



NAIC Meeting Notes

GLOBAL INSURANCE INDUSTRY GROUP, AMERICAS

NAIC 2010 SUMMER NATIONAL MEETING

The National Association of Insurance Commissioners held its 2010 Summer National Meeting in Seattle August 14-17. 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

- The Commissioners adopted as final the 2010 financial reporting form for the medical loss ratio, the new Supplemental Health Care Exhibit. The NAIC also held a Patient Protection and Affordable Care Act Implementation Status Briefing Meeting to review progress on the NAIC's work in implementing health care reform. (page 3)
- The newly formed Retained Asset Account Working Group held a hearing to discuss consumer issues related to the use of retained asset accounts to settle life insurance death benefit obligations; subsequent to the meeting they issued a consumer alert, which is posted on the NAIC's website. (page 4)
- In May, the Statutory Accounting Principles Working Group finalized its guidance to clarify the bifurcation of realized gains and losses for those entities subject to IMR and AVR and also finalized new reporting for securities lending arrangements. In Seattle, the working group exposed a proposal to extend the revised admitted deferred tax asset limitations in SSAP 10R from year-end 2010 to year-end 2011, and also re-exposed revised proposed guidance for related parties guarantees, guarantee fund assessments, pensions and postretirement benefits other than pensions. (page 5)
- The Blanks Working Group approved procedural changes and adopted twelve blanks proposals as final since the Spring National Meeting and exposed five new proposals for comment. (page 9)
- The NAIC/AICPA Working Group held a conference call in June to discuss proposed annual statement disclosures modeled on the new SEC compensation disclosures in Rule 33-9089; in Seattle the working group reviewed industry's counterproposal to the working group's extensive suggested disclosures. (page 10)
- The Valuation of Securities Task Force announced no modeling of valuation ranges for residential mortgage-backed securities will be obtained for June 30, 2010; however modeling will be performed for December 31, 2010 reporting. The task force adopted three amendments to the SVO Purposes and Procedures Manual, including one which prohibits the use by insurers of NAIC ratings designations as triggers to modify economic terms in private agreements. The task force released four SVO proposals for public comment, three of which would provide filing exemptions under various circumstances. (page 11)
- The Capital Adequacy Task Force and its working groups had a busy spring and summer; the task force backed away from its proposal to increase the base factor for mortgage loans from 2.6% to 4% for the 2010 RBC filings; however the regulators adopted an increase in the range of the MEAF for 2010-2011

reporting to 80%-175% from the 75%-125% range for 2009. The Life RBC Working Group continued progress on its long-term commercial mortgage and derivatives risk mitigation proposals. After much spirited debate, and strong suggestions from industry to revisit its entire methodology for setting underwriting risk charges, the P/C Risk-Based Capital Working Group adopted underwriting risk charges for 2010 with a 5% cap on all lines. The newly formed Solvency Modernization Initiative RBC Subgroup held a day and half meeting in Washington, D.C in July to begin working on "redesigning RBC." (page 13)

- The Solvency Modernization Initiative Task Force and its seven working groups comprised a significant portion of the NAIC's agenda in Seattle. The Statutory Accounting and Financial Reporting Subgroup made significant progress in outlining issues related to "the future of statutory accounting." The Group Solvency Issues Working Group completed its project to propose revisions to the holding company models to reflect concerns in a group supervision setting. The Corporate Governance Working Group is working to summarize state and international corporate governance principles to consider a model law on corporate governance best practices. The International Solvency Working Group exposed for comment a Consultation Paper on Own Risk and Solvency Assessment (ORSA). (page 16)
- The International Accounting Standards Working Group held an interim two day meeting in April to receive specific input from working group members on current IASB exposures and related International Association of Insurance Supervisors' positions. The working group has also developed a tentative position paper on the IASB Insurance Contracts exposure draft, which will refine over the next quarter. (page 18)
- The Life and Health Actuarial Task did not complete the Valuation Manual at the Summer National Meeting as the NAIC had hoped, mostly as a result of agreeing that field or impact testing should be done this fall. The task force released for comment a revised version of VM 20, Requirements for Principles-Based Reserves for Life Products, and also received a presentation on the variable annuity statutory accounting results under Actuarial Guideline 43 and RBC C-3 Phase 2 methodologies. (page 20)
- The Life Insurance and Annuities Committee held a public hearing in May on Stranger Originated/Owned Annuities and decided that they would develop a model alert for insurers with regard to these types of transactions. (page 24)
- The Annuity Disclosures Working Group continued work on its July 19 Annuity Disclosures Model Regulation and hopes to have a final draft for its parent committee at the Fall National Meeting. (page 25)
- The Reinsurance Task Force discussed the adoption of the federal Nonadmitted and Reinsurance Reform Act, which requires single-state regulation of reinsurance. The task force also discussed revising the Credit for Reinsurance Model Act and Regulation in light of individual states considering reinsurance collateral reduction reform. (page 26)
- The Climate Change and Global Warming Task Force questioned states as to whether they would still require the Climate Risk Disclosure Survey after the Commissioners made the survey voluntary; only eighteen states responded that they will be asking for the survey and only seven of those would make it mandatory. (page 26)
- The Risk Retention Group Task Force concluded that captive RRGs should calculate and file RBC using their GAAP results, with some limited exceptions, which are in the process of being finalized. (page 27)

Executive Committee and Plenary

Supplemental Health Care Exhibit Adoption

The Commissioners gave final approval for a new annual statement supplement and instructions for reporting of comprehensive major medical health insurance business for large group employer, small group employer, and individuals. The new supplement will assist regulators in identifying and analyzing the medical loss ratio (MLR) as required in the Patient Protection and Affordable Care Act of 2009. Health insurers will be required to submit this annual supplement by April 1, 2011 based on 2010 annual results; however the MLR will not impact the federal rebate until the 2012 submission of 2011 results. As a result it is expected that the commissioners will evaluate the medical loss ratio submissions in 2011 and may revise the calculation or instructions for the 2012 submission if necessary.

Other Adoptions

The commissioners approved a *Resolution to Protect the Ability of Licensed Insurance Professionals to Continue to Serve the Public*. The non-authoritative resolution was co-sponsored by 25 states and emphasizes the role of agents and brokers in implementing national health reform and the importance for federal policymakers to establish standards for health insurance exchanges so that insurance professionals will continue to be adequately compensated for the services they provide.

The commissioners then approved the application process to select a state insurance commissioner to represent regulators on the Financial Stability Oversight Council (FSOC), the systemic-risk regulatory group created by the recently enacted federal financial reform law. Following the application, Executive Committee will make a selection based on the merits of the applicants and that selection will be ratified by Plenary. The selection process is expected to be completed within a few weeks as the first meeting of FSOC will be in September.

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

- *Product Filing Review Handbook* developed by the Speed to Market Task Force
- Implementation Commentary to the *Guidelines for Regulations and Legislation on Workers'*

Compensation Coverage for Professional Employer Organization Arrangements

- *Guideline for Implementation of Medical Professional Liability Closed Claim Reporting*
- *Property and Casualty Model Rate and Policy Form Law Guideline* and corresponding regulation guideline
- Part B and Part C accreditation standards applicable to risk retention groups organized as captives.

At its earlier meeting, Executive Committee approved a model law development request for the Regulation of Insurance Scoring Vendors and established a task force to develop and oversee implementation of state-based solutions addressing surplus lines requirements of the Non-admitted and Reinsurance Reform Act.

Health Care Reform

The Health Insurance and Managed Care Committee held a Patient Protection and Affordable Care Act (PPACA) Implementation Status Briefing Meeting at the Summer National Meeting and received status reports from the many NAIC committees working to assist HHS in implementing health care reform.

Exchanges Subgroup

The Exchanges Subgroup was established to implement the provisions of section 1321 of PPACA which provides that the Secretary of HHS, in consultation with the NAIC and its members and with health insurance issuers, consumer organizations, and such other individuals as the Secretary selects in a manner designed to ensure balanced representation among interested parties, issue regulations setting standards for: 1) the establishment and operation of Exchanges, including SHOP Exchanges; 2) the offering of qualified health plan through the Exchanges; 3) the establishment of the reinsurance and risk adjustment program; and 4) such other requirements as the Secretary determines appropriate.

The subgroup held a hearing during which it received testimony from various stakeholders on their perspectives regarding the establishment, function and design of health insurance exchanges, as outlined in PPACA. The subgroup heard from representatives of consumers, insurers, businesses, and economic, public policy and Medicaid experts. The subgroup also heard from representatives of the Massachusetts

Connector Authority and the Utah Health Exchange regarding the design, structure and function of their exchanges.

Health Reform Solvency Impact Subgroup

The subgroup of the Financial Condition Committee met for dozens of hours over eleven conference calls in the spring and summer to develop a medical loss ratio reporting form, the Supplemental Health Care Exhibit, to support compliance with section 2718 of PPACA. As discussed above, this reporting received final adoption in Seattle. Conference call summaries and comment letters received by the subgroup are posted to the subgroup's webpage.

PPACA Actuarial Subgroup

This subgroup of the Accident & Health Working Group has worked on two significant projects related to PPACA. The first was developing responses to requests for information from HHS related to the definition of medical loss ratio and rate review. The second involves establishing, in accordance with section 2718(c) of PPACA, uniform definitions related to medical loss ratios as well as its calculation. The subgroup drafted letters in response to the HHS request for information, which were subsequently adopted by the Health Insurance and Managed Care Committee and the Financial Condition Committee.

The subgroup began working on the MLR definitions and its calculation this summer and has tracked 75 issues through an issue resolution document posted to the A&H Working Group webpage; remaining issues are down to 26 and conference calls are being scheduled throughout September to complete the process. Following completion, the subgroup intends to develop a NAIC model law that will reflect its resolution of those issues, which has been tentatively named the "Model Regulation for Uniform Definitions and Standardized Rebate Calculation Methodology Per Section 2718(b) of the PHSA."

Speed to Market Task Force

The task force has led several efforts related to rate and form product filing. Earlier this year, the task force developed a filing checklist for product filings submitted as a result of PPACA with the objective of streamlining the filing review. This led to the adoption of the Uniform Compliance Summary on June 1, 2010. With regard to rate filing disclosure, under PPACA, insurers will be required to submit a Rate Filing Summary to HHS and the state insurance department for all future

filings meeting the definition of "unreasonable." The insurer will also be required to post this to its company website. The definition of "unreasonable" and the basic rules for submission have not yet been defined by HHS. The task force's discussion to date has focused on content appropriate for inclusion in the form.

Regulatory Framework Task Force

The task force began its work related to PPACA implementation at this meeting, during which the task force finalized a work plan for reviewing and revising NAIC models impacted by PPACA's September 23 immediate reform provisions. The task force will also develop a plan for assisting the states in implementing PPACA.

Retained Asset Account Working Group

This newly formed commissioner-level working group was formed in response to the controversy generated by the July 28 Bloomberg Market article on the common use of retained asset accounts to settle life insurance death benefit obligations. The charge of the working group is to review the use of RAAs and "make recommendations as may be necessary, including whether there is appropriate consumer disclosure."

At its two hour, standing-room only meeting, the working group heard from representatives of life insurers, the ACLI, the National Organization of Life and Health Insurance Guaranty Associations, NCOIL and consumer organizations. The life insurers emphasized that most RAAs are held for less than a year and earn higher interest rates than comparable investments like checking accounts and money market mutual funds. They noted that a RAA is provided to the beneficiary when they specifically elect that option or when no election is made on the claim form. The NOLHGA representative stated emphatically that RAAs are explicitly covered under state guaranty association laws.

The NCOIL representative urged the NAIC to develop a model law to regulate RAAs and noted NCOIL's proposed Beneficiaries' Bill of Rights would allow RAAs only with the written consent of the beneficiary. The co-chair of the working group (CT) replied that a model law would take too long to develop and get adopted by the states. Consumer representatives asked that the 16 year old NAIC bulletin on RAAs be updated (which has been adopted by only 7-8 states) and that a data call be issued so that better information can be

obtained. They also asked for access to the disclosure forms used by life insurers.

The working group reached no conclusions in Seattle, but shortly after the meeting, the NAIC issued a Consumer Alert entitled *RETAINED ASSET ACCOUNTS AND LIFE INSURANCE: What Consumers Need to Know About Life Insurance Benefit Payment Options*. The Alert describes RAAs, key questions consumers should ask and issues to understand and other payout options available. Another meeting of the working group is expected shortly.

Financial Condition Committee

Separate Account Risk Charge Working Group

This working group met twice on interim calls to discuss risks taken by companies through the guarantee of separate account products such as minimum guarantees on variable annuities. The working group previously recommended to the Financial Condition Committee that risk charges for these guarantees should adequately compensate the general account for taking on these risks, but now appears to be struggling with how to achieve this without rate regulation. The working group also considered the possibility for establishing reserves for these benefits in the separate account instead of the general account but there was little support for this due to a number of concerns. The working group also discussed the need to understand how the guarantees on separate account products are treated in insolvency.

Another significant tentative conclusion reached by the working group is that an actuarial opinion regarding the adequacy of risk charges in separate account products with guarantees "may be best way to protect the general account from untoward risk, as well as deter regulatory arbitrage and objectionable practices contrary to the fundamental rationale for separate accounts." Based on these discussions, the working group voted on its July 30th conference call to expose its discussion document that identifies issues, observations and possible recommendations for a 45 day comment period.

Rating Agency Working Group

The Financial Condition Committee adopted its final report *Evaluating the Risks Associated with NAIC Reliance on NRSRO Credit Ratings* during an April 28 conference call after referring the remaining recommendations to other NAIC groups.

The report is posted to the working group's webpage.

Investments of Insurers Model Act Revision Working Group

The working group held a conference call July 20 to hear a lengthy presentation from the ACLI on how life insurers use derivatives to manage asset and liability risk; the presentation had been requested by the working group. Before beginning, however, the ACLI noted that although they understood the rationale to revisit investment model laws in the aftermath of the financial crisis, they believe the current NAIC investment models are very comprehensive and have been recently updated.

Statutory Accounting Principles Working Group

Adoption of New Standards or Revisions to SSAPs

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

The working group held a conference call May 10 to hear comments on the proposal; several interested parties noted they strongly object to the proposal as it would require system changes and additional work with no appreciable benefit. They also noted that the guidance would require cash flow analysis at the date of sale, which currently not generally done.

The working group noted this bifurcation is required by SSAP 43R and the intent of this discussion is to clarify what has already been adopted. The regulators then voted to adopt, but with a 1/1/2011 effective date at the request of interested parties, with early adoption permitted. Insurers that previously bifurcated gains and losses between AVR and IMR for sale transactions are not permitted to reverse previous bifurcations,

and cannot revert to a policy that does not bifurcate before the January 1, 2011 effective date.

SSAP 90 Clarification - The working group adopted a nonsubstantive revision to SSAP 90 to clarify that properties occupied by the company are subject to recoverability testing when any (not all) of the conditions in paragraph 6 are present.

ASU 2010-9, Subsequent Events - The working group rejected recently issued revisions to Topic 855/FAS 165 as the working group believes the amendments to address the GAAP conflict with SEC guidance do not affect statutory financial statements.

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

The working group modified its exposed guidance on the determination of which investments will be considered valued at fair value on a recurring basis. The following was added to footnote 1 and paragraphs 55 and 57 to SSAP 100:

For purposes of statutory accounting, investments that are consistently measured at fair value shall be disclosed as securities "measured at fair value on a recurring basis." The term "consistently measured at fair value" includes, but is not limited to, securities reported at the lower of cost or fair value based on NAIC designation regardless if the security was reported in the previous period at amortized cost.

SSAP 91R Revisions to Address Measurement of Sufficient Collateralization for Securities Lending Transactions - During a conference call in May, the working group adopted proposed revisions to SSAP 91R that provide a modified GAAP approach of defining what is on and off balance sheet, and which require that if the collateral can be sold or pledged by custom or contract it would be recorded "on balance sheet," with one line reporting for certain securities lending collateral. The new guidance also requires a new schedule, Schedule DL, for reporting securities lending transactions.

During its discussion in May, the working group noted that some changes to the guidance exposed at the Spring National Meeting have been made to correct some erroneous descriptions of repurchase and reverse repurchase agreements. Paragraphs 70-71, 80-81 and 82a and 82b have been corrected.

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

Items exposed for comment have a comment deadline of September 16, 2010 (unless otherwise stated).

DTA Subgroup

The subgroup made some progress on its DTA long-term project since the Spring National Meeting. During May, the subgroup approved a data call requesting more detail from companies on deferred tax assets. The subgroup then held an educational session on DTAs for regulators in Columbus, Ohio on July 27. At that meeting the subgroup heard presentations from representatives of industry, the AICPA and the American Academy of Actuaries and also received a preliminary report from NAIC staff on the results of the data call.

The focus of the industry presentation was on how DTAs originate and reverse, grouping of DTAs for measurement and the statutory valuation allowance. The AICPA's presentation discussed the auditing of income taxes, including audit risk, procedures, and documentation. The AICPA representatives discussed the four possible sources of taxable income including tax planning strategies. An extended discussion then ensued of the use of such strategies and how they affect the determination of admitted DTAs; several regulators seemed concerned that a significant admitted DTA can be recognized with the use of tax planning strategies.

The AICPA representatives pointed out that tax planning strategies must be prudent and feasible, supported by documentation, must reflect the cost to apply the strategies, and cannot be contradictory to other assumptions made by the company.

Lastly, the subgroup heard a presentation from a representative of the AAA on the preliminary findings of the project requested by the Capital Adequacy Task Force to review the treatment of DTAs in all three RBC formulas. The study's findings propose that there be no RBC charge for

well capitalized companies if the current SSAP 10R limitations are maintained, as there is an "implicit" RBC charge from the nonadmission requirement. The Academy also agrees that weakly capitalized companies should still be subject to the 100% RBC charge. The preliminary report was exposed for comment by the Capital Adequacy Task Force in June and comments will be accepted until September 15.

At its meeting in Seattle, the working group, after hearing an update of the above from the subgroup's chair, voted to expose for comment until August 27 a one year extension of SSAP 10R until December 31, 2011, with a proposed additional disclosure related to tax planning strategies. (Interested parties had hoped to get at least a two year extension.) A joint conference call of the SAP Working Group, Accounting Practices and Procedures Task Force and Financial Condition Committee has been scheduled for September 8 for the task force and committee to consider adoption of the changes to SSAP 10R.

SSAP 5R Revisions to Adopt FIN 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Others - The working group continued its long deliberations of the requirement for liability recognition at the inception of a related party guarantee. Since the Spring National Meeting, NAIC staff has worked with interested parties and representatives of the AICPA on outstanding issues including liability recognition. The working group had previously concluded that "unlimited" guarantees and guarantees between a parent insurer and its wholly owned subsidiary would be subject to the disclosure requirements of SSAP 5R, but not the liability recognition requirements.

At its meeting in Seattle, the working group discussed comments from interested parties to replace liability recognition with expanded disclosure. The working group voted not to revise the previously exposed guidance regarding the offset to the liability recognized at inception or the guidance for recognizing a contingent liability. However, they did defer the effective date from year-end 2010 to year-end 2011. In addition, an illustration to the disclosure requirements of paragraph 27a and 28 has been added to SSAP 5R. Both SSAP 5R and SSAP 25R were re-exposed for comment. Proposed revisions to SSAP 25R are minor and are to conform to the proposed changes to SSAP 5R.

Accounting for Pensions and SSAP 92, Accounting for Postretirement Benefits Other than Pensions - The working group exposed for comment revised SSAPs for pensions and OPEB with new transition guidance. The guidance adopts, with some modifications, FAS 158/ASC 715. The comment deadline for these SSAPs is October 1.

Issue Paper 143, Prospective-Based Guaranty Fund Assessments - The working group had previously released for comment a draft Issue Paper that proposes substantive revisions to SSAP 35 to incorporate the ASC 405-30/SOP 97-3 approach for guaranty fund liability recognition. Under this approach, accounting for guaranty fund assessments would be determined in accordance with the type of guaranty fund assessment imposed, and would incorporate the concept of an "obligating event" for prospective-based premiums assessments in determining whether a liability should be accrued. The only significant outstanding issue when Issue Paper 143 and SSAP 35R were re-exposed this spring was the requirement to nonadmit assets recognized from anticipated recoverables from policy surcharges and premium tax offsets from accrued liability assessments.

At the Summer National Meeting, the working group voted to allow such receivable assets as admitted and re-exposed the guidance for a final comment period. Transition guidance was also added. SSAP 35R is expected to be adopted at the Fall National Meeting and would be effective January 1, 2011.

SSAP 43R, Definition of Loan-Backed Securities - The working group exposed for comment a proposed revision to the definition of loan-backed securities proposed by New York. The following sentence is proposed to be added to the definition (among other changes): "Examples of loan-backed securities include, but are not limited to, pass-through securities, lease-back securities and equipment trust certificates." Some interested parties believe this is a substantive change to the definition.

Expanded Disclosures of Withdrawal Characteristics - The working group exposed for comment proposed changes to SSAP 51, Life Contracts, SSAP 52, Deposit-Type Contracts and SSAP 61, Life and A&H Reinsurance to expand the disclosures of withdrawal characteristics. The revisions would require disclosure separately for the general account, separate account with

guarantees and non-guaranteed separate accounts, effective January 1, 2011.

ASU 2010-08, Technical Corrections to Various Topics - The working group exposed for comment a proposed change to par. 21(e) of SSAP 86, Derivatives, to change the term "hedged items" to "related financial assets or liabilities." The working group rejected other guidance from ASU 2010-08 such as using the GAAP terms of "noncontrolling interest" or "noncontrolling shareholder" to replace "minor ownership interest" within SSAP 48 and SSAP 97.

Issue Paper 141, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities and Issue Paper 142, Variable Interest Entities - There was no discussion on the proposed issue papers in Seattle. A meeting of the FAS 166/FAS 167 Subgroup has not yet been scheduled. At the Summer National Meeting, the working group did refer *ASU 2010-15, How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of those Investments* to the FAS 166/167 Subgroup.

ASU 2009-14, Certain Revenue Arrangements that Include Software Elements - The working group voted to expose for comment adoption of this guidance. Interested parties commented that they do not believe such arrangements are common among insurers.

Policy Statement on Coordination with the PBR Valuation Manual - At the Spring National Meeting, the working group exposed for comment a proposed process for updating the Valuation Manual. Comments from interested parties noted that the policy statement would not require input from the SAP Working Group for "changes which are non-substantive or which provide purely actuarial guidance and do not have an accounting impact" as determined by the Life and Health Actuarial Task Force. The working group voted to expose for comment deletion of the above guidance and also sent a referral to LHATF requesting the same change in the Valuation Manual.

Fund Demand Disclosure for Institutional Business - 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.

The working group received the report but did not expose it for comment. The regulators directed NAIC staff to use the template to prepare materials for discussion at the 2011 Spring National Meeting.

Rating Agency Working Group Referral

The working group briefly discussed a referral to "analyze whether it is appropriate to continue using changes in NAIC designations to determine if realized capital gains or losses are to be classified as interest rate gains or losses." NAIC staff will begin work on a Form A for the working group to consider.

FASB Financial Instruments Exposure Draft -

For the first time in its history, the SAP Working Group asked for comments on a FASB ED prior to the standard being finalized. Staff had asked for comments by July 30, but none were received. The working group may schedule a call to finalize a response to the draft standard, but no call has yet been scheduled. Comments are due to the FASB by September 30.

Emerging Accounting Issues Working Group

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

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

North Carolina Beach Plan - After a long discussion at the Spring National Meeting on the accounting for equity interests in the North Carolina Beach Plan, the working group had only a brief discussion in Seattle, as the sponsor withdrew its request to discuss the issue further. As a result, the working group did not finalize its tentative interpretation, but instead referred the

broader issue of accounting for state pools and assessments to the SAP Working Group.

INT 07-05T: EITF 06-10, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements - The working group voted not to finalize its tentative interpretation on this issue, as they believe the guidance is not necessary since issues of control and ownership of such contracts are now included in SSAP 21, Other Admitted Assets.

Intercompany pooling - The working group briefly discussed a request from the Connecticut Insurance Department to develop illustrations for reporting of intercompany pooling transactions. The Department believes that in practice, some companies are presenting the unsettled intercompany reinsurance amounts on a net basis (where no right of offset exists) and/or classifying amounts in non-reinsurance accounts, including receivables from/payable to parents, subsidiaries and affiliates. As a result, they believe that unsettled intercompany reinsurance amounts are being inaccurately and/or inconsistently reported within some reporting entities' balance sheet and or reinsurance schedules.

The working group directed NAIC staff to work with Connecticut to develop an illustration for discussion at the 2011 Spring National Meeting.

Blanks Working Group

The working group held a conference call in June to consider proposals exposed at the Spring National Meeting in order to meet annual statement changes cutoff deadlines as a result of changes to the National Meeting schedule. In Seattle, the working group considered three proposals which were deferred from the June conference call and expose five new proposals for comment. During these two sessions the working group adopted twelve blanks proposals as final, including those discussed below which are effective for the 2010 annual statement unless otherwise stated.

- The grouping of sub-categories used for mortgage-backed and asset-backed securities were reduced from the five to three for the Schedules D, DA and E, as applicable. The new categories are residential mortgage-backed securities, commercial mortgage-backed securities, and other asset-backed

securities. The single-class and defined multi-class categories were removed as it was determined these were no longer needed. This change is effective for the first quarterly statement of 2011. (Agenda item 2010-01BWG)

- The list of identifiers was expanded to include additional collateral types for asset-backed securities disclosed on Schedule D Part 1. (Agenda item 2010-02BWG)
- Two columns were added to various parts of Schedule S and Schedule F to identify the bank issuing or confirming a letter of credit to support reinsurance balances. The new columns capture the banks ABA routing number and name. This change is effective for the 2011 annual statement. (Agenda item 2010-03BWG)
- Certain instructions which apply to C-3 Phase I only and not to C-3 Phase II were removed from the Life and Fraternal annual statement instructions. The remaining instructions were revised to be consistent with the RBC instructions. This change is effective for the 2011 annual statement. (Agenda item 2010-05BWG)
- A supplement was added to the P/C annual and quarterly statements to capture premium and loss data related to director and officer insurance. Related interrogatories were also added. These changes are effective for the first quarterly statement of 2011. (Agenda item 2010-06BWG)
- A supplemental exhibit for the analysis of annuity operations by line of business and analysis of changes in annuity reserves during the year was added. Related interrogatories were also added. (Agenda item 2010-07BWG)
- Instructions and an illustration were added to Note 5E with regard to securities lending transactions. (Agenda item 2010-08BWG)
- A new Schedule DL, Part 1 and Part 2 were created. These schedules require reporting of any reinvested collateral assets. (Agenda item 2010-09BWG) A new line was also added to the asset page for Securities Lending Reinvested Collateral - Restricted Asset and to the liability page for Payable for Securities

Lending. Other schedules were also be updated to make conforming changes. (Agenda item 2010-10BWG)

- Instructions were added to the General Interrogatories (Life and Fraternal blanks) to incorporate non-binding guidance provided by the Life and Health Actuarial Task Force with regard to the reporting of new reserving standards under AG 43. (Agenda item 2010-11BWG)
- Illustrations were added to the instructions for Note 9, Income Taxes, as a result of the adoption by the Statutory Accounting Principles Working Group of SSAP 10R, Income Taxes. (Agenda item 2010-12BWG)

The comment period for the five proposals exposed in Seattle ends September 17. These proposals include the following and will be considered for adoption at the Fall National Meeting and would:

- Add a new question to the General Interrogatories Part 1 regarding letters of credit unrelated to reinsurance. (Agenda item 2010-14BWG)
- Add a new interrogatory to the General Interrogatories Part 1 for modified duration buckets using 5 different interest rate scenarios. (Agenda item 2010-16BWG)
- Modify the definition of "All Other Governments" in the Investment General Instructions to include bonds issued by corporate entities that are fully guaranteed by non-U.S. governments. (Agenda item 2010-17BWG)

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

Upon re-examination of the NAIC's transition to a three National Meeting schedule per year, it was determined the four meeting schedule is still necessary for the Blanks Working Group in order to permit the timely exposure and adoption of blanks proposals. As a result, the working group adopted previously exposed procedural changes which include holding a June conference call on a planned, rather than ad hoc, basis for the exposure and adoption of blanks proposals.

NAIC/AICPA Working Group

SEC Rule on Compensation

At the Spring National Meeting, the working group discussed newly adopted SEC Rule 33-9089 on executive compensation and board of director structure. The working group reviewed a staff memo summarizing the new disclosures which require a narrative disclosure of the company's compensation policies as they relate to company risk management; the nature and extent of services of compensation consultants and detailed disclosures about the board of director leadership structure and why the chosen structure is best for the company. Shortly after the National Meeting, the working group exposed for comment a Blanks proposal with numerous additional disclosures to incorporate most of these SEC disclosures; the working group and held a conference call June 22 to discuss the proposal, which the regulators viewed as "starting point for discussion."

During the interim conference call, interested parties stated that these proposed detailed disclosures "do not appear to fit the intended purpose of the annual statement for solvency reporting." In addition, interested parties reiterated their concerns related to duplication of SEC disclosures in the statutory financial statements. Representatives for mutual insurers noted that the SEC disclosures are primarily for stockholders not policyholders. Interested parties requested an opportunity to provide an alternative proposal, which includes revisions to the annual confidential Supplemental Compensation Exhibit and enhancements to the Examiners Handbook to provide an enhanced review of potential risks posed by insurer compensation plans. The working group agreed that interested parties should pursue this alternative.

At the Summer National Meeting, the working group discussed this counterproposal, which recommends the following revisions to the Supplemental Compensation Schedule:

- A new interrogatory that requires disclosure when an insurer has made material changes to the general philosophy and objectives of its material compensation policies and practices for employees
- Reporting stock-based incentive compensation elements for key officers and certain other employees as well as directors

- That publicly-held stock insurers (or insurers that are owned by public-held companies) have the option to file their annual proxy report with the domiciliary regulator in lieu of the Supplemental Compensation Exhibit.

The proposal also includes additional review steps in the Financial Examiners' Handbook, Exhibit M, Understanding the Corporate Governance Structure. The proposal expands guidance in the following areas: the general design philosophy of compensation programs and incentive plans, background and qualification of directors and nominees, board leadership structure and role, and the use of compensation consultants.

After reviewing the counterproposal, the working group chair noted that although the group's first proposal was "too detailed," the interested parties' proposal needs additional work including more disclosures on compensation plans and incentives, board leadership structure and the role of the board with respect to compensation. The working group then referred the initial working group proposal and the counterproposal to the Corporate Governance Working Group for its consideration.

MAR Implementation Issues

The working group exposed for comment proposed changes to the MAR Implementation Guide's sample management attestation reports to include additional sample wording for insurers where there were significant control processes not tested for SOX purposes due to group materiality considerations.

The working group then noted that the version of the Implementation Guide included in the 2010 Accounting Practices and Procedures Manual is not the most recently revised version. Interested parties should use the version posted to the working group's webpage instead.

Interrogatory on Audit Committee Members

At the Spring National Meeting, the working group discussed a referral from the Blanks Working Group (agenda item 2009-38), which would require the names of audit committee members and whether each is an independent member to be disclosed in the annual statement. Interested parties had objected to the disclosure as not being meaningful. At its meeting in Seattle, the working group decided not to pursue the issue further. The working group instead encouraged insurance departments to verify compliance with audit

committee requirements through discussions with insurers as deemed necessary.

Valuation of Securities Task Force

Residential Mortgage-Backed Securities

The task force adopted an amendment to the Purposes and Procedures Manual to clarify that residential mortgage backed securities (RMBS) and commercial mortgage backed securities (CMBS) that are subject to financial modeling are no longer eligible for the general filing exemption but also do not have to be filed with the SVO.

The task force held a conference call two days following the Summer National Meeting to receive a mid-year review report from SVO staff on the RMBS. The SVO's analysis noted that RMBS delinquencies, home prices and loss severities have begun to stabilize over the last six months; and that insurance industry holdings of RMBS are performing consistent with the market. The SVO noted that historically low interest rates and federal government stimulus programs have likely contributed to the stabilization of RMBS valuations. Based on its analysis the SVO has concluded that no modeling of valuation ranges for RMBS is deemed necessary for June 30, 2010, which supersedes an earlier decision to perform modeling for the second quarter. The next SVO valuation update of the RMBS portfolio is expected to be December 31, 2010, although the NAIC has not finalized how it will conduct the required financial modeling or which vendor will be utilized.

Structured Transactions

A proposed amendment to the *Purposes and Procedures Manual* to modernize instructions for structured transactions was exposed for a thirty-day comment period. The amendment describes the methodology applicable to RMBS, and creates a framework for CMBS and asset-backed securities. The existing instructions are retained for securities whose cash flow derives from pools of obligations where an NRSRO-rated entity guarantees or insures and identifies other populations of securities assigned to the SVO structured transactions group and the procedures applicable to them.

Invested Asset Working Group

The working group has not met since the Spring National Meeting; however it did form a Risk Other than Credit Technical Resources Subgroup, which held three conference calls between May and July. The subgroup is tasked with implementing the

investment data symmetry initiative which seeks to link securities data from various sources into a unified database. The database would enable regulators to develop tools that would provide for more comprehensive assessment and risk-focused analysis of investment risks other than credit.

U.S. Government Backed Securities

An amendment to the Purposes and Procedures Manual to modify the List of Securities Backed by the Full Faith and Credit of the United States Government was adopted by the task force. This list is used to identify investments that are exempt from asset valuation reserves and risk-based capital and also serves as guidance for the mutual fund exemption lists.

SVO Monitoring of Compliance with Filing Requirements

A regulatory proposal to expand the duties of the SVO to include monitoring insurance company compliance with filing requirements was discussed. The scope of SVO activities would extend to all aspects of reporting compliance, including whether securities reported as filing exempt are actually rated and whether securities reported with a "Z" are over the permitted 120-day filing period. The task force agreed to form a subgroup to study the issue and develop applicable procedures and to consult with the Chief Examiners' Forum to obtain input and advice.

Filing Unrated Hybrids

The task force clarified that any security fitting the NAIC definition of hybrid securities that is not rated by an NAIC ARO can be filed with the SVO. However, the SVO has authority to classify these securities as part of the process of assigning a designation. This could result in a classification other than as a bond.

FDIC Guaranteed Securities Filing Exemption

The task force discussed a proposal to consider granting a filing exemption for a small class of structured securities guaranteed by the FDIC. The securities in question are private, unrated structured securities. The securities are issued by a trust and are collateralized by assets sold by the FDIC to the trust and acquired by the FDIC as part of the receivership process for failed banks. The applicable statute confirms that the FDIC guarantee is backed by the full faith and credit of the US; however, it also limits the amount of obligations the FDIC can create. The task force exposed the proposal for a thirty-day public comment period.

Foreign Securities Filing Exemption

A proposal to examine approaches to permit insurance companies to self rate foreign securities held in support of foreign obligations but which are not eligible for the subparagraph D filing exemption was exposed for a thirty-day public comment period. Subparagraph D of the Foreign Securities section of the SVO Purposes and Procedures Manual, permits a filing exemption for foreign securities held by a domestic insurer that holds the securities in support of foreign liabilities and which derives no more than 20% of its gross worldwide premiums in the U.S. In this circumstance, where there is no NRSRO rating, the NAIC designation may be determined by the reporting insurance company. Companies that do not meet this premium threshold cannot self-designate and instead must use the NAIC 5*/6* rule if no NRSRO rating exists. This may result in a higher RBC charge than warranted.

Certificate of Deposit Filing Exemption

A proposed amendment to the P&P Manual to add a filing exemption for Certificates of Deposit issued by rated banks was exposed for a thirty-day public comment period. The statutory accounting guidance provides that CDs with a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition are to be classified as bonds. As a result, these CDs are required to be filed with the SVO. Insurers have argued that the filing is cost prohibitive given the low-yield of these CDs. The proposed amendment would permit insurers not to file CDs with the SVO when the issuing bank is ARO rated.

Contingent Capital Securities

The SVO reported on its consideration of contingent capital securities, noting that they have some features in common with hybrid securities and with mandatory convertible securities. Contingent capital securities have been utilized principally within the banking industry to raise regulatory capital. The security is designed as a bond but on the occurrence of a stated event, such as a reduction in the bank's capital ratio below a stated level, the security converts to an equity instrument. The task force agreed that no decision is necessary at this time because certain technical issues have stalled further issuances of these securities. In particular, there is no agreement on how to structure the events that trigger conversion from debt to equity. SVO staff cautioned that the issue is broader than this specific security because federal banking regulators are under pressure to recapitalize banks and have been directed by Congress to develop hybrid or contingent

regulatory capital. The SVO will continue to monitor developments and report back to the task force.

Use of NAIC Designations as Ratings Triggers

The task force adopted an amendment to the Purposes and Procedures Manual to clarify the scope of a policy that prohibits insurers from using SVO determined NAIC ratings designations as rating triggers to modify economic terms in private agreements. The term "rating trigger" refers to any contract clause which requires an increase in interest rates or some other benefit to the insurer if the NAIC rating designation of a borrower falls below a specified level. The prohibition is on insurers inserting clauses in their private loan agreements with borrowers (investments in private debt) and not on an insurer issuing its own debt. The prohibition applies to transactions entered into on or after September 1, 2010, and includes those transactions which are amended after that date. The SVO will be prohibited from processing any initial filing for a security that contains such clauses. However the SVO is not required to look for these clauses; instead the insurer must affirm that they do not exist. Insurers can continue to use NAIC ARO credit ratings as rating triggers, but not NAIC designations assigned by the SVO.

NRSRO Ratings

The SVO will no longer be assigning NAIC ratings designations in the VOS database for securities rated by an NRSRO via a private rating letter. This is the result of a new reluctance by NRSRO analysts to discuss the rating logic for securities rated in this manner. The SVO staff indicated that they are working on several items related to the NAIC's reliance on NRSRO credit ratings. These items are the result of a referral to the task force from the Rating Agency Working Group. The SVO will update the task force when it has made significant progress on these referrals.

Capital Adequacy Task Force

The task force met via four times since March via conference call and at the Summer National Meeting and discussed the following items:

2010 Life RBC MEAF Proposal

As a result of the regulators concluding that a long-term replacement of the mortgage experience adjustment factor will not be ready for 2010, at the Spring National Meeting, the working group exposed for comment a proposal to maintain the current range of the MEAF at 75%-125%, but raise

the base factor from 2.6% to 4% for 2010 because of increasing mortgage default rates.

The working group received 40 pages of comment letters from eight companies and trade associations all objecting to the increase as not supportable by the data. These comment letters were discussed during a June 14 conference call, during which the chair conceded that the 4% was excessive. As an alternative, but to provide some additional cushion above the 2009 RBC level, the working group adopted a revised MEAF range of 80%-175% for year-end 2010 and 2011. The NAIC estimates that the change from 125% to 175% will increase required capital by \$620 million for the industry. The revised calculation received final approval by the commissioners at their Plenary meeting in Seattle. (See below in the summary of the Life RBC Working Group discussion of progress on the long-term mortgage proposal.)

Deferred Tax Asset RBC Proposal

The task force heard a brief report from the American Academy of Actuaries, whose representative stated that they are on track to complete the project by September 15. As discussed in the summary of the DTA Subgroup on page 6, the AAA's preliminary conclusion is that there is no need for an RBC charge on DTAs for well capitalized companies, as the non-admission requirements already act as an implicit RBC charge.

Presentation on P/C Reinsurance Underwriting Factors

The task force received a detailed presentation from the Reinsurance Association of America on its concerns with the current methodology for calculating the reinsurance underwriting risk factors, which results in "excessively" high capital requirements for reinsurers. For example, the current factors require \$8 of capital to support \$1 of non-proportional reinsurance premium.

After the presentation, one regulator agreed that the factors did seem "draconian." The task force agreed to add a charge to the agenda of the P/C RBC Working Group to review how underlying data is filtered, with the hope of some short-term relief by 2011. Others thought the issue would be better addressed by the new Solvency Modernization Initiative RBC Subgroup. The RAA strongly believes that a special subgroup with representatives from industry, regulators and the AAA needs to be formed to provide input into the

project, and that the entire methodology for calculating risk charges should be reviewed.

Solvency Modernization Initiative RBC Subgroup

This subgroup of the Capital Adequacy Task Force had a kick-off meeting in Washington DC on July 21-22 for the purpose of "redesigning RBC." In addition to regulators and members of the American Academy of Actuaries, more than 50 others attended as interested parties. Early into the two day meeting, the chair of the subgroup quickly indicated that the NAIC was not anticipating any radical changes to RBC. There was consensus among those present that, although there should be consistency where possible between life, P&C and health RBC requirements, there should continue to be separate requirements. During a discussion of the purpose of RBC, regulators were clear that the sole purpose of RBC was to identify weakly capitalized companies and they are concerned about what they termed the "improper use" of RBC by rating agencies. However, no practical suggestions on curtailing this use were identified.

The majority of the meeting was spent discussing the current "calibration" of RBC, that is, the X% probability that an insurance company has enough resources to meet its obligations over an N-year horizon. The International Association of Insurance Supervisors has requested all of its members provide this calibration of their minimal capital requirements. Presumably, this request is stemming from Solvency II actions taking effect in Europe, which sets the standard stress level at 99.5% over a one year time horizon across all products. None of those participating at this meeting thought that calibrating the NAIC's RBC requirements will be easy particularly since current RBC requirements, particularly for life insurance, are combinations of simplification and accuracy measures that were adopted at different times since RBC was first introduced in the early 1990's.

The subgroup met again during this Summary National Meeting to review the topics discussed earlier. No new issues were identified.

Life Risk-Based Capital Working Group

Long-Term Commercial Mortgage Loan Proposal

The working group met August 5 and in Seattle and discussed the "ACLI Commercial Mortgage Proposal" for revising the RBC calculation for

these mortgages. This revision is intended to replace the widely criticized Mortgage Experience Adjustment Factor ("MEAF") methodology currently in place. The proposal recommends a process similar to that used for corporate bonds, and incorporates industry standard measures to assess default risk adjusted for different property types and different amortization periods. The ACLI's proposal is that debt service coverage and loan to value (LTV) will be key components of the new methodology to develop portfolio level RBC that is adequate for the risk profile of a company's commercial mortgage loan portfolio.

The ACLI had contacted vendors to model mortgage loan losses based on different LTV, default service coverage, property type, amortization period and maturity. The working group expressed concern about engaging a consultant since they don't know yet if they will use the results of the modeling for this project. The working group concluded that they will make a decision on the use of modeling after the Summer National Meeting. The ACLI will provide a public document on the modeling, and the working group will consult other experts and decide if a public call is needed before giving guidance on the modeling.

Updated ACLI Derivatives Risk Mitigation Proposal

The ACLI discussed its proposal to provide a credit for hedging of C-1 asset risks for fixed income securities and common stocks, not already considered in C-3 modeling. Recommendations address basic hedges pairing single assets and derivatives, and intermediate hedges pairing a portfolio of assets with a closely matched basket of derivatives. The proposed formula for the basic hedge credit reflects counterparty credit risk, credit spread mismatch risk and general business risk. The proposed approach for determining the credit on intermediate hedges would treat each security common to the portfolio and basket hedge as a basic hedge. The working group approved a motion to expose the proposal for comment for 30 days; interested parties are hopeful that the proposal can be adoption by year-end 2010 for implementation in 2011 RBC. They also noted that the proposal is structured so that intermediate hedges can be easily eliminated if necessary to get the basic hedge proposal adopted for 2011. An interim conference will be scheduled before the Fall National Meeting to continue discussion.

C-3 Phase 3 Proposal

C-3 Phase 3 was not discussed during the meeting but will be discussed at a conference call expected to be scheduled shortly. It was noted that work

related to the Solvency Modernization Initiative and PBR activities may impact but was not in conflict with the proposal. The ACLI encouraged the task force to use the input from the PBR field testing phase and the Actuarial Guideline 43 and C-3 Phase 2 considerations (discussed below in the LHATF summary on page 20) to make C-3 Phase 3 as effective as possible.

Non-US Affiliates Proposal

A large mutual life insurer submitted a proposal to exclude a foreign insurance affiliate's statutory carrying value from both the total adjusted capital and RBC components of the RBC ratio. Including the foreign insurance affiliate's statutory carrying value in the RBC ratio will decrease a company's ratio. The proposal is intended to achieve better parity between mutual companies and stock companies, where the foreign affiliates are typically owned by a non-insurance holding company, leaving the U.S. life insurance company's RBC unaffected. The working group approved exposure of the proposal for 30 days. The chair noted that the change, if adopted, could not be reflected in the 2010 instructions as these have already been adopted. However, the working group asked for comments as to whether a 2010 implementation date could be made applicable via alternative guidance.

C-3 Phase 1 Economic Scenario Generator

The RBC instructions point to the NAIC website for the economic scenario generators for C-3 Phase 1. It was noted that the generator calculated negative interest rates when Treasury rates were at record low rates as they were in May 2011. The generator did not have a mechanism to floor the rates at zero, and the situation had not occurred prior to the current low interest rate environment. A change was implemented that selects the prior month's rates if the current month's rate is negative. The revised generator will be placed on the NAIC's website.

P/C Risk-Based Capital Working Group

The working group met via conference call twice in May and discussed the following topics:

Underwriting Risk Charges

At the Spring National Meeting, the working group exposed for comment an updated study from the AAA of proposed underwriting risk charges for 2010. The updated study recommended, with factor changes capped at +/- 15%, an increase to the reinsurance lines of 15%, which would be a

15% increase for the third year in a row. Other lines including personal lines recommend significant decreases.

During the two conference calls in May there was significant discussion of the proposed 15% charge for the reinsurance lines, some of which was heated. Industry and trade association representatives stated that the increases of the past three years significantly overstate capital requirements for reinsurance. The working group ultimately adopted a proposal to cap all factors at 5% for 2010, which was also adopted by the Capital Adequacy Task Force. This discussion led to a presentation in Seattle to the task force by the RAA asking for reconsideration of the methodology for choosing underwriting factors. That discussion is summarized above.

2010 Industry Average Reserve and Premium Factors

The working group approved the ten-year industry average reserve and premium factors for 2010 RBC, noting that there were some significant increases on the short-tail lines. However, they believe the impact will be mild to the overall industry unless companies experience adverse development on those lines.

Catastrophe Risk Subgroup

The subgroup met three times via conference call this spring and summer and made significant progress on its catastrophe model draft proposal. The subgroup considers the first five assumptions of the proposal to be complete which are as follows:

- The property catastrophe risk will be the modeled catastrophe losses using any one of the three commercially available catastrophe risk models, using the company's own insured property exposure information as inputs to the model. The subgroup later clarified that companies can also average the results of two of the three models, but this is not a requirement.
- The charge will be based on the once-in-100 years' modeled loss level.
- A separate charge will be determined for the hurricane peril and for the earthquake peril and no other catastrophe perils will be considered at this time.

- The charges for the hurricane and earthquake perils will be considered to be independent of each other, which means that they will each be subject to the covariance adjustment.
- The charge will be calculated on a gross of reinsurance basis, and a negative charge or credit for modeled anticipated ceded reinsurance.

One for the significant open items discussed on the conference calls is whether to exclude other affiliated reinsurance from the credit risk charge, similar to the exemption for intercompany pooling. Other items on the "to do list" for future consideration are issues related reinstatement premium and a potential offset for federal income taxes. The next conference call of the subgroup is scheduled for September 23.

Health Risk-Based Capital Working Group

The working group met twice via conference call and discussed the following issues:

Health Care Reform

The working group discussed at both its conference calls the potential effect of health care reform on health RBC results of companies. Several regulators noted that the change in definition of the medical loss ratio could potentially affect the solvency of companies as a result of less opportunity to recover losses. The working group will continue to monitor this issue going forward.

Adoption of 2010 Health RBC

The working group adopted the 2010 Health formula and instructions. Changes from 2009 include the following: an expanded DTA sensitivity page has been added to the Total Adjusted Capital page, the second year of a two-year phase-in of the Medicare Part D supplemental benefit factors has been updated to 35% and a new derivatives line is included in the Fixed Income Asset page. The Off-Balance Sheet Collateral page has also been updated to reflect the new treatment of securities lending collateral.

Covariance Calculation

The working group had asked that the AAA to review the covariance calculation in Health RBC which one regulator views is a "weak tool to address risk reduction." The Academy's representative noted that changing the covariance formula would not significantly affect the number of

insurers that trigger an action level and that a longer term project to "fine tune" the formula would be required. NAIC staff was directed to generate a report showing the average of RBC before and after covariance to explore this issue further in future meetings.

Solvency Modernization Initiatives Task Force

The work of the SMI Task Force and its seven working groups (discussed below) dominated the meeting schedule of the Summer National Meeting. In addition to hearing progress updates from its groups, the task force approved an update version of its SMI Roadmap to reflect progress made on its many charges. The Roadmap dated August 25 has now been posted to the task force's webpage.

Statutory Accounting and Financial Reporting Subgroup

This newly formed subgroup met April 21 and released a "preliminary considerations" document that included the following issues for comment:

- What should be the purpose of the regulatory accounting model?
- Given that the IAIS and major jurisdictions are advocating the use of IFRS (possibly with modifications) for regulatory purposes, should the NAIC continue to maintain an entire codification of statutory accounting?
- Should regulatory financial statements be utilized for public purposes or should a separate public financial filing be required?

In addition, NAIC staff prepared a detailed analysis of five different accounting basis possibilities that the subgroup could consider:

- Freeze SAP without any IFRS/GAAP conversion item changes
- U.S. GAAP with statutory adjustments, with a step by step review of IFRS/GAAP convergence items
- IFRS with statutory adjustments
- IFRS for public companies and IFRS/GAAP with statutory adjustments for nonpublic companies, and
- IFRS without any statutory adjustments

The subgroup met in Seattle to discuss comments on these issues. Several regulators commented that they believe no change to the current process is required as the recent financial crisis demonstrated that statutory accounting is an effective regulator basis of accounting. They believe that the SAP Working Group should continue to current process to review new GAAP as it is issued, which would include all IFRS convergence guidance.

Industry interested parties noted that they cannot meaningfully comment on a proposal to adopt IFRS because accounting for insurance contracts under IFRS has not yet been finalized and the SEC has not yet concluded whether U.S. public companies should report under IFRS.

The subgroup directed staff to incorporate revisions to the documents and re-exposed them for comment. The subgroup's anticipated deadline for a final decision on whether to pursue another basis of accounting for regulatory purposes is December of 2011. This deadline could obviously be affected by the timing of any SEC decision.

Group Solvency Issues Working Group

The working group was very active this spring and summer trying to meet its deadline to adopt revisions to the Holding Company Model Law and Regulation to reflect concerns in a group supervision setting by the Summer National Meeting. As a result of its seven interim conference calls and a public hearing in June, the working group made significant changes to the models and adopted those changes for consideration by its parent committee, Financial Condition Committee.

Significant adopted changes to *Insurance Holding Company System Model Act* (#440) and *Insurance Holding Company System Model Regulation* (#450) included the following:

- The concept/definition of "contagion risk" of entities within a holding company group added in earlier draft revisions was replaced with "enterprise risk identification," which is defined as "any activity, circumstance, event or series of events involving one or more affiliates of an insurer, that, if not remediated promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or the insurance holding company system as a whole."

- Additions were made to Section 19 of the Model Regulation on affiliate agreements to enhance significantly the minimum requirements for cost sharing and management agreements.
- A new section 7 was added to the Model Act to give the commissioner the authority to establish and/or participate in supervisory colleges for insurers with international operations.
- Controversial corporate governance requirements have been added. There was significant discussion as to whether the Form B filings should require a statement that the board of directors "is responsible" for corporate governance and internal controls or just oversees such processes. As a compromise, the working group included both alternatives for states to choose from, i.e. "the board is responsible for and oversees" or "the board oversees."
- Enhancements have been made to allow examination of affiliates including access to books and records to "better ascertain the financial condition of the insurer and any contagion risk within the insurance group."
- A requirement to file Form Bs (annual registration statement) and Form Cs (changes to the registration statement) with the NAIC was added. This new requirement was discussed at length. The regulators believe centralized data collection and sharing is crucial to an effective national state-based system of insurance regulation.

Interested parties are concerned about confidentiality issues of filings with the NAIC. It was noted that at least one state does not allow information to be kept confidential when it is also filed with the NAIC. NAIC legal counsel noted that the proposed changes to the Model Act include specific provisions that allow such information to be kept confidential when adopted by a state, similar to the RBC Model Act.

- A requirement for prior notice of divestiture of controlling interests in an insurer has been added.

As discussed above, the working group adopted the proposed changes, which were also adopted August 5 by the Financial Condition Committee. The proposed changes will be discussed by Executive Committee this fall, and the NAIC anticipates that the revised models will be ready for legislative consideration in January, 2011.

Corporate Governance Working Group

The working group held two interim conference calls in May to review referrals from the Group Solvency Issues Working Group on two corporate governance issues being addressed in the revisions to the Holding Company models. The first issue was resolved by inclusion of the two alternatives in the Model Act relating to the role and responsibilities of the board of directors as discussed above.

The second issue addressed is to whether to make Section 5.C of the Model Act, Management of Domestic Insurers Subject to Registration, mandatory, as opposed to the current optional status. The working group concluded it should be mandatory, but removed guidance from Section 5.C.4 related to the selection of the independent CPAs and reviewing the insurer's financial condition and results of internal audits. This was done as those requirements are now covered by the Model Audit Rule; the working group wanted to eliminate any potential conflicts between the two models. The Group Solvency Issues Working Group adopted these changes as well.

In Seattle, the working group reviewed a draft summary of state corporate governance law prepared by NAIC legal staff. Only California, Delaware, Georgia, Illinois, Iowa, Nevada, New York and Texas are currently included in the summary. The working group then heard a presentation on emerging corporate governance best practices for public companies from a law firm and how such evolving best practices may or may not be appropriate for insurance company policyholders.

The working group then reviewed its project timeline which shows review of state and international corporate governance standards to develop best practices. If the working group concludes that a Corporate Governance Model Law should be developed, the timeline shows completion by the 2012 Summer National Meeting.

International Solvency Working Group

The working group held two interim conferences call and met at the Summer National Meeting to discuss the following items:

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

The working group released the Consultation Paper on ORSA for comment. This paper includes topics of what Bermuda, Canada, the European Union, and Switzerland are implementing; what is included in the International Association of Insurance Supervisors' standards related to enterprise risk management; and the possible requirements that should be included in a U.S. tool. Solvency II has defined ORSA as an assessment that the insurer makes about the adequacy of the insurer's risk management and the current and future solvency position. The ORSA should include all likely foreseeable and related material risks. An insurer must calculate the amount of financial resources needed due to its own risk tolerance, business plans and illustrate how the insurer will be able to continue in business over the next several years. Specifically the working group is looking for comments related to the following issues:

- What content should be provided and how frequent
- How to maintain confidentiality
- What level should regulators require this tool (i.e. group, legal entity, intercompany pool)
- Should the requirement vary based on size and complexity of an insurer
- Should the U.S. implement a questionnaire or minimum level of standardized reporting
- Should the tool be driven by the company or should regulators specify items such as specific stress tests or safety levels
- Should the Board be responsible for the ORSA/ERM
- Would development of the assessment require significant additional resources

Comments are due by October 4 and will be discussed at the Fall National Meeting.

International Accounting Standards Working Group

The working group held an interim meeting at the NAIC SVO Offices in New York April 29-30 to get specific input from working group members on current International Accounting Standards Board

exposures and related International Association of Insurance Supervisors positions. The NAIC comments on the IASB will be reflected in the IAIS comment letter; the NAIC does not currently anticipate that it will issue a separate comment letter.

IAS 37, Provisions, Contingencies and Contingent Assets

The working group discussed a draft of the IAIS letter to the IASB regarding the IAS 37 limited re-exposure draft. The IAIS is supportive of the IAS 37 exception for insurance contracts. Working group members and interested parties shared views on the exposure draft, expressing particular concern with the IASB's decision to replace the "probable" recognition threshold for contingent liabilities with a probability-weighted measurement approach. Following the discussion, the working group agreed to submit comments to the IAIS noting its agreement with the existing IAIS letter regarding the IAS 37 exception for insurance contracts and to request that the IAIS comment letter be expanded to include the following three matters:

- Identify concerns with the IASB due-process and limited exposure of IAS 37 with a request that the IASB expose the full IAS 37 for comment.
- Identify concerns with the elimination of the "probability" threshold, noting that although an IASB staff memo has been issued to address concerns, this memorandum does not have authority within IFRS. It is preferred that the probability criteria be re-included within IAS 37 to provide for the most useful information to be included in the financial statements, but if this is not supported by the IASB, then the concepts and guidelines from the IASB staff memo should be included within IAS 37 to ensure the IASB intent of the standard is properly interpreted.
- Identify that IAS 37 provides limited guidance on the inclusion of a risk margin in the measurement of a liability and how such risk adjustments should be determined, and identify the need for clarity on the risk margin.

IFRS 9, Financial Instruments

The IFRS exposure draft regarding the amortized cost treatment and impairment of financial instruments, if adopted, would replace the current requirements in IAS 39, *Financial Instruments*:

Recognition and Measurement. A summary of key issues was provided by NAIC staff, noting that the current impairment guidance under U.S. GAAP and IAS 39 utilize an "incurred loss" model, where a "triggering" event must occur before an impairment is recognized. There is a belief among regulators that incurred loss model delays loss recognition and may have contributed to the financial crisis. The G-20 and Financial Stability Board have agreed that an "expected loss" model which does not utilize triggering events, as proposed in the exposure draft would enable earlier, and in their view more timely, recognition of impairments. The working group discussed the complexity and cost benefit disparity of the proposal; however, NAIC staff noted that given the political nature of the issue it is unlikely that the IASB will revert back to an incurred loss approach. The exposure draft provides for two recognition treatments for financial instruments, fair value changes recognized in the income statement or amortized cost. The "available-for-sale" classification with fair value changes recognized in other comprehensive income would be eliminated. It was noted that the recognition treatments are not elective, but rather dependent upon the company's business model. As a result it is generally expected that most insurers would be captured within the amortized cost business model. However, given the uncertainties with regard to measurement of insurance liabilities it is difficult to assess which financial instrument model would be most appropriate.

IAIS Draft ICP 14, Valuation for Solvency Purposes

The working group discussed the IAIS draft Insurance Core Principle 14 (ICP 14), *Valuation for Solvency Purposes*, which provides a supervisory standard on the valuation of assets and liabilities for insurer solvency assessment. The working group agreed to send a comment letter to the IAIS reiterating previously communicated comments that the U.S. does not agree with the adoption of ICP 14 until the release of the IFRS Insurance Contracts standard and the related IAIS guidance paper. The letter will also request the IAIS to provide additional guidance regarding the application of the standard to non-life and life contracts.

IFRS 4, Insurance Contracts

At the interim meeting in New York, the working group began to develop its views with regard to the pending IASB Insurance Contracts exposure draft. A tentative position statement was finalized during a May conference call and subsequent email vote

of working group members. The Insurance Contracts exposure draft was published on July 30 with comments due by November 30.

The position statement includes a preamble expressing the working group's strong preference for a two-model approach whereby life insurance contract accounting is separate and distinct from non-life insurance contracts, noting the success of the two-model approach during recent and historical periods of economic stress. Assuming the IASB does not adopt a two-model approach the working group reached the following tentative positions:

- **Margins** - the majority of working group members support the single composite margin approach over the separate risk margin and residual margin approach, due principally to the lack of available market information to calculate a relevant risk margin. The working group supports the revenue recognition of the composite margin over the claims-paying period; however, members expressed concern with how the change in recognition for short-term contracts, which have historically recognized revenue over the coverage period, will impact company capital, and further, how this change in capital will impact product prices and product availability.
- **Subsequent Measurement** - The working group tentatively agrees with the IASB view that changes in prior period development should be result in an immediate impact to profit or loss, but requested that the views of the actuarial task forces be obtained. Members also concluded that the IASB should reconsider whether differentiation between life and non-life products would be appropriate, and whether fluctuations not resulting from changes in estimates (e.g., interest rates) should be accounted for through an other comprehensive income component rather than profit and loss.
- **Acquisition Costs** - With regard to acquisitions costs, the working group concluded that only incremental costs, defined as costs that are incurred from issuing a contract (selling, underwriting and initiating coverage) should be included. The working group agreed to refer to such costs as "transaction costs" rather than "acquisition costs" to distinguish such costs from the typical definition of "acquisition costs" prevalent in other industries.

- **Discounting** - The working group expressed concerns with the requirement to apply discounting for short-duration contracts, due to the cost benefit and relative materiality. They agreed to tentatively recommend that the IASB perform additional research and modeling before making a final decision.

In Seattle, the working group and interest parties discussed high-level concerns regarding the exposure draft. Key issues raised included concern with the cost benefit of the building block approach for short term, short duration products and the related pre-claim unearned premium approach, questions regarding the application of the margin approach and whether it should be composite or risk and residual, and concerns with the proposed presentation model including over-extensive disclosure requirements. NAIC staff had identified the margin and presentation issues as key, together with the guidance regarding discount rate selection.

NAIC staff also shared a work plan which includes a timeline of key dates as the working group prepares its response to the exposure draft. It was noted that actuaries should have significant input into the process, and the working group heard that the Society of Actuaries and the Casualty Actuarial Society are studying the effects of the proposals on U.S. products. The study may be available by the end of September.

The working group will be very active this fall in order to meet the comment deadline of November 30. The working group has scheduled several joint conference calls in September with the SAP Working Group, the Casualty Actuarial and Statistical Task Force and LHATF, including an educational session on September 1 "to point out key issues and get up to speed on the IASB Insurance Contracts Exposure Draft."

Life and Health Actuarial Task Force

Principles-Based Reserving

LHATF's primary goal for 2010 was to complete the Principles-Based Reserves Valuation Manual by the Summer National Meeting. However, pressure from the American Academy of Actuaries and industry groups threatening to withdraw their support of PBR resulted in the addition of a field testing project to be completed before the adoption of the Valuation Manual. Although the VM was not finalized, the emphasis of the two day LHATF meeting was to expose a new draft of the VM

requirements for life insurance, VM-20, which they achieved. This exposure draft will serve as a baseline for the field testing project.

Other highlights of the meeting included an update from the LHATF Regulatory Testing Subgroup promoting impact testing of VM-20, also known as "Field Testing" and a report from the actuarial consulting firm Oliver Wyman on their evaluation of RBC C-3 Phase 2 and AG 43 methodologies. The Field Testing initiative will be coordinated by an actuarial consulting firm and will identify companies to participate in determining the implementation impact of VM-20. All companies with at least \$100 million of new annualized premium last year will be strongly encouraged to participate in the testing. The objective of the testing is to develop an understanding of the industry effect and identify any sections of the guidance or requirements that may need refinement. The testing is to be completed by year-end 2010 in order to keep the PBR project moving forward, and could delay the introduction of the valuation manual up to one year. LHATF clarified their 2011 charge related to the review of AG 43 to include consideration of modifications that may be needed pending the completion of the Oliver Wyman study.

PBR Life (VM-20)

Proposed amendments regarding mortality assumptions and margins, the components of the stochastic exclusion test and the definitions of reinsurance cash flows were approved for inclusion in the new VM draft. The nature of the amendments was generally to clarify wording, provide greater consistency in application, and to clarify documentation requirements.

An amendment from the Academy's Life Reserve Working Group clarifying the requirements to determine equity returns was discussed, but not voted on pending further discussion. One key element of the amendment is that stochastic interest and equity returns will be developed using prescribed scenario generators and prescribed parameters, providing scenarios that adjust more dynamically to the current environment. The scenario generators are expected to be available on the Academy's website.

Prior discussions regarding VM-20 changes had addressed an Academy-recommended alternative to calculate reinvestment spreads that provide for more dynamic determination of such spreads. The LHATF chair noted that both the originally drafted guidance and the Academy recommendation will

be included in the working draft for field testing purposes.

Regulators from New York submitted an amendment modifying the asset default cost assumption to increase the amount of the spread attributable to default costs, based on their understanding of the historical relationship between asset spreads and default costs. The amendment was set aside for further review and discussion during the impact testing phase.

Lengthy discussion ensued around a proposed amendment from New York regarding the calculation of the Gross Reserve and reinsurance credit. The debate centered around (1) whether the reinsurance credit should be the net of the gross and net reserves (as drafted), or calculated directly and then added to the net reserve to get the gross reserve (NY's recommendation), and (2) whether the reinsurance credit should be calculated separately for each treaty. It was noted that calculation of the reinsurance credit at the treaty level is important for collateral purposes, but does not affect the net reserve. It was also noted that undue stress on resources will result if companies are required to do stochastic runs at the reinsurance treaty level. The amendment was rejected by vote, but the chair noted that this issue will be addressed in field testing to confirm that the current guidance is sufficient, particularly as it applies to reinsurance of variable annuity benefits and UL secondary guaranty products.

Amendments to other sections of the VM on Process and Coordination (VM-00 and VM-01) and Experience Reporting (VM-50 and VM-51) were approved. Amendments to the Reporting and Review sections (VM-30 and VM-31) were tabled pending review of the impact testing results.

LHATF Regulatory Testing Subgroup

As discussed above, the NAIC has commissioned an impact or field study to address industry and legislator concerns around implementation of VM-20, including the financial statement impact, level of prescription, the need for a feedback loop and support for a minimum floor on reserves. The study will be conducted by an actuarial consultant (to be selected by August 31) and the field testing will provide management oversight of the project. The RTS Subgroup is comprised of LHATF members from KS (chair), AK, CA, FL, NY, OH and TX. The objective for the impact study is to perform modeling and analysis that examines the following:

- the effect of the proposed PBR valuation methodology compared to the current formula based methodology
- the effectiveness of the Exclusion Tests, both stochastic and deterministic and the effectiveness of the Net Premium Reserve as a floor
- the effectiveness of the AAA generator in exposing asset and liability risks embedded in a life insurer's balance sheet and the most effective processes for understanding how companies select the number of economic scenarios to model
- the most effective processes for understanding the determination of experience assumptions, margins for adverse deviation and company variation
- the most effective processes for understanding the level of granularity used in grouping model cells so that all major risks characteristics are reflected, for understanding the use of sensitivity testing, and the most effective reporting and documentation of reserve results, assumptions, and sensitivity testing
- the most effective regulatory benchmarks and/or metrics to be used in evaluating compliance with the PBR requirements
- the ease of implementation of the proposed methodology, considering human resources and IT resources, modeling run times and required sensitivity analysis as well as available scenario reduction techniques
- areas where further clarification of the proposed methodology or processes are needed to facilitate a smooth implementation and/or to improve risk measurement functionality

Products to be tested include term life (with and without return of premium, universal and variable universal life, and indexed life (all with and without secondary guarantees), and participating and non-participating whole life products. Testing will include modeling of the last 12 months of new business as well as projected new business for each future model year.

LHATF has identified a universe of 60 companies to participate in this study, including 42 with over

\$100 million of new life premiums, plus 18 other companies writing different types of term business, simplified issue business and reinsurance. The actuarial consultant will identify the companies to be included, and each company will have a task force responsible for compiling reports in accordance with the approved valuation methodology and coordinating with the consultant. The project is to be completed by year-end 2010.

The ACLI encouraged immediate notification of the appointed actuaries of the 60 companies on the "short list" so that they can plan for this work and begin selecting assumptions, identifying assets for inclusion, and generally have a better chance of meeting the timeline considering other work generally taking place in valuation areas during the fourth quarter. There will also need to be a rapid response facility to address questions that arise. It was noted that it may be desirable to hold a practitioners' education session to introduce the project and address questions.

PBR Requirements for Deposit Fund Contracts

The Academy's Deposit Fund Subgroup of the Annuity Reserve Work Group presented a report summarizing the direction the group is taking relative to the statutory valuation of deposit fund contracts in a principles-based environment. The recommendations were formed with a focus on GICs, synthetic GICs, guaranteed separate account group contracts and funding agreements, and recognize that no single methodology would be appropriate for particular classes of business due to the changing nature of products in this category and wide range of risks accepted by insurers. The guidance suggests that the actuary would start with existing regulations and tailor a valuation methodology based on the risks inherent in the product. Such methodology may be deterministic or may involve stochastic simulations, but such choice would be at the discretion of the actuary. LHATF moved that the group continue with this approach.

Variable Annuity Statutory Framework Review

Oliver Wyman presented the results of Phase 2 of their Variable Annuity Statutory Framework Review Initiative, for which the firm has been commissioned by 12 of the largest VA writers in North America to review "unintended consequences" of the VA statutory reporting framework under AG 43 and C-3 Phase II RBC. Phase 2 of the project is further investigation of issues identified in Phase 1 and recommendation of potential solutions. Areas identified for refinement relate to hedging and the often counter-

intuitive result of increased total asset requirements in response to hedging, and the domination of the standard scenario floor for AG 43.

Proposed refinements are intended to be practical, focus on risk management, and be easy to implement. Potential refinements to stochastic calculations to address the hedging issues include use of a cash flow valuation methodology for the AG 43 and C-3 Phase 2 CTE amounts rather than a rollforward of balance sheet results, allowing starting asset amounts to include all assets supporting the VA block, not just assets equal to statutory reserves, and modification of the starting parameters of the "real world" scenarios to force more dynamic calibration. Potential refinements to the standard scenario include use of a two step approach reflecting the "time-to-worst" result that is then used to calculate the seriatim present value of accumulated net revenue, and imposing a cap on the AG 43 standard scenario result. The 12 sponsor companies will test the impact of these proposals on their own books of business and a final proposal will be presented to LHATF at the Fall National Meeting.

Actuarial Guideline XXXVIII – The Application of the Valuation of Life Insurance Policies Model Regulation (AG 38): Sunset of Section 8C

There was a lively discussion regarding the extension or elimination of the sunset provision in Section 8C of AG 38. The original provision provided for the application of lapse rates in the valuation of UL policies issued between 1/1/2007 and 12/31/2010. The year-end 2010 sunset was included to address concerns that the provision might weaken the interest in valuation reform. As the sunset date approaches the ACLI submitted a proposal to eliminate the sunset provision altogether, and then modified the proposal to suggest an extension to 12/31/2016. A motion to extend the sunset provision to 2016 failed, however, a motion to extend the sunset provision to January 1, 2014 was adopted.

Payout Annuity and Simplified Issue Mortality

The SOA and AAA Joint Project Oversight Group presented a report on the development of a new Payout Annuity Mortality table. The group analyzed experience data from 2000-2004 and created a preliminary table with good fit to experience results for ages 50-94. The table results at other ages (ages < 50 and > 94) reflect anomalies where the experience mortality exceeds current annuity table mortality as well as current life population mortality. Alternative methodologies

for fitting the mortality at these ages are being considered, as well as differentiating gender table mortality by pension amount. The joint group plans to propose a table with projection scale at the Fall National Meeting, but may postpone adoption until data from a more recent (2005-2008) data call can be reviewed in early 2011.

The joint group also presented results of an industry study for guaranteed issue and simplified issue products to determine the approach for conducting an industry mortality study. Based on the study results, the group proposed separate mortality studies for GI, SI, and Pre-need mortality, noting that the data call may pose challenges due to uncertainty about companies' willingness to contribute. LHATF approved a motion to conduct separate studies; one for pre-need business and one for all other business.

Nonforfeiture Improvement

The AAA Non-Forfeiture Improvement Work Group presented a report on the status of its work to study the feasibility of a new nonforfeiture law for life insurance and annuities. The framework guiding the nonforfeiture reform proposal leverages PBR principles for providing general guidance with respect to the establishment of assumptions and promotes enhanced disclosure and approach to data collection. Another update is expected at the Fall National Meeting.

Generally Recognized Expense Table Factors

The SOA Committee on Life Insurance Company Expenses previously submitted analysis supporting the recommended 2011 GRET factors. One weakness noted in the analysis is that for companies with multiple distribution systems, their expenses are included in the category representing the greatest portion of their overall business. LHATF voted to adopt the 2011 GRET factors, and will schedule a conference call to discuss the allocation of expenses by distribution channel so that future results will be better aligned by distribution channel.

Accident and Health Working Group

Regulation for PPACA Rebate Requirement

The PPACA Subgroup of the working group submitted its report on the definition of medical loss ratio under health care reform. The report, which was well received, identified 75 issues that needed resolution, 49 of which have been resolved, 13 of the remaining 26 are expected to be resolved soon. The remaining issues are in

preliminary status. Upon resolution of the remaining issues the working group will make recommendations to the Executive Committee.

Medicare Supplement Refund Formula

There was an update from the Senior Issues Task Force charged with review of the Medicare Supplement Refund Formula. While this is an important initiative to move forward, resource constraints were cited as a factor causing delays in progress. Analysis of recent data downloads is not anticipated until the spring of 2011.

Replacement for 1985 Cancer Table

There was a lively discussion related to the development of a new cancer claims cost table. The Academy subgroup charged with reviewing how the 1985 Cancer Table could be used in the current environment reported that the current table cannot be reasonably adjusted to reflect the current environment. The current table was based on data from the 1970's and current products and treatment protocols have changed so dramatically that factor adjustments to the current table do not produce reasonable results. The group is considering a proposal that the current table be decommissioned, or that the appropriateness of the table be clarified. It was noted that the current table produces redundant reserves in most instances, but could produce insufficient reserves in other instances. Without a prescribed table, current statutory guidance requires the use of tables established for reserve purposes by a qualified actuary and acceptable to the Commissioner. In order to develop a new table, the state regulators may need to make the data call request of their companies to emphasize the importance of this matter.

Long-Term Care Insurance

An update was received from the SOA and AAA subgroup working on developing a PBR model for LTC reserves and a LTC valuation table. The group has developed an Excel model featuring stochastic generation of relevant assumptions (e.g. lapses, mortality, and claims costs). The model attempts to stimulate how a block of LTC business would perform over time, to provide some perspective on the range of outcomes that would emerge under a PBR approach to LTC valuation. Resource constraints will prevent presentation of the model before the third quarter of 2011, when the group expects to summarize the model.

The development of a LTC valuation table is proceeding. Data for 24 companies will be obtained and the first step will be to understand

the data and eliminate anomalies. The second step will be to perform calculations on the raw data. The data includes zip code information so geographic distinctions may be possible. The group is targeting 3Q 2011 for release of a proposed table.

Life Insurance and Annuities Committee

At the Summer National Meeting, the working group met in Seattle to discuss the following items:

STOLI Public Hearing

The committee held an interim meeting and public hearing on May 20 on "Is the STOLI Market Moving to Annuities, and How Should we Protect Consumers?" due to reports that the stranger-originated life insurance (STOLI) market has been targeting the sale of annuities to terminally ill individuals. The purpose of the hearing was to receive testimony related to the following questions: 1) whether these transactions are lawful; 2) how these transactions affect insurable interest; 3) whether current laws and regulations provide adequate consumer protections with regard to these transactions; and 4) if not, whether current laws and regulations need to be revised or new laws and regulations developed. The committee heard testimony from representatives from insurance departments, consumer groups, trade associations, the insurance industry and the life settlement industry.

The consensus from the panel is that these transactions are not lawful. The regulators believe that these transactions are fraudulent in nature and violate existing state and federal laws. However, there was not a consensus that the current laws and regulations should be revised or new laws and regulations needed to be developed. Most felt that insurance companies have the necessary controls and procedures in place that should detect these types of transactions.

Based upon the results of the public hearing, the committee adopted at the Summer National Meeting a recommendation to develop a model alert based on a 2009 bulletin from the Ohio Insurance Department entitled *Companies Encouraged to Have Safeguards in Place to Limit Potential Exposure to Stranger Originated Annuity Transactions*.

Annuity Disclosure Working Group

At the Summer National Meeting, the working group met in Seattle to discuss the following items:

Annuity Illustration Revisions

The working group issued an updated draft of the Annuity Disclosure Model Regulation on July 19 based upon comments received from the trade associations, consumer representatives and the AAA. The comments identified issues that will require further meetings to resolve as well as further revisions to the model regulation, which include the following:

- The ACLI discussed the Financial Industry Regulatory Authority (FINRA) safe harbor language. Currently, the ACLI commented, there is no safe harbor for variable annuities or other registered products until summary prospectus rules are developed by the SEC. Based upon the current proposed language, insurers will have to comply with duplicative regulation for registered annuities and consumers will have to read through these redundant disclosures, if the working group does not grant the safe harbor for compliance with existing FINRA annuity disclosure and SEC prospectus rules. The ACLI stated that the safe harbor should apply holistically to annuity disclosure that would include sales illustrations. The working group agreed this was a major issue that will be discussed on a future call. They requested additional information and language from the ACLI and AAA on this matter.
- The "Standards for Annuity Illustrations" section of the model regulation requires inclusion of a specific statement as to how the Market Value Adjustment (MVA) affects withdrawals. The AAA commented that this exact wording should not be required. They suggested requiring a statement that in substance explains the impact of the MVA with the statement shown included as an example. Per the AAA, the benefit would be that companies could each draft a statement to describe the specific design of the MVA feature in its contracts. The working group did not agree with this as they want to verify that the MVA is a specific description. They have added this to the list of issues to resolve.
- The last issue relates to whether the annuity illustrations should be mandatory or optional.

The ACLI has submitted comments that they should be optional. The AAA believes that a requirement to use an illustration for all sales of a product would help confirm consistency of information available to prospective buyers. The working group has requested that a small group work on the language that would include the ACLI and AAA comments.

The working group plans to expose a revised draft of this model regulation for further comments. They plan to hold a series of calls to address these outstanding issues starting in early September with the plan to provide an updated and final draft to the Life Insurance and Annuities Committee prior to the Fall National Meeting.

Annuity Buyer's Guides

The working group discussed that they are in the process of revising the Annuity Buyer's Guides. These will be updated over the next couple of weeks and will be exposed for comments. These revisions will also be discussed in the several conference calls held starting in early September.

Financial Regulation Standards and Accreditation Committee

The committee met in Seattle and took the following actions:

Health RBC

The committee voted to release the Risk-Based Capital for Health Organizations Model Act (#315) as a possible accreditation standard for a preliminary comment period of 30 days. Making Health RBC an accreditation standard has been discussed at previous National Meetings by many NAIC working groups.

Standard Valuation Law

The committee voted to release the 2009 revisions to the Standard Valuation Law for a one year comment period beginning January 1, 2011. The major revisions to the SVL include authorizing the use of a Valuation Manual and also authorizing a principles-based reserve basis for those policies and contracts specified in the Valuation Manual.

Risk Retention Groups

The committee adopted proposed recommendations from the Risk Retention Group Task Force regarding suggested clarifications on the Reinsurance Ceded Part A standards for risk retention groups effective January 1, 2011. These recommendations had been released for a 30-day

period, and three comment letters received supported the recommendations.

Revisions to the Examiners Handbook

The committee adopted immediately significant revisions made during 2009 to the Financial Condition Examiners Handbook, which consist of eighteen examination repositories for examiner use and the new information technology review process as a result of the newly effective risk-focused surveillance approach to financial examinations.

Reinsurance Task Force

The task force met in Seattle and discussed the following:

Update on Federal Reinsurance Activities

The task force heard an update from NAIC staff on the newly adopted Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 which includes the Nonadmitted and Reinsurance Reform Act (NRRA), effective July 29, 2011, and which requires single-state regulation of reinsurers. NAIC staff has prepared a key issues document of the adoption of the NRRA which includes discussion of the effects of preempting the extraterritorial application of state credit for reinsurance laws, the effects of the domiciliary state being solely responsible for regulating the financial solvency of the reinsurer and the Act's definition of a reinsurer.

The task force also heard an update on a proposal to eliminate the federal tax deduction for excess reinsurance premiums ceded to offshore affiliates with respect to U.S. risks, also referred to as the "Neal bill."

Accreditation Reinsurance Issues

The task force exposed for comment a draft paper entitled Reinsurance Collateral Reduction and Accreditation Recommendations. The paper notes that the NRRA prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes such credit or has financial solvency requirements substantially similar to NAIC accreditation requirements. The paper also notes that some states are interested in considering individual state reinsurance collateral reductions similar to the Federal Reinsurance Regulatory Modernization Framework Proposal (which was not adopted by Congress).

As a result, the task force exposed for comment a recommendation for a two-step process to consider state-based reinsurance modernization efforts as follows:

1. Consider amendments to the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation to incorporate key elements of the Framework Proposal.
2. Provide guidance on the key elements to the Financial Regulation Standards and Accreditation Committee when reviewing individual states' collateral reduction reforms. The key elements would not be required for all states.

The document was exposed for comment until September 16.

Climate Change and Global Warming Task Force

At the Spring National Meeting in Denver, Plenary voted to overturn the task force's previous decision to "stay the course" with regard to the Climate Risk Disclosure Survey. As a result, the previously mandatory survey required in 2010 was made voluntary (i.e. at the discretion of each state) and that responses would not be made publically available. Following the Denver meeting the NAIC distributed a questionnaire to all states requesting feedback on states' intentions to participate in the Climate Risk Disclosure Survey.

In Seattle, the results of the questionnaire were discussed. Of the 38 jurisdictions that responded, only 18 indicated that they would be participating in the survey. Of those participating jurisdictions, seven indicated that they would be mandatory (California, Connecticut, Maryland, New York, Pennsylvania, Puerto Rico and Washington). In addition California, New York, Pennsylvania and Washington intend to make all responses public, as do three other states where the insurers responses are not mandatory (Florida, New Jersey and Oregon). Twenty jurisdictions decided not to participate in the survey, although Wisconsin plans to develop a more extensive survey which will be confidential. The remaining jurisdictions had not yet responded to the NAIC questionnaire. Those task force members whose states are participating in the survey discussed their high-level observations with regard to the quality of responses received. While some responses were found to be quite robust, others were very limited

and not that meaningful. The task force agreed to wait for all survey results to be fully reviewed by participating states before considering any further action.

Casualty Actuarial and Statistical Task Force

The task force held four interim conference calls and met in Seattle at the National Summer Meeting to discuss the following issues:

Opinion Instructions, Paragraph 7

The task force discussed their conclusion that Appointed Actuaries should improve their Actuarial Reports. If these reports have clearer documentation, the review of the reserves information in the financial examination will be easier. There continues to be concerns among the regulators that the documentation is difficult to understand. The task force will work on potential changes to the instructions for the Actuarial Report. A key item that will be addressed in the proposed changes is including an exhibit that would reconcile to the Annual Statement and compare the Actuary's conclusions to the carried amounts. The plan is to address the concerns and implement changes to the Opinion Instructions, paragraph 7 for 2011.

Workers' Compensation Large Deductible Subgroup

The subgroup was formed to address a charge to "develop an assessment basis that would be equitable and not unduly burdensome for insurers to calculate." The subgroup was unable to reach a consensus position and instead documented the issues that were discussed and provided recommendations that could be utilized as guidance by each state in developing its own solution to the issue. The subgroup provided this report in April and no comments were received and therefore, the report was adopted. A motion was made to disband this subgroup, but comments were recently received from interested parties on the recommendations; therefore the motion was withdrawn. The subgroup will work to address these comments.

Examination Oversight Task Force

The task force met in Seattle to discuss the following items:

Hazardous Financial Condition Model Survey

In September 2008, the NAIC membership adopted revisions to the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition. This included additional standards to identify if an insurer still in business might be hazardous to its policyholders, creditors or the general public and provide the commissioner authority to require any companies deemed to be in hazardous financial condition to take corrective action. Based upon these revisions, the NAIC decided to survey quarterly states' progress in adopting the revisions. The survey results highlighted that only 12 states thus far have completed the process to adopt the 2008 revisions to the Model.

Examination Coordination Framework and Revised Exhibit Z

The Financial Examiners Coordination Working Group adopted a new Examination Coordination Framework for inclusion in the NAIC Financial Condition Examiners Handbook. The framework includes requirements related to the following: coordination of holding company group exams; review and reliance on another state's workpapers and examinations of underwriting pools, syndicates and associations.

Risk Retention Group Task Force

The task force received an update from the Capital Adequacy for RRGs Technical Subgroup on its charge to consider the development of a capital adequacy standard regulatory tool that would be applicable to risk retention groups organized as captives. The subgroup has concluded that while most captive RRGs report on a U.S. 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 standard for captive RRGs should include the requirement for domestic regulators to enforce RBC, with only limited exceptions.

This limited exception would allow the domestic regulator of a captive RRG to elect not to take

regulatory action in defined instances, for example, when 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 annual audited financial statements of the members and/or sponsors in order to establish the financial ability of those entities to support of the RRG.

The task force had been expected to vote on the subgroup's recommendation in Seattle; however, an additional exception was proposed by Vermont which was not fully vetted by the subgroup. As a result the vote has been deferred to the Fall National Meeting, following further consideration by the subgroup. The Vermont proposal would allow the domestic regulator the option of not taking regulatory action against an RRG should an RBC action level occur as a result of the regulatory pre-approval of material reinsurance arrangements, discounting of loss reserving, and any other element of a captive RRG's plan of operation having a material impact on the calculation of RBC, whereby without specific approval, would otherwise result in no action level RBC.

In addition, the subgroup proposed recommendations for additions to the RBC instructions regarding captive RRGs and an additional guideline to be included in the Part B-2: Financial Analysis accreditation standards applicable to captive RRGs. This additional guideline would require a domestic regulator to provide documented notification to other states when an election is made not to take regulatory action when an RBC action level is triggered by an RRG. The subgroup will continue its deliberations on these items and will also consider potential RBC reporting issues for U.S. GAAP items in the annual statement.

Title Insurance Task Force

The Statistical Plan Working Group presented its completed Title Insurance Agent Statistical Plan and Instructions which is the result of nine meetings over the past seven months. The task force unanimously adopted the Plan, noting that it was comprehensive, but not overly burdensome to small agencies. Title insurance agencies will be required to submit the report data on an annual basis beginning with 2012 results. The first report will be due June 1, 2013. The working group will begin

developing a best practices document to assist with implementation.

The Title Annual Statement Instructions Subgroup recommended changes to the Title quarterly and annual statement instructions. The changes were made to conform, where appropriate, to the P&C annual statement blank and to clarify certain other items. The task force accepted the recommendations and exposed the document for comments through September 20.

The next National Meeting of the NAIC will be held in Orlando October 18-21. We welcome your comments regarding issues raised in this newsletter. Please give your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor: Jean Connolly, Managing Director, PricewaterhouseCoopers LLP, 200 Public Square, 18th Floor, Cleveland, Ohio, 44114-2301 — (440) 893-0010 or jean.connolly@us.pwc.com.

Disclaimer

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

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