conference call to consider for adoption the remaining recommendations as referrals to other committee task forces and working groups.

Investments of Insurers Model Act Revision Working Group
The working group is charged with assessing the need to modify the Investments of Insurers Model Act, which has not been updated since its adoption in 1996. Staff surveyed state insurance departments regarding the use of the existing models and their effectiveness in addressing the issues that exist within insurers' portfolios; 100% of states responding agreed that improvements could be made to the current NAIC investment law models to address insurers' investment risks in light of the recent economic crisis. Areas to focus may include securities lending, structured securities, rated credit instruments including hybrid securities, and pledged securities.

The survey was discussed on a March 16 conference call of the working group and was exposed for comment until April 30. A conference call will be held after that to review comments received.

Statutory Accounting Principles Working Group

Adoption of New Standards or Revisions to SSAPs

SSAP 43R Q&A - The working group held two conference calls in January to discuss the SSAP 43R Question and Answer Implementation Guide. Among other guidance, the Q&A document contains direction on AVR and IMR issues and clarifies that the transition adjustment to adopt SSAP 43R should include all other-than-temporary-impairments, not just adjustments to securities that were previously impaired. The Q&A also includes guidance stating that once an entity concludes that it has an intent to sell a particular security, that assertion cannot be changed back to "ability and intent to hold."

The Q&A document was issued February 2 and is posted to the SAP Working Group's webpage.

ASU 2009-02, Omnibus Update - Amendments to Various Topics for Technical Corrections - This update was rejected as not applicable to statutory accounting.

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

Items exposed for comment have a comment deadline of May 28, 2010 (unless otherwise stated).

SSAP 5R Revisions to Adopt FIN 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Others - The working group continued its long-standing discussion of the requirement for liability recognition at the inception of a related party guarantee. Interested parties continue to object to liability recognition for any related party guarantees (which is not required by U.S. GAAP). (At the Winter National Meeting, the working group agreed to exclude recognition for guarantees to wholly owned subsidiaries of insurers.)

At its meeting in Denver, the working group re-exposed minor proposed wording changes to SSAP 5R and directed staff to work with interested parties on clarifying additional issues, such as the accounting for guarantees to sister companies, which interested parties believe should not result in an expense being recorded, but rather as a dividend to the parent company and a capital contribution to the sister company.

SSAP 91R Revisions to Address Measurement of Sufficient Collateralization for Securities Lending Transactions - At the Winter National Meeting the working group exposed proposed revisions to SSAP 91R that would provide a modified GAAP approach of defining what is on and off balance sheet, and which requires that if the collateral can be sold or pledged by custom or contract it would be record "on balance sheet," with one line reporting for certain securities lending collateral.

The subgroup met in February and March to discuss comments received on the proposed changes. During the conference calls, the subgroup finalized its proposed Schedule DL for securities lending. Part One of the schedule would list reinvested collateral held for the "one line item reported items" (where the collateral is held by an unaffiliated agent and can be sold or repledged).

Part Two would list collateral held that is also reported in the annual statement investment schedules (for securities lending programs where the insurer receives the collateral directly and can sell or repledge it). Insurers with securities lending arrangements administered by affiliated agents can chose to report using either the single line item treatment or within the investment schedules. The subgroup also drafted the related Blanks proposals.

At its meeting in Denver, the working group re-exposed the proposed changes with a comment deadline of April 29, in order to meet Blanks Working Group deadlines for 2010 changes to the annual statement.

<u>Issue Paper 143, Prospective-Based Guaranty Fund Assessments</u> - The Guaranty Fund Subgroup had previously released for comment a draft Issue Paper that proposes substantive revisions to SSAP 35 to incorporate the ASC 405-30/SOP 97-3 approach for guaranty fund liability recognition. Under this approach, accounting for guaranty fund assessments would be determined in accordance with the type of guaranty fund assessment imposed, and would incorporate the concept of an "obligating event" for prospective-based premiums assessments in determining whether liability should be accrued.

After the Winter National Meeting, the subgroup held two conference calls to review comments and finalize the proposed issue paper and revised SSAP 35R for consideration by the SAP Working Group at its meeting in Denver. The regulators voted to expose these documents as drafted by the subgroup, which adopts GAAP with the following substantive modifications:

- Assets recognized from anticipated recoverables from policy surcharges and premium tax offsets from accrued liability assessments are nonadmitted for statutory accounting.

- Liabilities for guaranty fund and other assessments may not be discounted.

The proposed effective date was extended from year-end 2010 to January 1, 2011.

There was significant discussion at the subgroup and working group level of the proposed guidance to allow an admitted asset for policy surcharges and premium tax offsets only when the related assessment has been paid. The regulators recognize this is a conservative position and have agreed to consider it further during the exposure period.

<u>AVR and IMR Guidance within SSAP 43R and SSAP 7</u> - During the discussion of the SSAP 43R Q&A, the working group noted that there is a discrepancy between the guidance in SSAP 43R and the intent of the working group related to AVR and IMR bifurcation. To resolve the discrepancy, the working group exposed proposed revisions to SSAP 43R and SSAP 7 to clarify that gains and losses are to be bifurcated between AVR and IMR regardless of whether the NAIC rating has changed by more than one designation or whether the loss is related to a sale or an other-than-temporary impairment.

<u>SSAP 90 Clarification</u> - The working group exposed for comment a proposed nonsubstantive revision to SSAP 90 to clarify that properties occupied by the company are subject to recoverability testing when <u>any</u> (not <u>all</u>) of the conditions in paragraph 6 are present.

<u>Issue Paper 141, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities and Issue Paper 142, Variable Interest Entities</u> - The working group received preliminary comments from interested parties on Issue Paper 141 and 142 but had very little discussion on the proposed issue papers in Denver. The comments will be referred to the newly formed FAS 166/FAS 167 Subgroup for its consideration. In response to a question from interested parties, the chair noted he is in support of deferral of the proposed effective date of the standards from year-end 2010 to no earlier than year-end 2011, due to the complexities of the proposed standards. The FAS 166/FAS 167 Subgroup will also be asked to consider the guidance in *ASU 2010-10, Consolidation (Topic 810), Amendments for Certain Investment Funds*. A meeting of the subgroup has not yet been scheduled.

<u>ASU 2009-14, Certain Revenue Arrangements that Include Software Elements</u> - The working group asked interested parties to comment as to whether the arrangements covered by this guidance are prevalent for insurance companies and whether the guidance is necessary/applicable.

<u>Policy Statement on Coordination with the PBR Valuation Manual</u> - The working group exposed for comment a proposed process for updating the Valuation Manual, which is expected to be finalized this summer. The process will include significant

interaction with the Life and Health Actuarial Task Force.

Accounting for Life Settlement Contracts - The working group briefly discussed the issue of accounting by insurance company as third party investors. The chair noted he would like more information on the valuation and marketability of such contracts. The working group deferred action and may include the topic in a future conference call.

Fund Demand Disclosure for Institutional Business
The working group resumed discussion of this long standing project (a 2004 Blanks Working Group referral), which goal is enhanced disclosure of liquidity risk management of insurers. The working group received a report from interested parties, who recognize the need for disclosing "some detailed liquidity information" and are reviewing liquidity reports requested by individual states and other information to develop a standard template for reporting at the company level.

These reports include documented liquidity plans, rating agency liquidity findings, reliance on reinsurers, liquid and illiquid assets and cash demands related to institutional business. Interested parties plan to submit the results of this analysis to the working group by the May 28 deadline, with a focus on what information should be made publically available and what should be confidential filings to regulators only.

ASU 2010-9, Subsequent Events - The working group exposed for comment a proposal to reject recently issued revisions to Topic 855/FAS 165 as the working group believes the amendments to address the GAAP conflict with SEC guidance do not affect statutory financial statements. Under the revised guidance, SEC filers will not be required to disclose the date through which subsequent events were evaluated.

ASU 2010-06, Fair Value Measurements and Disclosures - The working group exposed for comment proposed revisions to SSAP 100, Fair Value Measurements, to adopt with some modifications, the new and revised disclosures in ASU 2010-06. The proposed disclosures would be effective for December 31, 2010 financial statements and thereafter.

The working group also exposed for comment proposed nonsubstantive revisions to SSAP 100 to clarify which assets should be considered "recurring" and "nonrecurring" for statutory accounting. An excerpt of the proposed revisions is as follows: "For purposes of statutory accounting, investments that are held at the end of the prior reporting period and are measured at fair value at the end of the current period are considered to be "measured at fair value on a recurring basis." For example, under SSAP 32, bonds may be held at lower of cost or fair value depending on their NAIC rating. If at the end of the prior period, the bond was reported at fair value, and the bond is currently reported at fair value, it would be considered a recurring fair value measurement for disclosure purposes."

DTA Subgroup
The working group reported that the DTA Subgroup has been formed and will be chaired by representatives from Ohio and Virginia. The subgroup's goal is to have a long-term solution on income taxes and deferred taxes effective for the first quarter of 2011, as SSAP 10R is in effect through year-end 2010. No meetings have yet been scheduled.

Emerging Accounting Issues Working Group

ASU 2009-15: Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing - The working group adopted as final a consensus to reject this EITF guidance as not applicable to statutory accounting, as such transactions are rare. This guidance will be listed as rejected in INT 99-00, Compilation of Rejected EITFs, which was adopted at the 2009 Winter National Meeting.

ASU 2009-13: Revenue Recognition: Multiple-Deliverable Revenue Arrangements - The working group exposed for comment a tentative consensus to reject ASU 2009-13 as such arrangements are infrequent within insurance companies.

ASU 2010-01: Accounting for Distribution to Shareholders with Components of Stock and Cash
The working group reached as tentative consensus to reject this guidance as not applicable to statutory accounting.

North Carolina Beach Plan - The working group's longest discussion in Denver related to the accounting for equity interests in the North Carolina Beach Plan; the issue arose as a result of changes made to the Beach Plan in 2009 that capped total assessments that could be charged to writers of homeowners insurance in North Carolina. Previous assessments made by the

Beach Plan had been recorded by insurers as equity interests in accordance with SSAP 63; as a result of the changes to the plan, these amounts will not be recovered but may be used to offset future liabilities to the plan in certain circumstances.

The regulators reached a tentative "narrow scope" interpretation that equity interests that are not expected to be recovered should be written off to aggregate write-in to miscellaneous income/ expense. This is consistent with the view of the North Carolina Insurance Department. The regulators agreed that further discussion of the accounting for future assessments is warranted and will be discussed in an interim conference call.

Blanks Working Group

The working group adopted ten blanks proposals as final, including those discussed below which are effective for the 2010 annual statement unless otherwise stated.

- Two General Interrogatories were added regarding the establishment of an audit committee in compliance with the domiciliary state insurance laws. The questions are designed to provide state insurance departments with information regarding the insurer's compliance with the Model Audit Rule, which was effective January 1, 2010. An additional interrogatory which would have required audit committee members to be named and identified as to their independence was deleted from the proposal and referred to the NAIC/AICPA Working Group for review. (Agenda item 2009-38BWG)

- The instructions and illustration for Note 29, Premium Deficiency Reserves, were modified to permit data capture. (Agenda item 2009-39BWG)

- A fair value column was added to Schedule DB, Part B, Section 1 to be consistent with the other investment schedules and a total line was added to permit mapping to the Schedule DB Verification page. (Agenda item 2009-40BWG)

- Illustrations were added to Note 5D, Loan-Backed Securities, to permit data capture. (Agenda item 2009-41BWG)

- Disclosures were added to Note 33, Separate Accounts, and a General Interrogatories exhibit for the life and fraternal statements was added to comply with the new disclosure requirements of SSAP 56. (Agenda items 2009-42BWG and 2009-43BWG)

- The instructions for Note 21, Events Subsequent, were modified to be consistent with the changes adopted for SSAP 9. (Agenda item 2009-44BWG)

- Disclosures were added to Note 22, Reinsurance, of the P/C statement to provide for the disclosure of transfer of P/C run-off agreements as required by SSAP 62R. (Agenda item 2009-45BWG)

- Instructions and illustrations were added to the P/C statement for a new note for financial guaranty insurance. Certain parts of the note will permit data capture. (Agenda item 2009-46BWG)

- Note 20, Fair Value Measurement, was added to reflect additional disclosures required by the adoption of SSAP 100. (Agenda item 2009-47BWG)

Blanks proposal 2009-35BWG was withdrawn, and was replaced by a LOB Subgroup proposal (Agenda item 2010-06BWG) which would incorporate a supplemental filing for reporting the break-out of directors and officers business from other liability coverage.

The working group exposed twelve new proposals for comment. The comment period for these proposals ends May 21. The proposals will be reviewed for adoption during a conference call schedule for June 21. The exposed proposals would:

- Combine the grouping of sub-categories used for mortgage-backed and asset-backed securities from the current five groupings into three for the Schedule D, DA and E, as applicable. (Agenda item 2010-01BWG)

- Expand the list of identifiers which classify the types of Other Asset-Backed Securities disclosed on Schedule D Part 1. (Agenda item 2010-02BWG)

- Add two columns to Schedule S, Part 4, and Schedule F, Parts 1 and 5 to identify the bank issuing or confirming a letter of credit. The new columns would capture the banks' American Bankers Association (ABA) routing number and name. The goal of proposed change is to allow regulators to easily identify where letters of credit are provided by troubled banks. (Agenda item 2010-03BWG)

- Modify the Actuarial Opinion section of the annual statement instructions for the Health blank by adding several exemptions in which the actuarial opinion is not required. (Agenda item 2010-04BWG)

- Remove certain instructions from the Life and Fraternal annual statement instructions which apply to C-3 Phase I only and not to C-3 Phase II. The remaining instructions would be modified to be consistent with the RBC instructions. (Agenda item 2010-05BWG)

- Add a supplement to the P/C annual and quarterly statements to capture premium and loss data related to director and officer insurance. New interrogatories would also be added. (Agenda item 2010-06BWG)

- Add a supplemental exhibit for analysis of annuity operations by line of business and analysis of change in annuity reserves during the year. New interrogatories would also be added. (Agenda item 2010-07BWG)

- Add new instructions and illustration to Note 5E with regard to securities lending transactions and add a new Schedule DL, Part 1 and Part 2 to the annual statement beginning in 2010 and to the quarterly statement beginning in 2011. The schedules would require reporting of any reinvested collateral assets. The changes are the result of the Securities Lending Subgroup discussed above. (Agenda item 2010-08BWG and 2010-09BWG)

- Add a line to the asset page for Securities Lending Reinvested Collateral Restricted Asset and to the liability page for Payable for Securities Lending. Other schedules would also be updated to make conforming changes. The changes are also the result of the Securities Lending Subgroup. (Agenda item 2010-10BWG)

- Add instructions to General Interrogatories (Life and Fraternal blanks) to incorporate the non-binding guidance provided by the Life and Health Actuarial Task Force with regard to the reporting of new reserving standards under AG43. (Agenda item 2010-11BWG)

- Add illustrations to the instructions for Note 9, Income Taxes, as a result of the adoption of SSAP 10R, Income Taxes. 10. (Agenda item 2010-12BWG)

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

The working group also exposed procedural changes which include establishing a June conference call for the exposure and adoption of blanks proposals. Upon reexamination of the NAIC's transition to a three national meeting schedule per year, it was determined the four meeting schedule is still necessary for the Blanks Working Group in order to permit the timely exposure and adoption of blanks proposals.

NAIC/AICPA Working Group

<u>MAR Adoption</u>
The working group heard a brief update on the status of the final work for states to adopt the revised MAR, which was effective January 1, 2010. Staff reported that 49 jurisdictions have adopted the MAR. Florida published its rule March 26, which is enforceable upon publication; Texas and Washington D.C. are still working to complete adoption.

<u>SEC Rule on Compensation</u>
The working group discussed newly adopted SEC Rule 33-9089 on executive compensation and board of director structure. The working group reviewed a staff memo summarizing the new disclosures which require a narrative disclosure of the company's compensation policies as they relate to company risk management; the nature and extent of services of compensation consultants and detailed disclosures about the board of director leadership structure and why the chosen structure is best for the company.

When asked for comments from interested parties as to whether such disclosures should be required by insurers, companies expressed concerns about reporting at the legal entity level as compensation and board decisions are often not made at that level. In addition, companies would likely not want to duplicate the SEC disclosures in the statutory financial statements. Representatives for mutual insurers noted that the SEC disclosures are primarily for stockholders not policyholders.

After hearing the comments, the working group directed staff to draft a blanks proposal for new disclosures modeled on the SEC disclosures, which will used as a "starting point for discussion." An interim conference call will be scheduled to discuss the issue further.

<u>Interrogatory on Audit Committee Members</u>
The working group discussed a referral from the Blanks Working Group (agenda item 2009-38), which would require the names of audit committee

members and whether each is an independent member to be disclosed in the annual statement. Interested parties had objected to the disclosure as not being meaningful and the agenda item was referred to this working group, which will discuss it during their interim conference call.

Valuation of Securities Task Force

Residential Mortgage-Backed Securities
The task force reflected on the significant actions taken during 2009 to develop and enact a revised, short-term approach for the determination of NAIC ratings designations for non-agency residential mortgage-backed securities (RMBS). SVO staff noted that in total approximately 21,000 securities were rated under the new approach in conjunction with the 2009 annual statement filings. The process was viewed by the SVO as a success, noting very few issues.

The task force adopted a recommendation that the NAIC continue to model the intrinsic value of RMBS for year-end 2010 reporting as the NAIC considers long-term proposals. RMBS would likely be modeled semi-annually. The next modeling for RMBS is scheduled for the second quarter of 2010.

NAIC Designations for Structured Securities
The task force discussed comments received on previously exposed recommendations relative to the determination of NAIC ratings designations for structured securities. The task force adopted the following recommendations:

- Financial modeling should be used to determine NAIC ratings designations for commercial mortgage backed securities beginning with year-end 2010 annual statement filings. The task force expects the approach would be similar to the current short-term approach for RMBS. This would include the use of a third party modeling firm similar to the use of PIMCO for RMBS.

- Financial modeling should be used to determine NAIC ratings designations for other asset backed securities if it is cost effective to do so.

- Structured securities which cannot be modeled but are rated by an NAIC ARO should be subject to the filing exempt rule. However, the filing exempt rule should be modified to require the insurer to exclude any NAIC ARO rating that does not have either an effective date or a confirmed evaluation date less than 12 months old, measured as of the date of the annual statement date.

- Securities that are not modeled and not rated would be subject to the 5*/6* rule outlined in the Purposes and Procedures Manual.

- Securities that are modeled, and that have zero expected loss, and for securities which are rated an NAIC 1 equivalent by an NAIC ARO, would be assigned an NAIC 1 designation regardless of the carrying value. This would also apply to the recommendation for RMBS.

Defined Multi-Class Mortgage-Backed Security
SVO staff had previously suggested that guidance should be developed to clarify what percentage of second lien mortgages would be permitted for the mortgage-backed security to be classified as first-lien within quarterly and annual statement disclosures as opposed to requiring the insurer to report the security as a defined multi-class mortgage-backed security. The task force deferred consideration of this topic as there is a pending Blanks Working Group proposal (Agenda Item 2010-01BWG) that would combine these sub-categories, making the clarifying guidance irrelevant.

Invested Asset Working Group
The working group held two conference calls during the first quarter of 2010 to discuss two NAIC staff proposals: (1) a proposal to develop a disclosure framework for investment risks other than credit, and (2) a proposal to develop a fixed income security risk-focused framework to respond to a recommendation of the Hybrid RBC Working Group. Both proposals were exposed for a thirty-day comment period on the January conference call and comments received were discussed during the February conference call.

The North American Securities Valuation Association (NASVA) expressed concerns that the proposed investment risk disclosure framework would eliminate the existing reporting framework that classifies securities as debt, preferred stock or common stock. NASVA further commented that both proposals would require significant systems changes for insurers. A representative of ACLI expressed support of the working group's efforts and offered to help staff technical resource groups that the working group may form. The proposals were not adopted during the February conference call; the working group plans to continue to consider the aspects of both proposals during additional conference calls in the second quarter of 2010.

The working group also discussed the investment data symmetry initiative which seeks to link securities data from various sources into a unified database. The database would enable regulators to develop tools that would provide for more comprehensive assessment and risk focused analysis.

NAIC Designations for Hybrids
The SVO noted that it continues to consider possible options that could be utilized to assign NAIC designations for hybrid securities which are not rated by an NAIC ARO.

SVO Value Techniques
The task force discussed an SVO response to the SAP Working Group to detail the sources of valuations utilized by the SVO to determine fair value. The NAIC's adoption of *SSAP 100 - Fair Value Measurements* requires insurers to identify the valuation technique utilized to determine fair value. The SAP Working Group previously noted that valuation techniques used by the SVO were not disclosed. The task force directed the SVO to forward the response to SAPWG.

The SVO response notes that the VOS database contains approximately 210,000 active securities, of which approximately 93% are valued using third-party valuation services (including CORP IDSI, IDCFOREIGN, and MUNI IDSI). Where a public value or an SVO-approved independent organization value is not available, the SVO uses analytical methodologies. The SVO commonly determines a fair value for the following categories of securities:

Privately Issued Common Stock and Warrants
The SVO will typically determine a fair value by assessing the book value of the security. The assessment is an estimate of the residual claim of common stock and warrant holders based on financial information contained in the security issuer's audited financial statements. Where appropriate, the SVO may use other analytical valuation methods such as EBITDA multiples, discounted cash flows, and asset liquidation instead of a book value assessment.

Privately Issued Preferred Stock - The SVO will typically determine a fair value using the present value of cash flows method discounted by applicable yields or estimating the residual claim that can be allocated to the preferred stock. Where appropriate the SVO may use other analytical valuation methods.

Privately Issued Bond with NAIC-6 Designation
The SVO notes that determining the value for securities that are in or near default often requires adjustment to incorporate specific underlying factual circumstances. The primary goal of the analysis is to estimate the bond's adjusted dollar value.

Privately Issued, Fixed-Rate Bonds - The SVO fair value is determined by calculating the present value of future cash flows discounted at a yield that, in the opinion of the SVO, reflects equivalent fair market yield curves and general private placement market conditions. Bonds with embedded options that have the potential for meaningful impact on the fair value are not within the scope of this valuation practice.

Military Housing Bonds Re-rating
During a December 2009 conference call, the task force adopted a proposal, effective for 2009 annual statement reporting, to extend the SVO's authority to re-rate municipal bonds formerly wrapped by mono-line financial guarantors to military housing bonds. At the Spring National Meeting the task force adopted an amendment to the Purposes and Procedures Manual of the NAIC Securities Valuation Office to formalize the SVO's rating authority and to clarify the certification process.

Contingent Capital Securities
SVO staff reported on a new security type known as contingent capital securities utilized principally within the banking industry to raise regulatory capital. The security is designed as a bond; however, on the occurrence of a stated event, such as a reduction in the bank's capital ratio below a stated level, the security converts to equity. The staff highlighted the need to study actual conversion triggers before the NAIC determines how insurers should report these securities, but stated based on information currently available, the SVO believes the securities most closely resemble mandatory convertible securities.

Use of NAIC Designations as Ratings Triggers
The task force received and released for a thirty-day comment period, a SVO staff proposal to amend the Purposes and Procedures Manual to clarify the NAIC policy on the use by insurers of NAIC ratings designations as rating triggers in private agreements. The term "rating trigger" refers to any contract clause which requires an increase in interest rates or some other benefit to the insurer if the NAIC rating designation of a borrower falls below a specified level.

2010 SVO Research Agenda
The task force approved the previously exposed SVO research agenda for 2010. The research projects include the analysis and review of commercially available credit risk models, completion of the annual default impact review, and the development of standardized financial information of incoming unrated transactions for internal analytic and benchmarking purposes.

Capital Adequacy Task Force

The task force met via twice this in March via conference call and at the Spring National Meeting and discussed the following items:

2010 Life RBC MEAF Proposal
During the March 16 conference call of the task force, the chair noted that because the long-term mortgage loan proposal will not be effective until 2011 at the earliest, unless the task force acts otherwise, the factors for year-end 2008 will become effective, which were a floor of 50% and a cap of 350%. Another alternative would be to leave the 2009 factors of 75%-125% in place for 2010.

The chair then proposed maintaining the range of 75%-125%, but raising the base factor from 2.6% to 4% for 2010 because of increasing default rates. Interested parties objected to raising the base factor by more than 50%. However, the task force voted unanimously to expose the 4% charge for a comment period of 30 days; they plan to meet with the Valuation of Securities Task Force in April and will discuss the status of commercial mortgages at that time. The task force will hold a conference call in late April to address comments on the MEAF proposal. (See additional discussion of the long-term mortgage loan proposal in the Life RBC Working Group summary below.)

Deferred Tax Asset RBC Proposal
In connection with the adoption of the expanded admitted deferred tax asset, the task force was asked to consider update to the related RBC charge for all three formulas. The task force heard a brief report from the American Academy of Actuaries, whose representative stated that they are on track for the June deadline for a preliminary report to the task force.

Consideration of Health RBC Model as an Accreditation Standard
At the Winter National Meeting, the working group voted to expose for a 45 day comment period a recommendation that the Health RBC Model Regulation be a required model for accreditation, similar to the Life and P/C RBC models. During its March 16th conference call, the task force approved this recommendation, which was also adopted by the Financial Condition Committee in Denver. The proposal will now be considered by the Financial Regulation Standards and Accreditation Committee.

Fraternal RBC Model Act
The task force is continuing its consideration of RBC for fraternals and has asked NAIC staff to draft a survey to states asking how the treat fraternal societies and whether there is a need for a model act for such entities.

Life Trend Test
The representative from Pennsylvania again raised the proposal to increase the Life Trend Test trigger point from 250% to 300%. The task force directed NAIC staff to perform an analysis of the effect of increasing the trigger point to 300%, i.e. how many more companies would be subjected to the trend test if it were raised to 300%. The results will be discussed at a future meeting.

Solvency Modernization Subgroup
The subgroup was formed to review referrals from the SMI Task Force regarding evaluation of "alternative approaches to regulatory capital measurement, and review of the U.S. RBC system specifically." The subgroup met in March and provided some initial comments on the draft *Consultation Paper on Regulatory Capital Requirements and Overarching Accounting/Valuation Issues* for the Solvency Modernization Initiative. The Consultation Paper asks for input on 60 questions related to regulatory capital including the use of internal models and consideration of off balance sheet items.

The subgroup also commented that they believe the current risk-based capital formula provides a "strong, albeit mostly standardized minimum capital calculation for the U.S. insurance industry, and serves its purpose within the overall solvency monitoring structure," but it is a "good time to identify strengths and weaknesses of the current methodology for establishing regulatory capital across the industry and consider enhancements for the future, in addition to looking in more depth at how companies set their own internal capital needs beyond regulatory capital requirements."

Life Risk-Based Capital Working Group

The working group met three times since the Winter National Meeting and in Denver and discussed the following items:

<u>Derivative Risk Mitigation Proposal</u>
Work by the ACLI on their derivatives risk mitigation proposal continues, but interested parties have concluded additional work is needed to address regulator concerns; therefore, the proposal will not be completed in time for 2010 RBC filings. Because implementation is now 2011, the proposal will now consider both basic hedges and intermediate hedges. The working group requested that the ACLI structure the proposal so that the two different kinds of hedges could be easily split out.

<u>Long-term Mortgage Loan Proposal</u>
The working group continued discussion of an ACLI proposal for the RBC treatment of mortgage loans. In November 2009, the ACLI submitted a long-term proposal to replace the current RBC mortgage experience adjustment factor on commercial mortgages. ACLI's recommendation would require that a debt service coverage ratio be determined for each loan. Based on that factor, the loan would be assigned one of six RBC factors, which would be multiplied by the statutory book value of the loan. The sum of all such charges would constitute the company's RBC amount for all performing commercial mortgages.

The working group held a conference call in January to discuss the proposal. During the call, an ACLI representative stated that the debt service coverage ratio is the best indicator of the likelihood of default of a mortgage loan. ACLI had also considered using a loan-to-value ratio, but noted that it would be more volatile and more subjective.

Some working group members expressed concerns that the debt service coverage ratio was a historic measure and may overstate the RBC in a bad economic climate, which perhaps, would be the opposite of what might be intended. They suggested that the ACLI should consider whether there may be a way to make the calculation less "pro-cyclical." Another concern raised by regulators was whether the debt service coverage ratio was as useful for variable rate loans. ACLI noted that fixed rate loans comprised approximately 80% of the insurance industry's loan portfolio. The working group agreed to consider recommending changes to Schedule B to clarify whether loans are fixed-rate or variable-rate.

The working group also discussed the appropriateness of the current 2.6% factor that is used in the ACLI proposal to calibrate the adjustment factors. The ACLI agreed to perform a statistical analysis of mortgage experience and is targeting a September completion date. The results of the analysis will be used to recalibrate the six RBC factors included in the ACLI proposal.

At the Spring National Meeting, the ACLI submitted an updated proposal with modifications to clarify the treatment of certain kinds of loans, such as construction loans, credit-tenant loans, non-standard properties, etc. Some regulators continue to express concerns about using only the debt service coverage ratio and the resulting pro-cyclicality. The working group plans to hold a conference call to identify any other issues which regulators believe should be addressed in the proposal, which has not yet been exposed for public comment. Any approved changes to the adjustment factors would be enacted for the year-end 2011 RBC calculation at the earliest.

<u>C-3 Phase 3 Proposal</u>
The working group briefly discussed two exposures for C-3 Phase 3 regarding RBC instructions and scope limitations. Although the exposure period has ended, the chair is expecting comments shortly from New York that will be considered. During this discussion, the chair noted that a year-end 2010 effective date is no longer possible for C-3 Phase 3 and the working group will be striving for 2011 implementation.

<u>C-3 Phase 2 Results</u>
The C-3 Phase 2 Results Subgroup of working group presented its observations from analyzing year-end 2008 RBC filings, which include the following:

- C-3 Phase 2 results appeared to be low and some companies may have increased reserves in an attempt to lower required capital.
- Current disclosures and assumption setting information in the C-3 Phase 2 memorandum were not sufficient.
- Lapse assumptions for in-the-money benefits were quite varied.
- Total Asset Requirements ("TAR") in excess of cash values were volatile.
- There was virtually no disclosure of hedging for companies that hedge these guarantees

but do not have a Clearly Defined Hedging Strategy.

The working group will hold conference calls to discuss these observations in detail and recommend corrective actions.

P/C Risk-Based Capital Working Group

The working group met via conference call on March 18 and discussed the following topics:

Underwriting Risk Charges
Having previously completed a two-year phase-in of adjustments to the underwriting risk charges in the RBC formula, the working group directed the AAA to update its study of appropriate risk charges. During its conference call, the working heard a report from the AAA, whose study incorporated the most recent three years of data (2006-2008) not included in their original study.

The updated study recommends, with factor changes capped at +/- 15%, an increase to the reinsurance lines of 15% for 2010, which would be a 15% increase for the third year in a row. Other lines including personal lines recommend significant decreases. The report was exposed for comment and will be discussed during an April conference call.

Expansion of Schedule P Two-Year Lines
The working group continued its discussion of extending Schedule P development to ten years for all lines. Interested parties have been opposed to the expansion from two to ten years, expressing concerns that the change could trigger tax issues. The working group has preliminarily concluded that there are data quality issues for the short-tail development and will be following up with software vendors to isolate the issue.

RBC Charge for State Deposits
Pennsylvania had requested that the working group consider what the appropriate risk charge should be for state deposits. It was noted that in the event of an insurer's insolvency, the domestic regulatory generally cannot call upon the funds held on deposit in another state. The working group will solicit input from state actuaries and examiners as well as the AAA on this topic. The working group hopes to have a proposal for this issue for 2011 RBC.

Catastrophe Risk Subgroup
The subgroup has not met for some time, but a conference call is scheduled for April 21.

Health Risk-Based Capital Working Group

The working group met via conference March 4 and discussed the following issues:

Healthcare Receivables
The working group had asked the AAA to review the individual factors for each healthcare receivable line within the Credit Risk H3 component of the RBC formula. During the conference call, the working group heard a report from the AAA that several sensitivity analyses had been performed on 2008 data to determine the effect on RBC after co-variance of changing the healthcare receivables factors plus or minus 50%. The results indicate that change in RBC is "very modest" using the 50% change factor. The AAA subgroup will now look at 2009 data (which will be available at end of May) before providing recommendations to the working group. As a result, changes, if any, to the factors will likely not be effective until 2011 since 2010 factors must be adopted by the end of June.

Covariance Calculation
The New York representative of the working group asked that the group review the covariance calculation in Health RBC which one regulator views is a "weak tool to address risk reduction." The AAA was charged with evaluation of the current formula to identify appropriate changes, which could increase the "overall efficiency" of the formula. The AAA is expected to report back during the June conference call of the working group and a long-term charge may be developed.

Reinsurance Task Force

Proposed Federal Legislation
The task force heard an update from Washington D.C. staff on proposed reinsurance-related Federal legislation. The Reinsurance Regulatory Modernization Act still has no sponsor in Congress, but the NAIC is still actively working to get the proposed legislation introduced.

Credit for Reinsurance Model Law
After several meetings of discussion, the working group voted to initiate a request from its parent committee for model law development related to the "Tawa proposal." This proposal would reduce the trusteed surplus requirement for a multiple-beneficiary trust maintained by an assuming reinsurer in a run-off situation. Some task force members questioned whether they should spend time to consider piecemeal changes to the Credit

for Reinsurance Model when the model may be superseded by Federal legislation. In the end, the task force voted to recommend consideration.

Letters of Credit
The task force approved a proposal to recommend to the Financial Examiners Handbook Technical Group to revise the Example Letter of Credit in the Examiners Handbook to specifically refer to the International Chamber of Commerce Uniform Customs and Practices Publications 590 and 600 as successor publications to UCP 500. The current guidance has a generic reference to "UCP 500 or successor publications."

The task force also heard brief comments from a task force member on a Blanks Working Group proposal (2010-03BWG) exposed for comment to require disclosures of financial institutions which have issued or confirmed LOCs for reinsurance collateral purposes. The proposal is in response to LOCs issued by banks taken over by the FDIC becoming "worthless."

Life and Health Actuarial Task Force

Principles-Based Reserving
Valuation Manual
At the beginning of the two-day LHATF meeting, the chair noted that the task force's emphasis in Denver is to focus on the Valuation Manual that is critical to move the Principles-Based Reserves project through the NAIC. The current timetable is for the Executive Committee to adopt the Valuation Manual, including the life insurance requirements contained in VM-20, at the Summer National Meeting in August of this year. The chair also noted that a lot of work still needs to be done to meet this deadline, particularly with regard to the net premium reserve floor, margins, general asset issues such as default and reinvestment spreads and mortality tables. While progress was made during this meeting, the task force will need to complete a significant amount of work during interim calls in order to meet the target date.

In the course of the LHATF meeting, the American Academy of Actuaries expressed their concern that actions by the task force on PBR, which have moved PBR requirements further away from a purely principles-based system, will cause PBR to be just another regulatory requirement and not a tool used by management to analyze and manage risk. The Academy specifically mentioned areas of the current PBR requirements that are problematic including aggregation limitations, regulatory prescribed margins and prohibition of company specific stochastic scenario generators. An underlying issue may be that, as LHATF moves away from a pure principles-based reserve system, the Academy's ability to recruit and retain the volunteers to complete the substantial work necessary to support the PBR initiative is reduced.

Mortality Tables and Margins
The task force received a report from the Academy on credibility theory with regard to mortality assumptions and included a discussion of a PwC report on margins (*Analysis of Methods for Determining Margins for Uncertainty under a Principle-Based Framework for Life Insurance and Annuity Products*) which can be found on the Society of Actuaries' website at http://www.soa.org/files/pdf/research-analysis-life-annuity.pdf.

The task force also received a report from the joint group of the Society of Actuaries and the Academy regarding mortality margins. The group is not yet ready to submit a formal proposal to LHATF but expects to do so in the next few weeks. The group reported that they are working on language in VM-20 to allow the use of non-company mortality data, such as from reinsurers, and language to incorporate credibility theory into PBR requirements.

The joint group also reported that they are in the first stage of developing 2012 CSO mortality tables for use in PBR calculations. They are looking to gather five years of industry data to support the new tables. In addition, work is progressing on the development of mortality tables to support guaranteed issue and simplified issue business. The group is surveying the industry to best determine how to segment the data by market.

The joint group also reported progress on the development of a new payout annuity mortality table. A preliminary table has been developed using experience from 2000 to 2004.

Net Premium Reserves in VM-20
The ACLI provided a significant update to their proposal on the use of a net premium reserve floor as part of PBR for life insurance products in VM-20, Life Insurance. Where the ACLI had initially split the proposal between fixed premium and flex premium products, they are now recommending splitting products into fund type products, such as UL, and non-fund type products, such as traditional life policies. For non-fund type products, the ACLI is recommending a CRVM type net premium floor with updated expenses allowances, lapse rates for

certain products and higher interest rates for policies without cash values. For fund type products, the ACLI is recommending the retention of the current UL CRVM structure with an expense allowance and other adjustments. No decisions were reached at this meeting regarding the net premium reserve floor. The task force will need to address this proposal during interim calls.

Default Costs in VM-20
The task force received an update from the Academy on its proposed methodology for determining default costs under VM-20. The Academy's methodology contains a relatively complicated set of calculations in order to develop prescribed annual default costs to be used in calculating reserves under VM-20. Regulators continue to express their interest in the Academy's proposal although they noted that the complicated process is difficult to understand initially. At the conclusion of the discussion, LHATF voted to expose the Academy's proposal for comments, noting that the parameters in the proposal are still under review.

Other VM-20 Issues
The task force reviewed a few amendment proposals for VM-20. One adopted proposal clarified guidance regarding a company's assumptions when their experience data is limited. In a lively discussion, the task force discussed a New York proposal regarding the scope of VM-20 which called for the exclusion of all life policies except competitive term and UL products with secondary guarantees. There was not much support for New York's proposal as many LHATF members viewed that this provision, if adopted, would be perceived as a watered-down PBR. One regulator believed that the current exclusion tests in VM-20 were sufficient. The motion failed.

The task force also briefly discussed the aggregation issue; VM-20 currently limits the ability of companies to aggregate the results from different products. Such limitation essentially removes any natural hedges that may exist in different products in a company's portfolio. The LHATF chair expressed his support for full aggregation. A conference call will be scheduled to discuss this issue.

PBR Scenarios Subgroup
A relatively long discussion took place regarding interest rate generators for PBR with particular emphasis on the mean reversion parameter (MRP). LHATF voted to expose the subgroup's recommendations that included a weighted MPR of 50% of a 3-year average, 30% of a 10-year average and 20% of a historical average. The ACLI expressed their concern that this proposal would generate too much volatility in the PBR calculations.

Other Issues

Federal Health Care Update
NAIC staff gave a brief presentation regarding the recently signed health reform bill. Some of the provisions in the bill will require NAIC support. These provisions include definition and methodology for calculating loss ratios, rate review procedures and a national reinsurance program for early retirees.

Non-forfeiture for Indexed Death Benefit Policies (AG 25)
AG 25 provides guidance for the minimum non-forfeiture requirements for products containing a death benefit provision that increases based on an index such as the CPI. For policies with initial death benefit amounts of less than $10,000, AG 25 allows minimum non-forfeiture benefits to be calculated without including the index in future death benefit amounts. Since AG 25 was first adopted in 1991, the $10,000 threshold has not been adjusted. The task force received a report from the Academy which recommends that the threshold be increased to reflect inflation from 1991 and that an automatic adjustment also be included in AG 25 that will adjust the threshold each year based on changes to the CPI. The purpose of the change is to fix an IRS §7702 problem with small face amount policies. LHATF voted to expose the Academy recommended changes to AG 25. An interim call will be scheduled with the expectation that the task force will adopt changes to AG 25.

Variable Annuity Statutory Framework Review
The task force received a presentation from an actuarial consulting firm, commissioned by twelve of the top variable annuity writers in North America, which communicated certain observations with regard to AG 43 (VACARVM) and C-3 Phase 2 of the RBC requirements for variable annuities. The presenter observed that: (1) the treatment of hedging in AG 43 has created a disincentive for companies to hedge these risks, (2) the standard scenario dominated reserves more than what was intended for a reserve floor, (3) sensitivity of statutory results is not aligned with the underlying risks, and (4) there is increased volatility in required capital.

The task force was very interested in the presentation but took no action the task force believes they are already have a very full agenda with PRB issues. The actuarial consulting firm indicated that a more detailed report would be provided to LHATF in the near future.

Accident and Health Working Group

PBR VM-25
The working group adopted VM-25 which contains the PBR requirements for health insurance products; the regulators noted that the provisions in VM-25 are not meant to change current reserve requirements.

Rate Filing Guidelines
The working group has been working on a generic model act for rate filing requirements that is not based on loss ratio standards. An standing room only audience was present for this part of the working group's discussion and many of those in attendance advised the working group to discontinue this project in light of Present Obama's recent signing of the health reform bill, noting that the regulators should "clear their agenda" for future projects that will be required as a result of the new federal legislation.

New Cancer Table
The development of a new cancer table was discontinued because of insufficient data. The Academy was asked to study how the current 1985 Cancer tables could be used in the current environment.

A&H Policy Exhibit
With little interest from members to continue this project for state policy experience exhibits, the working group voted to discontinue this project.

Life Insurance and Annuities Committee

Annuity Transactions Model Regulation
The committee met via conference call on December 21 to discuss comments received on previously exposed revisions to the Suitability in Annuity Transactions Model Regulation. The committee discussed several non-substantive comments from interested parties and unanimously adopted the Model Regulation. The committee is also considering developing a Frequently Asked Questions document for the Model Regulation. The amendments were adopted at the joint Executive Committee/Plenary meeting in Denver.

2010 Charges
In Denver, the committee discussed its charges for the year. A significant new charge is exploring the issue of "stranger originated/owned annuities and how these transactions may interact with insurable interest laws and the impact of this activity on consumers." The committee will consider appropriate regulatory action, if any, including revisions to the Viatical Settlements Model Act or development of a model act. The chair noted there will be a public hearing on this issue May 20 in Washington D.C.

Annuity Disclosure Working Group

At the Spring National Meeting, the working group discussed the latest draft revisions of the annuity illustration guidelines, specifically comments from the American Academy of Actuaries as well as the AAA-suggested illustration template. Comments on the illustration template are due mid-April, with conference calls to follow, one of which is tentatively scheduled for April 26. Specific items to be addressed during the conference call(s) and before the Summer National Meeting include:

- When to include an illustration
- What annuitization rate to use in an illustration
- How the timing of the use of an illustration relates to the content of the illustration
- Whether to create an illustration template as part of the guidelines
- How to incorporate the guidelines into the *Annuity Disclosure Model Regulation* (#245)

The working group then discussed proposed revisions to the annuity buyer's guides resulting from comments by the SEC.

Financial Regulation Standards and Accreditation Committee

The committee met in Denver and took the following actions:

Revisions to Documents Required for Accreditation
Revisions made during 2009 to publications that are required for accreditation purposes (i.e., 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 as revised accreditation standards by reference. With the exception of two items in the Examiners

Handbook, these revisions were considered insignificant for accreditation purposes. The committee released the two significant items from the Examiners Handbook related to examination repositories and the new information technology review process for a 30-day comment period.

Actuarial Opinion and Memorandum Regulation
The committee adopted the 2009 revisions to the Actuarial Opinion and Memorandum Regulation as acceptable but not required for accreditation purposes. The only revision made to the regulation was the addition of an example for when the appointed actuary may elect to make comments on any interim results that may be of significant concern to him/her within the regulatory asset adequacy issues summary.

Standard Valuation Law
The committee released the 2009 revisions to the Standard Valuation Law for a 30-day comment period to consider whether the revisions should be required for accreditation. The major revisions to the law relate to a number of different issues, including authorizing the use of a Valuation Manual and also authorizing a principles-based reserve basis for those policies and contracts specified in the Valuation Manual. Sections 3 and 4 of the model are the two significant elements currently required for accreditation in the Part A “Liabilities and Reserves” standard. The Life and Health Actuarial Task Force is recommending that the several additional sections be considered significant elements for accreditation.

Guaranty Association Model Acts
The committee adopted the 2009 revisions to the Life and Health Insurance Guaranty Association Model Act and the Property and Casualty Insurance Guaranty Association Model Act as acceptable but not required for accreditation purposes. These revisions provide additional standards for consideration by the commissioner with regard to mechanisms for the payment of covered claims under certain insurance policies and minimizing financial loss to claimants or policyholders because of the insolvency of an insurer by raising certain coverage limits.

Company Licensing
The committee discussed comments received and adopted proposed implementation guidance regarding the new Part D accreditation standards related to company licensing and change in control. The implementation guidance includes revisions to existing documentation as well as new guidance applicable to the Part D accreditation standards. The Part D accreditation standards were adopted by the committee at the 2009 Summer National Meeting in response to comments made by the U.S. Government Accountability Office and become effective January 1, 2012. These standards will not be part of the “scored” section; therefore, a state cannot fail accreditation based solely on its lack of compliance with these standards. If deficiencies are noted, the accreditation review team would provide management comments to the state insurance department similar to the current Part C standards.

Risk Retention Groups
The committee considered comments received and adopted a referral from the Risk Retention Group Task Force regarding the applicability of the Part B and Part C accreditation standards to RRGS organized as captives. The referral also identifies certain additional standards which the task force considered necessary given the unique nature of captive RRGs. The most notable recommended additional standard is the need for state regulators to review and approve the RRG's business plan and to monitor the RRG's operations for compliance with the approved plan. The Part B and Part C standards become effective January 1, 2011, consistent with the previously adopted the Part A standards applicable to captive RRGs.

The committee also discussed a letter received from the Risk Retention Group Task Force regarding suggested clarifications on the Capital and Surplus and Reinsurance Ceded Part A standards for RRGs. The committee released the proposed recommendations from the task force for a 30-day comment period.

Climate Change and Global Warming Task Force

The task force held a conference call in January and met in Denver at the Spring National Meeting to discuss the Insurer Climate Risk Disclosure Survey. The primary issue is that some states have expressed concerns with going forward with the mandatory survey as adopted in March 2009. The chair noted that there was significant discussion about the survey at the February Commissioner's Conference and several media reports about the differences of opinion.

After significant discussion amongst the task force members and interested parties with regard to the path forward, including the fact that California and Wisconsin have already distributed the survey to their insurer groups, the task force reached a general consensus that the survey should move forward as adopted, but that the NAIC should acknowledge that some states will not request that the survey be completed and that other states would not exercise their rights to request the survey where lead states do not require the survey. However, as discussed on page 3 above, at the subsequent Plenary meeting, the task force's decision to "stay the course" was overturned. The previously mandatory survey required in 2010 will now be voluntary, i.e. at the discretion of each state, and insurer group responses will not be made publically available.

SEC Interpretive Guidance
A representative of the SEC gave a presentation on the Commission's recently issued interpretive guidance regarding disclosure related to climate change. The speaker commented that the SEC's intent with the interpretive guidance was to focus on legal and accounting disclosure requirements which already exist and not on the politics or the science of climate change.

Solvency Modernization Initiatives Task Force

Interim Meeting
The task force held an interim meeting March 11-12 in Phoenix, Arizona whereby the task force and related working groups met in joint session. During the meeting, the following two papers released during the Winter National Meeting were discussed: *Consultation Paper on Capital Requirements and High-level Accounting/Valuation Issues* and *Consultation Paper on Corporate Governance and Risk Management*. Discussion continued surrounding the solvency framework and the role of RBC, accounting, valuation and capital resources issues, stress testing, risk-focused surveillance, risk management, and other issues, such as taxes, international accounting standards and convergence. While the task force acknowledged there is room for improvement within the U.S. solvency system and affirmed the desire to converge solvency systems internationally, where applicable, they noted that there may be areas which need to remain different given the different business cultures across the world. The NAIC's summary of the two day meeting can be found at http://www.naic.org/documents/index_smi_update_100317.pdf

Spring National Meeting
The task force heard a presentation on IFRS from John Hancock Financial Services, who expressed support for the modernization initiative, but stressed that it be used with accounting practices that are not too conservative. The presentation also included discussion of what some U.S. insurers perceived to be flaws with IFRS.

The task force then reported on the new SMI Statutory Accounting and Financial Reporting Subgroup, whose formation was adopted by email vote on March 19. The task force's charge is as follows: "appoint a Statutory Accounting and Financial Reporting Subgroup, with insurance commissioner level participation, to recommend the future of U.S. statutory accounting and financial reporting." The first draft of the charge, discussed at the SMI Task Force interim meeting, was more detailed and included a charge to recommend "whether the NAIC should instead adopt a public accounting model with additional statutory analysis." However the task force agreed the charge should be more open-ended. The subgroup will receive significant assistance from the SAP Working Group and its staff.

The subgroup will be chaired by Commissioner Al Gross of Virginia; an organizational call is expected by the end of April.

SMI Task Force Webinar
The task force will hold a webinar April 28 to acquaint participants with the five areas of the solvency modernization initiative: capital requirements, international accounting, insurance valuation, reinsurance and group solvency.

Corporate Governance Working Group

This working group of the SMI Task Force held its first meeting in Denver; its charge is to "outline high-level corporate governance principles, determine the appropriate methodology to require compliance and evaluate adherence with such principles, giving due consideration to development of a model law." The working group heard comments from interested parties about whether there is an actual need for additional corporate governance requirements and if such requirements could lead to legal conflicts and other unintended consequences.

The next steps for the working group include:

- A response to a referral from the Group Solvency Issues Working Group requesting comments on how to proceed with revisions to Section 19: Transactions Subject to Prior Notice - Notice Filing of the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450), as it pertains to the responsibilities of boards and management.

- Preparation of a survey to better understand industry practices and policies in place surrounding corporate governance.

- A review of recent insolvencies to determine the role, if any, corporate governance deficiencies play in the downfall of the insurers.

- A review of several states' existing legislation and case law in place to better understand existing corporate governance requirements for insurers.

A conference call is being scheduled for later in April to continue discussion of these issues.

Group Solvency Issues Working Group

The working group held two interim conference calls this winter to discuss proposed revisions to the holding company model law and regulation to reflect concerns in a group supervision setting.

Notable changes made to *Insurance Holding Company System Model Act* (#440) as a result of the interim conference calls include:

- Definitions for the words "contagion" and "material" were added. The draft revisions to #440 add the concept of affiliates in a holding company group spreading "financial and/or reputational contagion to the insurer." "Contagion" has now been defined as "an event or circumstance where one affiliate within an insurance holding company system can materially affect another insurer or the group as a whole."

- The exclusion of commercial contracts in the definition of "control" was added back; i.e. a party cannot be deemed to control an insurer with just the existence of a commercial contract for goods or nonmanagement services.

- Section 3 *Acquisition of Control of or Merger with Domestic Insurer* was modified to clearly require the acquiring party to file pre-acquisition notifications (Form E filings) sixty days prior to the proposed effective date of the acquisition.

- Additional requirements were added for the annual report filed with the commissioner in Section 3.B.12-13; this issue will be discussed further on future calls.

- Section 3.D.3, related to *Consolidated Public Hearings* was revised to incorporate efficiency and the ability to have a quick resolution to acquisitions in the event approval of more than one commissioner is required.

- Language was added to Section 4.B.5 to allow SEC-registered companies to use audited financial statements filed with the SEC to meet the requirement of submitting financial statements of a holding company system.

Notable changes made to *Insurance Holding Company System Model Regulation* (#450) as a result of the interim conference calls include:

- Proposed modification to Form A: *Statement Regarding the Acquisition of Control of or Merger with a Domestic Insurer* to add Item 13: *Agreement Requirements for Financial and/or Reputational Contagion*

- Proposed modification to Form B: *Insurance Holding Company System Annual Registration Statement* to add Item 9: *Annual Form B Group Filing Requirements for Enterprise Risk Management*

At its meeting in Denver, the working group discussed additional comments received on the draft revisions to Models #440 and #450, but moved further discussion to its April 9 conference call.

The co-chair, Director Ann Frohman of Nebraska, then provided the working group with an update on her testimony before the Congressional Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises Committee on Financial Services. As a result of a question posed by the Subcommittee, NAIC staff distributed a survey to all states regarding the number of insurers with a parent holding company.

The working group reported that it had presented to the SMI Task Force its "windows and walls" approach for the regulation of U.S.-based insurers operating within corporate groups. Specifically, the working group is recommending that regulatory windows be added to the current solvency regime, "regardless of the multidimensional nature of the group." The five step recommendation includes the following: Communication between Regulators, Supervisory Colleges, Access to and Collection of Information, Enforcement Measures and Group Capital Assessment.

International Accounting Standards Working Group

Presentation on Acquisition Costs
The working group received a presentation from the ACLI with regard to the treatment of acquisition costs under the joint Insurance Contracts Project of the International Accounting Standards Board and Financial Accounting Standards Board. The ACLI representative noted that the current direction of the IASB and the FASB to immediately expense acquisition costs would result of losses at policy issuance (i.e., day one loss), followed by gains over the remaining policy period. It was noted that such a requirement would not reflect the economic reality that the policy at inception is expected to be profitable and is inconsistent with a "current value" measurement objective. The ACLI's position is that the measurement of insurance liabilities should take into account all cash flows, including acquisition and maintenance costs. As acquisition costs and other policy maintenance costs are paid they would reduce a policy expense liability (determined as the present value of future policy expenses). This would alleviate the day one loss concern where a policy is expected to be profitable at issuance. The ACLI's presentation included several exhibits comparing and contrasting the financial statement impact of the FASB and IASB insurance accounting models to the ACLI position. NAIC staff noted the ACLI position is consistent with the position taken by the International Solvency and Accounting Working Group in 2007, and is also the current position of the International Association of Insurance Supervisors (IAIS).

Under current statutory accounting, all acquisition costs are expensed as incurred.

IASB / FASB Projects Update
The working group also received updates on the activities of the IASB and the FASB since the Winter National Meeting with regard to the Insurance Contracts Project and the Financial Instruments Project. NAIC staff reiterated his view that, at present, the IASB and FASB seem to be diverging more than converging with regard to insurance and financial instrument matters. With regard to the Insurance Contracts Project, it was noted that the IASB and FASB intend to issue an exposure draft in May or June 2010. Comments on the exposure draft are expected to be due in September, with a final standard published in June 2011. The working group discussed clarifications on a possible risk margin approach and received comments from interested parties.

The working group discussed the current draft of the IAIS letter to the IASB regarding the exposure draft, “Measurement of Liabilities in IAS 37”. It was noted that the IASB had extended the comment deadline until May 19; therefore, the working group agreed to request further comments by April 19.

The working group then received an update on the meetings of the IASB’s Expert Advisory Panel on Financial Instrument Impairment. The working group also exposed for comment the IAIS draft Insurance Core Principle #14: Valuation for Solvency Purposes and related standard. Comments are due at the IAIS by April 30.

An interim meeting of the working group will be held on April 29th and 30th at the NAIC SVO Offices in New York. The purpose of the meeting is to get specific input from working group members on current IASB/IAIS positions, as well as begin to prepare for the Insurance Contracts exposure draft expected in May or June. Space is very limited, however; interested parties that wish to attend the interim meeting should email Dan Daveline (ddaveline@naic.org).

Regulatory Modernization Task Force

The task force received testimony from four state legislators regarding their perspectives on regulatory modernization. The panel included Senator Kelley of Maryland, Senator Leavell of New Mexico, Representative Wren of Alabama, and Representative Kennedy of Rhode Island. In general, the panel supports state regulation. Senator Leavell also has the perspective that certain areas including licensing agents and market conduct may warrant modernization. Senator Kelley shared the same perspective on licensing of agents.

The task force then moved on to hear the perspectives of two industry representatives including Dennis Johnson, President and CEO of United Heritage, and SueAnn Schultz, Senior Vice President and General Counsel of IMA Financial Group. Johnson discussed his preference for state-based regulation for certain property and casualty rate filing aspects, but noted that he is otherwise a strong proponent of federal regulation as the different state requirements become difficult and cumbersome to deal with from an industry perspective. Schultz also shared a mixed viewpoint, supporting uniform standards for certain aspects such as agent licensing, but concluded by supporting state-based regulation.

Casualty Actuarial and Statistical Task Force

The task force held two interim conference calls and met in Denver at the National Spring Meeting to discuss the following issues:

Actuarial Standard of Practice 41
The second exposure draft of ASOP 41 was released with comments due to the Actuarial Standards Board by March 31. The most notable point of discussion is the potential repeal of ASOP 9 after revisions to ASOP 41 are finalized. This would result in no longer requiring the documentation of material changes in methodology. NAIC comments were expected to be adopted via email before the March 31 deadline.

Statistical Subgroup
The background and key issues surrounding the *Guideline for Implementation of Medical Professional Liability Closed Claim Reporting* were discussed during the February conference call. The guideline consists of five main parts:

- Part A - Suggested Regulation on Reporting Requirements, which details best practices
- Part B - Mechanism for Reporting and Collection of Data, which ensures a level of consistency in reporting data from state to state
- Part C - Insurance Department Outreach Efforts, which describes the other organizations that the insurance departments will need to coordinate with to collect the data
- Part D - Compiling, Verifying, and Releasing Data, which assists the regulators in compiling claims data pursuant to the NAIC *Medical Professional Liability Closed Claim Reporting Model Law*
- Part E - Codebook, which describes the coding of data collected

The guideline was adopted during the Spring National Meeting.

Profitability Working Group
In December 2009, the working group released the 2008 *Profitability by Line by State* and approved expanding the lines of business within the 2009 report, which will include separating product liability, mortgage guaranty, financial guaranty, accident and health, and warranty into their own lines. The working group will next look into the impact of premium deficiency reserves on profitability.

Risk Retention Group Task Force

The task force held an interim conference call on February 12 and met in Denver to finalize its consideration of Part A: Laws and Regulations standards for new or revised NAIC models that have changed since the task force began addressing the Part A standards in 2003. The Part A standards that were amended include Capital and Surplus; Liabilities and Reserves; and CPA Audits. The task force adopted its conclusions as to which standards were applicable to captive risk retention groups (RRGs) and referred its recommendations to the Financial Regulation Standards and Accreditation Committee.

The task force received an update from the chair of the Capital Adequacy for RRGs Technical Subgroup. The subgroup is considering the development of a capital adequacy standard regulatory tool that would be applicable to RRGs that do not meet certain criteria for exemption. The subgroup plans to prepare a statement regarding the applicability of RBC for RRGs other than those whose parent companies meet certain criteria.

The task force also received an update from NAIC staff regarding the ongoing work of others on RRGs. This update included information regarding H.R. 4802, the Risk Retention Modernization Act of 2010, which was introduced into the U.S. House of Representatives on March 10. Among other things, the Act would allow RRGs to write commercial property coverage and authorized the U.S. Treasury to resolve disputes between the states. The update also covered the Financial Regulation Standards and Accreditation Committee's consideration of the task force's referral of proposed Part B: Regulatory Practices and Procedures standards and Part C: Organizational and Personnel Practices standards for RRGs.

Having substantially completed its current charges, the task force discussed whether it should remain intact to consider the applicability of future changes of accreditation standards to RRGs or whether that charge should be taken up by another group.

Some task force members suggested it might be appropriate to reconstitute the task force as a working group under the Financial Regulation Standards and Accreditation Committee. The chair noted that it was premature to reach a conclusion, but that a determination will need to be made at the Summer National Meeting.

Title Insurance Task Force

The task force was recently established to study various issues related to title insurers and title insurance producers. In Denver, the task force discussed and adopted its charges for 2010, which include:

- Modernize the regulation of title insurance by: (1) updating and revising the title insurer annual and quarterly instructions to the NAIC annual statements; (2) considering the development of risk-based capital requirements, early warning tools, and risk focused financial examination guidelines for title insurers; (3) evaluating the original purposes and current effectiveness of mono-line title insurance laws, including their impact on the competitiveness of the title insurance market; and (4) determining the reasons for recent title company financial failures.

- Develop a nationwide title statistical plan that would include, to the extent feasible, title agent data.

- Explore possible ways to promote effective consumer shopping for title agents. The task force will consider development of best practices for the design and implementation of title cost comparison guides for consumers.

The Title Statistical Plan Working Group outlined its approach to developing an agent statistical plan that will help states in analyzing the marketplace. The focus of the working group is to collect data for market analysis and market regulation. The performance of the title business is generally based on the title agent, rather than the underwriter. The current reporting from title companies, rather than title agents, does not give regulators with a complete picture of the profit, loss and expenses in the title business. As a result the working group believes that jurisdictions need to obtain data from agents. The agent statistical plan would be developed to capture critical data, while limiting to the extent possible the amount of reporting.

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The next National Meeting of the NAIC will be held in Seattle August 14-17. 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:

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