
NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2012 Fall National Meeting

The National Association of Insurance Commissioner held its Fall National Meeting in National Harbor, MD November 27-December 2. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. This Newsletter also covers conference calls held throughout December. 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

- After nearly eight years of often intense effort, the Commissioners adopted the Valuation Manual for Principles-Based Reserving, which will allow the Standard Valuation Law amendments and related state legislation necessary for PBR along with the Valuation Manual to be presented as a package in 2013. (page 2)
- The Statutory Accounting Principles Working Group continued discussion of significant projects including accounting for the Affordable Care Act fee to be paid in 2014, a proposed new disclosure for seed money in separate accounts and potential new disclosures for restricted/pledged assets. (page 3)
- The Emerging Accounting Issues Working Group exposed for comment on January 3 a proposed one-time extension of the 90 day rule for amounts due from agents and policyholders directly impacted by Hurricane/Superstorm Sandy. (page 6)
- The Capital Adequacy Task Force agreed to maintain the present level of public disclosure of RBC results in the annual statement, but deferred action on a proposal to increase the RBC charge on restricted/pledged assets. The C-1 Factor Review Subgroup continues to consider a recalibration of RBC C-1 factors and expects to complete its work during 2013 with the potential implementation of revised C-1 factors in the 2014 RBC calculation. The SMI RBC Subgroup continued its discussions of operational risk. (page 6)
- The Life RBC Working group discussed the ACLI commercial mortgage proposal throughout the fall, and in National Harbor voted unanimously in favor of continuing to work toward adopting a proposal that would be effective for 2013. The Catastrophe Risk Subgroup discussed comments pertaining to the RBC formula spreadsheets to incorporate property/casualty catastrophe risk for 2013, and adopted a requirement for companies to submit catastrophe loss data on an informational-only basis for 2012. The Health RBC continues to monitor the impact of ACA. (page 8)
- The IAIS 2012 Annual Conference was held in Washington DC in October; its discussions focused on ComFrame, a critical project to update supervisory practices. The IAIS released for comment its proposed policy measures that would be applied to Global Systemically Important Insurers. (page 12)
- Following adoption of the Valuation Manual by the Plenary and Executive Committee, the PBR Working Group was elevated to an executive-led joint working group of the Life Insurance and Annuities and Financial Condition Committees, which will work on PBR implementation guidelines. The working group discussed its draft implementation plan for PBR and exposed the plan for public comment until January 10, 2013. (page 13)
- This fall the NAIC adopted the Group Solvency Issues Working Group's Risk Management and Own Risk and Solvency Assessment Model Act (#505) which is expected to be effective January 1, 2015 when adopted by the states. The working group plans to develop a new section for the Financial Analysis Handbook that will document the U.S. state regulatory approach to group supervision, and the role of the lead state regulator. (page 15)
- The ORSA Subgroup recommended changes to the ORSA Guidance Manual to reflect the results of the ORSA pilot project and adoption of the Risk Management and ORSA Model Act, and exposed the amended draft for a 60-day comment period. The subgroup recommended referrals to the Financial Analysis Handbook Working Group and the Financial Condition Examiners Handbook Technical Group for drafting of guidance for the review of insurers' ERM processes and the ORSA. (page 16)
- The Corporate Governance Working Group exposed for comment updated drafts of its controversial proposed Exhibits A, B, and E from its document "Proposed Response to a Comparative Analysis of Existing U.S. Corporate Governance Requirements" until January 18 2013. (page 16)
- The International Accounting Standards Working Group heard updates on the insurance contracts and financial instruments projects of the FASB and IASB. (page 18)
- The International Insurance Relations Committee heard updates on the IAIS's

Financial Stability Committee, EU-U.S. Dialogue Project, Joint Forum, and ComFrame. (page 18)

- The Valuation of Securities Task Force adopted the controversial assumptions for 2012 financial modeling of RMBS and CMBS investments in October; the new assumptions mark a shift toward a more conservative bias. The task force also adopted the proposed statutory accounting framework for Working Capital Finance Investments. (page 21)
- The Reinsurance Task Force exposed for comment the draft "NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions," a document that includes an evaluation methodology covering the industry, regulatory framework and measures applicable to U.S. reinsurers operating overseas, until January 16, 2013. The task force heard an update on the adoption of the revised credit for reinsurance models by the states. The task force was informed that New York and Florida have each approved more than a dozen entities as Certified Reinsurers. (page 23)
- The Captives and Special Purpose Vehicles Subgroup continued work on its controversial white paper on the use and regulation of captives and SPVs, which may recommend significant changes to the current regime. The subgroup received and discussed comments on the draft white paper in National Harbor, and a new draft of the white paper is expected shortly. (page 24)

- The Blanks Working Group exposed 10 new blanks proposals for public comment at the Fall National Meeting. (page 25)
- The Life Actuarial Task Force continued its discussion of proposed revisions to VM-20, PBR for Life Products. The task force also discussed options to address the perceived reserve redundancies created by AG 33, but no conclusions were reached. (page 26)
- The Emerging Actuarial Issues Working Group, formed this fall, reviewed and approved interpretations from questions received on the recently adopted revisions to AG 38 for universal life products with secondary guarantees. (page 28)
- The Health Insurance and Managed Care Committee heard an update from the Center for Consumer Information and Insurance Oversight on the Affordable Care Act implementation activities. (page 28)
- The Contingent Deferred Annuity Working Group heard comments on its draft proposed recommendations regarding the regulation of contingent deferred annuities. (page 29)
- The Financial Regulation Standards and Accreditation Committee voted to include the Credit for Reinsurance Model Law and Model Regulation as accreditation requirements effective immediately for states which are considering collateral reductions. (page 29)

Executive Committee and Plenary

Note: All documents referenced in this Newsletter can be found on the NAIC's website at naic.org.

Election of Officers

The NAIC held its annual election of officers and the officers for 2013 are as follows: Commissioner James Donelon of Louisiana was elected President, North Dakota Commissioner Adam Hamm was chosen as President-Elect, Commissioner Monica Lindeen of Montana was elected as Vice-President and Pennsylvania Insurance Commissioner Michael F. Consedine was chosen as Secretary-Treasurer.

Adoption of New or Revised Models

The Executive Committee and Plenary held a joint conference call in September at which both

committees adopted the Risk Management and Own Risk and Solvency Assessment Model Act (#505), and the amendments to Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation (AG 38).

The Executive Committee and Plenary also adopted the following items:

- The Valuation Manual for Principles-Based Reserving (PBR). The Valuation Manual was subject to extensive discussion, and passed narrowly. Details of the discussions and the current status of PBR are summarized below as part of the PBR Working Group summary.

- The NAIC Model Rule (Regulation) for Recognizing a New Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities (#821)
- Amendments to the Business Transacted with Producer Controlled Insurer Act (#325), to remove the exclusion for Risk Retention Groups
- Best Practices for Rate and Premium Comparison Tool
- Best Practices and Guidelines for Consumer Information Disclosures

The Executive Committee and Plenary adopted the Risk-Based Capital for Health Organizations Model Act (#315) and the 2011 Revisions to the Model Risk Retention Act (#705) into the Accreditation Standards, and agreed to expose the 2011 Revisions to the Risk-Based Capital for Insurers Model Act (#312) for an additional one-year comment period for accreditation purposes.

Executive Committee

Since the Summer National Meeting, the Executive Committee has held five interim conference calls. On September 19, the Executive Committee approved a new charge for the Mortgage Insurance Working Group to determine and make a recommendation to the Financial Condition Committee on changes necessary to the solvency regulation of mortgage insurers, including changes to the Mortgage Guaranty Insurers Model Act (#630). On October 19, the Executive Committee adopted a charge for the Financial Condition Committee to form the Emerging Actuarial Issues Working Group to develop guidance with respect to requirements under AG 38; see details of the working group discussion on page 28.

At the Fall National Meeting, the Executive Committee adopted model law development for amendments to Long-Term Care Insurance Model Act (#640), Long-Term Care Insurance Model Regulation (#641), and Property and Casualty Actuarial Opinion Model Law (#745).

Appointment of NAIC Interim CEO

On November 14, the Executive Committee approved the appointment of Andrew J. Beal as interim CEO, following an announcement regarding the accelerated departure of former CEO Dr. Theresa Vaughan on November 30.

Statutory Accounting Principles Working Group

The working group met in National Harbor and discussed the following issues. (After each topic is a reference to the SAP Working Group's agenda item number.) The working group also held a conference call December 18th to discuss accounting for the PPACA fee (detailed below), during which the long-time chair Joe Fritsch announced that he would be retiring at the end of the year from the New York Insurance Department. The new chair of the SAP Working Group has not yet been announced.

Adoption of New Standards or Revisions to SSAPs

[Disclosure of Permitted Practices \(2012-04\)](#) – The working group adopted a proposal to amend SSAP 1 to require disclosure in each applicable financial statement note if the amounts reported in that note have been adjusted by state prescribed or permitted practices. This would be in addition to the certain disclosures related to practices that differ from NAIC prescribed.

[Clarification of Measurement Date \(2012-19\)](#) – The working group adopted a proposed change in the effective date of the measurement date change to December 31, 2014 in SSAP 92 and SSAP 102 and adopted a clarification that INT 03-18, Accounting for the Change in Additional Minimum Liability, is nullified by SSAP 102.

[Additional Pension and OPEB Guidance \(2012-18\)](#) – The working group adopted three additional implementation examples for underfunded pension plans with a prepaid benefit cost (no deferral elected, deferral elected with a funded ABO and deferral elected with an unfunded ABO) which include suggested revisions from interested parties. The working group also adopted revisions to the first three examples, which had been previously adopted.

[SSAP 61 and SSAP 62 Amendments to Incorporate the Concept of Certified Reinsurer \(2011-10 & 11\)](#) – In June the working group adopted revisions to the reinsurance SSAPs to provide specific accounting guidance for reinsurance ceded to certified reinsurers, a concept that was adopted by the NAIC as part of the Reinsurance Modernization Framework. At the Fall National Meeting, the working group adopted proposed guidance and disclosures to both SSAP 61 and 62 related to certified reinsurers which have been downgraded; this guidance is effective December 31, 2012. The

working group also adopted additional revisions to SSAP 62R to make certified reinsurance guidance consistent with the language adopted in SSAP 61 as modified at the Fall National Meeting. During its December 18 conference call, the working group also adopted consistency changes to SSAP 61 and SSAP 62, as well as placement of Emerging Actuarial Interpretations in the Accounting Practices and Procedures Manual.

[ASU 2010-20 Receivables-Disclosures About the Credit Quality of Financing Receivables and the Allowance of Credit Losses \(2011-22\)](#) – The working group adopted proposed revisions to SSAP 34 and SSAP 37 to incorporate GAAP “financing receivable” disclosures specific to mortgage loans effective for year-end 2013 financial statements. Note that these disclosures have been considered for the audited financial statements since 2011 because of the statutory OCBOA disclosure requirements.

[Issue Paper 132, Accounting for Pensions and Issue Paper 133, Accounting for Postretirement Benefits Other than Pensions](#) – At the Fall National Meeting, the working group exposed for comment updated issue papers reflecting the adopted guidance in SSAPs 92 and 102. These issue papers were adopted as final during the working group’s December 18th conference call.

[ASU 2011-22, Disclosures about Offsetting Assets and Liabilities \(2012-17\)](#) – The working group adopted the following effective January 1, 2013: 1) revisions to ensure offsetting only in accordance with SSAP 64; 2) modify the adoption of FIN 39 rejecting the ability to offset in accordance with master netting agreements and rejecting FSP FIN 39-1 and FIN 41; and 3) reject ASU 2011-11 for statutory accounting. The ASU was rejected as it permits optionality for offsetting repurchase and reverse repurchase agreements under master netting arrangements. The working group deferred the adoption of the disclosures required by ASU 2011-11 until the FASB completes its project to narrow the scope of the offsetting disclosures.

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

Comments on exposed items are due to NAIC staff by February 8.

[Policyholder Loyalty Program Obligations \(2012-15\) and Actuarial Calculation of DDR Reserve \(2012-16\)](#)

At the Summer National Meeting, the working group exposed for comment proposed amendments to SSAP 65, P&C Contracts, to address loyalty program benefits and additional guidance on reporting the death, disability and retirement (DDR) reserve. Based on the significant number of comment letters received from interested parties and the Casualty Actuarial and Statistical Task Force, the working group asked staff to collect additional information and report back to the working group.

[Seed Money Disclosures \(2012-23\)](#) – The working group exposed for comment a proposed new disclosure related to seed money and fees and expenses due to the general account, the intent of which is to identify the materiality of seed money in the separate account. The proposal also includes a sample disclosure/illustration.

[Hedge Accounting Requirement \(2012-24\)](#) – The working group exposed for comment a proposed clarification to SSAP 86 that hedging transactions which meet the hedging effectiveness criteria can follow fair value hedge accounting if elected by the reporting entity i.e. it is not mandatory to follow hedge accounting when a transaction qualifies for such accounting.

[Preferred Stock Class of ETFs \(2012-30\)](#) – This proposal is to add a preferred stock class of Exchange Traded Funds to the APP Manual, provided the SVO criteria are met. Under current statutory accounting, ETFs are classified either as common stock, or as bonds when specific criteria are met.

[Inconsistency Regarding Tax Planning Strategies \(2012-31\)](#) – NAIC staff has identified an inconsistency between SSAP 101, paragraph 14 and the Q&A paragraph 13.6 as to when consideration of tax planning strategies is required. The working group exposed proposed clarifications to the SSAP to clarify that tax planning strategies are not required in the admittance calculation but if used should be consistent with the tax planning strategies used in computing the statutory valuation allowance if such strategies were used in the SVA determination.

[Impact of Loss Portfolio Transfer on Provision of Reinsurance \(2011-45\)](#) – The working group will hold an interim conference call to discuss this proposal from a large P&C insurer, which addresses situations where collection risk for third party reinsurance has been transferred and secured by the counterparty in a LPT, but novation has not occurred. The call was expect to occur in December,

but has not yet been scheduled. A new LPT issue is also expected to be discussed on that call; a proposal from a large property/casualty company regarding LPTs between affiliates where there is no gain in surplus was briefly discussed in National Harbor. The company would like reconsideration of the accounting for the LPT, i.e. for the payment to the assuming company to be accounted for as a paid loss and not ceded premium.

Title Insurance Loss Reserves (2012-33) – The working group exposed for comment proposed revisions to SSAP 57, Title Insurance, to clarify the reporting of loss reserves including known claims reserves, statutory premium reserves, supplemental reserves and the bulk reserve.

SSAP 100 and Review of ASU 2011-04 (2012-14)
There was no discussion on the progress of the Issue Paper to address ASU 2011-04, but staff hopes to have an exposure draft by the 2013 Spring National Meeting.

SSAP 43R Subgroup – The subgroup met twice this fall via conference call to consider possible revisions to the definition of loan-backed and structured securities in SSAP 43R as requested by interested parties. Per their comment letter, interested parties believe SSAP 43R is being inconsistently applied, and would like the standard to be “more principles-based and objective.” The two conference calls were similar to many other discussions of this topic, with some regulators wanting to keep the definition more broad and interested parties arguing for a narrower interpretation. One recommendation suggested was that if ultimate repayment is from a single obligor/debtor, then the insurance company holder should consider the structural features to see if it the security is overly dependent on overall collateralization or subordination. If the answer to those questions is yes, then interested parties agree it belongs in SSAP 43R. The subgroup distributed an Examples of Securities under Discussion memo which documents New York’s view why various complex instruments are appropriately classified as SSAP 43R securities. No conclusions have been reached; the next call of the subgroup has been tentatively scheduled for sometime in January.

Restricted Asset Issues – The working group discussed a referral from the Financial Analysis Working Group requesting research of certain guarantees and other financial activities that have pledge-like restrictions. The working group asked NAIC staff to begin work on addressing the issues including consideration of enhanced disclosures. The working group briefly discussed Interrogatory 24 of the annual statement which summarizes assets

“not exclusively under the control of the reporting entity,” and questioned whether this interrogatory captures all such restricted assets. Note that the Capital Adequacy Task Force had significant discussion of a proposed higher RBC charge for restricted assets; see that discussion on page 7.

Derivatives Investment Reporting – The SAP Working Group formed a Derivatives Investment Reporting Subgroup to review gain recognition for changes in variation margin for futures contracts. The NAIC is aware that insurers are treating it inconsistently, with some companies reporting the change as realized gain/loss while others are reporting it as unrealized gain/loss.

Working Capital Finance Investments – The working group received a referral from the Valuation of Securities Task Force which recommends that working capital finance investments be included as a new invested asset class (after much discussion in 2011 and 2012 by the task force). Interested parties had hoped the guidance would be effective in early 2013 so that insurers can invest in these instruments. The working group will hold interim conference calls to expedite consideration. See page 22 for additional discussion of WCFI.

SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers (2011-38) - The working group held an interim call on December 18th to continue discussion of the accounting for the new health insurer fee mandated by the federal Patient Protection and Affordable Care Act. In June 2012, the SAP Working Group had concluded that they will not require accrual of the fee in 2013, but that companies should disclose the dollar effect of the assessment at year-end 2013, in accordance with SSAP 9, Subsequent Events.

The purpose of the conference call was to discuss all the various views and not to make any decisions. The call was unexpectedly contentious with very spirited debate. The chair of the Financial Condition Committee, Commissioner Torti, was especially vocal in his comments, stating that the GAAP guidance for the fee (i.e. record in 2014) is “ridiculous and outrageous,” which has interested parties understandably concerned.

The working group heard first comments from interested parties where they expressed their belief that the fee, which is payable each September, is a cost of doing business in that year and should be recognized as an expense over the course of that year. The fee will be levied each year only on those companies that are engaged in the business of providing health insurance during calendar years beginning on and after January 1, 2014. Further,

they believe that since the fee will be paid in September of each year, there should be no liability remaining at year-end. Illinois commented that they agree with interested parties.

A concern was raised that recording the expense in 2014 and then setting up the accrual for the 2015 expense as of year-end 2014 will cause doubling-up of expense in 2014. However, some regulators believe that because companies will be “given a break in 2013” (i.e. not recording a liability), then the double recording in 2014 is reasonable and should not change the accounting going forward. Other regulators stated they would be willing to address the “double hit” by a possible phase-in approach or other measures.

The working group next heard from interested parties that some insurers are starting to bill the fees in the 2013 approved rates. The working group noted that companies will begin collecting fees in 2013 that are linked to services for 2014 and not accruing a liability in 2013. A request was made during the call for the NAIC staff to conduct a quick survey to inquire what states are doing in terms of collection of fees for 2013 that relate to 2014 since it was noted that some states allow collection of up to 6 months in 2013 while other states allow 12 months of prepayment. Additionally, information will be sought from the states on what companies are doing with the 2013 rates (i.e. whether the rates incorporate the fee). The sense is that there is no consistency on rates among states. This is the first discussion in which it appears the issue may have expanded from a tax/assessment issue into a premium revenue recognition issue because of the way the fee is built into rates.

At the end of the meeting the alternatives to be considered for exposure were summarized as follows:

- No accrual of the liability at year-end 2014 for 2015 payments with disclosure required
- Accrue the full year-end liability at year-end 2014 for 2015 with a potential phase-in period
- Accrue the liability for the pre-paid collected fees only

No decision was made by the working group; the next conference call is expected to occur in early January.

Emerging Accounting Issues Working Group

At the Fall National Meeting, the working group voted to nullify fourteen INTs issued in 2002 and

fourteen INTs issued in 2003-2004, and include the guidance directly in the relevant SSAPs. The working group exposed a proposal to move thirteen INTs from the 2005-2009 interpretations into the SSAPs. Comments are due February 8. The working group also discussed a referral from the Derivative Investment Reporting Subgroup regarding the treatment of assets pledged under derivative contracts, particularly for centrally-cleared, non-exchange traded derivatives. As the referral was not yet finalized at the time the working group met, no action was necessary.

The working group voted January 3, 2013 via email to expose for comment a tentative consensus, INT 13-01, for a one-time extension of the 90 day rule for uncollected premium balances, bills receivable for premiums and amounts due from agents and policyholders directly impacted by Hurricane/Superstorm Sandy. The extension would apply to policies in effect as of October 29, 2012; insurers with policyholders in areas impacted would be granted 150 days, not to extend beyond March 28, 2013, before nonadmitting premiums receivable from those policyholders as required by SSAP 6. These receivables would still be subject to impairment analysis. The tentative consensus is exposed until January 11 and a conference call will be held the week of January 14 to finalize the guidance.

Capital Adequacy Task Force

Low-Income Housing Tax Credit

At National Harbor, the task force adopted the state and federal low-income housing tax credit investment proposal for 2013 RBC filings. The proposal applies a reduced factor to the property, health and fraternal formulas for LIHTC investments, similar to existing provisions for life insurers.

Confidentiality

The task force adopted a motion to maintain the present level of public disclosure of RBC results in the annual statement. The task force had previously exposed a proposal and received one comment in support of keeping the existing level of RBC public disclosure in the annual statement.

Revision to Timetable for Changes to RBC

The task force exposed amendments relating to the timing of proposed changes to the RBC formulas, which would allow proposed structural changes to the formulas that are received by the Spring National Meeting to be considered for adoption by the task force by June of the year of the effective date of the

change. Currently all structural changes must be adopted by the prior year end. During its December 13th conference call, the task force adopted a revised procedure that any proposal that affects RBC must be adopted no later than April 30 in the year of the change, which recognized the comment from interested parties that a June adoption is too late in the year to allow for any changes in strategy to adjust for changes in RBC.

Securities/Broker Receivables

The task force exposed a letter from the American Council of Life Insurers regarding the sale of securities/broker receivables for a 45-day public comment period ending January 15, 2013. The ACLI letter states that the current "trade date" practice of assigning a 6.8% RBC charge as a proxy for investment risk to broker receivables can lead to overly punitive or overly beneficial RBC treatment, depending on the risk level of unsettled assets. Adopting a "settlement date" approach for RBC calculations will result in a more accurate representation of investment risk and therefore, more accurate RBC.

Working Capital Finance Investments

The task force exposed a referral from the Valuation of Securities Task Force regarding working capital finance notes for a 45-day public comment period ending January 15, 2013. The referral recommends that the task force consider that WCFIs must be preapproved by the SVO before an insurer can engage in them and that the SVO has developed a corporate methodology which would assign NAIC 1 or 2 designations based on the credit risk associated with the corporate obligor, as it currently does for other bonds.

Restricted Assets

During its October 29 conference call, the task force discussed a referral from the Financial Analysis Working Group concerning a potential increase to the RBC factor for restricted assets. The current charge is 1.3% of the carrying value of restricted assets as disclosed in Interrogatory 24 in the annual statement. After significant discussion the task force voted to expose for comment a proposal that three RBC formulas be modified to incorporate a Co/Ro/Ho charge for insurers with a large proportion of restricted assets on their balance sheets. The specific charges were not being proposed, but rather the concept of an increasing charge based on the level of restricted assets held, e.g. no additional charge if less than 5% of assets are restricted, an additional 2% charge if 5-10% of assets are restricted or pledged, an additional 5% charge if

10-25% of assets are restricted and a 10% charge if greater than 25% of assets are pledged or restricted.

The comment period ended December 3 and during its December 13 conference call, the working group heard comments from four parties who all strongly objected the proposal, including the Iowa Department of Insurance. The task force agreed more time was necessary to study the issue and deferred a vote that would have made the structural change effective for 2013.

RBC Think Tank

At the Fall National Meeting, the formation of an "RBC Think Tank" was announced, which purpose is to take an overall view of the work being done by all the RBC groups, with a focus on the use of the AAA's resources and whether the groups are working on the appropriate issues. The Think Tank is comprised of the chairs of the working group and NAIC staff, including Lou Felice, former chair of the CADTF.

C-1 Factor Review Subgroup

The subgroup continues to consider a recalibration of C-1 factors used in the RBC calculation. The C-1 factors are intended to capture an asset's risk of default of principal and interest or fluctuation in fair value. These factors have not been updated since 1991. The subgroup met frequently throughout 2012, with much of the discussion focused on the bond modeling project being led by the AAA, which has developed a bond model which replicates the 1991 model, such that when using the 1991 scenarios and assumptions, the new model generates the same or very similar C-1 factors.

Since the Summer National Meeting, the AAA has devoted significant attention to determining the appropriate assumptions and developing representative bond portfolios of 400-600 securities to be used in the model. The AAA has tentatively determined that it will use Moody's cumulative bond default rate data based on experience over the last 10-years. The AAA had considered using data over a longer period; however, the volume of below investment grade issues has increased significantly in the last 10 years, providing for more data. Moody's default data is aggregated based on 13 ratings categories, as a result the AAA noted that it will likely recommend expanding the current 6 NAIC ratings designations to either 12 or 13.

At the Fall National Meeting, the AAA discussed its consideration of recovery assumptions. The AAA has

identified issues with how to assess subordination within debt structures and whether consideration should be made at the issue or issuer level, noting that certain data is only captured at the issuer level. The AAA plans to have calls with bond experts to resolve both issues. It had been expected that the subgroup would be in a position to endorse the AAA methodology and assumptions by February 1, 2013. The subgroup was then expected to consider the results of the bond modeling, and decide by March 31, whether to expand the number of NAIC ratings classes. However, in National Harbor, the Academy representative acknowledged that they were falling behind the "optimistic" project plan timeline. It is therefore likely that this project will extend further into 2013.

The subgroup also received updates from subgroup members on their consideration of the following asset classes: common stock, mortgages, real estate, derivatives and other invested assets. Once the subgroup has completed its work, it will make a proposal to the Capital Adequacy and Valuation of Securities Task Forces, with a goal of implementing the revised C-1 factors for the 2014 RBC calculation. The subgroup plans to continue to hold bi-weekly conference calls over the next several months to continue its discussions.

SMI RBC Subgroup

The subgroup met by conference calls in September, October, and December and in person in National Harbor. A significant part of the subgroup's discussions relate to operational risk and a comparison of the international regimes' treatment of operational risk. It was discussed that operational risk charge increases for insurers with substantial change, positive or negative, in their premium volume. The factors vary by regime and it appears that the life operational risk factor is higher than the non-life or the other way around, depending on the regime. Bermuda varies its operational risk factor charge by its equivalent of an RBC ratio. Most regimes use a premium based or reserve based calculation and for others, it is based on specific types of business.

In response to a request from the working group to identify risk correlation methodologies used to determine regulatory solvency capital requirements in advanced jurisdictions outside the U.S., the AAA issued its report in November entitled "Dependency Structures in Risk-Based Capital: Summary of Methodologies Used by a Variety of Jurisdictions to

Reflect Risk Correlation in Property/Casualty Standard Formulas." The report indicates that the U.S. RBC formula is simple to use; however, to an outsider, it is not easy to understand and requires a significant amount of data including some that is not available in the NAIC annual statement. The current RBC correlation structure constitutes judgments and if correlation factors could be calibrated with sufficient accuracy, the formula becomes more risk sensitive. Bermuda's overall correlation structure is similar to the U.S. The AAA report also reviews the methodologies used by Canada, Australia, Solvency II and the Swiss Solvency Test.

The working group discussed that life RBC includes a business risk charge which some may refer to as an operational charge or a catch-all charge based on premiums; the property/casualty RBC has a growth charge; and the health RBC also has a growth charge which relates the growth in RBC to the growth in premium. Thus, a question remains regarding the extent of operational risk charge that is embedded in existing charges. The working group discussed the need to develop useable definitions of operational risk before developing an operational risk charge. A regulator commented that the risk charge is not specific by company but rather by the product line being sold.

The working group also heard a presentation by the Operational Risk Consortium where it was discussed that operational risk, as defined by Basel II and imposed on banks, is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external risks. Operational risk does not include underwriting, strategic or reputational risks, but includes legal risks. Operational risk is perhaps the most significant risk faced by the financial services industry. The chair stated the working group is "highly motivated" to have an operational risk charge in the RBC formulas, and will continue to study different methodologies to capture operational risk.

Life Risk-Based Capital Working Group

The working group met via conference call in October and November and again in National Harbor with the primary goal of reaching consensus on the ACLI commercial mortgage proposal, which was officially exposed for public comment for the first time on the October 26 call.

The most controversial issue in the ACLI proposal continued to be the use of a standardized 25 year amortization period for debt service coverage, which the ACLI believes will "level the playing field" between different types of loan structures and is much less complex than using the actual amortization period for individual loans. Some regulators and the NAIC Capital Markets Bureau believe that not using actual amortization periods might encourage manipulation of the system. However, after significant discussions with the ACLI in November, the Capital Markets Bureau agreed to the use of standard amortization tables, but with the filing by life insurers of "additional data points" including the actual amortization and coupon rate for individual loans. The exact detail of the new disclosures and the format for filing, e.g. as a new schedule filed with the confidential RBC report, has not been exposed for comment. The ACLI and the Bureau also agreed to use a three year weighted period for both discounted cash flows and loan-to-value with the current year being weighted 50%, the prior year 30% and the second prior year 20%.

During its meeting in National Harbor, the chair noted that the current factors in the ACLI proposal would result in a 30% decrease in RBC held for commercial mortgages compared to the current MEAF methodology. Several working group members suggested revising the proposal factors to reduce the level of the decrease. No final decision was made with respect to this issue at the Fall National Meeting. The ACLI's proposed five new risk categories for commercial loans in good standing, are .9%, 1.75%, 3%, 5% and 7.5% for CM1 through CM5, respectively.

The working group and interested parties had been working at a very accelerated pace all summer and fall with the intent of having a completed package by the end of 2012 in order for the new commercial mortgage RBC proposal to be in effect for 2013. With the resolution of the standard amortization period issue discussed above, and the working group reserving the right to increase the factors before the factors are finalized, the working group voted unanimously in National Harbor to adopt the structure of the ACLI commercial mortgage proposal for 2013 Life RBC. The working group had anticipated holding at least one additional conference call in December to resolve open issues, but with the change in the procedures for adopting revisions to RBC as late as April 30 of the current year (as discussed above in the CADTF summary), that work was not considered necessary by year-end

2012. The next conference call of the working group has not yet been scheduled.

Property/Casualty Risk-Based Capital Working Group

On November 1, the working group held a conference call to continue its discussion on a referral from the Risk Retention Group Task Force relating to additional guidance for RRGs in the Property and Casualty RBC Instructions. The need for additional guidance is arising from implications for RRGs in completing RBC reports due to the fact that many RRGs utilize an accounting basis other than statutory accounting principles (SAP) and the NAIC RBC formula was developed based on the application of SAP. The chair discussed an issue she had just been made aware relating to discounting of loss reserves; if an RRG discounts its loss reserves and those discounted reserves are used in the RBC formula, then the application of the investment income offset factor would cause double-counting of the discount. The working group was informed that it is not uncommon for not-for-profit RRGs to discount loss reserves.

Following discussion by the working group, it was determined that Vermont would undertake an assessment of the appropriateness of the draft proposal for not-for-profit entities, ensuring that the proposal does not adversely affect the NFPs' RBC and tax status. Discussion of this matter will continue in the next conference call planned for January 2013.

The working group discussed an industry comment regarding an inconsistency between the instructions and the formula in calculating the insurance affiliates that are subject to RBC. The working group discussed whether it would be appropriate to change the instructions to match the formula and it was determined that a review of the issue is needed, and as such, regulators and interested parties were urged to provide comments to NAIC staff prior to the next conference call.

The working group then discussed the long-standing issue of the 10% Credit Risk Charge for Reinsurance Recoverables, which many in the industry think is too high, considering the charge used by the rating agencies in their formulas is 1-2% per the RAA and applies even when the recoverable is fully collateralized. The RAA representative also noted that this issue has resurfaced because the current catastrophe risk charge proposal is also using 10%

for reinsurance receivables and that this application of the 10% would exacerbate the problem.

The regulators noted that the flat 10% charge includes some risks that are difficult to quantify. The American Academy of Actuaries agreed that some of the components in the credit risk are unquantifiable. The working group asked the AAA to prepare a short white paper to list all the issues and questions surrounding this topic and recommended charges for the risks that are quantifiable. For those risks that are hard to quantify, a recommended judgment factor could be applied. AAA noted that in theory, the credit risk charge for catastrophe might be higher than regular credit risk charges because the risk for reinsurers to go bankrupt is higher if a significant catastrophe happens. Research indicates that companies that use more reinsurance than others have a greater risk of insolvency. The working group will continue its discussion of the issue in the next conference call.

Lastly, the working group was informed that the issue of the underwriting risk factors is still being reviewed by the AAA and the Casualty Actuarial Society and updates will be provided in the near future.

Catastrophe Risk Subgroup

On September 17, the subgroup held a conference call to discuss the timeline for implementing the RBC catastrophe formula on an informational-purpose only basis for the 2013 RBC reporting. The task force will need to approve the revised R5 underwriting risk factors on an "ex-catastrophe" basis by June 30, 2013. The factors cannot be developed until data on actual catastrophe losses for 2012 has been collected and analyzed. The task force had previously approved the collection of insurers' actual U.S. hurricane, tropical storm and earthquake catastrophe loss data in the 2012 RBC reporting. In addition, the subgroup had previously agreed to collect non-U.S. catastrophe losses in the same level of detail as U.S. catastrophe losses, separately through an informal process by the NAIC staff. It is anticipated that the revised "ex-cat" R5 underwriting risk factors will be calculated based on the collected data in March 2013 and exposed for comments in April 2013. The subgroup heard that calculation of the indicated "ex-cat" factors will not be a difficult task to accomplish; however, because there are significant differences between the existing indicated and selected factors, developing a method for

choosing the selected "ex-cat" factors will need to be worked through in the near future.

During a regulator call on October 11, the subgroup voted to expose changes to the RBC formula spreadsheets to incorporate property catastrophe risk on an information-only basis for the 2013 annual statements. Minor changes to the proposal were made resulting from comment letters received and the revised proposal was re-exposed. At National Harbor, the subgroup discussed comments received and adopted the catastrophe risk formula proposal.

Also at National Harbor, the subgroup discussed a comment relating to pooling and reinsurance arrangements. It was noted that PR025 requires model catastrophe losses to be reported gross of reinsurance and net of reinsurance on a legal entity basis. PR025 also requires "catastrophe losses that would be ceded to reinsurers that are not subject to the RBC credit risk charge." It was pointed out that many insurance groups conduct business through intercompany pooling agreements and/or through 100% intercompany quota share reinsurance agreements. These insurance groups do not model catastrophe losses on a legal entity basis and thus, would have to allocate modeled catastrophe losses from a pool basis. The subgroup determined the comment worthy of consideration and held a conference call on December 6. During the call, the subgroup discussed the inclusion of interrogatories on PR025, thus exempting companies with pooling/reinsurance agreements from calculating the catastrophe risk charge. On December 10, the subgroup adopted the revised PR025 and on December 13, the task force adopted the revised PR025 of the Catastrophe Risk Formula Proposal for 2013 RBC Reporting.

As a follow-up to the changes to the 2012 Property RBC report as approved by the task force during the Summer National Meeting, the subgroup issued an FAQ document on November 14 which was discussed at the Fall National Meeting. For year-end 2012 Property RBC reporting, companies are required to provide U.S. catastrophe losses by annual statement Schedule P line of business in the confidential Schedule P RBC filings. Catastrophe losses are cumulative incurred to date net losses only (no expenses) as of December 31, 2012 for accident years 2003 through 2012 as well as total net catastrophe losses unpaid as of December 31, 2012. A "catastrophe" is defined for this purpose as arising from events numbered and labeled by Property Claim Services (PCS) as a hurricane, tropical storm,

or earthquake. The data will be collected via two additional columns in the existing Schedule P Part 1 confidential filings. The requirements for the data to be reported in the existing columns have not changed; that is, net earned premiums, net losses and expenses unpaid, and net losses and expenses incurred by line of business would continue to be reported as per existing requirements.

In addition to the required 2012 filing of U.S. catastrophe losses, companies are requested to provide the same information for non-U.S. catastrophe losses, to the extent possible, via separate 2012 reporting forms, as adopted by the subgroup on December 11. Non-U.S. catastrophe losses are defined as arising from a hurricane, tropical storm, or earthquake that meets a \$25M industry threshold as published by Swiss Re Sigma or Munich Re Nat Cat Service. The 2012 reporting of non-U.S. catastrophe losses is strictly voluntary. This data is intended to be used by regulators to develop ex-cat premium underwriting charges for use within the catastrophe risk charge component of the RBC formula that will be reported on an informational-only basis beginning with 2013 reporting in order to avoid double counting of catastrophe losses. This data will be held confidential in the same manner that all data submitted as part of annual RBC reporting is held confidential.

Lastly, during the Fall National Meeting, the subgroup approved the Applied Research Associates, Inc. HurLoss Model and Florida Public Model as allowable hurricane loss models.

Health Risk-Based Capital Working Group

The working group met by conference calls on November 13 and December 17, and did not meet in National Harbor. During the calls, the working group continued its discussion of health care receivable factors including the American Academy of Actuaries' recommendation to augment the reporting of these receivables in the Underwriting and Investment Exhibit Part 2B, by adding a new Section B entitled Analysis of Health Care Receivables. The proposed change would provide additional detail on the six types of health care receivables, and would provide data for a follow-up study of the health care receivables. The proposal would provide information for future analysis to the sufficiency of the current RBC factors, higher quality financial disclosures, and provide for a more meaningful study of claims. AAA is recommending a

proposed implementation date of 2013. AAA will then use the year-end 2013 data for analysis of the health care receivable factors in 2014. The proposed new Section B has not yet been exposed for comment.

The working group received an update from a subgroup of AAA relating to RBC factors for the Medicare Part D Supplemental benefits. It was reported that factors related to benefits for defined standard benefit plans appear reasonable. However, data issues on the supplemental benefit programs have delayed the completion of this study. The working group hopes to have a recommendation by AAA by May 2013.

The working group continues to monitor the impact of Affordable Care Act on the Health RBC formula. There is currently a delay in the readiness for the exchanges, and from an RBC perspective this increases the risk for companies because the government still plans for companies to begin offering and selling in October 2013, policies effective January 1, 2014. The working group discussed a study conducted by the Health Actuarial Task Force Risk and Reinsurance Subgroup to identify those aspects of the ACA that may have a material effect on the risks. It was noted that some of the impact identified may be temporary, thus creating a complex and difficult question of how to treat risk-based capital in the context of these very risky changes that are coming. A suggestion was made to request comments from industry to guide states that are monitoring solvency in these unusual times. A comment was made that because there are interactive effects of various items in reinsurance, risk adjustment and risk corridors, it is important to look at other provisions of the ACA. There are some mitigating factors with reinsurance, risk adjustment, and risk corridors, but depending on how risk adjustment is implemented, it could have a significant impact on small companies with healthy blocks of business. The concern is a one-time concern, but if a small company renews an underwritten block of business in 2013 and the rates are still effective in 2014, then the company will have to pay out risk adjustment amounts, which could have some impact on their solvency.

The working group also discussed issues related to industry segment concentration risk. AAA has developed a model indicating that more RBC is needed for those insurers who have business concentration. The model is for administration cost items arising from concentration risk, and attempts to calculate the loss of a large block of business that

occurred quickly because the carrier was concentrated in a particular industry or customer. A primary solvency concern would be the ability to cover fixed expenses. AAA was asked to comment on increased utilization concentration risk when a large contract is lost. AAA noted that it would depend on why the business went away. If the business went to another carrier, then increased utilization concentration risk is not a concern. However, if everyone in the industry lost their job at the same time and they had only a few months to use their health care coverage, then increased utilization concentration risk would be a concern and it would be worthwhile to have others look at the line of business factor. AAA commented it did not have any data to estimate or quantify this risk.

AAA provided an update on underwriting risk and investment risk. Utilizing data provided by NAIC, AAA calculated the H1 asset risk and compared it to the change in H2 underwriting risk, noting that there did not appear to be correlation. On November 20, the working group formally requested for AAA to review the correlation of market valued investments, such as equities, mutual funds and other equity-like investments to the underwriting risks and losses that may have an impact on capital adequacy.

During the November 13 call, the working group noted that NAIC staff was drafting a survey relating to pandemic and bio risk. The draft survey was discussed during the December 17 call, which calls for companies to comment on whether they allocate a component of surplus for pandemic or bio risks; whether modeling is used and if so, a description of the modeling; and whether a computation exists and if so, a description of the computation.

IAIS 2012 Annual Conference

The International Association of Insurance Supervisors (IAIS) held its annual conference from October 10-12, in Washington DC, hosted by the NAIC. The conference was attended by regulators and observers from around the world, including many U.S. companies and industry associations. Discussions at the conference revolved around the future of insurance regulation and supervision, and the IAIS's role in shaping this.

ComFrame was a significant topic of discussion at the conference. Regulators and industry both view ComFrame as a critical project to update supervisory practices, which regulators recognized need to

develop in order to regulate sophisticated insurance groups. There was consensus that ComFrame will need to balance flexible principles with more detailed rules and guidance, and that it should avoid being overly prescriptive. Group capital was also discussed at length, with some regulators favoring a move towards a global capital standard for Internationally Active Insurance Groups (IAIGs). U.S. regulators were supportive of a system to assess the financial health of IAIGs, but spoke strongly against the use of a global capital standard to achieve this objective, for reasons including its potential infringement on the powers of a local supervisor, and the lack of a consistent global accounting basis for insurance contracts. The increasing importance of Colleges of Supervisors was also discussed at the conference, although there was debate on the role of the group supervisor, and whether there should be defined powers associated with this role. (Developments around ComFrame since the IAIS 2012 Annual Conference, including several of the key topics discussed in Washington DC, are summarized under the International Insurance Relations Committee, below.)

Financial stability issues were also discussed extensively. There was broad agreement that the measures applied to banks should not be mapped directly to insurers, which have a substantively different business model and risk drivers, and both regulators and industry agreed that non-traditional and non-insurance activities are the primary potential sources of systemic risk for insurers.

It was recognized at the conference, however, that further work will be required to establish the policy measures that will be applied to Global Systemically Important Insurers. Shortly following the conference, the IAIS released its proposed policy measures, for public consultation until December 16.¹ The proposed policy measures are described further under the International Insurance Relations Committee, below.

Supervision of consumer protection issues, currently an important topic of discussion among European regulators, was also discussed at the conference. Discussions were also held on the supervision of emerging markets, micro-insurance, the Access to Insurance Initiative, and longevity risk.

Alongside the IAIS Annual Conference, the EU-U.S. Dialogue Project Steering Committee also held a

¹ http://www.iaisweb.org/view/element_href.cfm?src=1/16648.pdf

public hearing on the reports prepared by its seven technical committees comparing certain aspects of the EU and U.S. regulatory regimes.² The Steering Committee was comprised of Terri Vaughan, Kevin McCarty, Michael McRaith, Karel Van Hulle, Edward Forshaw and Gabriel Bernardino, representing the U.S. and EU regulatory systems respectively. A second public hearing was held four days later in Brussels.

The Steering Committee heard comments from industry organizations and political representatives from the EU, U.S. and Bermuda. Many of the comments concerned reinsurance collateral requirements for alien reinsurers in the U.S., a major point of difference between the two regimes, and a perceived inequality given that no collateral requirements are imposed on alien reinsurers by most EU countries.

While the collateral requirements are reduced by the new Credit for Reinsurance Model Law and Model Regulation (#785 and #786), it was noted that the collateral reductions are not mandatory for accreditation. The perceived difficulty and time involved in implementing new model laws and regulations consistently across the states was also discussed, and it was noted in this context that the former collateral requirements currently remain in place across the majority of states. Regulators' data collection and analysis capabilities were also discussed, and were generally recognized as being stronger in the U.S. than in the EU. Commentators did also note areas in which the EU and U.S. regulatory systems appear to be well aligned, based on the report, including professional secrecy and confidentiality measures.

The EU-U.S. Dialogue Project is a long-standing dialogue between the two regions, and the Steering Committee reinforced the message at the public hearings that its report is not connected to any questions around Solvency II equivalence. However, many commentators drew a link, and urged the Steering Committee to use the report to pave a clear path to equivalence.

Further updates on the EU-U.S. Dialogue Project were discussed at the NAIC Fall National Meeting,

and are summarized under the International Insurance Relations Committee.

Solvency Modernization Initiatives Task Force

The NAIC's SMI Roadmap anticipated that all major policy decisions would be completed by the end of 2012, so as the last NAIC National Meeting of 2012, the meeting at National Harbor represented an important milestone for the SMI working groups. Based on discussions there, many of the SMI workstreams will continue beyond the end of this year, and the task force approved its charges for 2013. The task force also instructed NAIC staff to update the SMI Roadmap, which was distributed by the NAIC on December 21.

SMI White Paper

The task force has continued work on its white paper "The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative." The task force discussed redrafting work to the first four sections of the white paper, drawing attention to a number of areas of previous industry comment, none of which received significant discussion at the National Meeting.

At the Summer National Meeting, the task force had heard comments from interested parties that assertions made in the white paper about the strength of the U.S. regulatory system should be supported with evidence, and the task force then asked the American Academy of Actuaries to outline methods of measuring regulatory financial success. In National Harbor, the AAA presented a report recommending a series of qualitative and quantitative indicators for regulatory success, which the task force agreed to expose for a 30 public comment period.

In National Harbor, the task force noted its intention to complete the first four sections of the report so that it could move on to the SMI section, which is expected to document policy decisions arising from the SMI.

PBR Working Group

At its joint meeting on the final day of the Fall Meeting, the Executive Committee and Plenary narrowly adopted the PBR Valuation Manual, with 43 votes in favor of the motion. The VM required a supermajority adoption, needing 42 affirmative votes out of a possible 56. The newly adopted VM,

²

https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/EU_US_Dialogue_Project_Report_for_Conversation.pdf

with the 2009 revised Standard Valuation Law and the Standard Nonforfeiture Law for Life Insurance will begin to be presented to 2013 legislatures as a package. In order for PBR to become effective, the package must be adopted by at least 42 jurisdictions representing at least 75% of the subject premium. The prospect of attaining the 75% of premium threshold may have dimmed with both California and New York voting against the proposal. If ultimately effective, the new requirements would phase in over 3 years from the effective date and are currently applicable only to new business issued after the effective date. States and territories voting against the proposals were California, Guam, Maryland, New Mexico, New York, North Carolina, Oregon and Wyoming. Minnesota and Oklahoma abstained, and the Northern Mariana Islands, Puerto Rico and South Carolina did not vote.

Alongside the adoption of the VM, members also voted to elevate the PBR Working Group to an executive-led joint working group of the Life Insurance and Annuities and Financial Condition Committees, which will work on guidelines to ensure that there are adequate resources for states to implement PBR, in addition to working on transitioning reserving practices, data compilation and engaging consumers.

Representatives from New York and California spoke against the adoption of the VM. California noted that it is not opposed to PBR, but presented three areas of further analysis which it recommended should be completed before PBR is presented to state legislatures: fiscal analysis and how the cost of PBR will be met; resource requirements for the states to implement PBR; and collaboration procedures for the NAIC. California shared its own experience of reviewing insurers' internal models, noting that specialist modelling experts are needed to review complex models, which states may not have on their staff.

New York presented both technical and structural arguments against PBR at the meeting, consistent with a letter that it sent to the NAIC on November 26, urging commissioners not to vote in favor of PBR.³ New York questioned the timing of PBR, which it expected to result in reserve reductions in the aggregate at a time of economic stress and low interest rates. New York also argued that a principles-based reserving regime had resulted in lower reserves for banks, which contributed significantly to the financial crisis. New York also

suggested that the implementation of PBR may be perceived as deregulation and the lessening of consumer protection, and insurance regulators would likely be blamed in the event of any future insurer insolvency. New York also questioned whether the lower reserves that it expects to be permitted by PBR would provide any benefit to consumers in an already highly competitive and aggressively priced life market.

New York further expressed concern about the resources needed to implement PBR properly, and advised that thorough and comprehensive planning should be carried out to ensure that PBR, its administration and its implications are fully understood before replacing the current rules-based regime.

Several other members of the NAIC, including Delaware, the District of Columbia, and Texas also spoke at the meeting. Most agreed that more detailed implementation planning would be required to implement PBR, but argued that the adoption of the VM was necessary to show that U.S. state-based regulation is adapting and moving forward and to show effective leadership by the NAIC. The proposed new joint working group would be a resource to carry out more detailed planning, which speakers argued could be implemented effectively following adoption of the VM.

The PBR Working Group discussed a draft implementation plan for PBR, which includes updating the detailed PBR implementation plan and timeline created in 2008, and that the implementation process will involve coordination with the Life Actuarial Task Force and a number of other NAIC working groups and committees.

The draft plan covers key issues and policy decisions to implement PBR. Recognizing that adequate resources will be vital, the draft plan proposes that the working group will conduct a survey of the states on their current level of resources, anticipated resources to support PBR, and the expected costs of and potential for obtaining the necessary resources. In addition, the draft plan recommends the creation of two major components to support PBR review and updating process; an NAIC Actuarial Resource (comprised of a combination of NAIC actuarial staff and consultants) and a new NAIC working group (Actuarial Analysis Working Group). The roles of the new resource and working group would support state and NAIC activities for PBR implementation and ongoing review. The draft plan also considers the statistical data collection that will be required for

³ http://www.dfs.ny.gov/insurance/life/pbr_ny_11262012.pdf

PBR, and recommends a phased introduction of data collection over 3 years, most likely starting with life policy data. The draft plan recommends that data collection be in place for annual 2015 reporting.

The draft plan also notes that the implementation of PBR will require changes to current reporting schedules, and for new schedules to be developed, including the collection of a greater granularity of product information, the amount of public versus confidential data, and the NAIC's automated financial analysis and prioritization tools. Further, the draft plan notes that the NAIC is working on accessing the default and bond bid-ask spread data that will be required to implement the VM, from rating agencies and broker-dealer sources.

The draft plan recognizes the importance of providing training for state insurance department staff, and proposes an online training program for late 2013 or early 2014. In addition, the draft plan also proposes that the NAIC develop training on VM-specific actuarial topics, and considers that further training will also need to be developed as PBR is implemented, including for analysts and examiners as the relevant tools and handbooks are updated.

The working group agreed to expose the draft plan for public comment until January 10. The working group also asked interested parties to suggest questions for its survey on state resources. During its meeting, the working group heard industry comments on PBR, including the need for due process around updates to the VM, adequate resources, and coordination with other working groups.

Group Solvency Issues Working Group

Own Risk and Solvency Assessment (ORSA)

As anticipated at the Summer National Meeting, the working group held a joint conference call with the Financial Condition Committee in September, which was shortly followed by a joint meeting of the Executive Committee and Plenary. At both of these meetings, the Risk Management and Own Risk and Solvency Assessment Model Act (#505) was unanimously adopted.

The final version of the model act was substantially unchanged from the version discussed in Atlanta. New wording was introduced to strengthen confidentiality protection where the ORSA Summary Report is shared with the NAIC or third party

consultants, which requires the commissioner sharing the report to obtain written agreement from the recipient to maintain confidentiality, and confirmation that the recipient has legal authority to do so. Sharing with other state regulators is also restricted to states in which the group providing the report has a domiciled insurer. The adopted draft also retains the requirement, discussed extensively on working group conference calls over the summer, for an insurer subject to the act to maintain a risk management framework.

When adopted by the states, the model act is set to become effective on January 1, 2015, with the first ORSA Summary Reports filed in 2015. Insurance groups are required to file the report annually to their lead state regulator, with individual insurers required to provide a report on request, but no more than once annually. Drafting guidance in the model act indicates the intention for all insurers to submit a report annually, with a flexible submission date depending on the insurer's internal strategic planning process.

At its meeting in National Harbor, the working group discussed proposed recommendations to the Financial Regulation Standards and Accreditation Committee, for Part A accreditation standards and guidelines for the new model act, including sections that should be considered significant elements. The working group agreed to expose the recommendations for a 45 day comment period ending January 14, 2013.

Additional work on the ORSA was also carried out over the fall by the ORSA Subgroup, as detailed below.

Holding company analysis

The working group discussed holding company analysis by conference call in October, and received a further update in National Harbor. On its interim conference call, the working group noted that additional guidance on the states' responsibilities for holding company analysis appeared to be required, and the working group therefore voted to make a request to the Financial Regulation Standards and Accreditation Committee to extend the effective date for the holding company analysis accreditation standards and guidelines from January 1, 2012 to January 1, 2014. The proposal was adopted by the committee later in October. The working group noted on its conference call that its intention in making the recommendation was to provide extra time for states to work on analysis processes and procedures before being scored by the accreditation

team, rather than for states to stop holding company analysis, or for the accreditation team not to provide feedback on completed analyses, in the meantime.

The working group also heard in National Harbor that revisions to the Financial Analysis Handbook relating to holding company analysis had been adopted, and that a webinar to clarify the states' responsibilities had been conducted.

Group supervision

In National Harbor, the working group discussed the designation of a single lead state for groups which currently have more than one designated lead state (the working group heard that this applies to approximately 15% of groups). A single lead state was considered to provide a useful single contact point for international regulators, and was also considered to be useful for groups themselves. The working group agreed to charge NAIC staff to work with the states to establish a single lead state for each group.

The working group also charged NAIC staff to develop a new section for the Financial Analysis Handbook that explains the U.S. state regulatory approach to group supervision, and the role of the lead state regulator. The working group also asked interested parties to provide any input or suggestions for the new section by December 31. The new section is intended to clarify the U.S. approach to group supervision to international regulators and other parties.

ORSA Subgroup

The subgroup met by conference call in November, and discussed and adopted its report on the ORSA pilot study conducted over the summer. The pilot study involved the review of 14 ORSA Summary Reports submitted by volunteers. Of these, 9 reports were considered complete, of which 3 included complete data. Two submissions included a framework only, and 3 submissions omitted entire sections. The report was later adopted by the Financial Condition Committee in its meeting at National Harbor. The results of the pilot study are summarized in PwC's NAIC Summer Meeting Notes Newsletter.

The subgroup recommended that the language should be aligned between the ORSA Guidance Manual and the Risk Management and Own Risk and Solvency Assessment Model Act (#505), and proposed a number of other drafting suggestions to

clarify technical language and intent. These included proposed guidance for insurers to include a summary of material changes to the ORSA from the prior year and that the insurer should provide a comparative view of risk capital from the prior year. During its November conference call, the subgroup voted to expose the amended draft for a 60 day comment period.

The subgroup also recommended referrals to the Financial Analysis Handbook Working Group and the Financial Condition Examiners Handbook Technical Group, which are intended to start the drafting of guidance for regulators of the review of ERM and the ORSA submitted by companies. The subgroup recommended that it continue to be involved, in order to provide expertise and guidance. Matters that the subgroup recommended be considered include:

- The goals of the examination.
- The impact on existing examination plans and procedures, including scope, focus, the need for target examinations, the potential for group examinations, and the impact on holding company analysis procedures.
- Resource constraints.
- Interstate, intrastate and international coordination, and the role of the lead state.

The referrals also recognized that, due to the nature of the ORSA, a "checkbox approach" to review would not be appropriate. Given the referrals made, the subgroup further recommended that the Financial Condition Committee wait to consider the need for Part B accreditation standards until after examination and analysis guidance has been fully discussed.

Finally, the subgroup recommended performing a second pilot exercise in 2013, which the subgroup believes would help in the drafting of guidance on the regulatory review of ORSA Summary Reports. The subgroup did not meet in National Harbor.

Corporate Governance Working Group

The working group met twice by conference call during the fall, and met at the Fall National Meeting.

Corporate governance comparative analysis

At its meeting in National Harbor, the working group discussed and agreed to expose for public comment updated drafts of its proposed Exhibits A,

B, and E from its document Proposed Response to a Comparative Analysis of Existing U.S. Corporate Governance Requirements. The working group had drafted the response document, including the proposed exhibits, to recommend enhancements to U.S. corporate governance regulation following its review of current U.S. requirements, and had previously exposed it for a public comment period ending in September, 2012. The document will inform the working group's final conclusions and recommendations on corporate governance policy decisions, which it was expecting to provide to the SMI Task Force in National Harbor. However, the task force agreed to make a request to the SMI Task Force, which the task force approved later at the Fall National Meeting, to delay delivery until the Spring National Meeting.

The working group had received extensive (and strongly worded) comments from interested parties in response to its September consultation, which it discussed on conference calls in October and November, and which the group considered in producing the revised draft exhibits exposed in National Harbor. In its discussions, the working group particularly emphasized that its proposals will not be finalized on adoption by the working group, and that its proposed Exhibit E on a proposed corporate governance template in particular is likely to go through an extended development process.

A summary of each of the exhibits exposed for comment is provided below:

Exhibit A: Narrative filing covering four topic areas: a general description of the corporate governance framework; the board of directors and committee policies and practices; management policies and practices; and management and oversight of critical risk areas. Discussion of significant changes from prior year is also included, to allow insurers to file the report unchanged year-on-year where no significant changes have occurred. Discretion is provided as to whether information is provided at ultimate parent, intermediate holding company or legal entity level, to allow the disclosure to be aligned to the level at which corporate governance oversight is provided to each legal entity required to submit the filing.

Exhibit B: Proposed annual statement schedule covering compensation paid to officers, employees and directors, aggregate compensation, and interrogatories. The exhibit would require disclosures similar to those currently required by the

SEC with narrative discussion of compensation practices covered by Exhibit A.

Exhibit E: A common assessment methodology for corporate governance, which the working group originally envisaged would include a standardized assessment template, ratings methodology and follow-up procedures. The three proposals all met with significant pushback both from industry and from some members of the working group, who suggested that the NAIC should wait for a few years before developing a standardized methodology, when regulators have more experience reviewing corporate governance issues. The exhibit exposed for comment at the Fall National Meeting therefore makes referrals to the Financial Analysis Handbook Working Group and Financial Examiners Handbook Technical Group, asking those groups to start considering the development of a common methodology, but recognizing that this will be a longer-term project.

A particularly significant area of discussion between the working group and industry over the fall was the confidentiality of any new corporate governance filings, and this topic was regarded as critical by both regulators and industry. The working group discussed potential options to maintain confidentiality on its November conference call, including modifications to existing models, creation of a new model, or collection through the annual statement process. Consensus on the topic had not been reached by the time of the Fall National Meeting, at which the working group asked the industry to support its efforts to finalize the information that regulators should collect on corporate governance, and to defer discussion on how the information should be protected until later.

The need for the regulatory approach to corporate governance to allow for proportionality and flexibility was also discussed extensively, particularly in relation to the proposed exhibit E. Industry representatives noted that corporate governance practices vary between individual insurers, and that a one-size-fits-all approach would not be appropriate. While not disagreeing with this, working group members were supportive of greater structure around corporate governance regulation. In discussions, the working group viewed its proposals, in conjunction with the new ORSA and Form F filings, as a significant upgrade to the regulation of corporate governance issues, which would create greater discipline through the annual filing process, and provide necessary information in between periodic examinations. Working group

members also considered that the proposals would benefit industry, by aligning regulation more with companies' own view of their risks and internal management.

Throughout the discussions, the working group recognized the need to avoid duplication in the information requested, and welcomed input from interested parties on where information consistent with the proposed exhibits is already collected. Language was also added into Exhibit A to allow insurers to reference information already contained in other documents available to the regulator. The need for more training and guidance for examiners and analysts was also raised by both industry and the working group.

The proposed exhibits are available for public comment until January 18, 2013.

International Solvency and Accounting Standards Working Group

The working group met at the Fall National Meeting in National Harbor, and discussed the following topics:

Insurance contracts project

The working group heard that the IASB expects to issue a targeted exposure draft of its replacement for IFRS 4 in the first half of 2013. The exposure draft is expected to include the entire standard, but will contain targeted questions, rather than inviting comments on the whole text. Areas of focus for the exposure draft are expected to include:

- Treatment of unearned profit.
- Treatment of participating contracts.
- Presentation of premiums, claims and expenses in the statement of comprehensive income.
- Presentation of the effect of changes in the discount rate in OCI.
- Retrospective application if practicable.
- Estimated residual margin on transition if retrospective application is impracticable.

The IASB currently intends to publish a final standard by the end of 2014. However, the working group heard that this timeline is optimistic, and that publication in 2014 may therefore be unlikely. The IASB expects the standard to be effective approximately 3 years after publication.

Financial instruments project

The working group heard that the IASB has just published a new exposure draft of limited changes to the IFRS 9 classification and measurement requirements. The amendments propose the introduction of a fair value through OCI category for financial instruments, and the working group heard that almost all insurers would be likely to meet the requirements to use this category. The exposure draft is available for comment until March 28, 2013, and the NAIC intends to provide comments.

Other IAIS activities

The working group heard that the IAIS Accounting and Auditing Issues Subcommittee is drafting an issues paper on supervisors' expectations of external auditors, and may consider drafting a new ICP on the topic over the coming year.

International Insurance Relations Committee

The committee met several times by conference call over the late summer and fall, and then held an in-person meeting at the Fall National Meeting in National Harbor and discussed the following topics.

Financial Stability Committee and Global Systemically Important Insurers (G-SIIs)

The committee discussed the IAIS's Financial Stability Committee both by conference call in early November, and at the Fall National Meeting. The committee heard that the FSC completed a second data call from around 50 insurers in October, and that its analysts are now working through the data produced. A subset of companies has been identified and will now be investigated further by the FSC's analysts, working with national supervisors. It is possible that another data call will be required. These further investigations are expected to be completed in February, with recommendations on which insurers, if any, should be designated G-SIIs made in March. The names of any insurers designated G-SIIs are expected to be finalized and made public in April, in consultation with the insurers' national supervisors.

The committee further heard that the IAIS released a public consultation on the proposed policy measures to be applied to G-SIIs in October, with comments due by December 16. The paper recommends that policy measures be applied to G-SIIs in 3 areas:

- Enhanced supervision – supervision should cover the whole group, and in particular should

take into account non-traditional and non-insurance (NTNI) activities. G-SIIs should work with their supervisors to produce a Systemic Risk Reduction Plan, which may include separation of or prohibition from undertaking NTNI activities.

- Effective resolution – G-SIIs should be required to establish Crisis Management Groups, develop Recovery and Resolution Plans, conduct resolvability assessments, and adopt cross-border cooperation agreements.
- High Loss Absorption (HLA) – G-SIIs should have higher HLA capacity, applied first to NTNI activities if effectively separated, and then at the whole group level. The paper notes that HLA at the whole group level may not necessarily be needed after NTNI measures have been applied.

Following the National Meeting, the committee met by conference call to discuss the NAIC's draft comments on the consultation paper. Consistent with the NAIC's previous position on the measures, the comments support the separation and/or restriction of NTNI activities, and recommends that the measures be targeted to those activities that are considered to cause systemic risk. The comments also recommend that group-wide HLA should not be considered mandatory, and/or should only be applied after all other measures. The comments suggest that mandatory group-wide HLA and/or higher capital requirements could produce unintended consequences including higher prices for consumers and reduced competition.

At its meeting in National Harbor, the committee heard that, following the consultation, revised policy measures are expected to be presented to the FSC in March 2013 and to the G20 in April 2013. The IAIS's consultation notes that G-SII measures on enhanced supervision will begin as soon as the first group of G-SIIs has been designated.

The committee also heard comments and questions from interested parties on the identification process and proposed policy measures. Questions included the timeline for decisions on which companies will be designated G-SIIs, and how data from different companies has been adjusted for comparability. Interested parties also requested the proposed policy measures to be subject to a second public consultation once the criteria and methodology for the identification of G-SIIs have been concluded.

EU-U.S. Dialogue Project

The IIR Committee heard an update on the EU-U.S. Dialogue Project, and the public hearings held in Washington DC and Brussels in October on its report comparing certain aspects of the EU and U.S. regulatory regimes. The discussions at the public hearings are summarized under the IAIS 2012 Annual Conference, above. The committee heard that the dialogue project steering committee and its technical committees are currently reviewing the comments received to ensure that the report is factually accurate, and reflects recent regulatory regime enhancements. The steering committee expects to finalize the report by December 19.

The committee heard that the steering committee is also considering its next steps and potential areas of convergence, and that it may set out a timetable for its activities in 2013 by the end of the year. In response to a request from an interested party for the discussions to be opened to observers, Commissioner Kevin McCarty, a member of the dialogue project steering committee, confirmed that discussions are likely to be kept closed for now, although greater transparency will be considered as the project moves forwards.

Joint Forum

The committee received an update on the activities of the Joint Forum, including its recent meeting in Tokyo, at which longevity risk and the potentially significant impact of forecasting errors around demographic trends were a significant topic of discussion. The committee also heard that the Joint Forum Working Group on Risk Assessment and Capital is near to finalizing its paper on mortgage insurance, and is also working on a report on point of sale disclosures for collective investment schemes (for example, mutual funds), including consideration of the variations between schemes and disclosures cross-sector. The working group is also considering longevity risk.

The committee further heard that the Joint Forum's Principles for the Supervision of Financial Conglomerates were issued in September 2012, and that the forum is now considering pilot testing the principles. The Joint Forum is expected to ask 2 to 3 countries to take place in the pilot.

The committee also heard that the forum is considering potential future mandates, which it will discuss further in February 2013. Potential future areas of focus include convergence, asset encumbrances (for example, assets pledged as collateral), compensation best practices, and fit and proper requirements. Finally, the committee heard

that Thomas Schmitz-Lippert of BaFin will replace Dr. Terri Vaughan as the Chair of the Joint Forum.

ComFrame

The International Insurance Relations Committee discussed ComFrame both on interim conference calls, one of which was held jointly in August with the SMI Task Force, and in National Harbor. In August, the committee and the SMI Task Force discussed the NAIC's comments on the IAIS's 2012 consultation on its ComFrame concept paper, in addition to comments on ICP 9 (Supervisory Review and Reporting) and the IAIS's Application Paper on Regulation and Supervision supporting Inclusive Insurance Markets. The final draft comments discussed by the committee were consistent with those discussed at the Summer National Meeting in Atlanta, and were represented by the NAIC at the IAIS's 2012 Annual Conference in Washington DC in October, as described further in the summary of the Annual Conference above.

In National Harbor, the committee discussed several significant recent developments to ComFrame, i.e. that it is now generally recognized at the IAIS as being too long, too prescriptive, and too detailed in certain areas. The committee heard that the IAIS Technical Committee has approved the restructuring of ComFrame. Further, the expansion and interpretation of the ICPs in the 2012 concept paper is now to be removed, and material from the ICPs quoted in ComFrame verbatim. Changes will also be made to clarify conflicting terminology.

One of the most significant changes is ComFrame's approach to the assessment of group capital. Much discussion at the IAIS's 2012 Annual Conference surrounded whether ComFrame should be used to create a top-down, global capital standard for IAIGs. The NAIC argued strongly against this objective at the Annual Conference, and in National Harbor reported that the IAIS is now expecting to use a scenario-based approach to group capital assessment. Using this approach, IAIGs are expected to assess capital adequacy in the context of a set of agreed scenarios, which may be prescribed for all IAIGs, set within prescribed boundaries by national supervisors, or a combination of the two methods.

ComFrame was also discussed in National Harbor by the International Solvency and Accounting Standards Working Group. The working group heard that the IAIS Technical Committee, at the suggestion of the NAIC and others, had now agreed to change ComFrame's valuation standard to recognize other accounting frameworks, and that IFRS or any

equivalent set of accounting standards could now be used, including specifically U.S. GAAP or Japanese GAAP. However, recognizing the differences between these frameworks, and also the differences that remain in the valuation of insurance contracts between different countries that have adopted IFRS, in the absence of a single standard for insurance contracts, the IAIS Accounting and Auditing Issues Subcommittee (AAISC) intends to require adjustments to narrow, but not attempt to eliminate, the differences between different GAAP figures.

In order to reach the required adjustments, the AAISC intends to carry out a study into the valuation of insurance contracts under each key GAAP, in addition to making use of previous work on prudential filters. The study is expected to involve valuing a representative sample of insurance contracts under each GAAP, in order to help quantify the differences in valuation. The working group heard that the AAISC has called on industry, rating agencies and professional accounting firms to support the study with any available data or existing work.

The IAIS expects to carry out a field testing exercise for ComFrame in 2013, and a field testing task force is expected to be established in early 2013. The scenario-based approach to group capital assessment is expected to be tested, in addition to testing on the scope of the group. Notwithstanding the decision to move forward with the scenario-based approach, a top-down approach to group capital is also expected to be tested.

At its meeting in National Harbor, several NAIC committees and working groups heard comments from interested parties on ComFrame, who overall welcomed the new direction for the project, and recognized the NAIC's role in shaping this at the IAIS. Industry concerns discussed at the Fall National Meeting included the potential for the framework to create an un-level playing field for international groups, the need for an appeals process for the designation of a group as an IAIG, and the need for the reduced level of prescription to be applied throughout the draft. Interested parties also raised the need for clear objectives for the ComFrame project, and asked whether solvency assessments carried out under ComFrame will be public information, the purpose of the solvency assessment, where any additional capital required should be held (for example, at holding company level), and how the Prescribed Capital Requirement (PCR) should be calculated. With respect to potential requirements for groups to hold additional capital,

the International Solvency and Accounting Standards Group heard that it is not envisaged that ComFrame would prescribe where additional capital should be held, but that this would be decided by the relevant IAIG's college of supervisors on a case-by-case basis, and indeed that the college may decide that de-risking would be more appropriate than holding additional capital.

Comments were also heard on whether ComFrame has the potential to apply the measures designed to be applied to G-SIIs to all IAIGs. In general, the NAIC concurred with industry concerns expressed at the National Meeting, including the need for a level playing field. However, the NAIC confirmed that there is no intention for ComFrame to incorporate measures for G-SIIs. This was confirmed by George Brady, Deputy Secretary General of the IAIS, who was also in attendance at the meeting on the invitation of the NAIC.

Further revisions to ComFrame are expected to be made in December, followed by review, discussion and possibly additional drafting in early 2013. The findings of the field testing, which will proceed concurrently, are expected to influence the drafting. By the end of May 2013, ComFrame is expected to enter a final "fatal flaw and fine-tuning" stage.

International Regulatory Cooperation Working Group

The working group met in National Harbor, and discussed various topics relating to the NAIC's engagement with overseas regulators. The working group heard that Washington recently became the second U.S. state to sign the IAIS's Multilateral Memorandum of Understanding (MMoU), and that a third U.S. signatory is expected before the end of 2012. Discussions at the International Insurance Relations Committee meeting at National Harbor further indicated that MMoU signatories now cover around 50% of global insurance premium, and that another 4 to 5 U.S. states are close to applying for membership. The International Regulatory Cooperation Working Group members were encouraged to enter the assessment process for the MMoU, although the working group also discussed the benefit of the time required to complete the assessment process, compared to entering into separate confidentiality agreements for individual supervisory colleges.

The working group also heard an update on the IAIS's Implementation Committee's projects,

including the Standards Observance Subcommittee's self-assessment and peer review program. The working group heard that reviews against ICPs 1, 2, and 23 (supervisory objectives, powers, and responsibilities, and group supervision) are nearly complete. A report making recommendations for improvement to the ICPs following the review is due to be drafted and issued next year. Reviews of ICPs 4, 5, 7, and 8 (governance, risk management and internal controls) are scheduled to take place next year, with estimated completion by October 2013.

The working group also recommended to the International Insurance Relations Committee that the NAIC enter into negotiations to establish Memoranda of Understanding (MoUs) with the UAE, India and Nigeria, in order to further regulatory cooperation between the NAIC and those territories. The request was later approved by the International Insurance Relations Committee, at its meeting at National Harbor.

Valuation of Securities Task Force

2012 Year-End RMBS & CMBS Modeling

The task force held three conference calls in October to discuss macroeconomic assumptions, scenarios and risk-weightings for the 2012 year-end financial modeling of RMBS and CMBS investments. The task force noted that since the modeling approach began, the SVO staff has been instructed to take a relatively "neutral bias" when recommending the assumptions for the year-end modeling effort. For the 2012 year-end modeling, the SVO staff proposed a shift to what the task force chair termed a "slightly more conservative bias." Industry representatives, including ACLI, expressed many concerns with the assumptions recommended by the SVO, including that they were too pessimistic and would have a significant impact on required capital levels.

Given the concerns raised by both task force members and industry representatives, the task force agreed to extend its consideration of the SVO recommendations for an additional two weeks. The SVO staff responded to concerns in a Q&A document and concluded that there was no basis upon which to modify the original recommendations. Based on the composition of the 2011 industry-wide RMBS portfolio holdings and price points, the SVO estimated that the aggregate capital charge would increase from 2.7% to 3.2% of the book/adjusted carrying value. The impact on the 2005-2007 RMBS vintage would go from 3.3% to 4.2%. The impact was

estimated to be much smaller for CMBS. The SVO further estimated the industry-wide capital requirements for the life insurers would increase by approximately \$700 million under the worst-case scenario, while the increase for P&C insurers would be closer to \$50 million.

Following significant discussion and debate, the task force adopted the SVO recommendations on the October 26 conference call. Iowa and Oklahoma voted against the recommendations and Kansas abstained. Task force members acknowledged that the process and timeline for developing and approving modeling assumptions must be critically reviewed before the 2013 year-end process begins.

At the Fall National Meeting the SVO reported that the RMBS and CMBS financial modeling process was well underway and expected to be completed before year-end.

Preferred Stock Exchange Traded Fund Category

On its September conference call the task force also adopted the previously exposed proposal to amend the SVO Purposes and Procedures Manual to add an Exchange Traded Fund (ETF) category for preferred stock in addition to the existing bond ETF category.

Quarterly Reporting of Modeled Securities

In National Harbor, the task force discussed proposed guidance for quarterly reporting of modeled RMBS and CMBS, and instructed the SVO to use it as a basis to develop edits to the SVO Purposes and Procedures Manual. The task force believes that insurance companies should report interim purchases of RMBS and CMBS that are subject to financial modeling as follows:

- If purchasing a modeled RMBS or CMBS where last year's modeling data are available, use last year's modeling data to determine the designation and book/adjusted carrying value;
- If purchasing a modeled RMBS or CMBS where last year's modeling data are not available, use the modified filing-exempt process to determine the designation and book/adjusted carrying value.

A formal proposal is expected to be exposed for public comment on a future task force conference call.

Working Capital Finance Investments

During a September 6 conference call, the task force unanimously adopted the previously exposed, proposed statutory accounting framework for

Working Capital Finance Investments (WCFI) developed by New York. The final proposal was referred to the Statutory Accounting Principles Working Group and related proposals to the Blanks Working Group and the Capital Adequacy Task Force. The proposal recommends that WCFI be admitted asset. The referral by the task force also included two additional recommendations: (1) WCFI should be reported on Schedule BA and (2) under the corporate methodology developed by the SVO, WCFI should be assigned either NAIC 1 or NAIC 2 designations based on the credit risk associated with the corporate obligor.

Local GAAP Financial Statements

The task force discussed a previously exposed ACLI proposal to allow the SVO to accept audited financial statements of foreign issuers expressed in accordance with a national generally accepted accounting principles (GAAP) or national International Financial Reporting Standards (IFRS), instead of just accepting audited financial statements expressed in, or reconciled to, U.S. GAAP or official IFRS. The task force directed the SVO to work with ACLI representatives to evaluate whether there are informational resources that would permit the SVO to use financial information presented on a national GAAP or national IFRS basis to conduct credit analysis comparable to that performed using financial information presented on the basis of U.S. GAAP or official IFRS.

NAIC Designation Recalibration Project

The SVO discussed proposed definitions for NAIC designation categories under the proposed recalibration project. As currently proposed, the NAIC would transition from the current single NAIC rating designation framework (1-6) to three separate frameworks: one each for corporate bonds, municipal bonds and asset-backed securities. The proposal would create new NAIC designation symbols and definitions. Additionally, RBC factors would be updated based on the work of the C-1 Factor Review Subgroup. The task force instructed the SVO to work with the ACLI and other interested persons to develop agreed-upon definitions and to present a joint recommendation to the task force for its consideration.

Mandatory Convertible Securities

The task force discussed the current regulatory framework for mandatory convertible securities and whether current instructions to the SVO on this issue, which expire January 1, 2013, should be continued, either in the SVO Purposes and Procedures Manual or in statutory accounting guidance. NAIC staff was asked to consider valuation

and definitional issues and to provide recommendations on an expedited basis to ensure instructions are in place by January 1, 2013.

Reinsurance Task Force

The task force met at the Fall National Meeting in National Harbor, and discussed the following topics.

Reinsurance Modernization Implementation

The task force heard an update on the adoption of the revised credit for reinsurance models by the states. The revised models have been adopted by California, Connecticut, Delaware, Florida, Georgia, Indiana, Louisiana, New Jersey, New York, Pennsylvania and Virginia. Eleven additional states indicated that they intend to adopt the revisions, with 26 undecided. The task force heard that Florida and New York had so far approved 19 and 23 reinsurers, respectively, for collateral reductions as of November 28.

The task force also heard an update from the drafting group of the Reinsurance Financial Analysis Working Group. The drafting group had finalized a draft of a procedures manual for the working group on November 19, which has been presented to the Reinsurance Task Force. The update provided at the Fall National Meeting indicated that reinsurance collateral reduction applications should initially be submitted to a single state, and that review priority will be given initially to those reinsurers that were approved by states before the adoption of the working group's procedures.

The task force also discussed a draft of the NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions, prepared by the Qualified Jurisdiction Drafting Group in collaboration with the FIO and federal authorities. The task force heard that the proposed process is intended to be an outcomes-based comparison, which considers adherence to international guidelines, rather than a prescriptive comparison to the reinsurance models. The draft document includes an evaluation methodology, which considers 8 key topics covering the industry, regulatory framework and measures applicable to U.S. reinsurers operating in the overseas jurisdiction concerned. Interested parties commenting in National Harbor encouraged the NAIC to make full use of reviews carried out for other purposes when assessing overseas jurisdictions, and to consider expediting the assessment of some key jurisdictions. The draft process notes that initial priority will be given to

Bermuda, Germany, Switzerland and the UK, each of which has already been approved by Florida and/or New York.

The task force agreed to expose the draft process for public comment until January 16, 2013, and intends to hold an interim meeting to discuss the comments received. The drafting group noted its intention to finalize the process document by the Spring National Meeting.

Reinsurance Modernization Accreditation

The task force heard that the Financial Regulation Standards and Accreditation Committee had adopted the 2011 revisions to the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786), and the significant elements proposed by the task force, at its meeting in National Harbor. The revisions are effective immediately. States are not required to adopt the revisions, but if they choose to introduce reduced reinsurance collateral requirements, they must be substantially similar to the key elements of the models.

Nonadmitted and Reinsurance Reform Act (NRRA) Survey

The task force discussed a survey of the states that it had conducted into issues with respect to the NRRA, and whether the NAIC should develop a standard definition or guideline to help promote consistency in its application. The task force agreed to discuss the results of the survey further at a future meeting.

International Reinsurance Issues

The task force discussed the EU-U.S. dialogue project (discussed further under the International Insurance Relations Committee, above), noting that reinsurance is likely to be an ongoing focus for discussions. The task force also received an update on IAIS discussions relating to reinsurance, including the Global Insurance Market Report, released in October 2012, which builds on the former Global Reinsurance Market Report, ComFrame, the stability of the reinsurance market, and captive insurers.

The task force also received a presentation from the IAIS on a study carried out into the impact of insurance/reinsurance following major natural catastrophes. The study found that sufficient insurance/reinsurance coverage can reduce the negative effect on economic growth that it considers would usually follow a major catastrophe, and that sufficient coverage of catastrophe losses can in fact lead to a positive growth effect overall.

Captive and Special Purpose Vehicle Use Subgroup

The subgroup held a conference call October 17, the goal of which was to discuss the latest draft of its Captives and Special Purpose Vehicles White Paper, before exposing it for comment. Significant revisions from the draft discussed at the Summer National Meeting are as follows:

- Confidentiality – The subgroup could not reach a consensus view so delineated both views and will likely ask its parent E Committee to decide. Some subgroup members support continuing to allow confidential treatment of captive transactions and financial statements while others support more transparency and public disclosures.
- Additional discussion on credit for reinsurance and accredited reinsurance was added.
- Captive database – The October 17 draft includes a suggestion that consideration be given to developing a database including NAIC company code, name, and domiciliary information with respect to all captives “to ensure that data on the universe of all such entities is available to allow regulators to quickly respond to questions on the same.”
- Conclusions – the subgroup tried to provide more clarity around the recommendations including a proposal to form a new group to “develop possible solutions for addressing the remaining XXX and AXXX perceived redundancies.” The recommendations also include the following statement: “The Subgroup held a consensus view that captives and special purpose vehicles should not be used by commercial insurers to avoid statutory accounting prescribed by states. If the liabilities are retained by the insurer, they should not be granted favorable treatment merely for carrying the liabilities on the books of an affiliate rather than directly.”

The subgroup then voted to expose the white paper for public comment.

At its meeting in National Harbor, the subgroup held a public hearing to discuss comments on the draft white paper; three states commented (Delaware, Nebraska and Vermont), along with six trade associations and one large life insurance company. The debate was very contentious at times, including

comments among regulators. It also included significant discussion of whether the white paper is “an attack on the captive industry.”

As a result of comments received, the subgroup agreed to clarify certain statements in the white paper, including modification or removal of the discussion of the captive industry as a “shadow banking system.” The regulators also agreed to clarify that they will not be recommending that IAIS standards be adopted; those standards do not recognize as captives insurance entities that assume third party risk. The chair commented that the primary point is that “captives owned by commercial insurers should not be utilized to engage in activities, or receive treatment for commercial business, that is not allowed by commercial insurers.” However, the subgroup member from Missouri stated that he believes the white paper should state that the vast majority of XXX and AXXX transactions have been through a diligent review process including consideration of the plan of operations and an actuarial review of reserves.

The suggestion to develop a database for all captives including pure captives was especially contentious and elicited comments from interested parties who previously had not been actively commenting. This proposal seems to have less support from the subgroup members than some of the other recommendations.

During the meeting, the chair of the subgroup’s parent committee, Commissioner Torti of RI, stated that he was “deeply disappointed” with the overall comments. He views the issues underlying the white paper as life insurance reserving issues and not a captive issue. Commissioner Torti also indicated his concerns about the use of permitted practices by captives, which he believes are intended to be used only for “narrowly defined issues or circumstances.” He also stated that with respect to confidentiality, states’ laws generally require that all information be public unless it is specifically deemed confidential, whereas comments received on the white paper “suggest just the opposite.”

Other than rectifying some “misunderstandings” in the white paper, eg the “shadow industry” comment, it is not clear what other revisions will be made to the white paper. A revised draft was expected to be distributed shortly after the Fall National Meeting, but nothing has been issued as of the publication of this Newsletter. Another public hearing is also expected to be held prior to finalizing the white paper.

NAIC/AICPA Working Group

The working group held a conference call on October 23 and discussed the following topics:

MAR Implementation Guide

The working group adopted a proposed addition to the MAR Implementation Guide to provide guidance and a sample report for situations where a holding company or parent insurance company not subject to Section 404 wishes to submit a group Management's Report of Internal Control over Financial Reporting for companies within their holding company system that are subject to Management's Report of Internal Control over Financial Reporting filing requirements.

Restricted Assets

In response to a referral from the Financial Analysis Working Group related to solvency concerns of material amounts of restricted assets at some insurers, the working group asked the AICPA representatives for assistance in determining whether generally accepted auditing standards require bank confirmations of restricted/pledged assets and what specific disclosures are required in audited financial statements. During the October conference call, a representative of the AICPA reported that under GAAS, audit confirmations are performed as a result of risk-assessment procedures and would not necessarily be performed on all assets held by the insurer. However, for those assets that are confirmed during an audit, the standard confirmation form asks whether any assets are pledged as collateral or otherwise encumbered. In addition, the sample representation letters provided in the AICPA insurance guides include representations by management on restricted assets.

The chair asked the AICPA to consider highlighting the importance of a review for restricted assets in its insurance audit guides and Audit Risk Alerts in light of the problems that have been identified, which the AICPA agreed to consider. The working group also adopted that a recommendation be sent to the Financial Examiners Handbook Technical Group to consider guidance for examiners in reviewing for asset restrictions. One regulator suggested that a better way to address problems related to asset restrictions might be for the states to pursue an asset protection act, similar to those in place in Virginia and Texas, which would require an insurer to get insurance department approval before pledging insurance company assets. That suggestion was referred to the Financial Analysis Working Group.

Blanks Working Group

The working group exposed 10 new blanks proposals for a public comment period which ends March 7, 2013. These proposals will be considered for adoption on a conference call to be scheduled in June. The proposals would:

- Add a requirement to the Annual Audited Financial Reports for auditors to include testing of underlying data provided to the actuary for estimating reserves to the statutory audit process for title insurance. This requirement would be similar to the current requirement for P&C insurance. (2012-31BWG)
- Add instructions to the Property and Casualty Line of Business Appendix to indicate that the write-ins line should include all types of business that are placed by a lender ("force-placed or lender placed"). For all force-placed business, a separate line should be used for each annual statement line of business that is written by the reporting entity. (2012-33BWG)
- Separate the State Low Income Housing Tax Credit (LIHTC) categories on Schedule BA into guaranteed and nonguaranteed similar to the Federal LIHTC. (2012-34BWG)
- Modify the illustration for Note 17C to allow for disclosure of unrated securities and securities other than bonds and preferred stocks. (2012-35BWG)
- Add a new line and modify instructions for certified reinsurers to page 3 of the Trusteed Surplus Statement. (2012-36BWG)
- Add instructions and an illustration to Note 22, Events Subsequent, to disclose assessments under the Affordable Care Act not being recognized in the financial statements. (2012-37BWG)
- Add category lines to Schedule BA for Working Capital Finance Investments and a description for those lines in the annual and quarterly statement instructions. (2012-38BWG)
- Modify various parts of Schedule F (property) and Schedule S, (life, health and fraternal) moving bank information for letters of credit to the footnote table. (2012-39BWG)

- Add information about Certified Reinsurer Identification Number (CRIN) to be consistent with the information provided in the general instructions for Schedule F and S in the annual statement instructions regarding federal ID number. The proposal would also add instructions for the column on how to indicate the type of reinsurer. New columns with description "Certified Reinsurer Rating (1 through 6)" and "Effective Date of Certified Reinsurer Rating" would be added to Schedule F and S. (2012-40BWG)

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

Life Actuarial Task Force

PBR Valuation Manual

VM-20 Asset Default Methodology

LATF received a report from the Academy which was essentially a refresher of the current methodology in VM-20 to determine asset defaults. The current methodology has 3 components: a baseline annual default cost factor, a spread related factor and a maximum net spread adjustment factor. Subsequently, regulators from NY listed several issues with the current methodology followed by an ACLI presentation on the subject. Conference calls will be scheduled to discuss.

Aggregate Margins

LATF formed a subgroup at their last meeting to consider an aggregate margin approach for quantifying uncertainty versus the current granular level of assessing margin in VM-20. The LATF subgroup is working with an Academy group which has reported significant progress. No specifics were presented at this meeting.

Post Level Term Profit Restrictions

During an interim call, LATF unanimously adopted a proposal to limit term life policy profits that a company can recognize by adjusting its modeling assumptions under VM-20 for periods for which credibility and relevance is low; generally this occurs beyond the level premium paying period.

VM-20 Mortality

LATF adopted during an interim call a proposal to change the mortality table in Section 9 (Assumptions) of VM-20 used to grade from company experience to industry experience. The amendment requires using a table with more

stringent credibility requirements for valuations on or after January 1, 2015.

VM-20 Economic Scenarios

LATF adopted a proposal that clarifies that the Valuation Manual does not specify a required number of scenarios. The change also clarifies how the economic scenario generator is to be used for the purposes of calculating deterministic and stochastic reserves, defines the mean reversion parameter and provides the website location at which the economic scenario generator can be accessed. The ACLI suggested that LATF continue to study the impact of the scenario generator and mean reversion rate. The ACLI will continue to do testing related to the reserve volatility.

Blanks Issues

LATF voted to expose for comment a draft document from 2008 that described potential changes to the annual statement blank to reflect PBR. Items included on the list of changes are Page 3 (Liabilities), Page 7 (Analysis of Increase in Reserves), Exhibit 5 (Reserves), Exhibit 5A (Changes in Valuation Bases) and a new Exhibit 5B (PBR Reserves). Regulators questioned the appropriateness of including changes in PBR reserves due to changes in PBR assumptions in Exhibit 5A. During this discussion, LATF was receptive to a verbal ACLI proposal to allow an additional 2 year grade-in period for small companies to implement PBR so that small companies are not competing for consulting resources during a time when these resources are likely to be scarce.

Other Items

During an interim call, LATF also adopted VM-20 changes to the mortality credibility percentages, starting asset requirements, and the allocation of the stochastic and deterministic reserves to individual policies using the net premium reserves as the basis.

Actuarial Guideline XXXIII (AG 33)

Guaranteed Living Income Benefits

LATF continued its discussion on issues related to the application of AG 33 to Guaranteed Living Income Benefits (GLIB) attached to fixed (non-variable) annuities. Regulators conceded that the current application of AG 33 for these benefits likely overstates reserves under AG 33's underlying principle that all policyholder behavior will be optimal, resulting in the highest possible reserve. LATF discussed 3 options available to the task force; (1) do nothing, thereby continuing with the current AG 33 redundant reserve requirements, (2) modify

AG 33 to allow election rates for these benefits to be less than 100% in the reserve calculation, or (3) modify AG 43 to cover these benefits since they are similar to GLIBs offered under variable annuities. After a lengthy discussion, the regulators rejected option 1, and then subsequently rejected option 3 which was quickly followed by the rejection of option 2. The LATF chair stated: "We have no direction right now." LATF opted to schedule a call to discuss further.

Reserves for Participating Income Annuities

LATF received a proposal from Northwestern Mutual to increase the reserve requirements for a new product design for participating income annuities with low minimum guarantees but with a significant portion of future benefits expected to come from non-guaranteed dividends on the contracts. The proposal, driven by a tax reserve issue, proposed a change in AG 33 for participating policies only that would increase the statutory reserve requirements (and would lead to higher tax reserves). Although LATF voted to expose the proposed revision to AG 33, there was considerable doubt among regulators that it is appropriate to have different reserve requirements for participating and non-participating policies.

C-3 Phase 2/AG 43 Subgroup

This subgroup of both A and E Committees is charged with developing more consistency between RBC's C-3 Phase 2 and AG 43 reserves. Short term action items, which include the definition of "in the money," issue year discount rates and standard scenario lapse rates, are expected to be completed by year end 2013. There was no specific timetable for longer term action items.

Nonforfeiture Modernization

LATF received a "mini report" from the Academy's Nonforfeiture Modernization Working Group. The Academy has developed a methodology for determining the Guaranteed Nonforfeiture Basis used to calculate the Required Policy Nonforfeiture Account. This is a retrospective approach predicated on the policy owner's prefunding of benefits through premiums paid and interest credited in excess of amounts required to pay benefit and expense charges to date. The Academy provided examples of how the methodology would work for common types of life insurance. The Academy is looking for significant guidance from LATF regarding assumptions and regulatory and actuarial guardrails for those assumptions. In the meantime, the Academy is developing additional examples for more

complex products and developing a position on a cash value option for nonforfeiture.

Generally Recognized Expense Table Factors

LATF adopted the 2013 GRET factors during an interim call. These factors had previously been presented by the SOA Committee on Life Insurance Company Expenses. These factors vary by distribution channel, consistent with the current factors, and reflect reductions in the General Agency and Brokerage factors and increases in factors for other distribution channels.

Payout Annuity Mortality Tables

Prior to the Fall National Meeting, LATF adopted NAIC Model Regulation #821 for Recognizing a New Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities. The effective date of the table will be January 1, 2014. The model was adopted by the NAIC at the Executive and Plenary session in Washington.

Synthetic GIC Reserves

LATF received a recommendation from the Academy to modify the reserve requirements for synthetic GICs. Currently there is a mismatch between asset and liability valuations with these products which creates unnecessary volatility in statutory financial results. The Academy's proposal suggested changing the valuation discount rate to a 50/50 blend of Treasury spot rates and a corporate bond index, and to eliminate the AVR factor-based deduction in the reserve in cases where the default risk is borne by the policyholder. LATF asked the Academy to mark up the current Model Law A-695 (Synthetic Guaranteed Investment Contracts). A conference call will be scheduled to discuss.

Experience Reporting

LATF received an update from the Medical Information Bureau proposing a new simplified policyholder behavior format for experience data gathering. LATF voted to expose this new format for comments until the end of January 2013.

Joint Qualified Actuary Subgroup

LATF (and subsequently HATF and the Casualty Actuarial and Statistical Task Force) agreed to form a Joint Qualified Actuary Subgroup (A/B/C) to develop recommendations on (1) a uniform definition of "qualified actuary" for life, health and P&C Appointed Actuaries signing prescribed Statements of Actuarial Opinion, identifying any differences that should remain between lines of business and a uniform definition of "qualified actuary" for other regulatory areas (e.g. rate filings,

hearings), and (2) a definition of inappropriate or unprofessional actuarial work and a process for regulatory and/or professional organizations' actions.

Emerging Actuarial Issues Working Group

The Emerging Actuarial Issues Working Group was formed by the NAIC to address implementation issues resulting from the revision to AG 38 for universal life products with secondary guarantees. Prior to Fall National Meeting, the working group had exposed for comment 18 interpretations from questions received on the new guidance, which were adopted at the Fall National Meeting. During this brief meeting, the working group reviewed new interpretations. A conference call will be scheduled for further discussion of these issues.

Health Insurance and Managed Care Committee

At its meeting in National Harbor, the committee heard an update from representatives of the federal Center for Consumer Information and Insurance Oversight (CCIIO) on the Affordable Care Act implementation activities. The CCIIO update was focused on the status of the creation of Affordable Insurance Exchanges, state-based marketplaces which launch in 2014 to provide consumers and small businesses with "one-stop shopping" for affordable coverage. In an effort to continue to encourage states to establish exchanges, CCIIO has extended the December 14 application deadline for states to apply for Exchange Establishment Funding from December 28. A federally-facilitated exchange will operate in states that have chosen not to build their own exchange. The exchanges will launch open enrollment in October 2013. With the advancement of the go-live date, the CCIIO has a few projects underway such as issuing a system application, building the website and 24-hour call center, and setting up plan valuation tools. Concerns regarding timing were raised during the meeting, as it relates to product filings and plan review. Additionally, the committee members raised concern over potential rate shock for young individuals resulting from the 3:1 age-band requirement. The concerns stem from the possibility that with an age band as narrow as 3:1, premiums for younger people will be brought up considerably higher in order to compensate for older individuals, who typically utilize more health care services yet can only have premiums that, at most,

are three times higher than those for younger individuals, who typically are light users of service.

The committee chair commented that it is a valid concern that younger folks facing a weak penalty will stay out of the market until those penalties have increased to a point where it makes sense to buy coverage. The chair suggested that the 3:1 age band start with a broader range (5:1) and then be brought down gradually over a period of several years, to minimize rate shock. While admitting that the statute in the reform law is clear about the 3:1 age band, CCIIO indicated that comments on policy implications are welcomed and will be taken into consideration for implementation of the 3:1 band.

Health Actuarial Task Force

Long Term Care

The LTC Actuarial Working Group received a presentation from Genworth which provided an overview of LTC product pricing. In an interesting comparison of "general" LTC pricing assumptions between pre-2000 issues and current new business, the report noted that ultimate lapse rates have gone from 5.5% to 1%, interest from 7.5% to 4% and mortality assumptions are lower partly due to the current use of mortality improvement factors. In other matters, the Academy noted that its practice note, Long-Term Care Insurance Compliance with the NAIC Long Term Care Insurance Model Regulation Relating to Rate Stability, has been released and is on the Academy's website (www.actuary.org). In addition, HATF asked the Academy for assistance in reviewing the appropriateness of current LTC reserve standards.

Cancer Claim Cost Table

The task force received a report from the joint Academy & SOA Cancer Claim Cost Table Work Group on the development of a new cancer morbidity table. The working group was pleased to report that 17 companies have responded to the data call and they are working to validate and synthesize the data. The working group reported that they hope to be in a position to present preliminary data at the Spring National Meeting.

Group Long Term Disability

During an interim call, the task force voted to (1) extend the deadline for comment on the proposed valuation table to May 31, 2013; (2) expose for comment the proposed revisions to Model #10, Minimum Reserve Standards for Individual and group Health Insurance Contracts, until May 31;

(3) expose for comment the proposed actuarial guideline until May 31; and (4) request that the AAA/SOA Group Long-Term Disability Work Group assist the task force in reviewing comments received concerning the initial valuation table exposure and all future comments related to the proposed valuation table, revisions to Model #10 and the proposed actuarial guideline.

Individual Disability Experience

The task force received a report from the SOA's Individual Disability Experience Committee regarding valuation tables for individual disability insurance. Current experience, both with regard to incidence rates and termination rates, has generally deteriorated since the current tables were developed (pre-2000). At the end of the presentation, the task force requested that the Academy develop a new individual disability income valuation table based on the SOA's current experience analysis.

Contingent Deferred Annuities Working Group

The working group met August 29 and in National Harbor and also held several regulator only calls to continue its discussion of the controversial issues surrounding contingent deferred annuities. During the regulator-only calls the working group developed three draft recommendations as follows:

1. Recommend to A Committee that CDAs be regulated as variable annuities for the purpose of market regulation and consumer protection. Existing laws that apply to variable annuities may need to be revised to clarify that they also apply to CDAs.
2. The adequacy of existing laws and regulations applicable to the solvency of annuities, as such laws are applied to CDAs, should be referred by the A Committee to other working groups with appropriate subject matter expertise.
3. A contingent deferred annuity shall be defined as an annuity contract that establishes an insurer's obligation to make periodic payments for the annuitant's lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually defined amount due to contractually permitted withdrawals, market performance, fees and/or other expenses.

At its meeting in National Harbor, the working group received extensive comments on the proposed

recommendations, but no conclusions were reached. A representative from the Center for Economic Justice objected to the fact that there is no documentation of the rationale for the recommendations, which were developed in closed meetings. The chair agreed to have the working group put together a document addressing the rationale for the recommendations.

The meeting included a presentation from the Insured Retirement Institute on investment parameters of CDAs and the related key components of an insurer's asset management evaluation for CDA protection. The working group also received a presentation from FINRA on its review of CDA sales material for compliance with the content standards of NASD Rule 2210. Lastly, a representative from NOLHGA gave a presentation on guaranty fund coverage of CDAs, in which he concluded that the form of the CDA reviewed by them "appears to be eligible for coverage as annuity certificates issued under a group annuity contract."

Separate Account Risk Working Group

The working group has not met since the Summer National Meeting, but will hold a conference call January 9 to resume its discussion on insulation classifications for separate account products.

Financial Regulation Standards and Accreditation Committee

The committee met in National Harbor and took the following actions:

Revisions to Review Team Guidelines

The committee adopted revisions to one of the review team guidelines under the "Communication of Relevant Information to/from Examination Staff" for financial examinations. The revision was the result of a referral from the Risk Focused Surveillance Working Group, and is intended to bring the guideline more in line with the language in the Financial Condition Examiners Handbook related to communications between examiners and analysts at the conclusion of an examination.

Revisions to Part A Preamble

The committee discussed a proposed revision to the Part A Preamble to clarify that certain accreditation standards are applicable to health organizations. The Preamble currently does not make reference to health organizations. The change became necessary as a result of the committee's adoption of the Risk-

Based Capital for Health Organizations Model Act as an accreditation standard at the Summer National Meeting. The proposal was exposed for a 30-day comment period.

CPA Audit Standards

The committee discussed a proposed revision to the Part A CPA Audits accreditation standard to clarify that state statute or regulation should contain a requirement for annual audits of domestic insurance companies "that is substantially similar to" the Annual Financial Model Regulation. The proposal was exposed for a 30-day comment period.

Viatical Settlements Working Group

At its meeting in National Harbor, the working group discussed in detail comments received on drafts of the proposed guideline amendments to the Viatical Settlements Model Regulation (#698), including the new Appendix A - Informational Brochure. The working group agreed to make certain revisions to the drafts based on comments received and discussion during the meeting. On December 7, the working group exposed the revised drafts of the proposed guideline revisions, including a revised Appendix A. During its December 18 conference call, the working group made minor revisions to the drafts based on comments received, and adopted the revised drafts, noting that the updated drafts will be circulated to the working group members and the Life Insurance and Annuities Committee. Unless the committee requests for the working group to convene, the working group has completed its charge and is not expected to reconvene.

Annuity Disclosure Working Group

The working group met to discuss the November 28 draft of the Annuity Buyer's Guide for Deferred Annuities. The draft contemplates a single guide for both variable and fixed annuity products. Given the brief period of time between the release of the draft and the meeting, there were no significant comments made during the meeting. In working toward finalizing the Buyer's Guide, the draft was exposed for comment and conference calls will be held early in 2013 to discuss comments received and effective date. Comments on the draft were due January 2.

Casualty Actuarial and Statistical Task Force

The task force discussed referrals from the Statutory Accounting Principles Working Group on the actuarial calculation of death, disability or retirement (DDR) reserve and accounting for policyholder loyalty program obligations. The DDR reserve referral pertains to policy reserves related to claims-made policies that provide extended service coverage at no additional charge in the event of death, disability or retirement of an insured person. For these policies, SSAP 65 requires a policy reserve for these contracts (i.e., DDR reserve) to ensure an ability to pay future claims arising from these coverage features as well as to ensure that the premiums are not earned prematurely. It has been identified that the current guidance in SSAP 65 for calculating the DDR reserve is inconsistently applied, can be materially impacted by slight changes in the underlying parameters, and may hinder application of actuarial methodologies outside of the traditional approach. The loyalty program referral pertains to incorporation of guidance for cash benefit loyalty programs into SSAP 65, whereby such cash benefits are treated as part of policy reserves for claims-made policies.

It was discussed at the meeting that an outreach has been made to the SAPWG for additional information and the task force is awaiting a response. The task force also requested input from the American Academy of Actuaries on both referrals. AAA has formally responded via comment letter on the DDR reserve matter and provided verbal comments on loyalty program matter. AAA commented that no change to SSAP 65 is recommended iff the SAPWG does not intend to revise the scope, definition, or representation of the DDR reserve obligation and conversely if the SAPWG desires changes in the definition or representation of the DDR reserve obligation, additional information to provide further perspective on the applicability of different methods and the financial impact of such a change is needed. AAA agreed with the task force that additional information is needed to consider the loyalty program referral.

Risk-Focused Surveillance Working Group

The working group, charged with reviewing the effectiveness of risk-focused exams and implementing improvements, met November 16 via conference calls and exposed two documents for comment: proposed Critical Risk Categories for Review in Financial Examinations and Sound Practices for Risk-Focused Exams Generated by Industry Feedback. Interested parties submitted a comment letter January 4 and appear to have some significant comments about the documents. Work on these issues will continue in 2013.

Climate Change and Global Warming Working Group

Impact of Climate Exam Subgroup

The subgroup met by conference call on November 15 to review proposed updates to the Financial Condition Examiners Handbook. The subgroup reached consensus on the call and recommended the updates be considered by the working group. The working group approved suggested changes to the Financial Condition Examiners Handbook via a November 19 email vote, and recommended the changes be considered for adoption by the Financial Examiners Handbook Technical Group. The technical group met by conference call November 20, at which time they adopted the working group's suggested updates to the handbook. The revisions are expected to be included in the next published version of the Examiners Handbook for 2013.

Impact of Climate Disclosure Survey Subgroup

The subgroup plans to resume monthly conference calls in the first quarter of 2013 to review the climate disclosure survey results from the multi-state initiative. The subgroup will consider whether the survey is meeting its objectives and whether any changes could be made to improve any aspects of the survey.

Title Insurance Task Force

At the Fall National Meeting, the task force received an update on projects as follows:

Title Insurance Risk-Based Capital

The Title RBC Joint Subgroup of the Capital Adequacy Task Force and the Title Insurance Task Force held a conference call on November 14 to discuss the pros and cons of developing risk-based

capital standards for title insurers. In order to determine if RBC standards are needed for title insurers, the subgroup acknowledged that it needs to identify unique risks of title insurers, examine causes and impacts of insolvencies, and identify challenges in implementing RBC standards for title insurers. The subgroup discussed contacting the Financial Examiners Handbook Technical Group and the Financial Analysis Research and Development Working Group to understand financial tools that have been developed for analyzing title insurers. The subgroup also discussed contacting domiciled states of large title insurers to identify prominent risk factors that title insurers face.

Title Insurance Escrow Theft White Paper

Since the Summer National Meeting, the subgroup held two conference calls to continue its work on drafting a white paper on escrow theft. It is hoped that the white paper will serve as a tool for regulators to research methods for combating and preventing escrow theft, title insurance theft and other forms of fraud associated with title insurance and closing services transactions. The subgroup has exposed several sections of the draft white paper and received comments. The subgroup plans to hold conference calls to continue drafting additional sections of the white paper.

Title Guaranty Fund

During a conference call held on November 13, the Title Insurance Guaranty Fund Working Group discussed the guaranty fund research summary prepared by NAIC staff. The research indicates the following:

- There have not been a large number of title insolvencies. The data suggests that there were some problems in 2008 when five title companies were declared insolvent and since then, insolvencies have slowed and there does not appear to be any single state with a significant problem.
- Although a majority of states have adopted laws substantially similar to the Title Insurance Agent Model Act (#230) and the Title Insurers Model Act (#628), only six states have implemented a guaranty fund or alternative mechanism.
- Of the six states that have established guaranty funds, only two state title guaranty funds have paid claims for insolvent title companies, which have been very small in relation to the title net premiums earned.

- It is doubtful whether a sufficient number of states would support the development of a title guaranty fund model law or guideline. Because states regulate title insurance in diverse ways, it is unlikely that a majority of states would agree on the utility of a guaranty fund or what it would cover or how it would be structured.

The working group discussed comment letters from the Center for Economic Justice and Old Republic Insurance Company. Although the Center for Economic Justice raised strong objections to the NAIC staff research findings and commented that there is a serious title insolvency problem, it expressed opposition to the development of a title guaranty fund model law or guideline. Old Republic commented that a guaranty fund is not necessary due to the presence of the title statutory premium reserve. The working group agreed that additional research on the impact that insolvency of a major title insurance company would have on consumers' needs should be pursued before the working group can recommend action.

Risk Retention Group Task Force

The task force discussed two audit-related concerns raised by NAIC staff regarding the requirements of the Annual Financial Reporting Model Regulation (#205) as applicable to captive RRGs. The first concern was whether the model regulation requires captive RRGs, which prepare GAAP financial statements for regulatory purposes, to have the GAAP to statutory reconciliation included as an audited footnote. A task force member noted that most captive RRGs do not maintain separate statutory financial records. It was noted that statutory financial records would be required in order for a CPA firm to audit the GAAP to statutory reconciliation. Such requirements may be cost prohibitive. The task force agreed to discuss this issue on an interim conference call.

The second concern raised was whether some states may be exempting captive RRGs from an annual audit requirement based on the RRGs premium dollar amount or number of policyholders. Such exemptions are permitted for traditional insurers in accordance with the model regulation; however, under the federal Liability Risk Retention Act of 1986 these exemption criteria are not applicable to RRGs. The task force agreed to survey states to determine whether any states are exempting captive RRGs from an audit requirement.

The Risk-Focused Examinations Subgroup completed its work to develop best practices suggestions for conducting risk-focused examinations of captive RRGs. The task force discussed the suggestions and referred the document to the Risk-Focused Surveillance Working Group for possible inclusion in a broader practice aid. Having completed its charge the task-force voted to disband the subgroup.

The next National Meeting of the NAIC will be held in Houston April 6-9. We welcome your comments regarding issues raised in this newsletter. Please provide your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor at jean.connolly@us.pwc.com.

Disclaimer

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

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

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