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# ***NAIC Meeting Notes***

Global Insurance Industry Group, Americas

## NAIC 2011 Spring National Meeting

The National Association of Insurance Commissioners held its 2011 Spring National Meeting in Austin March 25 -29. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

## Executive Summary

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- Fifteen newly appointed or elected Commissioners attended the Spring National Meeting. Noticeably absent were all representatives of the New York Insurance Department, who did not attend due to budget restrictions. The NAIC has not met in National session since October so this Newsletter also covers six months of interim meetings.
- The NAIC's work on health care reform continues; Executive Committee formed a Professional Health Advisors Task Force to analyze and recommend options for addressing the effects of the medical loss ratio requirements on agents, consumers and the insurance markets. (page 2)
- The Dodd-Frank Receivership Implementation Working Group is reviewing portions of the Dodd-Frank Act to assess whether state laws, regulations or procedures must be implemented or amended in order for state insurance commissioners to execute their responsibilities under the Act. (page 4)
- The Statutory Accounting Principles Working Group adopted additional fair value disclosures and guidance on early terminated leases and collateral requirements for high deductible policies. The working group exposed for comment the anxiously awaited proposed revisions on income taxes, SSAP 101, which recommends adoption of FIN 48 and imposes additional limitations on deferred tax assets. The working group also exposed proposed revisions to the definition of "related party," clarification that MLR rebates would be accounted for as return premium, extended the proposed effective date of the pension and OPEB guidance to 2013 and re-exposed Issue Paper 141 addressing FAS 166 on transfers of assets. (page 5)
- The Capital Adequacy Task adopted a revision to the RBC Model to increase the trigger of the Life RBC Trend Test from 250% to 300%. The Solvency Modernization Initiative RBC Subgroup received a report on implicit calibrations and missing risks in the three RBC formulas. The Life RBC Working Group adopted the derivatives risk mitigation proposal after several years of work. The P/C RBC Working Group set a target date of 2012 for a new methodology for reinsurance reserve and premium charges. The Health RBC Working Group discussed the effect of health care reform on the RBC formula and adopted proposed revisions to make reporting of health care receivables more consistent. (page 8)
- The Solvency Modernization Initiative Task Force heard comments from the CFO of the NAIC on group supervision and the IAIS Common Framework. The chair of the task force also gave comments on solvency modernization during PwC's Solvency Webcast on April 6. The Group Solvency Issues Working Group discussed group capital assessment options and which components of the recently adopted changes to the Holding Company Act and Regulation should be required for states to adopt for accreditation purposes. The Corporate Governance Working Group discussed a draft whitepaper on Corporate Governance Principles for Use in US Insurance Regulation and exposed the document for public comment. The International Solvency Working Group continued discussion of an ORSA proposal which would require US insurers to provide regulators with detailed documentation of their internal risk management policies. The project to consider the "future of statutory accounting" has been tabled until more is known about the FASB and IFRS insurance projects and the SEC plans to accept IFRS. (page 11)
- The International Accounting Standards Working Group discussed ICP 14, Valuation for Solvency Purposes and heard updates on the FASB and IASB projects related to insurance. (page 13)
- The Reinsurance Task Force heard comments from many interested parties on proposed amendments to the Credit for Reinsurance Model Act and Regulation to adopt the Reinsurance Modernization Framework. The task force will hold an interim meeting and hopes to adopt a final model at the Summer National Meeting. (page 17)
- The Valuation of Securities Task Force discussed the 2010 RMBS and CMBS financial modeling results and plans for the 2011 financial modeling approach, adopted proposals for the filing exemption of FDIC securitizations and certain bank issued certificates of deposit.

SVO staff discussed its development of a new credit assessment framework, which would create new NAIC ratings designations for corporate, municipal and structure securities. (page 18)

- The Rating Agency Working Group held a public hearing in November on the use of NAIC ARO ratings of municipal obligations, hearing testimony from rating agencies, issuers and investors. The working group is still considering whether to require additional reporting of insurers' investments in state and municipal obligations. (page 20)
- The Blanks Working Group adopted two blanks proposals as final and exposed thirty-three new proposals for public comment. (page 20)
- The Life and Health Actuarial Task Force was restructured into two groups at the beginning of the year: the Life Actuarial Task Force and the Health Actuarial Task Force. In Austin, LATF

had extensive discussion of the VM-20 impact study project, which has been split into two phases; thirteen companies are expected to meet the Phase I March 31 reporting deadline. The task force also had a spirited discussion of a new AG 38 interpretation issue. Other meeting highlights included an update on the Variable Annuity Statutory Framework Review. (page 22)

- The Life Insurance and Annuities Committee adopted a final bulletin on Stranger Originated/Owned Annuity transactions. (page 26)
- The Catastrophe Insurance Working Group held a public hearing on catastrophe modeling. (page 28)

## Executive Committee and Plenary

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### Adoption of New or Revised Models

The Commissioners took the following actions on significant proposals at the Spring National Meeting:

- Adopted a model law development to modify the life trend test trigger from 2.5 to 3.0
- Adopted the Antifraud Plan Guideline
- Received an FAQ document on the new Model Law Development Framework that is meant to clarify the criteria for a model law and ensure uniform adoption.

Executive Committee also met via conference call to adopt proposals before year-end. Those adoptions are discussed in the relevant topic sections below.

## Health Care Reform

### Formation of Professional Health Insurance Advisors Task Force

In December the Executive Committee formed this task force whose charge is to "work in an expedient manner to identify, analyze and recommend options to the Executive Committee for addressing the

negative impacts on health insurance brokers/agents, insurance consumers and insurance markets, prior to and as a result of the Medical Loss Ratio (MLR) requirements" of PPACA.

The task force held its inaugural conference call February 28 and concluded they should explore a proposal to ask Congress to amend relevant sections of PPACA in order to "preserve consumer and employer access to professional health insurance" by removing the requirement to include brokers' commissions in the MLR calculation. Several consumer representatives on the call objected to that proposal; on March 3, the task force exposed for comment proposed legislation to exclude "licensed independent insurance producer remuneration" from the MLR calculation. Comments were due March 24. Note, however, that the task force has not yet concluded they will move forward with submitting this proposed legislation to Congress as the task force is still accumulating data to analyze the effect of the MLR on commissions.

At its meeting in Austin, the task force held a lengthy public hearing and heard comments from consumer groups, health entities and insurance brokers on the proposed legislation and other questions including

whether commissions have been reduced since the passage of PPACA, the effect of present and potential future commission reductions, whether this will cause access issues and whether it is likely agents/brokers will abandon health insurance markets. During the public hearing several consumer groups commented that excluding commissions from the MLR will assuredly increase costs to consumers and the biggest consumer issue for health insurance is affordability. They requested that the task force consider the consequences of what they are considering; they believe the proposed legislation is not asking for an interpretation of the law, but a change in the law. Health insurance company representatives focused on the effects on insurance markets, as some insurers are exiting markets as they can't service the market without brokers and cannot meet the MLR requirement with the commission expense being excluded. The representatives from the agents and agent trade associations focused on the services provided by the health insurance advisors and the commitment of time and service to customers after the sale of the policy.

Many members of the task force appear sympathetic to the issues of the health insurance advisors although one commissioner raised the possibility that it is the insurance companies' reducing commissions to agents over the last ten years and not the MLR calculation that is causing the problems for agents. Another new commissioner raised the concern that the project is being too quickly fast-tracked and is not deliberative enough.

At the conclusion of the meeting, the task force expressed the need for concrete data to determine the effect of PPACA on commissions. They then adopted a motion to ask the Health Insurance and Managed Care (B) Committee to perform the following and report back to the task force within four weeks:

- Collect, analyze and report on relevant data regarding the level of commissions and/or other payments to producers in the individual, small and large group markets, including, but not limited to evaluating 2010 gross commission or fee payments as a portion of the denominator in the medical loss ratio, and
- Without determining whether any change is necessary, identify options to modify MLR definitions, methodology and/or numerical standards that may be necessary to protect health insurance consumers, and to preserve the

important role of producers in the health insurance transaction and in the resolution of disputed health insurance claims.

The Health Insurance and Managed Care Committee met via conference on April 4 (with nearly 200 participants listening) to discuss these charges. The committee discussed the need to obtain the data as soon as possible (4-6 weeks), noting that they are significant challenges involved with meeting that deadline since the Health Care Supplement Exhibit, which will contain useful data for this project, was just filed April 1 and a significant number of companies have asked for filing extensions. The committee then charged the newly formed Health Care Reform Actuarial Working Group to assist them in its two charges.

The Health Care Reform Actuarial Working Group met by conference call on April 7 to begin identifying potential sources of data that may be available for the group to complete its charge. In addition to the data available in the Supplemental Health Care Exhibit, the group explored potential sources of data from major insurers, producer associations, major brokerages, state insurance departments and other health care related organizations. Representatives of major health insurance companies on the call were not in a position to make any commitments at this time as to whether insurers would be able to provide the necessary data in the short time frame needed and would be willing to provide that information. Several times during the call, representatives of consumer advocate groups asked questions regarding the process which suggests that any proposals stemming from this initiative are likely to be met with strong debate in the future. The working group has scheduled weekly calls for at least the next 4 weeks to accomplish its objectives.

#### Health Care Supplement Exhibit

The Health Reform Solvency Impact Working Group met in December and January and adopted significant changes to the Supplement instructions for the 2010 filing that were considered controversial by some interested parties. The changes require that if there is reportable business in Columns 1-3 of the Supplement (comprehensive major medical in the small group, large group and individual markets) in any state, the carrier must fill out the supplement in every state. The original understanding of companies was that carriers with no reportable business in Columns 1-3 in a particular state would not be required to complete the Supplement for that state. Interested parties also objected to the changes

to Supplement being adopted so late, i.e. in February with the Supplement being due April 1.

In connection with this change, the working group also developed guidance for state insurance departments which were receiving requests for waivers from carriers for filing the Supplement. The guidance recommends that commissions "avoid granting filing exemptions except for the following scenario: carriers whose only reportable business in Columns 1-3 is comprised of closed blocks of small group, large group or individual business that, if totaled across all states does not equal 1000 lives in total."

The working group also developed proposed revisions to the Supplemental Health Care Exhibit and instructions for 2011 reporting. Among other changes, the proposal would add columns for student health, mini-med and expatriate plans to Parts 1 and 2. The proposal was exposed by the Blanks Working Group as agenda item 2011-30BWG.

## **Dodd-Frank Receivership Implementation Working Group**

The newly formed working group is charged to review and consider portions of the recently adopted Dodd-Frank Wall Street Reform and Consumer Protection Act to determine what, if any state laws, regulations or procedures are necessary for state receivers and the NAIC to be prepared for related to receivership activities, as well as, to monitor, review and provide input on federal rulemaking and studies related to insurance receivership. Under Dodd-Frank, state insurance commissioners, their designated receivers and state guaranty funds are charged with the responsibility of resolving a systemically significant insurance receivership.

The working group held an initial organizational conference call on February 4 to discuss a preliminary outline of its planned process and coordination. The outline was exposed for a brief public comment period in February, and as presented in Austin, includes four broad areas of consideration by the working group:

- What processes at the state level should be examined to ensure the state receivership mechanism will respond effectively?
- What future issues require analysis and preparation for the situation in which an insurance company is a subsidiary or affiliate of a covered financial organization?

- What national coordination initiatives should be considered to ensure the national state-based system provides an effective response to a systemically significant insurance receivership?
- What potential changes to state laws, regulations and/or statutes should be developed, and ultimately considered at the individual state level?

In Austin, the working group discussed the status of its consideration of each of the four areas included in the outline and considered potential legal drafting issues. The working group noted that it is working under an aggressive timeline and plans to have a draft document completed by the end of April with the hope of a final document being adopted by the working group at Summer National Meeting.

## **Financial Condition Committee**

### Anti-Money Laundering Procedures

The committee discussed a request from the US Department of Treasury's Financial Enforcement Network (FinCEN) for the NAIC to adopt more detailed anti-money laundering (AML) compliance examination procedures to be included in the Financial Condition Examiners Handbook. This would provide state examiners with guidance that will enhance their ability to perform consistent risk-based examinations of insurance companies who issue or underwrite covered life insurance products as defined by FinCEN. It was noted that the current Financial Condition Examiners Handbook instructs examiners to perform a high-level review of an insurer's AML compliance by determining whether life insurers writing covered products have established an AML program containing the required elements. The review consists primarily of interviewing insurers about their processes and the reporting of any concerns to the appropriate federal authorities.

The committee adopted a charge to the Financial Examiners Handbook Technical Group to consider and recommend appropriate revisions to the handbook which will address the FinCEN request. The committee also noted that the Antifraud Task Force is considering a further request from FinCEN for NAIC members to enter into Memoranda of Understanding, which would allow state insurance regulators and FinCEN to share information resulting from the AML compliance examinations.



## Statutory Accounting Principles Working Group

### Adoption of New Standards or Revisions to SSAPs

SSAP 100 Fair Value Disclosure Revisions - The working group held a conference call in November 2010 and adopted the amendments to SSAP 100 that were exposed at the Fall National Meeting. These changes included elimination of the requirement to distinguish and report separately fair values on a recurring and nonrecurring basis and to require a net presentation of purchases, sales, issuances and settlements in the Level 3 rollforward disclosure for 2010 reporting.

At its meeting in Austin, the working group adopted guidance that had been deferred from the November conference call. One new disclosure will show the fair value hierarchy of items that are disclosed with a fair value measurement but are not valued at fair value in the balance sheet. The second item will require gross presentation of purchases, sales, issuances and settlements in the Level 3 rollforward disclosure. The working group agreed to defer the effective date of these new disclosures until January 1, 2012 to coincide with the effective date of these disclosures for US GAAP. The working group did not agree with the interested party request to provide only aggregated disclosures of fair value for the new disclosures; for specific investment schedules in which fair value is already provided for individual investments, an electronic only column will be added. For all financial instruments, a new financial statement note will be added that will summarize hierarchy levels by type of financial instrument.

#### SSAP 22 Guidance on Early Terminated Leases

The working group adopted FAS 146/ASC 420 *Exit or Disposal Activities* guidance on lease terminations, which had been previously rejected by SAP. The guidance requires a liability to be recognized, measured at fair value, for costs to terminate the lease at the time the entity terminates the contract. The previously rejected guidance was reconsidered when the NAIC became aware that with the adoption of the FASB Codification, EITF 88-10, which is adopted by SSAP 22 but not excerpted therein, is no longer available for users to review.

#### Collateral Requirements for High Deductible Policies

- The working group adopted amendments

to SSAP 65 guidance on collateral for high deductible policies submitted by an interested party, which will allow a single collateral deposit to satisfy collateral requirements for multiple high-deductible policies, subject to a "fair and equitable" allocation agreement. In connection with the discussion of this issue, a member of the working group asked that NAIC staff research accounting issues identified in a prior white paper on workers compensation high deductible policies.

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

Items exposed for comment have a comment deadline of June 17, 2011 (unless otherwise stated).

SSAP 101, Income Taxes - The NAIC exposed for comment SSAP 101 on March 22, which would replace SSAP 10R and which expires on December 31, 2011. Industry has been anxiously waiting for the release of the exposure draft, which is more complex than the current standard and proposes additional limitations on deferred tax assets. Significant changes include the following:

- The exposure draft provides guidance on uncertain tax positions that is nearly identical to the ASC 740/FIN 48 guidance.
- For the first part of the DTA admissibility test, the RBC threshold has been removed. However, for the second part of the test, a new concept of "exDTA RBC" is introduced that requires RBC to be calculated without regard to DTAs and determines the length of the reversal period for this part of the test.
- The third part of the admissibility test would eliminate the offset of DTAs and DTLs if the scheduled reversals differ by more than year years.
- The DTA can also be limited by a ratio of adjusted DTA to adjusted capital and surplus. The higher the ratio, the greater the potential limitation.
- The proposed effective date is January 1, 2012.

At the Spring National Meeting, the comment period was extended to April 29. The working group plans to hold a public hearing via conference call May 11 with subsequent calls scheduled for May

25, June 8 and June 22. (All calls will be held at 3 PM EDT.) The working group hopes to adopt a final standard by the Summer National Meeting in August.

**SSAP 25, Definition of Related Party** - In connection with its project to consider the guidance of FAS 166 and FAS 167, NAIC staff identified that situations may exist which an insurer in its US GAAP financial statements may be required to incorporate an entity, such as a variable interest entity, within its consolidated financial statements, but such entity may not be considered a related party under SAP. As a result the working group exposed for comment proposed revisions to SSAPs 25, 48 and 97 to modify the definition of a related party. The proposed changes would include de facto agents or principals to the reporting entity as related parties and "control" would include non-voting interests when the reporting entity has the power to direct the activities of the entity that most significantly impact the entity's economic performance or the obligation to absorb losses or receive benefits of the entity that could be potentially significant to the entity.

**Medical Loss Ratio Rebates** - The working group exposed for comment proposed revisions to SSAP 66, Retrospectively Rated Contracts, in response to questions from issuers of health coverage subject to PPACA on the classification of medical loss ratio rebates. The proposed guidance clarifies that for managed care and A&H entities accrued rebates should be accounted for as a liability as part of accident and health reserves, with an offset to premiums (as opposed to loss expense). The deadline for this proposal is May 27 (in order to meet related Blanks Working Group deadlines).

**Definition of Preferred Stock** - The working group exposed for comment an explicit definition of preferred stock for use in SSAP 32, as "any class or series of shares the holders of which have any preference over the holder of any other class or series of share." SSAP 32 currently lists examples of preferred stock but no definition.

**Accounting for Pensions and SSAP 92, Accounting for Postretirement Benefits Other than Pensions** - Little progress has been made in finalizing these SSAPs. At the Fall National Meeting, the working group discussed a request to reconsider the requirement to establish a liability for OPEBs consistent with the GAAP guidance because of the ability of the sponsor to reduce or terminate benefits under an OPEB plan. No action was taken this fall or winter, but the working group will hold an interim conference call later this spring to discuss the comments. The working group did extend the

proposed effective date for both SSAPs from January 1, 2012 to January 1, 2013.

**Issue Paper 141, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities** - At the request of the FAS 166/FAS 167 Subgroup, the working group exposed for comment this revised issue paper adopted by the subgroup in February, which proposes adoption of most of FAS 166 guidance, including removal of the concept of qualifying special purpose entity, but would not require consolidation of SPEs. The issue paper does not include a proposed effective date.

**SSAP 94- Transferable State Tax Credits** - The working group exposed for comment proposed revisions that allow entities that purchase or acquire tax credits that are subsequently non-transferable to reflect the credits as admitted assets if the domestic state law requires the credit to be used in that taxable year. SSAP 94 currently does not allow non-transferable credits as admitted assets.

**SSAP 43R Q&A** - Industry interested parties are developing a Q&A document that addresses issues that have arisen with the January 1, 2011 adoption of a revised definition of loan-backed and structured securities. The revised definition includes lease-backed securities and equipment trust certificates as SSAP 43R bonds that many insurers previously classified as SSAP 26 bonds. Interested parties hope to get clearance shortly from regulators and have the document posted on the NAIC's website as unofficial guidance.

**ASU 2010-28, Intangibles - Goodwill and Other** - The working group exposed for comment proposed revisions to adopt guidance from ASC 350-20/*FAS 142, Goodwill and Other Intangible Assets* to require an annual testing of impairment for goodwill, with additional testing in response to specific events or circumstances. The revisions also propose rejection of the guidance in *ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*, but proposes additional restrictions to statutory accounting to prevent recognition of goodwill for any underlying investment that has a zero or negative reported value. The guidance also proposes limiting goodwill to the maximum of the reported value of the underlying investments.

**Fund Demand Disclosures for Institutional Business** - At the Summer National Meeting, the working group discussed this project, which goal is enhanced disclosure of liquidity risk management of insurers. Interested parties presented a proposed liquidity disclosure template that they had developed, which is based on the New York liquidity survey, and would be a confidential filing. The template proposes disclosure of documented liquidity plans, rating agency financial strength ratings, activities such as securities lending, reliance on reinsurers, liquid and illiquid assets, and general account guarantees of market value separate accounts and cash demands related to institutional business.

At its meeting in Austin, the working group exposed the interested party proposal for comment and asked for comments as to whether the information should be included in a regulator-only filing with the NAIC due to the confidentiality of the information that would be disclosed.

**Schedule for SSAP 43R Disclosures** - The working group exposed for comment a proposal to move the disclosures from paragraph 49g of SSAP 43R on non-interest impairment recognized from the annual and audited financial statement notes to a new schedule in the annual and quarterly statement. The first period this change could be effective would be the first quarter of 2012 so the footnote disclosure will be in effect for at least one more year-end.

**AVR/IMR Determinations through NAIC Designations** - The working group briefly discussed the proposal to modify significantly the AVR and IMR rules to allow judgment in the allocation of AVR and IMR except when the NAIC designation changes by more than one rating during the holding period or if the security is rated NAIC 6 at any time. The proposal was a result of a recommendation from the Rating Agency Working Group to consider whether changes in NAIC designations should be the sole factor to determine whether realized capital gains and losses are allocated to IMR and AVR for corporate bonds and debt instruments other than SSAP 43R securities.

Interested parties had commented that before such changes should be considered that the NAIC should research the effectiveness of the current allocation methods and whether the process is not adequate for a particular asset class(es). The working group agreed to form a subgroup to study the issue.

**Consideration of FAS 167** - The working group noted that the FAS 166/167 Subgroup has released for comment a revised Issue Paper 142, Variable Interest Entities on February 3. The revisions to the issue paper from its last exposure are not material; it would require a reporting entity to determine which of its relationships are VIEs and disclose information with respect to those VIEs. There is no effective date yet proposed for this issue paper. Comments are due April 8.

Separately, the subgroup also exposed for comment ASU 2010-15 – Topic 944 – *How Investments Held Through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments*. The Form A suggests that it may be appropriate for the variable interest consideration and documentation under SAP to take into account all separate account interests, including those products that do not meet the separate account GAAP classification criteria

**Referral from Life RBC Working Group** - The working group discussed a referral concerning a long-standing issue of the accounting mismatch between a hedged bond and a credit default swap when hedge accounting is not used e.g. the bond is valued at amortized cost and the derivative is valued at fair value. The working group noted two things: 1) insurers have the ability to eliminate the mismatch if the derivative transaction can qualify as an effective hedge and, 2) hedge accounting is under review by both the IASB and FASB. Therefore the working group concluded they will wait until those deliberations are complete before they consider any changes to SSAP 86.

**Referral from the PBR Working Group** - The referral asks that each technical group that was assigned a "Stage 1" deliverable related to the implementation of principles-based reserving begin to formulate their plan for addressing those items, and provide a written report to present to the PBR Working Group at the Summer National Meeting. The SAP Working Group asked that interested parties involved with the project in 2009 assist with this effort.

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

- ASU 2010-24 - Health Care Entities, Presentation of Insurance Claims and Related Insurance Recoveries



- ASU 2010-26 - Financial Services - Insurance
- AICPA SoP 05-1: Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts

## Emerging Accounting Issues Working Group

The working group met in Austin and exposed the following issues for comment.

EITF 03-12: The Impact of FASB Interpretation No. 45 on Issue No. 95-1, Revenue Recognition on Sales with a Guaranteed Minimum Resale Value - The working voted to reject this guidance as not applicable to statutory accounting.

Consideration of FASB Accounting Standards Updates - The working group reached a tentative conclusion that the EAIWG will continue with its existing focus, specifically concentrating on interpretations related to adopted NAIC statutory accounting principles. The Statutory Accounting Principles Working Group would then review all FASB Accounting Standards Updates, including those that reflect consensus positions of the FASB Emerging Issues Task Force.

## Capital Adequacy Task Force

The working group met three times since the Fall National Meeting and again in Austin and discussed the following items.

### Deferred Tax Asset Report

After many hours of work and discussion, the task force voted in December to defer final adoption of the Academy's DTA report pending the outcome of the SAP Working Group's project to revise SSAP 10R. The AAA's preliminary conclusions in its June report suggested that there is no need for an RBC charge on current DTAs for well capitalized companies, as the non-admission requirements already act as an implicit RBC charge. During its meeting in Austin, the task force noted that the AAA may need to look again at the asset limitations in relation to the RBC treatment when the accounting guidance is finalized.

### Life Trend Test

Over objections from the chair of the Life RBC Working Group, the task force adopted a model law development request to increase the Life Trend Test trigger from 250% to 300%, which will make it consistent with the P/C and Health Trend Tests.

The task force hope to obtain an exception to the Executive Committee model law procedures, which will allow final consideration of the change to the Life RBC model at the Summer National Meeting.

### Separate Account Issues

The task force discussed a referral from the Financial Condition Committee that the task force study the need to modify RBC to better capture the risks of non-unitized products i.e. held in a separate account but not legally insulated. The referral notes that it "may be appropriate to establish a capital charge on insurers that have more exposure to these types of risks when compared to the general account." The task force has added this issue to the working agenda of the Life RBC Working Group.

### DTA Sensitivity Test

The task force adopted a technical correction to the DTA sensitivity test, which is an informational test only. The chair noted that the sensitivity test may have to be adjusted again as a result of the future changes to SSAP 10R, Income Taxes.

### Fraternal RBC

The task force adopted a recommendation to Financial Condition Committee to consider amending the current RBC Insurers Model Act to include fraternal societies rather than developing a separate model for them. This request was subsequently adopted by the Committee. The task force also exposed for a 45 day comment period changes to the Fraternal RBC instructions to implement an action level page and a trend test page.

## Solvency Modernization Initiative Risk-Based Capital Subgroup

The subgroup met via conference call February 24 and in Austin and discussed the following issues.

### AAA Report on Current RBC

The Academy provided a summary of its 90 page report on implicit calibrations and missing risks in the current RBC formulas. The report was provided in response to the subgroup's request for assistance in understanding intended or expected safety levels or calibrations of risk factors. The report contains separate, detailed sections prepared by the Academy's Life, Health and Property/Casualty RBC Committees relative to each distinct RBC formula (which are discussed in more detail in the RBC Working Group summaries below).

The Academy noted that while none of the formulas contain an explicit safety level for aggregate RBC, some of the capital charges for individual risks are defined by an explicit calibration point. With regard to missing risks in the current formulas, the P/C report contains a discussion of how and to what degree risks faced by P/C insurers are reflected in the current formula. The discussion identifies potential shortfalls in the way various risks are treated, and these shortfalls include risks not reflected in the current formula as well as risks that are included but not fully captured by the formula. The Health report identifies missing risks, some that are new or more prevalent since the formula was first established, but notes that the effect needs to be quantified and evaluated for materiality before being included in the formula. The Life report indicates that there are no material risks excluded from the current formula, consistent with the objective of the RBC formula which is to identify weakly capitalized companies. The SMI RBC Subgroup voted to receive the report and will consider the information in this report as it continues its work evaluating potential changes to the RBC formula.

#### Capital Initiatives Working Group Update

The Capital Initiatives Working Group, comprised of seven large life insurers, provided an update on activities related to the assessment of calibrations underlying the current Life RBC formula and the development of an internal model, which will be used to illustrate potential alternative RBC methodologies. The group is targeting June 30 to have results of this work available for review. In addition, the CIWG studied differences in safety levels and time horizons of the current RBC formula, both at the product level as well as a business level.

At the Spring National Meeting, the working group distributed results from four volunteer life insurers which modeled a 100% Company Action Level RBC are as follows:

- Company A -95% using a 20 year run-out methodology
- Company B - 91-93% using a lifetime run-out methodology
- Company C - 96.5% using a one year measure
- Company D - 90-95% using a one year risk measure

The SMI RBC Subgroup voted to receive the report and will consider the information as it moves forward with its work.

## **Life Risk Based Capital Working Group**

The working group did not meet during the Spring National Meeting, but held two conference calls this winter and discussed the following items.

#### Derivatives Risk Mitigation Proposal

The working group unanimously adopted the ACLI Derivatives Risk Mitigation proposal including New York's proposal for an adjustment to the total adjusted capital (TAC) regarding the purchased premium of hedge bonds. The proposal was subsequently adopted by the necessary parent committees in Austin and will be effective for 2011 RBC. The ACLI proposal calls for a credit for hedging of C-1 asset risks for fixed income securities and common stocks not already considered in C-3 modeling. New York's proposal adjusts TAC to address their concern that there is a mismatch in reported values when a hedged bond is carried at amortized cost and the corresponding credit default swap is carried at fair value. Although the ACLI did not conceptually agree with New York's proposal, they favored the adoption of the proposal with New York's proposed TAC adjustment (as opposed to not adopting anything at this time).

#### Commercial Mortgage Proposal

The ACLI provided a progress update on work related to its proposal for revising the RBC calculation for commercial mortgages. This revision is intended to replace the widely criticized Mortgage Experience Adjustment Factor (MEAF) methodology currently in place. The ACLI is working with the modeller; Moody's Analytics, using Moody's software and database and has begun to receive modeling results. In addition, documentation of the modeling process is in progress so it can be shared and discussed. The ACLI's internal review process is ongoing and the initial reports should be completed soon. A conference call will be scheduled to discuss the results.

#### Low Income Housing Tax Credits

A request had been made to working group to make the RBC treatment of state low-income housing tax credits the same as that afforded federal low-income housing tax credits. The chair noted that this issue came up when the federal issue was originally discussed but he thought that the state issue was not addressed due to a lack of information with regard to the state aspect. NAIC staff was asked to provide a summary of the information reviewed when the

federal low-income housing tax credits proposal was first adopted.

#### C-3 Phase 3

A brief discussion was held on the number of outstanding issues regarding the yet to be adopted C-3 Phase 3 changes to the Life RBC requirements. The working group will combine this list with items from the C-2 Phase 2 Results Subgroup to develop a complete list of outstanding items.

### **P/C Risk-Based Capital Working Group**

The working group met via conference in December and March and discussed the following topics:

#### Overview of AAA SMI Report

As discussed in the SMI RBC Subgroup summary above, the AAA reviewed each formula and identified areas where either risks are not reflected in the formula or not fully captured. For the P/C RBC formula, five such areas were identified: catastrophe risk, reinsurance credit risk, underwriting risk, asset-related risk and precision in specifying risk. The chair noted that changing the formula to one based "entirely on a statistical outcome would not be in the best interests of the regulators." Others agreed that making modifications within the current RBC framework is the best solution. Work on this important project will continue.

#### Review of Underwriting Risk Factors

At the request of the reinsurance industry the working group adopted in 2010 a new working agenda item to "review the methodology for allocating the underwriting risk reserve and premium factors for the various lines of business." This issue was added due to industry concerns with the current methodology for calculating the reinsurance underwriting risk factors, which some believe results in "excessively" high capital requirements for reinsurers. The methodology for the factors has not been reviewed since RBC was developed 20 years ago. The AAA has been asked to review the methodology and provide regular updates to the working group and interested parties. At its March meeting, the working group acknowledged that given the scope of the project and tasks referred by the SMI RBC Subgroup that the review of the methodology will not be done for 2011 RBC. The working group then set a target completion date of 2012 RBC.

At the subsequent meeting of the Capital Adequacy Task Force the chair suggested that a conference call or e-mail vote be held after the Spring National Meeting to address some concerns of the Reinsurance Association of America whether underwriting risk factors would be increased for 2011 RBC.

#### Excessive Premium Growth Charge

The working group continued its discussion of the excess premium growth charge that could be triggered by a company in run-off when it has significant audit premium. The working group decided not to amend the RBC instructions to allow an exemption for such companies and suggested that a state could exempt run-off companies on a case by case basis.

### **Health Risk-Based Capital Working Group**

The working group held a conference call in December and March and discussed the following issues.

#### Overview of AAA SMI Report

As discussed in the SMI RBC Subgroup summary above, the AAA reviewed each formula and identified areas where either risks are not reflected in the formula or not fully captured. For the Health RBC formula, five such areas were identified: pandemic, biological terrorism, increased cost of compliance, privacy breaches and risk of reserve inadequacy on long-tail products. The chair noted the first two items are similar to catastrophe risk and coordination with the P/C RBC Working Group on its project is one potential alternative.

#### Health Care Reform

The working group continues to monitor progress of health care reform and the potential effects on health RBC results of companies. The working group noted that reviewing the insurance risk component of the formula would be a good starting point to assess the change in pricing and insurance models caused by health care reform. A representative from the AAA noted that PPACA poses new risks for health insurers due to the rebate requirements and the ability to recoup losses being restricted. The chair of CADTF noted that either the RBC instructions or formula will need to be revised to reflect this; the working group approved a motion to develop a proposal for discussion on its next conference call.

### Covariance Calculation

The working group had previously discussed the issue of "fine tuning" the covariance calculation. At its March meeting the working group noted that the SMI RBC Subgroup is currently reviewing the covariance and calibration of RBC across all formulas. This project has been re-evaluated to a "high priority" agenda item.

### Health Care Receivables

Because of "significant inconsistencies" in the way these receivables are reported in the RBC formula, working group developed clarifications to the annual statement instructions for line 24, Health Care and Other Amounts Receivable; this proposal was exposed by the Blanks Working Group in Austin (BWG 2011-28). Because the proposal cannot be effective for 2011 as hoped, the AAA Health Care Receivables Factors Work Group will hold a conference call to discuss the potential assumption or conclusions based on the current data.

### Stop Loss Work Group

The AAA Stop Loss Work Group appears to be making progress on this project that has been on the working agenda for several years; the work group was asked to assess the appropriateness of the stop loss risk charge of .25. A representative from the work group noted they have collected a significant amount of data from 18 insurers and they hope to complete their analysis by the end of the year.

### New Agenda Items

The working group added two new issues to its working agenda: evaluate industry segment concentration risk and evaluate the underwriting risk and the invested risk in relation to downturn of the economy. Both issues have a completed date of 2012 RBC or later.

## **Solvency Modernization Initiatives Task Force**

The work of the SMI Task Force and its working groups continue to dominate the National Meeting. The task force met March 7 and in Austin and discussed the following projects.

### Comments from Dr. Therese Vaughn

At the Spring National Meeting, the task force heard comments from Dr. Vaughn, CEO of the NAIC, on "Group Supervision and the IAIS Common Framework for the Supervision of Internationally Active Companies (ComFrame)." Dr. Vaughn shared her thoughts about development of a common

framework and working with international regulators which included the following observations:

- Regulators should be clear on the problem they are trying to solve, i.e. international standards and supervisory processes need to guard against a "race to the bottom" without creating inefficiencies for companies by complying with multiple sets of regulations.
- Regulators need to focus more on supervision of companies than creating new regulations.
- Regulators should not place excessive reliance on regulatory capital requirements as the solution
- The relationship between the group or lead supervisor and the other supervisors should create the proper incentives, and the Group Supervisor should be accountable to the other supervisors.
- Particular attention needs to be paid to creating mechanisms that facilitate information sharing.
- Regulators need a consistent benchmark for measurement, which may be the most difficult part. Dr. Vaughn stated that the "logical candidate at this point is IFRS."
- Incremental change is better than revolutionary change.

Dr. Vaughn's entire speech has been posted to the NAIC's website.

### Restructuring of Task Force Working Groups

To address concerns related to potential overlap of SMI activities among its working groups, the task force combined the International Solvency and International Accounting Standards Working Groups into the new International Solvency and Accounting Standards Working Group. The task force also dissolved the Statutory Accounting and Financial Reporting Subgroup and moved its charge to the new International Solvency and Accounting Standards Working Group. These changes took effect at the conclusion of the Spring National Meeting; the two international working groups met separately in Austin as discussed below.

### PwC Solvency Webcast

On April 6, PwC hosted a webcast on solvency-related issues relevant to the US insurance industry.



The chair of the SMI Task Force, Director Christina Urias of Arizona, participated in the webcast and answered questions from our panelists and the participants. Director Urias made the following observations:

With respect to ORSA, she noted that there are two drivers moving it forward: satisfying IAIS Insurance Core Principles and having an "additional regulatory tool for the tool box." She puts greater weight on the latter. Director Urias doesn't want the US ORSA to be too prescriptive and or too inflexible for smaller companies to use. Her goal is that the final tool could be used for both US and international compliance and should come as close as possible to what companies are already doing for risk assessment. She noted the goal of having the ORSA tool completed by the end of 2012 per the SMI Roadmap may be "wishful thinking."

As far as capital requirements are concerned, Director Urias noted that the regulators need to determine what they want RBC do. She does see some of the missing risks such as catastrophe risk and reinsurance credit risk being added to RBC, but noted that regulators view supervision as more than capital calibration. On the topic on reinsurance modernization, Urias believes the NAIC will retain the prescriptive sliding scale for collateral requirements but there may be some movement in the scale, especially in the 20% to 75% collateral requirement range for Secure 3 and Secure 4 reinsurers. (See further discussion of this topic in the Reinsurance Task Force summary below.) With respect to statutory accounting and PBR, Urias believes the need for an international common framework will lead US regulators to adopt IFRS, but retain some regulatory control. She believes completion of the principles-based reserving project by the end of 2011 may be achievable but will depend on the results of the Phase I and Phase II testing (as discussed below in the LATF summary).

The webcast archive can be accessed using this link <http://event.on24.com/r.htm?e=294386&s=1&k=E33F319CFEA5394AE6E6726EE5038837>

## **PBR Working Group**

### PBR Impact Study

The chair of the Life Actuarial Task Force provided an update on the status of the PBR impact study, including a presentation by a member of the Towers Watson team conducting the testing. The same update was provided during the LATF meeting; see page 22 for that summary.

### NAIC's Role with PBR Statistical Data

The working group discussed the statistical agent process relative to data gathering for regulatory evaluation of PBR results. The Standard Valuation Law authorizes commissioners to require that a company submit experience data as prescribed in the Valuation Manual. The purpose of this data is to establish industry experience that could be used by insurers that lack credible data to establish their own PBR assumptions, and to allow regulators to analyze the appropriateness of assumptions used in PBR calculations. To better understand how data collection might work, the working group reviewed LATF's response to its request to define the information that would be collected in a Feedback Loop to review PBR and how that information would be used.

The responses notes that key elements of such review are evaluation of assumptions and validation of assumptions against experience. The PBR Working Group is interested in national aggregation and validation through a centralized database and does not favor the Feedback Loop approach. The working group drafted a letter to Executive Committee proposing a number of NAIC actions to facilitate this data collection, including hiring a statistical agent to collect the data, developing and maintaining requirements for statistical agents, selecting which companies would be required to submit data for an experience study, and assessing all life and annuity writers for the cost associated with this experience reporting process. The working group voted to expose the letter for comment.

### Letter to Technical Group Chairs

The working group anticipates adoption of the principles-based Valuation Manual during the latter part of 2011. The original principles supporting the NAIC's adoption of a PBR approach provided a framework within which applicable technical groups (e.g. LATF, SAPWG, CADTF) would work to address action items assigned to them within the principles. As the NAIC moves closer to adopting the Valuation Manual the PBR Working Group is requesting that the technical groups review their action items, modify as needed and formulate plans for addressing the items. Written reports from the technical groups are to be presented to the PBR Working Group at the Summer National Meeting.



## International Accounting Standards Working Group

The working group discussed the following developments of the International Accounting Standards Board and International Association of Insurance Supervisors.

### IAIS ICP 14, *Valuation for Solvency Purposes*

The working group discussed the recently exposed draft IAIS Insurance Core Principle 14, *Valuation for Solvency Purposes*, which provides a supervisory standard on the valuation of assets and liabilities for insurer solvency assessment. The ICP, as drafted, would require assets and liabilities to be evaluated on an economic basis, rather than a more narrowly defined basis such as fair value. NAIC staff and interested parties discussed concerns as to whether the NAIC's current valuation approach for certain assets and liabilities (e.g., bonds and non-life loss reserves) would meet the definition of an economic valuation. The working group is considering providing a comment letter to the IAIS in advance of the April 19 comment deadline.

### FASB Financial Instruments Amortized Cost Restrictions

The working group discussed a letter written by the Statutory Accounting Principles Working Group to FASB dated February 15 to express the NAIC's concern regarding the additional language added to the requirements for amortized cost by the FASB relative to the wording in IFRS 9, *Financial Instruments*. This was to add the words "managed through a lending or customer financing activity." These words would likely preclude insurers from classifying their fixed income bond portfolios at amortized cost, irrespective of the level of trading activity. The working group adopted a motion that, if the FASB does not change this wording, the working group will recommend to the NAIC representatives on the IAIS Executive Committee that the IAIS raise this matter at the Financial Stability Board.

### IASB/FASB Supplement on Impairment

As part of the overall plan to converge IASB and FASB financial instrument accounting standards, the two boards issued a supplementary document on impairment in January with comments due by April 1. The supplement suggests that the impairment assessment of financial assets managed on an open portfolio basis should be split into two groups, based on their credit characteristics. For one group, the entire amount of the expected credit losses would be recognized in the impairment allowance (referred to

as the "bad book"). For the other group (referred to as the "good book"), expected credit losses would be recognized on a portfolio basis over a time period at the greater of the time-proportional expected credit loss (depending on the age of the portfolio) and the credit losses expected to occur within the foreseeable future period (being a minimum of twelve months). The working group adopted a motion to send an e-mail comment to the two boards requesting clarification that the supplementary document would provide a choice between an individual asset impairment approach and an open portfolio impairment approach for insurers with fixed income bond portfolios.

### IFRS 4, *Insurance Contracts* - Volatility Issue

The working group discussed a draft letter to the IASB concerning the issue of volatility in profits and losses which would result from the insurance contracts standard as currently drafted. The working group expects that the letter will be issued jointly by the NAIC and certain other major insurance jurisdictions. The principal concern expressed in the draft letter is with regard to the volatility that results from the selection of the discount rate. The letter states that insurers do not respond to changes in the yield curve by selling their entire portfolio and reinvesting in new assets to reflect the new yield curve. Insurers manage their investments in such a way as to achieve a stable investment return from their portfolio to fulfill their insurance contract obligations. Therefore, a performance result derived from a short-term change in yield curve as if all future cash flows are affected by this change is not appropriate. The working group adopted a motion to authorize the chair and NAIC staff to issue the letter with any minor amendments necessary to get the support of other jurisdictions expected to be referenced in the letter. The working group agreed that the letter would be held in abeyance until the IASB had issued its board papers on volatility, at which stage a decision could be made on whether to send the letter.

It was noted the IASB and FASB are continuing to hold joint meetings on the insurance contracts standard. NAIC staff noted that the IASB remains intent on issuing a final insurance standard by June 30, 2011.

## Group Solvency Issues Working Group

The working group met via conference in February and in Austin and discussed the following issues.

### Revisions to the Holding Company Model Law and Regulation

Executive and Plenary adopted in December the working group's proposed revisions to the *Insurance Holding Company System Model Act* (#440) and *Insurance Holding Company System Model Regulation* (#450) to enhance regulators' ability to look at any entity within an insurance holding company system that could pose an enterprise risk to the insurer. As of March 2011, five states' legislatures are considering these revisions and West Virginia has just completed its adoption.

At the Fall National Meeting, the working group exposed for comment a draft proposal to the Financial Regulation Standards and Accreditation Committee on *Laws and Regulations Substantially Similar Elements for Revised Insurance Holding Company System Act*. The draft shows the new language from the just-adopted Holding Company Act that would need to be adopted by the states for their model to be considered "substantially similar" to the NAIC model. During a conference call February 24, the working group reviewed comments received from four trade associations and adopted several "friendly amendments." However, on the issue of the wording of section 6(x) relating to the protection of confidential information filed with regulators and the NAIC, there was a lengthy discussion of proposed wording changes. The working group decided to defer adoption to allow for additional discussion and is expected to vote on the language during a conference call in April.

### ORSA and Group Capital Assessment Options

As approved by Executive Committee in Austin, the Group Solvency Issues Working Group will now be in charge of ORSA development as risk assessment is very closely related to group solvency assessment.

Last fall, the working group exposed for comment "group capital assessment options" as a result of its discussion of the IAIS Insurance Core Principles approaches to group capital assessment. Many responses expressed the belief that the group capital calculation is not feasible or achievable in the short term for many reasons including insurance regulators not having jurisdiction over many members in a holding company group. Still, the

working group tentatively concluded that the ORSA tool could include an analysis of the group's financial condition and target capital.

During its February 24 conference call the working group exposed for a 60 day period comment its *Draft Group Capital Assessment Proposal for US Compliance with the IAIS*. The working group noted that the draft can be viewed either as a starting point that needs additional detail on regulator expectations on how group target capital should be calculated. Alternatively, it could be used as a high-level principles-based document that provides flexibility on assessing group capital.

The two page document suggests that annually all US based insurance legal entities must provide a group capital assessment as part of its confidential ORSA filing. The draft suggests the approach and assessment of group-wide capital adequacy should consider, at a minimum, the following:

- Elimination of intra-group transactions and "double-gearing where the same capital is used simultaneously as a buffer against risk in two or more entities"
- Take into account leverage resulting from holding company debt
- Identify diversification credits and address restrictions on transferability of capital within the holding company system.
- Address contagion risk, concentration risk and complexity risk.

Since the comment period is still open, responses to the draft were not discussed in Austin. However, the working group received two presentations on group economic/target capital methodologies. A representative from the ACLI presented "Developing a Group Capital Calculation" and noted seven critical decisions in economic capital models: definition of solvency, time horizon of risk exposure, risks to model, how risks are quantified, measurement metric, target level of capital and reflecting diversification. When asked by the working group whether the regulators should require companies to discuss these seven critical decisions, the ACLI representative stated that insurers would likely prefer a more open-ended requirement, e.g. describe your risks and your analysis of them.

The working group then heard a presentation from the newly formed North American Chief Risk Officer Council on "Introduction and Perspectives on Own Risk and Solvency Assessment." The Council is comprised of CROs from 11 of the 15 largest North

American life insurers and 12 of the 15 largest North American P/C insurers. The presentation noted that CRO Council welcomes the "integration of risk management concepts and principles within the regulatory framework." One of the Council's primary recommendations is that the ORSA requirements need to be aligned with internal company risk management practices and that there is no "one size fits all" approach to capital management and enterprise risk management. There seemed to be a consensus among companies that requiring the analysis at the legal entity level would be inappropriate; most insurer groups don't analyze risk at that level.

The working group noted that in connection with its charge to develop an ORSA tool, the regulators are planning a several day meeting in May or June to hear presentations on enterprise risk management and will meet with the CRO Council to continue discussion of its views on what regulators should understand and focus on when reviewing an organization's risk management program and group capital requirements. The meetings will also include confidential ERM workshops where companies will present their ERM practices to regulators, and a discussion of current international ORSA developments.

#### Holding Company Best Practices

At the Fall National Meeting, the working group exposed its best practices document for comment. The document includes best practices for regulators to use in their oversight of insurance companies within a holding company group. The document includes sections on cross-border and other financial sector coordination, information from federal agencies, uniform practices for mergers and acquisitions of control. There is also a section on best practices for participating in international supervisory colleges.

The working group had scheduled a conference call for March 15 to discuss comments received on the draft; the meeting was postponed and will be rescheduled for later this spring.

#### Supervisory Colleges

The chair of the working group discussed the importance of US involvement with supervisory colleges for holding companies with international operations; the chair encouraged states to regularly participate in such interactions with international regulators. Related to this discussion, the working group heard a brief presentation on the launch of a web-based tool, which will facilitate coordination of

US regulators participation in such supervisory colleges. The request for a conference call or annual meeting is sent directly to the holding company group's lead and/or domestic supervisor who contacts the international regulator. The tool is available on the NAIC's website.

## **Corporate Governance Working Group**

#### International Corporate Governance Standards and FSAP Recommendations

At the Fall National Meeting, the working group discussed the review of the US regulatory system for compliance with the Financial Sector Assessment Program (FSAP) which was based on the 2003 IAIS International Core Principles (ICPs). It was noted that the United States "largely observed each of the ICPs related to corporate governance and risk management" but seven recommendations were made by the FSAP to "achieve stricter compliance with existing ICPs." As a result, the working group was charged by the SMI Task Force to specifically address the seven corporate governance and risk management related recommendations, as going forward, the US insurance regulatory system will be evaluated by FSAP based on its compliance with the ICPs.

At its meeting in Austin, the working group discussed a draft *Whitepaper on High Level Corporate Governance Principles for Use in US Insurance Regulation*. The whitepaper includes twenty principles, organized into seven sections: corporate governance, board of directors, senior management, suitability of individuals, reporting and transparency, risk management and internal control systems, control functions, and regulatory oversight. While the newly developed whitepaper was exposed for a 45 day public comment period, interested parties expressed procedural concerns with the development of the document. Some interested parties suggested that the "blank slate" approach to the development of the principles document presupposes that there are not already well established corporate governance practices in the US. Interested parties argued that a more measured approach would be to engage in a public discussion as to what deficiencies exist with the US insurance regulatory system, and then develop targeted principles to fill-in the holes.

The working group noted that it has not determined how the whitepaper will be used, but possibilities range from a best practices document to the

development of a model law. Interested parties raised concerns that it is difficult to comment on the exposed whitepaper without knowing exactly how the principles will be used. In response to this concern, the working group indicated that for now these are only principles and if a model law is subsequently developed there would be a separate exposure period. The working group plans to hold an interim conference call, in late May or early June, following the completion of the whitepaper's exposure period.

## International Solvency Working Group

### Consultation Paper on the Own Risk and Solvency Assessment (ORSA)

At the Fall National Meeting, the working group concluded that it would proceed with the development of a US specific ORSA tool. Solvency II defines ORSA as an assessment that the insurer makes about the adequacy of its own risk management practices and its current and future solvency position. The working group held a conference call on February 11 to discuss a draft US ORSA proposal developed by NAIC staff, who noted that given the current advancements in computer technology and internal models, there are better methods available today to measure risks than existed 20 years ago when the RBC regulatory framework was developed. Staff noted that ORSA would allow regulators to better understand the magnitude of risks present within a particular insurer and the processes in place at that insurer to mitigate those risks. This in turn would assist regulators when evaluating the scope and frequency of financial examinations. However, it was noted that the intent of ORSA is not for regulators to prescribe specific risk management practices.

As drafted, the ORSA proposal would require insurance companies to document, at the legal entity level, the following significant items, among others:

- A detailed description of the company's risk management policy, including all relevant and material risk categories, as well as a description as to how each risk category is managed on an operational basis. The risk management policy would also need to include the company's investment policies, underwriting policies, claims processing policies, retention policies, reinsurance counterparty policies, and anti-fraud policies.
- The quantitative measurements of risk exposure in both normal and stressed environments for each risk category. The quantification of risks would need to be performed under a range of outcomes, using risk measurement techniques that are appropriate as to nature, scale and complexity of risk.
- A description as to how the company combines the qualitative elements of its risk management policy with the quantitative measures of risk exposure in determining the level of financial resources it needs to manage its business over the longer-term business cycle (i.e., 3-5 years).

The ORSA proposal was exposed for a public comment period which ended March 18.

In Austin, the working group discussed comments received on the ORSA proposal. Areas of concern raised by working group members and interested parties include the need to ensure the confidentiality of ORSA documentation, the degree to which the proposal is prescriptive versus principles-based, achieving the appropriate balance of legal entity versus group level requirements, and the need for proportionality. With regard to proportionality, it was commonly agreed by members and interested parties that ORSA must be flexible based on the scale, scope and complexity of an insurer's business, so as not to be overly burdensome to smaller, single-state, short-tail insurers. While no specific actions were taken on the ORSA proposal in Austin by the working group, it was noted that going forward, the ORSA development will be carried out by the Group Solvency Issues Working Group as risk assessment is very closely related to group solvency assessment.

## Statutory Accounting and Financial Reporting Subgroup

This subgroup had been tasked with the broad project to consider the purpose of the regulatory accounting model and whether the NAIC should continue to maintain an entire codification of statutory accounting given the possible convergence of global accounting standards. The subgroup did not meet last fall or in Austin; as noted in the SMI Update memo dated January 2011, the chair of the SMI Task Force "has decided to monitor ongoing developments and postpone further discussions and decisions until the IAIS insurance core principle for valuation and the IASB, FASB, and the Securities Exchange Commission reach their decisions" as result of feedback received on the subgroup's Preliminary Considerations document. The



subgroup was dissolved at the Spring National Meeting and its project moved to the new International Solvency and Accounting Standards Working Group.

## International Insurance Relations Committee

The committee received a report on the revisions of IAIS Insurance Core Principles. The IAIS is currently revising the ICPs and corresponding standards and guidance material with the goal of having a complete set of revised and restructured ICPs ready for adoption at the October 2011 IAIS General Meeting.

The committee then received a report from the IAIS Secretary where it was discussed that the Financial Stability Board is very focused on issues relating to systemic risk in the insurance sector and to ensure that the insurance sector is appropriately represented at the FSB. One major initiative underway in response to FSB recommendations is the development of a methodology to assess systemic importance of insurers. Further discussions on this topic are scheduled for the April 4-6 meeting in Basel, Switzerland and May 4-6 meeting in Kansas City, Missouri.

The committee then discussed the IAIS Common Framework for the Supervision of Internationally Active Insurance Groups. This project continues with an aim to release for public comment a document detailing work in identification of Internationally Active Insurance Groups and jurisdictional matters in June 2011.

The committee received a report on the IAIS Supervisory Forum where it was noted that the inaugural meeting was held and a draft mandate was discussed, including a mandate to facilitate and coordinate better implementation of cooperation and exchange of information between supervisors.

The committee then discussed the US-EU dialogue, including next steps and future meetings. The NAIC hosted the regulator-only session, and topics discussed included solvency modernization, group supervision (including the exchange and maintenance of confidential information and the use of supervisory colleges) and the EU equivalence process. Regulators also discussed systemic risk and financial stability including representation of the insurance sector at the FSB through the domestic angle as well as through the IAIS Financial Stability Committee in addition to the regulators respective

roles at the Financial Stability Oversight Council and the European Systemic Risk Board.

The Committee discussed the IAIS multilateral memorandum of understanding (MMOU), which is a framework for cooperation and the exchange of information and sets minimum standards which signatories must meet in order to bolster cross border supervision of insurance companies. There are currently 13 signatories and there is a need for more validators with increasing demand from IAIS members to join the MMOU. The FAQ is being updated and additional guidance for MMOU applications is being work on, including a matrix to collect statistics on the use of the MMOU.

## Reinsurance Task Force

### Credit for Reinsurance Models

At the Summer National Meeting, the task force submitted requests to amend the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) to incorporate key elements of the Reinsurance Regulatory Modernization Framework Proposal, including collateral reductions for highly rated reinsurers and to incorporate the minimum trustee surplus requirement for a multiple-beneficiary trust fund maintained by an assuming insurer in run-off (Tawa Proposal). These requests for model law development were approved by Executive Committee at the Fall National Meeting.

The task force released for comment February 22 exposure drafts of proposed amendments to Models #785 and #786 to incorporate the above elements. Included for comment within Model #786 were proposed forms CR-1, CR-F and CR-S, which require annual statement-like filing forms showing assumed and ceded reinsurance for assuming reinsurers not domiciled in the US. At its meeting in Austin, the task force reviewed the sixteen comment letters and heard additional comments from ten interested parties. Remarks included the following:

- Several comment letters raised objections to the sliding scale provisions of the proposals; US ceding companies believe the requirement to hold collateral equal to 75% of ceded losses when a reinsurer is rated "Secure 4" (S&P BBB or its equivalent) is too low and suggest 100% should be required. Non-US reinsurers commented that the collateral requirements are still too high for "certified" reinsurers compared to US reinsurers.



- Many comment letters advocated deletion of all the new mandatory contract provisions in Section 8E as unnecessary.
- Two comment letters from US ceding insurers objected to the Tawa proposal which would allow a reduction of trusteed surplus for collateral in a multiple beneficiary trust for a reinsurer in run-off.
- Several comment letters had opposing viewpoints. Several interested parties requested that a commissioner be allowed additional discretion on collateral or allowing a single reinsurer rating (the current draft requires ratings from two acceptable rating agencies); others suggested that commissioners have less discretion.

The task force will schedule an interim meeting to continue its review. The project is on a fast track; the task force hopes to consider final amendments to the two models at the Summer National Meeting.

#### States Actions on Collateral Reduction

In connection with the task force's discussion of reinsurance reform, the task force noted that Florida adopted changes to its credit for reinsurance laws and regulations in 2007, and has recently approved several reinsurers for reduced collateral requirements. New York adopted changes to its credit for reinsurance regulations effective for new reinsurance agreements as of January 1, 2011, and recently approved a reinsurer for reduced collateral requirements. New Jersey just signed revisions into law as part of Senate Bill 2010/Assembly Bill 2670.

#### Nonadmitted and Reinsurance Reform Act

The task force continued its discussion of the federal law implemented under Dodd-Frank and whether the task force should issue implementation guidance regarding the effect of NRRA, whether any changes will be necessary to state laws and whether the NAIC should develop a uniform definition of the term "reinsurer." The task force is also considering monitoring state compliance with the NRRA for the federal Study and Report on Regulation of Insurance provided for under Dodd-Frank. Discussion of these issues will continue during 2011.

## **Valuation of Securities Task Force**

#### 2010 Year-End Financial Modeling Update

Subsequent to the Fall National Meeting, the task force held two "regulator to regulator" conference calls to consider the macroeconomic assumptions, modeling scenarios and probability weightings which will be used in the RMBS and CMBS modeling. These sessions were followed by a public hearing and conference call in late October/early November during which interested parties were provided an opportunity to present their comments. Interested parties expressed significant concerns with the lack of transparency provided with regard to the vendors' valuation models. The task force members and NAIC staff indicated that they had disclosed everything that could be disclosed under the confidentiality agreements signed by the NAIC and these vendors with regard to the 2010 year-end modeling. The task force committed to beginning the discussion with the industry for the anticipated 2011 year-end modeling in early 2011. This would enable the task force to consider what specific information the industry requires, and within reason, to incorporate this into 2011 vendor selection process. Following the discussion on the two open conference calls the task force adopted final assumptions, modeling scenarios and probability weightings for the 2010 year-end modeling.

NAIC staff provided an update of the 2010 year-end modeling results on a January 19 conference call of the task force. NAIC staff reported that PIMCO Advisory had modeled more than 19,400 RMBS. With regard to CMBS, it was reported that BlackRock Solutions had completed the modeled of 5,100 securities. The SVO executed a quality assurance process similar to the 2009 approach for both RMBS and CMBS.

#### 2011 Year-End RMBS/CMBS Financial Modeling

In Austin, the task force briefly discussed plans for the 2011 year-end evaluation of RMBS and CMBS. It is currently expected that updated modeling will again be performed only at year-end, consistent with 2010. The task force instructed NAIC staff to perform a mid-year assessment of market developments similar to last year.

#### Certificate of Deposit Filing Exemption

The task force adopted an amendment to the *Purposes and Procedures Manual*, previously exposed at the Fall National Meeting, which will provide a filing exemption for any certificate of deposit covered by the Federal Deposit Insurance Corporation up to the \$250,000 insurance limit, whether or not the CD is issued by an NAIC ARO rated bank. Further, any CD over the FDIC insurance limit will be subject to a filing exemption, if it is issued by an NAIC ARO rated bank. In this circumstance, the insurer would apply the bank's rating to the CD.

#### FDIC Securitizations Filing Exemption

Following considerable discussion on two conference calls and a second exposure period, the task force adopted an amendment to the *Purposes and Procedures Manual*, which will provide a filing exemption for securitizations created by the FDIC in its role as a receiver of failed banks, where the payment of principal and interest is guaranteed by the FDIC. The task force was initially concerned that while the governing statutes indicate that the FDIC can bind the full faith and credit of the US government, the authority is limited as to amount, creating questions as to whether any specific guaranty is provided by the regulation. However, following examination of the legal basis for such limitation by legal counsel of the New York State Insurance Department, it was concluded that these securitizations are in fact bound by the full faith and credit of the US government.

#### U.S. Government Securities Filing Exemptions

The task force discussed a proposal from the New York Insurance Department to update several listings of US government securities which are identified within the *Purposes and Procedures Manual* as filing exempt. The proposal notes that the current list is inaccurate, out of date and unnecessarily complicated. The proposal was released for a forty-five day comment period. The task force is also considering whether the exempt obligations list should be expanded to include all debt issued, guaranteed or insured by institutions of the US government.

#### Eliminating Conflict in Classifying Investment

The task force considered a previously exposed proposal from the New York Insurance Department recommending the deletion of the classification of securities methodology from the *Purposes and Procedures Manual* of the NAIC Securities Valuation Office as the SVO is required to follow the security classification definitions contained in the relevant

statutory accounting principles. The proposal also would require that as the SVO conducts annual updates, securities must be reclassified, as necessary, in accordance with SSAPs. The intent of the proposal is to create consistency between the work of the SVO and application of statutory accounting principles for invested assets.

In response to the proposal the SVO reported that the statutory accounting definitions are incompatible with the mission of the SVO and with the complex financial engineering that SVO staff are tasked with evaluating. The task force referred the proposal and SVO report to the Financial Condition Committee with a request that the Statutory Accounting Principles Working Group comment on the documents.

#### Invested Asset Working Group

The Risk Other than Credit Technical Resources Subgroup of the Invested Assets Working Group is developing a comprehensive security-level risk assessment process. This includes linking securities data from various sources into a unified database. The database would enable regulators to create tools which will provide for more comprehensive assessment and risk focused analysis of investment risks.

In response to a recommendation received from the SVO Review Working Group, the task force requested that the Invested Asset Working Group lead the efforts to redesign the SVO's portfolio analysis report (PAR) product and incorporate it into the risk-other-than-credit framework currently being developed. PAR was developed prior to the NAIC's implementation of risk-focused examinations. The task force believes that linking the PAR effort to the risk-other-than-credit framework will correlate better with the risk-focused approach. The working group suggested that PAR should include an asset-liability matching component in order to provide for a full understanding of portfolio risk.

#### Update on Referrals from RAWG

SVO staff provided a status update on the progress made on the charges referred to the task force by the Rating Agency Working Group. The staff presented three written reports which address the first four charges, all of which have the goal of placing less reliance on ARO's in favor of developing more tailored processes. The first report proposes a methodology that can be applied at more discrete credit rating levels. The second report identifies alternative analytical processes which can be utilized if the task force concludes not to use credit ratings.

The last report provides an assessment of the performance of credit ratings broken out by asset class. The purpose of this report is to evaluate whether the NAIC credit assessment framework (i.e., NAIC ratings designations) are still appropriately correlated with ARO credit ratings. The SVO determined that credit default rates for corporate, municipal and asset-backed securities differ significantly, and therefore concluded that the regulatory assumption that a particular ARO rating has the same degree of default risk across various asset classes is not accurate. Accordingly, the SVO has proposed a new credit assessment framework, which would create separate and distinct NAIC ratings designations for corporate, municipal and structure securities. The SVO reports were exposed for a thirty-day comment period following the task forces' January 19 conference call.

In Austin, the task force discussed the SVO's proposed credit assessment framework and related comment letters from interested parties. The task force directed SVO staff to work with interested parties to assess technical issues raised in the comment letters. The task force also recognized the need to coordinate the work on the SVO proposal with other NAIC regulatory initiatives, included the Solvency Modernization Initiative.

#### Working Capital Finance Notes

The task force received and exposed for a 45 day comment period a proposal to recognize the purchase of working capital finance notes as an invested asset. These notes are created at the request of a business; a bank establishes programs which permit eligible suppliers to sell receivables to the bank. Under such programs the bank confirms the terms of the invoice with the obligor and verifies that there are no defences to payment. Once confirmed, the payable is a legally binding obligation to pay a sum certain on a stated date to the bank or a note holder, such as an insurance company. The SVO would establish a criteria-based program which would permit insurers to engage in the revolving purchase of short-term obligations.

The task force heard a presentation from an insurer which described the benefits investing in working capital finance notes. The company argued that these notes provide superior risk-adjusted returns with an attractive liquidity profile as compared to similar-duration or perhaps longer-duration investment grade corporate securities. The short-term nature provides for a flexible funding commitment and allows for frequent credit re-underwriting of the obligor. The task force and some

interested parties raised concerns as to the admissibility of these investments under statutory accounting. The task force has requested input of other NAIC regulator groups, including the SAP Working Group and Blanks Working Group.

### **Rating Agency Working Group**

The working group held a public hearing on November 18 to assess the use of NAIC ARO ratings of municipal obligations. The working group heard testimony from the managing director of the SVO and from a group of panellists representing issuer, investor and rating agency perspectives. There was acknowledgement from all parties that default rates on state and municipal bonds are likely to stay low, but concerns do exist given the current economic conditions and unfunded obligations for pension and post employment benefits.

The working group then held a meeting via conference call March 15 and approved a charge to consider whether there is a need for more frequent and detailed reporting on state and municipal obligations, weighed against the cost of implementing such reporting and the increased burden of reporting. The working group will also decide whether or not to require more reporting, and if so, whether that reporting should be permanent and part of quarterly and annual statement reporting or temporary and outside the existing reporting framework. The regulators expect to complete this charge by June 1.

At the meeting of the Financial Condition Committee, the regulators reviewed a report of the status the Rating Agency Working Group's 29 recommendations to various task forces and committees. The report is posted to the committee's webpage.

### **Blanks Working Group**

The working group adopted the following blanks proposals, which were previously exposed during the Fall National Meeting. Both adopted proposals are effective for the 2011 annual statement.

- The instructions and an illustration for Note 32 A through E, Analysis of Annuity Actuarial Reserves and Deposit-Type Liabilities by Withdrawal Characteristics, of the annual statement blank were modified to require disclosure of the general account liabilities and

separate account liabilities, as well as the total. (2010-15BWG)

- The instructions and designation matrix for the NAIC Designation column for bonds was modified to include three new suffixes (AM, FM and SM). The new suffixes are applicable to loan-backed and structured securities, where the NAIC designation is modified by an insurer's carrying value of a security. The suffixes will allow regulators to track whether a security derives its final designation from a SVO assigned designation (SM), ARO rating (AM), or financial modeling (FM). (2010-20BWG)

The working group also considered modifications to a previously exposed blanks proposal which would add a new interrogatory to the General Interrogatories Part 2 for modified duration categories using five different interest rate scenarios (2010-16BWG). The adoption was deferred until the next meeting as the New York representative sponsoring the proposal was not present.

Thirty-three new proposals were exposed for a public comment period which ends May 27. These proposals will be considered for adoption on a conference call to be scheduled in June. Some of the more significant proposals would:

- Create two new categories for the reporting of preferred stock within Schedules D and DL. (Agenda item 2011-01BWG)
- Add three electronic only columns to Schedule D, Part 1 for call date, call price and maturity date and modify instructions. (Agenda item 2011-05BWG)
- Modify the Summary of Investments Schedule by adding a line for derivatives and securities lending. (Agenda item 2011-07BWG)
- Add a column to the reinsurance schedules to indicate if a reported letter of credit is a syndicated letter credit. (Agenda item 2011-15BWG)
- Add an interrogatory to the General Interrogatories, Part 2 for outstanding assessments in the form of liens against policy benefits. (Agenda item 2011-19BWG)
- Add an additional line to the Title Statement of Actuarial Opinion, Exhibit A: Scope, for the reserve for unpaid losses and loss adjustment expenses. (Agenda item 2011-22BWG)
- Modify the instructions for Line 15 (Premiums and Considerations) and Line 24 (Health Care and Other Amounts Receivable) of the Assets

page to clarify that premiums receivable for government insured plans are to be included on Line 15 and excluded from Line 24. (Agenda item 2011-28BWG)

- Add the actuarial certification for preferred mortality to the Supplemental Exhibits and Schedules Interrogatories. (Agenda item 2011-29BWG)
- Modify the Supplemental Health Care Exhibit blank and instructions. Among other changes, the proposal would add columns for student health, mini-med and expatriate plans to Parts 1 and 2. (Agenda item 2011-30BWG)
- Add medical loss ratio disclosures to Note 24. (Agenda item 2011-31BWG)

Several of the proposals would modify instructions and illustrations to the Notes section of the annual statement to be consistent with those included in the Accounting Practices and Procedures manual.

## NAIC/AICPA Working Group

The working group met via conference call December 2 and finalized the following issues exposed for comment October 6.

### MAR Implementation Guide Revisions

The working group adopted new guidance for non-accelerated filers (public companies with less than \$75 million in public debt) who are now permanently exempt under Dodd-Frank from filing an external audit report on the effectiveness of internal accounting controls. The guidance clarifies the reporting requirements for non-accelerated filers and provides two example reports for users.

### Cut-off Date for Internal Control Testing

The working group had previously discussed a question raised by industry as to whether controls testing should extend past the filing of the annual statement. For example, if management finds a financial statement error after the filing of the annual statement but before the filing of the audited financial statements, does that indicate an internal control deficiency? The working group concluded that all financial reporting controls that could reasonably impact financial statement values should be completed in advance of the annual statement filing.



## Life Actuarial Task Force (LATF)

This was the first meeting of the renamed Life Actuarial Task Force (LATF) following the split in January of the Life and Health Actuarial Task Force (LHATF) into two groups, LATF and the Health Actuarial Task Force (HATF, formerly the Accident & Health Working Group). The split was made in order to give more recognition to A&H WG that was operating under LHATF. HATF will now report directly to the Health Insurance and Managed Care (B) Committee.

The most spirited session at the meeting was debate over the implications of a Universal Life Secondary Guarantee (ULSG) product design feature that may result in reported reserves less than the statutory minimum intended under Actuarial Guideline 38 (AG38). Other highlights of the two-day LATF meeting included an update on the Principles-Based Reserves (PBR) VM-20 impact study, continued discussion of the purpose and objectives of a PBR Feedback Loop, an update on the Variable Annuity Statutory Framework Review and a discussion of the purpose and use of separate accounts.

### Actuarial Guideline 38 Issue

The New York Insurance Department submitted a report to LATF highlighting a ULSG product design feature that increases the premiums used in the reserve calculations, resulting in reserves below NY's interpretation of the minimum statutory requirement in the spirit of AG38. The specific feature in question is a second set of policy charges that apply when the account value is exactly zero, particularly on the policy's anniversary date, generating higher premiums under the exact requirements of AG38 for determining the minimum premium and resulting in reserves that NY believes are below the minimum statutory requirement. The New York Insurance Department is aware of several companies applying this interpretation of AG38 but has not yet taken any regulatory actions.

There was lively debate over this issue, with some task force members raising questions of "blatant manipulation" and possible disciplinary action, but LATF recognized that more information is needed before any action on their part is taken. LATF voted unanimously to draft a communication to all state insurance regulators making them aware of the issue. The task force also discussed the possibility of drafting a referral to the Actuarial Board for Counselling and Discipline (ABCD). At this meeting,

there was no consensus to move this proposal forward and it is not clear what actions the ABCD could take given. If regulators want to proceed with this action, a separate vote will be required.

### PBR Life ("VM-20")

Towers Watson presented an update on the impact testing project. Phase I of the project, to assess the impact of PBR on the US life insurance industry, began in November and remains in progress. Phase II, to evaluate documentation and reporting requirements and to assess the effectiveness of specific elements of the PBR methodology, will begin in early April. The target date for submission of the Phase I results was March 31. There are 41 companies participating in the study and due to year-end resource limitations, progress has been delayed for several companies. Other reasons cited for delays have been difficulty setting up the Net Premium Reserve calculation and in establishing appropriate margins. Thirteen companies expect to submit results by the target date of March 31, while the remaining companies will experience delays of 1-3 months. Companies will begin working on Phase II testing upon completion of Phase I, with Phase II results targeted for May 31. A final report from Towers Watson is targeted for June 30. However, the report may be delayed if there is insufficient data to provide meaningful results and preserve the confidentiality of study participants. Towers Watson may also provide separate reports for Phases I and II so that the NAIC can begin review of the Phase I results as soon as possible. The project bulletin board containing industry and impact study specific articles, presentations and technical tools is located at <https://oneplace.ehr.com/sites/NAIC/default.aspx>. The project email address is [vm20.impactstudy@towerswatson.com](mailto:vm20.impactstudy@towerswatson.com); interested parties can contact Towers Watson at this email address to obtain access to the bulletin board.

### PBR Feedback Loop

In response to a request from the PBR Working Group for assistance in defining a PBR Feedback Loop, LATF formed a subgroup to work on this initiative. The subgroup debated the purpose of a feedback loop, including the appropriateness of using the feedback loop as a means for evaluating assumptions but also for evaluating how a PBR system should be monitored. LATF sees data collection as a primary element of a feedback loop and plans for a phased-in approach to data collection and evaluation, in order to support an assessment of how well the valuation process is being performed and how it can be improved. Phase I data collection efforts will be focused on life insurance experience and variance testing. In particular, experience on life insurance mortality will be collected in the first



year, initially through a New York Pilot Project and subsequently at a national level. The subgroup asked the American Academy of Actuaries for assistance in developing a more comprehensive concept of a feedback loop. The PBR Process and Coordination Subgroup is coordinating this effort and hopes to have a more complete Feedback Loop proposal near the end of the current VM-20 impact study testing efforts.

#### PBR Experience Reporting (VM-50 and VM-51)

Experience reporting under a PBR framework will include aspects related to policyholder behavior which encompasses a much larger number of factors and assumptions than statutory requirements have considered in the past. Drivers of experience can be company specific, and can be influenced by factors not normally included or considered in an experience study. There is also variety among companies in the extent to which these factors are studied. These factors create challenges in developing industry level experience studies. The PBR Experience Reporting Working Group charged the AAA Life Experience Subcommittee to work in conjunction with the SOA and interested parties on the format of the behavior data collection form for VM-51, with a goal of completing the form by the 2012 Fall National Meeting.

#### PBR Process and Coordination (VM-00 & VM-01)

This subgroup provided an update on its activities since the last meeting. They anticipate changes to the Valuation Manual due to the PBR impact testing study and will schedule conference calls to address significant changes. The subgroup will also provide recommendations to LATF for potential modifications to the Standard Nonforfeiture Law and will propose changes to the NAIC Annual Statement Blanks, particularly with regard to the Analysis of Increase in Reserves. The subgroup is working in conjunction with the ACLI on modifications to the blanks.

#### VASFR Phase 2 Findings

Oliver Wyman presented findings and recommendations from Phase 2 of its Variable Annuity Statutory Framework Review Initiative, under which the firm was commissioned by 12 of the largest VA writers in North America to review "unintended consequences" of the VA statutory reporting framework under AG43 and C-3 Phase II RBC. Phase 2 of the project was further investigation of issues identified in Phase 1 and recommendation of potential solutions. The primary issues are the effect of hedging within the stochastic projections (i.e. the potential for disincentives for

appropriate risk management) and dominance of the AG43 Standard Scenario. Oliver Wyman tested various refinements with a subset of the participant group. Results indicated that the refinements would not significantly alter the current reserve requirements, suggesting that the proposed refinements were unable to address root causes of the issues, at least in the current market environment. As such, Oliver Wyman did not make any recommendations and suggested that further investigation into other systemic elements is needed before changes should be made to the existing framework.

The impact of issues raised in connection with this study apply broadly to principles based frameworks (e.g. C3 Phase 2 ) and not just to VACARVM. In evaluating potential changes to the AG43 framework, LATF will now consider input and actions by regulators including the Life RBC Working Group, the C3P2 Subgroup and other interested parties.

#### Purpose and Use of Separate Accounts

Following debate at the Fall National Meeting over issues raised with respect to the use of separate accounts for non-variable products, the Financial Condition (E) Committee referred the matter to LATF for further investigation. LATF then gathered more detailed information on the history and use of separate accounts in order to better frame the issues including those related to solvency, valuation and nonforfeiture. Regulators want to protect against companies structuring products that get the benefits of separate account treatment without providing insurance benefits. To do so they need to understand the products that are being offered as non-unit linked products in the separate account and if there is a compelling reason to market them as such. A motion was passed to form a subgroup that will research the issues and report back to the E Committee. This subgroup will be chaired by Blaine Shepherd (MN).

#### Contingent Annuity Subgroup

At the Fall National Meeting, this subgroup was appointed by LATF to review a new insurance product that has been filed in virtually all states and has subsequently raised regulatory concerns. The product is essentially a stand-alone guaranteed lifetime withdrawal benefit (GLWB) offered to a mutual fund investor. While the benefit covers investments in a range of mutual funds that would be considered "Covered Funds," the key feature is that the Covered Funds are neither owned nor maintained by the insurer.

The task force reviewed and discussed the product filing and its preliminary conclusion is that the product is a financial guarantee product and should not be classified as in insurance or annuity product. The subgroup submitted a report to LATF describing the product and related issues, with the intention that the report be sent to all commissioners to alert them to potential issues with respect to this product. Given a variety of views expressed during discussions, LATF elected to continue working on this issue, gather additional information, solicit input from the Academy, and provide an update at a future date.

#### Payout Annuity and Simplified Issue Mortality

The SOA and AAA Joint Project Oversight Group presented the 2012 Payout Annuity Mortality table including a basic table, projection scale (G2), and proposed margins for valuation. The table is based on experience data from 2000-2004 and the projection scale incorporates mortality improvement from the Social Security Administration (SSA) 2010 Trustee's Report. The mortality rate is capped at 400 per 1,000, or 0.400 at older ages, rather than grading to 1.0 by age 120. The proposed margins are similar to those in the current A2000 valuation table. Relative to reserves based on the A2000 table, the proposed table results in higher reserves at issue for all age/gender combinations, and generally higher reserves at later durations. LATF voted to expose the table, projection scale and proposed margins for comment. Once approved, the table will be effective for valuation.

The joint group also presented a progress update on the development of guaranteed issue (GI) and simplified issue (SI) mortality tables. The data call was issued in mid-March, delayed from the original target schedule due to challenges in differentiating mortality drivers of pre-need business versus all other business and resulting complexities in the data call. Sample carriers responded positively regarding their ability to provide data. There will be two tables, one for pre-need business and one for all other business. The group expects to have proposed tables by late 2012. To encourage participation in the data call, LATF will draft and recommend a communication to Commissioners notifying them of the data call and requesting their support through contact with appropriate leaders at solicited companies.

The joint group also commented on the development of a 2014 VBT/CSO table for the intended use with PBR when that becomes effective. Experience data for 2002-2007 has been collected to develop the

table, and 2008-2009 data will be used for validation. The current focus is on base and aggregate tables. Analysis of preferred risk criteria is targeted for late 2012; that information will be used to split the tables into different risk classes.

#### Nonforfeiture Improvement

The AAA Non-Forfeiture Improvement Work Group (NFIWG) provided a progress update on its work to study the feasibility of a new nonforfeiture law for life insurance and annuities. The work group expects to make a presentation to LATF at the Summer National Meeting. At the Fall National Meeting the work group received a charge to articulate the public policy issues that arose during its deliberations. The work group chair presented a summary of the issues. The NFIWG full report on the results of the feasibility study will articulate a specific position or potential courses of action on some issues, but others will simply be identified and no position or course of action is indicated. The identified issues include those related to the actuarial approach used in the determination of nonforfeiture mandates, regulation or non-regulation of non-guaranteed elements, whether cash surrender values should be required as additional benefits under the policy when nonforfeiture values are present, and the degree of regulatory establishment and review over nonforfeiture assumptions.

#### Standard Nonforfeiture Law

The ACLI provided an update on the status of changes to the Standard Nonforfeiture Law (SNFL) to make it consistent with PBR requirements and the revised Valuation Manual. Proposed revisions pointing to the Valuation Manual as the source for the applicable interest and mortality rates, and clarifying the effective date of the SNFL relative to the Valuation Manual were presented and subsequently exposed for comments.

#### Preferred Class Certifications

The actuarial certification required for use of preferred class mortality tables in determining minimum statutory reserve requirements has not yet been included in the annual statement blanks. LATF reviewed a Blanks proposal that incorporates the certification into the Supplemental Exhibits and Interrogatories sections. LATF voted to proceed with moving the certification through to the Blanks Working Group for inclusion in the 2011 Annual Statement.

#### Regulatory Asset Adequacy Issues Review

LATF received a referral from the Financial Analysis Working Group regarding regulators' review of the

**Regulatory Asset Adequacy Issues Summary.** Currently the Financial Analysis Handbook does not specifically address the review of the Issues Summary. There is concern by the FAWG that the summary is not being reviewed, particularly in states without regulatory actuaries. Recently the FAWG alerted states that they need to be reviewing the Issue Summary in conjunction with their examinations. FAWG recommends that additional guidance and procedures be included in the 2011 Handbook addressing various elements of the review including communication about the risks addressed by the Issues Summary and recommendations for additional analysis if certain risks are identified. LATF will draft recommendations for review and discussion. The final recommendations are expected to become part of the accreditation process.

### IIPRC Report

The Interstate Insurance Product Regulation Commission provided a report of recent activities, including adoption of additional standards for private placement VA and VUL products, and for change in insured benefits and overloan protection benefits. Current proposals which are expected to be promulgated without comment are modifications to Long Term Care product standards for rate filing, refund provisions for misstatement of age and annual reporting requirements. The group is currently reviewing Disability Income product standards.

### International Update

Larry Bruning, former LHATF chairperson and now in a new role focusing on international actuarial developments, gave an update on his activities. The update included an overview of the structure of the International Association of Insurance Supervisors, currently representing insurance regulators in 180 jurisdictions. The IAIS' primary mission is to establish a set of Insurance Core Principles (ICPs) that will be used to score each country's regulatory regime. There are 26 ICPs; five are still being drafted while the rest are final. The United States, through the requirements of the NAIC Blanks and RBC reporting criteria, has one of the best data collection facilities through the NAIC. This will play a key role in evaluating the US regime.

## **Health and Actuarial Task Force**

### Long-Term Care Insurance Valuation

Work continues on the development of a Long Term Care valuation table and related guidance. The Medical Information Bureau is coordinating the data

collection and has asked the SOA/AAA Joint Experience Committee for clarification regarding organization of the data so that it will be useful for valuation. Errors in the sample data set are being corrected and a complete data set is expected to be provided to the MIB by mid-year, with a report targeted for June 2012.

The Valuation Subgroup is also reviewing the Accounting Practices and Procedures Manual's Appendix A-010, Minimum Reserve Standards for Individual and Group Health Insurance Contracts, and Actuarial Standard of Practice 18, Long Term Care Insurance, to evaluate the need for additional guidance. One key issue being debated is the reflection of rate increases in premium deficiency reserve testing. There appears to be variation in practice in reflecting rate increases, with most companies assuming all necessary rate increases are granted, while others believe the calculation should not reflect any future rate increases. Research and discussion will continue in 2011.

### Long-Term Care Insurance Pricing

The LTC Model Regulation requires that pricing actuaries sign a certification that rates are sufficient under marginally adverse experience to be sustainable over the life of the product with no increases anticipated. In light of recent LTC product rate-increase activity and lack of specific guidance relative to rate adequacy, the LTC Task Force asked its valuation subgroup to clarify the definition of "moderately adverse" in the model regulation. The subgroup's recommendation defines a "required adverse development threshold" which requires that both future expected and lifetime expected claims exceed those projected under current pricing by more than 20% before a rate increase is requested. This definition, along with additions to other relevant sections of the model regulation, were exposed for comment. Once the proposed changes are approved, the proposal will be forwarded to the LTC Task Force to authorize changes in the model regulation.

### Group Long Term Disability Table

The SOA Long Term Disability Experience Committee presented the results of a Group LTD experience study, introducing the 2008 GLTD Experience Table as a basis for LTD claim termination rates. Recent experience tables reflect termination rates in excess of emerging experience, and current tables don't provide key levels of variation needed to set appropriate reserves. The 2008 study covers 72% of 2007 market share and is significantly credible. The 2008 table provides

separate recovery and death rates and recognizes and quantifies key parameters influencing terminations such as elimination period, diagnosis, duration and gross monthly benefit amount. The task force passed a motion requesting that the Academy develop a valuation table based on the 2008 GLTD Experience table, targeting November 2011 for a recommendation.

#### Health Actuarial Opinion Review

At the Fall National Meeting a Health Actuary Opinion Subgroup was formed to provide guidance to regulators related to review of actuarial opinions for health reserves. A conference call was held with regulators early in 2011 and the subgroup provided reference materials including the Practice Notes from the Academy's State Health Committee for actuaries writing statutory opinions, and a guidance document produced annually by the Casualty Actuarial Society statistical task force. The subgroup will schedule a call in late May or early June for regulators to discuss health opinions and observations. The subgroup will also evaluate the need to produce a regulatory guidance document, based on the nature of the issues raised in the call.

#### Update on PPACA Issues

The PPACA Actuarial Subgroup oversees two subgroups, an ACA Risk and Reinsurance Subgroup and an HHS Rate Disclosure and Review Subgroup. Each group is becoming familiar with emerging issues. The HHS Group is in the process of reviewing NAIC comments on forms and will develop responses to the NAIC.

The Academy has released several comment letters addressing various areas of Health Reform but primarily MLR Reporting and Rebates. The Academy is currently working on a statement of actuarial value and evaluating components of the calculation. Visits to meet with Congressional staffers and agencies are underway, with topics of discussion including alternatives to individual mandate and essential benefits.

#### Medicare Supplement Refund Formula

There was an update from the Senior Issues Task Force charged with review of the Medicare Supplement Refund Formula. The group continues to collect data and is evaluating changes needed to make the refund formula more equitable. Once the data is compiled it will be turned over to the Academy for review. No date was provided for the completed analysis.

## **Life Insurance and Annuities Committee**

#### Stranger-Originated Annuity Transactions

The committee continued its year-long project to consider stranger originated/owned annuities and how these transactions may interact with insurable interest laws and the impact on consumers. The committee developed a draft Insurer Bulletin in 2010 on Stranger-Originated Annuity transactions (STOA) which suggests approaches for insurance companies to guard against such transactions. Since the Fall National Meeting, the committee reviewed suggested revisions to the NAIC bulletin, suggested through a collaborative effort undertaken by New Jersey and Iowa. At the Spring National Meeting, additional comments were heard from interested parties including a trade association for the insured retirement income industry.

The most significant change to the draft bulletin since the Fall National Meeting was to combine the following guidance:

- Establish methods to detect agents who may be involved in the facilitation of Stranger-Originated Annuity transactions
- Ensure the underwriting department has established criteria to identify questionable applications which would be subject to additional levels of review

into one revised item as follows: "create detection methods to identify STOA transactions and those producers who may be involved in facilitating such transactions, including controls to flag questionable applications." After making the final revisions, the committee adopted the sample bulletin/industry alert.

#### Annuity Disclosures

At the Fall National Meeting, the Annuity Disclosure Working Group adopted a final draft of the proposed revisions to the *Annuity Disclosures Model Regulation* (#245) which was then submitted to the committee for acceptance. The committee adopted working group's proposed revisions to the Model Regulation but decided to provide an additional 30-day comment period for interested parties to submit comments on issues not already considered by the working group.

At its meeting in Austin, the committee discussed newly proposed revisions that were added to address concerns raised during the comment period; the revisions were primarily for clarification purposes. The committee then moved to adopt the draft regulation, pending exposure of Section 6, Standards



for Annuity Illustrations, for a two-week comment period, and it is anticipated that the draft regulation will be adopted following expiration of the comment period for Section 6. A question was raised with respect to whether the annuity illustration in Section 6 requires actuary certification and it was determined certification is not necessary on the basis that the illustration is not complex and therefore, companies should be able to complete this section.

The committee then re-appointed the Annuity Disclosure Working Group for the purpose of completing its work on revising the *Annuity Buyer's Guide*, a project that has experienced some delays.

### Other Matters

The committee approved formation of a new working group to revise the *Viatical Settlements Model Regulation* (#698) for consistency with the 2007 revisions to the *Viatical Settlements Model Act* (#697). The working group will also revise the consumer informational brochure, which is Appendix A of the regulation.

The committee then reviewed a memorandum highlighting issues involving corporate-owned life insurance and Section 1035 of the Internal Revenue Code exchanges. Concerns relate to instances whereby a company desires to replace the policy but the individual is inactive, e.g. retired or terminated. The committee decided to hold a conference call in May to continue its discussions.

## **Separate Account Risk Working Group**

The working group has not met since October but in March its parent committee modified the charge and name of the working group. Its charge is now "study the need to modify existing or develop new regulatory guidance related to separate accounts where, in recent years, various products and contract benefits has increased the risk to the general account." The name of the working group is now "separate account risk" instead of "separate account risk charge" working group.

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

The committee met in Austin and took the following actions:

### Revisions to Documents Required for Accreditation

Revisions made during 2010 to publications that are required for accreditation purposes (e.g., the Annual

Statement Blanks and Instructions; Life and P/C RBC Formulas; the Purposes and Procedures Manual of the NAIC Securities Valuation Office; the Accounting Practices and Procedures Manual; and the Financial Condition Examiners Handbook) were adopted by the committee as revised accreditation standards. The committee released one significant revision made to the Financial Condition Examiners Handbook for a thirty-day public comment period. This revision relates to the contents and the timing of the review of the examination planning memorandum.

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

The committee discussed the 2010 revisions to the Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation. The committee is waiting for guidance from the Group Solvency Issues Working Group as to which sections of the models should be considered significant elements for inclusion in Part A: Laws and Regulations accreditation standards.

### Companies Deemed to be in Hazardous Financial Condition

The committee received an update on the 2008 revisions to the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition. These revisions were previously released for a one-year public comment period which ended December 31, 2010. There were no comments received, and there have been no further revisions to Model since 2008. The committee will consider adoption of these revisions for accreditation purposes at the Summer National Meeting.

### Exemption of Risk Retention Groups

The committee discussed the exemption for RRGs which is currently provided in the Business Transacted with Producer Controlled Property/Casualty Insurer Act. The committee will request that the Property and Casualty Insurance Committee consider whether the exemption for RRGs should remain.

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

### Statement of Actuarial Opinion

The task force heard a presentation from the American Academy of Actuaries regarding proposed changes to the Statement of Actuarial Opinion (SAO). These changes were triggered by



modifications to requirements for Associateship by the Casualty Actuarial Society and the need for consistency between the new CAS requirements and the SAO. The discussion focused on the definition of a "qualified actuary." It was confirmed during the meeting that neither AAA nor CAS would attest to whether an actuary has fulfilled the required education requirements; the burden of qualification lies upon the individual member. A comment was raised regarding the need for a mechanism to provide feedback on the quality of an actuary's work. The proposal was tabled for further evaluation, including possible changes to Exhibit B of the Actuarial Opinion relating to the actuary's qualifications.

#### Salvage and Subrogation Issue

The task force also commented that the NAIC has received several inquiries regarding companies having unusually high amounts of anticipated salvage and subrogation. Auditors are asking what standards can be applied in making sure these amounts are valid. Discussion pursued on whether the current SSAPs provide enough guidance regarding salvage and subrogation, including whether credit should diminish as the recoverable ages and whether it is clear that the quantification should be supported and documented. SSAP 55 addresses the manner by which recoverables are estimated, and the task force believes this guidance is sufficient. The task force noted that quantification should be supported and documented, and the focus should be on the documentation of the estimation process.

### **Catastrophe Insurance Working Group**

The working group held a public hearing regarding catastrophe modeling and the use of short-term vs. long-term horizons. Representatives from RMS, AIR Worldwide and Karen Clark & Company presented the pros and cons of catastrophe modeling. There is grave concern on the part of the commissioners that catastrophe modeling may not be reliable and recent changes to the model due to changes to risk levels by geographic areas may not be aligned with the general understanding of catastrophe risks and losses. The three presenters noted that catastrophe models do not provide the complete picture of a catastrophe's loss potential. These models are only one tool for catastrophe risk assessment and must be used in conjunction with high quality data, a process for validating model output, and other information on losses not captured by the models.

The working group did not discuss any "next steps" as a result of the hearing, i.e. what they planned to do with the information obtained or whether they planned to share the work with the Catastrophe Risk Subgroup of the P/C RBC Working Group.

### **Risk Retention Group Task Force**

#### Risk-Based Capital

The task force received a report from the Capital Adequacy for RRGs Technical Subgroup, which included the subgroup's recommendation regarding the applicability of the Risk-Based Capital for Insurers Model Act to risk retention groups organized as captives. The subgroup has concluded that while most captive RRGs report on a US GAAP basis, rather than SAP, the RBC calculation is still a meaningful measure for most captive RRGs. While the subgroup acknowledged that utilization of a basis of accounting in the RBC formula that differs significantly from SAP will produce different RBC amounts, it concluded that the capital adequacy standard for captive RRGs should include the requirement for domestic regulators to enforce RBC. The subgroup's proposal would require captive RRGs to file annual RBC reports. In addition, captive states would need to adopt the RBC Model Act.

In limited circumstances, domestic regulators of RRGs could elect not to take regulatory action which would otherwise be required by the RBC Model Act. These circumstances include:

- Where an RRG's members and/or sponsoring organizations are well-capitalized entities whose financial condition and support for that RRG can be adequately established. However, the domestic regulator of the RRG must, at a minimum, require the filing of at least three years of historical audited financial statements of the members and/or sponsors in order to establish the financial ability of those entities to support the RRG.
- Where each policyholder qualifies as an industrial insured in their state or in the state of the RRG's domicile.
- Where the RRG's Certificate of Authority is dated prior to January 1, 2011, and, based on a minimum five-year history of successful operations, is specifically exempted in writing from the requirements for mandatory RBC action by its domestic regulator.

The task force exposed the subgroup's proposal for a thirty-day public comment period.

### Risk-Focused Exam

The task force also received a report from the RRGs and Risk-Focused Examinations Subgroup, which included the subgroups recommendation that captive RRGs not be exempted from the risk-focused examination approach (RFE) or certain phases of the RFE. Some subgroup members and interested regulators have argued that the RFE would significantly increase the cost of examination to captive RRGs and would provide limited to no additional benefit to regulators, due principally to the nature and size of the RRGs. However after significant discussions on two conference calls, the subgroup members concluded that the RFE is flexible enough to allow examiners to tailor the examination to fit the unique characteristics of captive RRGs. Additionally, the subgroup was concerned that developing an alternative examination approach may not qualify as a full-scope examination in accordance with the Financial Condition Examiners Handbook, causing a state to potentially fail accreditation standards.

The task force exposed the subgroup's proposal for a thirty-day public comment period.

## **Title Insurance Task Force**

The task force discussed Private Transfer Fee Covenants (PTFCs), which allow a developer or other person to collect a fee (typically 1% of the sale price) on each future resale of the affected property during the term of the covenant. Typically, these covenants are in effect for 99 years and are applied to residential properties. Bills have been proposed in Congress that would outlaw PTFCs.

At the Fall National Meeting, the task force held a public hearing on private transfer fee covenants, a result of which they concluded more information was needed. A survey of NAIC members related to private transfer fee covenants began in December 2010 to ascertain whether the NAIC should pursue a model law or guideline to limit or prohibit private transfer fee covenants; or, secondly, whether the NAIC should support legislation, if introduced, that is similar to the bills. Although the survey results indicated a majority vote of "No Opinion," the task force believes this could be attributed to whether the members feel that this is an insurance matter versus a real estate matter. Although there is no clear line between title insurance and real estate settlement, the task force has concerns on the adverse effects

PTFCs have on consumers, title insurance companies, and the real estate settlement practice.

As a result, the task force adopted a motion to draft a comment letter, making a referral to the Government Relations Leadership Council in support of a proposed rule by Federal Housing Finance Agency regarding prohibiting private transfer fee covenants; comments are due to FHFA by April 11.

The task force then heard an update on seven recommendations to the Blanks Working Group regarding improvements to the title annual statement and filing instructions. The proposals have been exposed for comments and will be voted during a conference call in June.

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The next National Meeting of the NAIC will be held in Philadelphia August 29-September 1. We welcome your comments regarding issues raised in this newsletter. Please give your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor: Jean Connolly 440 893-0010 or [jean.connolly@us.pwc.com](mailto:jean.connolly@us.pwc.com).

### **Disclaimer**

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

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

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