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NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2013 Fall National Meeting

The National Association of Insurance Commissioners held its Fall National Meeting in Washington, D.C. December 13-18. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

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Executive Summary

- The NAIC held its annual election of officers; for the first time in its history, the nominations were conducted in a public forum.
- The Executive Committee discussed a contentious proposal from Connecticut to engage outside consultants to conduct a thorough evaluation of the NAIC's governance structure. The proposal failed, but a subsequent motion to refer the proposal to an ad hoc governance review group was adopted unanimously.
- The FIO Report, *How to Modernize the System of Insurance Regulation in the United States*, was finally released, just as the Fall National Meeting began. The NAIC issued press releases on the report.
- The Private Equity Issues Working Group met for its first public meeting and heard a presentation from a private equity firm, which included a comment letter response on proposed best practices for regulators in their review of potential acquisitions of life insurers by private equity companies and hedge fund managers.
- The Statutory Accounting Principles Working Group adopted controversial guidance on accounting for the Affordable Care Act fee and also adopted SSAP 105 on working capital finance investments.
- The Emerging Accounting Issues Working Group adopted clarification guidance on OPEB and pension transition surplus deferral and exposed statutory accounting guidance for "the 3Rs" of the federal Affordable Care Act.
- The Capital Adequacy Task Force exposed for comment a significant proposal for an operational risk charge for all three RBC formulas; the regulators are suggesting a 2014 effective date. The task force also discussed whether it should more strictly prioritize its projects due to time and resource constraints.
- The Life RBC Working Group discussed potential alternatives to update C-3 Phase I which it hopes to be effective for 2014 and heard comments on New York's unauthorized reinsurance proposal. The working group's Stress Testing Subgroup also had its first meeting.
- The Investment RBC Working Group continues to consider the recalibration of invested asset factors. The AAA has made significant progress on the corporate bond modeling project, and presented preliminary results at the Fall National Meeting. The working group exposed for public comment a proposal to update the real estate factors used in the life RBC calculation.
- The Property/Casualty RBC Working Group continues to consider a proposal to revise the reinsurance credit risk charge. The working group also received a presentation from the Casualty Actuarial Society on its current research regarding underwriting risk charges.
- The Catastrophe Risk Subgroup adopted its previously exposed U.S. Hurricane and U.S. Earthquake lists, discussed concerns relating to the attestation for catastrophe modeling, and requested proposals for a revised contingent credit risk charge for R6 and R7.
- The Health RBC Working Group adopted an ACA Fee Sensitivity Test for 2014 RBC; the proposal will not be finalized until the statutory accounting for the fee receives final adoption.
- The Valuation of Securities Task Force discussed 2013 year-end RMBS and CMBS modeling, evaluated the accounting classification of residual tranches of securitizations, amended the SVO Purposes and Procedures Manual to provide filing instructions for working capital finance investments, and adopted a recommendation that insurers file Freddie Mac's STACR and similar mortgage-referenced transactions with the SVO to receive a modeled NAIC designation.
- The PBR Implementation Task Force discussed the Rector & Associates Initial Report on captives, which recommends the use of an actuarial standard, such as VM-20, to evaluate all XXX and AXXX captive transactions.
- The Corporate Governance Working Group discussed and exposed its draft Corporate Governance Annual Filing Model Law, which would require all insurers/insurer groups to file annual corporate governance reports effective January 1, 2016. The working group also released an updated draft of its proposed internal audit requirement for large insurers.

- The NAIC held an EU-U.S. Dialogue Project: Supervisory Colleges Best Practices Forum at the Fall National Meeting which had high-level attendance from insurers and regulators, both international and U.S.-based.
- The ORSA Subgroup released the results from its 2013 ORSA pilot project, which showed improvements in the quality of the ORSA Summary Reports submitted compared to the first pilot done in 2012.
- The Reinsurance Task Force approved four conditionally qualified jurisdictions: Bermuda, Germany, Switzerland and the UK.
- The Blanks Working Group adopted three blanks proposals as final since the Summer National Meeting. Two previously deferred proposals were rejected and five blanks proposals were exposed for public comment.
- After significant debate, the Life Insurance and Annuities Committee adopted a charge to undertake a study to determine if recommendations should be made to address unclaimed death benefits.
- The Life Actuarial Task Force now estimates that January 1, 2016 is the earliest possible operative date for the implementation of Principle-Based Reserving and the Valuation Manual. The Joint Qualified Actuary Subgroup continued its discussion on the definition of a "qualified actuary."
- The Emerging Actuarial Issues Working Group continued its work on addressing implementation issues related to the AG 38 revisions.
- The Contingent Deferred Annuity Working Group discussed its work plan and timeline for completion of its charges. With the assistance of many other NAIC groups, the working group hopes to develop and adopt revisions to existing NAIC model regulations applicable to contingent deferred annuities at the 2014 Fall National Meeting.
- The Separate Account Risk Working Group exposed suggested principles for insulating assets to address equity and solvency concerns for insulated products.
- The Terrorism Insurance Implementation Working Group finalized a letter in response to a Federal Insurance Office request for comment on issues related to terrorism insurance and the Terrorism Risk Insurance Act which is set to expire December 31, 2014. The NAIC fully supports the reauthorization of TRIA.
- The Mortgage Guaranty Insurance Working Group exposed for comment in November proposed significant changes to the *Mortgage Guaranty Insurance Model Regulation (#630)*; the working group heard extensive comments on the draft in Washington and extended the comment deadline to February 15.

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. The officers for 2014 are as follows: Commissioner Adam Hamm of North Dakota was elected President, Commissioner Monica Lindeen was chosen as President-Elect, Pennsylvania Commissioner Michael Consedine was chosen as Vice President, and Commissioner Sharon Clark of Kentucky was elected Secretary-Treasurer. For the first time in the history of the NAIC, the nomination of the officers was conducted in the public forum. However, the voting was administered by secret ballot and the vote counts were not disclosed publicly. Commissioners Julie Mix McPeak of Tennessee and Wayne Goodwin of North Carolina ran against Commissioner Clark for the position of Secretary-Treasurer. The remaining executive positions were unopposed.

NAIC Policy Statement on Open Meetings
Proposed revisions to the NAIC Policy Statement on Open Meetings were exposed for public comment. The proposed revisions reemphasize the NAIC's commitment to conducting its activities openly and

clarifies when it is appropriate for regulator-only sessions to occur. It would require that the reason for holding any meeting in a regulator-only session to be disclosed publicly.

<u>Adoption of New or Revised Models</u>
The Commissioners unanimously adopted the following items which were the subject of public hearings and debate as they were considered by various groups of the NAIC:

- Guideline amendments to the *Annuity Disclosure Model Regulation (#245)*
- Amendments to the *Standard Nonforfeiture Law for Life Insurance (#808)*

<u>Executive Committee</u>
In Washington, the Executive Committee approved a model law development request from the Life Actuarial Task Force to amend the *Actuarial Opinion and Memorandum Regulation (#822)* to include a requirement for the appointed actuary to present the actuarial opinion and memorandum to the insurer's board of directors annually. The task force will also consider modifications to enhance the usefulness of the actuarial opinion and memorandum as a regulatory tool by making its information more accessible.

The Executive Committee discussed a motion from Connecticut Insurance Commissioner Thomas Leonardi, and seconded by New York, to engage outside consultants to conduct a thorough evaluation of the NAIC's governance structure. The Connecticut Commissioner expressed significant concerns with current governance practices and the lack of true transparency in the decision making process. Indiana Insurance Commissioner Stephen Robertson expressed concerns with raising this topic for discussion in the public forum and suggested that the proposal be referred to the ad hoc NAIC governance review group and that further discussion be conducted at the Commissioners Forum in February. Perhaps lending credibility to Commissioner Leonardi's concerns was the fact that the existence of this ad hoc governance group had not previously been disclosed publicly. (Members of that group are the directors/commissioners from Missouri, Kentucky, North Carolina, Nevada, Connecticut and Tennessee.)

A brief, but heated, debate commenced among Executive Committee members with references made to a letter sent by the Commissioner Leonardi to state regulators dated December 11, which has now been widely distributed. In the letter, the commissioner cites numerous concerns and, in addition to the request to hire outside consultants, recommends the following specific additional actions:

- Clarify the role and specific authorities of the President, the officers, the Executive Committee, and the broader membership in key decision making that impacts state regulation. Particular attention should be given to the manner in which representatives of the state system and NAIC are appointed to external bodies or forums that could directly impact state regulation, such as IAIS, Joint Forum, or others.

- Review the election process to determine whether it follows best practices for organizations of government officials and make changes as necessary.

- Review/clarify the role and authority of the NAIC CEO to determine whether it follows best practices. The NAIC board should establish and adopt a strategic plan at the beginning of each year and task the management and staff of the organization with the execution of that strategy, utilizing the vast talents, resources and relationships of the various members and their state staffs.

The debate was cut short by a motion by Kansas Insurance Commissioner Sandy Praeger to call the question. The motion to call the question passed by a 10-7 margin; the Connecticut proposal then failed by a 12-5 margin. Indiana then made a motion to direct the ad hoc NAIC governance review group to consider whether to engage an outside consultant to assist in their review. That motion passed unanimously.

FIO Report

On December 12th, 2013, the Federal Insurance Office released its report, *How to Modernize the System of Insurance Regulation in the United States*. The report, required by Title V of the Dodd-Frank Act, was due for submission to Congress in January 2012.

The report considers both prudential (solvency) and marketplace (business conduct) regulation. The report considers that a lack of uniformity in the U.S. regulatory system creates inefficiencies and a cost burden for insurers, consumers and the international community, and risks creating opportunities for regulatory arbitrage. The report also notes that the increasingly international nature of the insurance marketplace necessitates a federal presence in insurance regulation, and that international negotiations would be substantially facilitated by uniform regulation.

However, the report also notes advantages of state-based regulation, including the local nature of many insurance products, and the substantial cost and resources of establishing a federal regulator. The report also recognizes the existence of current state regulatory initiatives relevant to many of the recommendations in the report, although it notes that progress so far has been uneven.

The FIO report therefore considers not whether federal regulation should replace state-based regulation, but whether there are areas in which federal involvement in regulation under the state-based system would be warranted. As a result, most of its recommendations are focused on steps that could be taken by the states, and federal involvement is recommended only where state-based regulation is considered to be legally or practically limited in its ability to address specific concerns.

The report proposes 18 recommendations for actions from state regulators, and 9 recommendations for direct federal involvement. The report in full can be accessed on the FIO's website.

Some of the more significant recommendations in relation to state supervision include the following:

- Convergence of solvency and capital regulation
- A uniform and transparent solvency oversight regime for captives
- An independent, third party review mechanism for the NAIC's accreditation program
- "Cautious" implementation of PBR, subject to binding guidelines on regulatory practices over compliance with accounting and solvency requirements, adequate resources and expertise, and uniform guidelines for supervisory review
- Character and fitness expectations for directors and officers
- A uniform approach to closing out and netting qualified contracts with counterparties
- Uniform policyholder recovery rules in relation to guaranty funds.

Significant recommendations in relation to direct federal involvement include federal standards and oversight for mortgage insurers, pursuit of a covered agreement for reinsurance collateral requirements and FIO engagement in supervisory colleges.

As noted above, the report aims to recommend improvements to U.S. insurance regulation within the existing state-based regulatory system. However, the report recommends that Congress consider direct federal involvement more broadly, should modernizing reforms not be achieved by the states in the near term.

The NAIC's President, Louisiana Insurance Commissioner Jim Donelon, and CEO, Senator Ben Nelson, both issued statements following the release of FIO's report. The statements recognized the report's acknowledgement of the effectiveness of state-based regulation, and stated that the NAIC would consider its recommendations. However, the statements also noted that the responsibility for implementing regulatory changes rests with the states.

Commissioner Donelon, Senator Nelson, FIO Director Michael McRaith, and 17 other state insurance commissioners and NAIC representatives subsequently met with Treasury Secretary Jack Lew, to discuss the FIO, aspects of the FIO's report, and current international insurance work. At the meeting, Secretary Lew noted the international role of FIO, and emphasized that state regulators and the Treasury should continue to engage on regulatory issues, and to work together to modernize insurance regulation.

PwC issued a Regulatory Brief on the FIO report which is available on PwC's CFO Direct.

Private Equity Issues Working Group

At the Fall National Meeting, the working group held its first public meeting, which has been charged with developing best practices that emphasize different regulatory approaches using existing authority to address additional risks created by the ownership of life and annuity insurers by private equity interests and hedge fund managers. The chair opened the meeting by stating that the focus of the working group will be the development of best practices for the Financial Analysis Handbook and the Financial Condition Examiners Handbook. Before doing that, the working group agreed they needed to get input from all relevant parties, including private equity firms, to get their perspectives. The majority of the hour long meeting was a presentation from Apollo Global Management and Athene Holding Ltd. during which management discussed their history, structure, operations, insurance expertise and the need for private equity investors in the insurance industry. They noted that while they agree that the overriding regulatory principle should be protection of policyholders, "equitable treatment of companies is an issue of equal concern." All entities should be "regulated on the basis of a level playing field."

Athene Holding Ltd. also distributed a comment letter at the meeting, responding in detail to the May 6, 2013 letter from the Financial Analysis Working Group to the Financial Condition Committee on "possible best practices" for regulators in their review of potential acquisitions by private equity company and hedge fund managers. The comment letter analyzed the draft best practices and separated them into four categories: 1) suggested best practices already within the purview of state insurance departments, and therefore no changes to laws or regulations to implement would be required, 2) suggested best practices that, if adopted, should be applied to all potential investors, not just private equity companies, 3) suggested best practices that are not feasible, set an unfair standard or are not germane to the regulatory practice, and 4) those that require subjective assessment and are best left to the insurer's management and board of directors. Included in the third category was the suggestion of "requiring the acquiring entity to demonstrate that the policyholder is fundamentally more secure with the proposed acquisition of control." Included in the last category was determination by regulators that the investment strategy and related affiliated agreements "are appropriate for the backing of annuity contracts and ensuring that assets properly match insurance liabilities."

At the conclusion of the presentation, the working group re-exposed for comment the May 6 letter until January 31.

Statutory Accounting Principles Working Group

The working group was very active during the fall and early winter holding five conference calls and meeting in Washington D.C. to discuss the issues below. The most contentious issue has continued to be the proposed accounting for the Affordable Care Act (ACA) fee summarized below.

Adoption of New Standards or Revisions to SSAPs

(After each topic is a reference to the Statutory Accounting Principles Working Group's agenda item number.)

<u>SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers (2011-38)</u> – In the period since the Summer National Meeting, the working group held three lengthy conferences calls and released a revised exposure draft in November in an effort reach final consensus of accounting for the ACA fee. The issue in conflict is whether, after 2013, should the assessment payable in the subsequent year (i.e. fee year) be accrued as a liability as of current year (i.e. data year). During its November 14 conference call, the working group voted 7-4 to re-expose the proposed guidance with revisions to 1) expense the fee on January 1, as opposed to recognizing a deferred asset which would be non-admitted, and 2) expand the RBC disclosures beginning in 2014 to highlight the RBC effect of the fee not accrued. This most recent draft does not require accrual of the fee in the data year, but does require entities subject to the fee to reclassify from unassigned surplus to special surplus the estimated subsequent year's assessment. This segregation in special surplus would be accrued monthly throughout the data year.

In a repeat of what occurred at the Summer National Meeting, there was contentious discussion in Washington D.C. at every meeting the ACA fee was discussed. At the SAP Working Group meeting, the working group voted 10-2 to adopt the current draft of the guidance after lengthy and heated debate. At the meeting of its parent, the Accounting Practices and Procedures Task Force overturned the decision of the SAP Working Group in a 19-18 vote and revised the guidance to require accrual of the fee during the data year. At the subsequent meeting of the Financial Condition Committee, the outcome of APP Task Force meeting was again overturned, this time with an 8-4 vote; the committee then approved the guidance adopted by the SAP Working Group. The next and final step is consideration by all the commissioners at an Executive and Plenary meeting, which is expected to require a roll call vote. The NAIC is working to arrange a date for the conference call vote so that the issue can be resolved in early 2014.

Unlike 2014 and subsequent years, there is no uncertainty related to accounting for year-end 2013; no liability accrual is required for the fee payable in 2014, but disclosure of the nature of the assessment and an estimate of its financial impact, including the impact on RBC position, is required per paragraph 15 of SSAP 35R.

<u>Working Capital Finance Investments (2013-10)</u>
During the fall, the working group continued discussion of working capital finance investments, having substantive and sometimes contentious debate during conference calls October 4 and

November 12, including whether or not the domiciliary regulator should also have to give explicit permission for an insurer to invest in such assets, in addition to having the WCFI program approved by the SVO. A revised SSAP 105 was exposed for comment after the November 12 conference call with the following revisions:

- changes requested by industry to paragraphs 13-15 related to documentation of "first priority perfected interest"
- changes related to the audit report requirement for the finance agent, and
- revising the explicit permission requirement by the domiciliary commissioner to the following guidance: "initial permission to invest in Working Capital Finance Investment Programs may be required by the domiciliary commissioner," which will allow individual states to determine whether such approval is required.

At the Fall National Meeting, the working group adopted the revised SSAP 105, effective January 1, 2014. Consistent with earlier drafts, the final guidance requires that the investments must be rated NAIC 1 or NAIC 2 by the Securities Valuation Office (SVO) in order to be admitted assets. The SVO has issued additional guidance on its filing requirements for WCFI programs; see the Valuation of Securities Task Force meeting summary for those requirements.

Share-Based Payments with Non-Employees (2013-03) – During its November 12 conference call, the working group adopted exposed revisions to Issue Paper 146, Share-Based Payments with Non-Employees and exposed proposed revisions to SSAP 104 to adopt, with modification, ASC 505-50 *Equity Payments to Non-employees*. At the Fall National Meeting, the working group adopted the guidance, now SSAP 104R, with a revision to the effective date to December 31, 2014 from January 1, 2014; the accounting will be applied prospectively.

SSAP 43R Impairment Footnote (2013-15) – The working group adopted revisions to SSAP 43R to reduce the "cumulative OTTI footnote" for loan-backed securities to report only current year impairment activity; this change is effective for 2013 financial statements.

Restricted Asset Subgroup and Proposed FHLB Disclosures (2013-27) –At its October 4 conference call, the SAP Working Group adopted the Restricted Asset Subgroup's proposed new disclosures related to FHLB transactions, which include significant new disclosures in the following areas: FHLB capital stock, collateral disclosures, borrowing capacity and agreement asset and liabilities**.** Revisions to the general interrogatories clarify that the FHLB stock and collateral are subject to the RBC off-balance sheet risk charge. The new disclosures are effective the first quarter of 2014 and are required each quarter regardless of whether there has been significant change in activity since the prior year end. The subgroup plans to hold a conference call in early 2014 to discuss liquidity issues related to FHLB transactions.

SSAP 5R Revisions (2013-18) – The working group adopted, with modification, ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. The only modification from the ASU relates to estimating an obligation: if there is no better estimate within a range, then the midpoint is to be used as the estimate. The guidance also includes disclosure requirements which are effective for 2013 financial statements (which is earlier than the related GAAP guidance's effective date).

Make Whole Call Provisions and Continuously Callable Bonds (2013-21) – The working group adopted proposed revisions to SSAP 26 to clarify amortization requirements for bonds with make whole call provisions and bonds that are continuously callable. The revisions will not require insurers to consider make whole call provisions in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the provision.

Title Insurance Loss Reserves (2012-33) – The working group adopted 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. These amendments had been extensively debated over the last year.

SSAP 68 and Goodwill (2013-20) – The working group adopted revisions to SSAP 68 to clarify that the elimination of goodwill when the investee ceases to exist applies to both statutory purchases and mergers, and that internally generated goodwill and goodwill of the reporting entity in itself are not permitted.

SSAP No. 101 Q&A – Financial & Mortgage Guaranty Insurers (2013-25) – The working group adopted nonsubstantive changes to the SSAP 101 paragraph

22 disclosures and Q&A questions 1 and 4 to be consistent with the changes to SSAP 101 paragraph 11.b. adopted at the Spring National Meeting related to DTA admissibility.

SSAP 69 Revisions (2013-22) – The working group approved revisions to SSAP 69 to adopt, with modification, ASU 2012-05, *Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows* and clarify that donated, use-restricted financial assets are nonadmitted.

ASU 2013-07, *Liquidation Basis of Accounting* (2013-19) – The working group adopted rejection of this new GAAP guidance as not applicable to statutory accounting.

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

Comments on exposed items are due to NAIC staff by February 12.

Three Risk Sharing Provisions under ACA (2013-28) Consideration of the "3Rs" is now being addressed by the Emerging Accounting Issues Working Group as discussed below.

Consideration of ASU 2013-10, *Derivatives and Hedging – Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes* (2013-32) – The working group exposed for comment proposed revisions to SSAP 86 to adopt the ASU, with inclusion of a definition of a benchmark interest rate that includes the GAAP revisions in ASU 2013-10 and to eliminate the restriction regarding use of different interest rates for similar transactions.

ASU 2011-09, *Disclosures about an Employer's Participation in a Multiemployer Plan* – The working group exposed proposed revisions to SSAP 92, OPEB, and SSAP 102, Pensions, to incorporate some but not all of the disclosures required by ASU 2011-09. The working group also requested comments on whether use of multiemployer plans is prevalent by insurance entities.

Derivatives Reporting (2013-13) – The working group reported that NAIC staff have drafted "preliminary elements" for a centrally-cleared derivative issue paper and will begin working with regulators and industry representatives. Insurers interested in working on the project should contact NAIC staff.

Insurance Contracts – The working group issued a comment letter in October to the FASB on its June 2013 FASB exposure draft on insurance contracts. The comment letter does not support the proposed ASU for insurance contracts as the NAIC believes the guidance "will not result in decision-useful information necessary for financial statement users" and "does not improves existing U.S. GAAP."

Consideration of GAAP Tax Guidance (2013-26) – At the Summer National Meeting, the working group exposed for comment proposed revisions that define tax positions and their settlement. The working group proposes rejection of ASU 2009-06, *Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities* and partial rejection of FSP FIN 48-1, *Definition of "Settlement."* The guidance also proposes a definition of "tax position" that mirrors the GAAP definition to prevent a GAAP to SAP difference for terminology. In their comment letter, interested parties requested that the FSP and the concept of "effective settlement" be rejected for statutory accounting as adoption would impact small insurers that do not prepare GAAP financial statements and are not subject to frequent or on-going tax examinations. They also submitted alternative guidance. The working group deferred action to allow staff additional time to review the proposed alternative.

Accounting for Single-Member or Single-Asset LLCs (2013-17) – At the Summer National Meeting, the working group exposed for comment a proposal from a large life insurer to account for real estate held by certain LLCs under SSAP 40 (primarily valued at cost) as opposed to SSAP 48 (valued using an equity method and with a higher RBC charge) when certain criteria are met. Comments received in Washington demonstrated support by interested parties of the proposal and they requested that the proposal be expanded to include multiple member LLCs when all the members are in the same affiliated group. The working group decided to keep the scope of the proposal to single members (and discuss other structures as part of its long-term project on investment classifications (discussed below)). The working group deferred further action until it receives input from the Capital Adequacy Task Force on the RBC aspects of the proposal.

Definition of Mutual Funds and Bond/Equity (2013-36) – After a brief discussion of inconsistencies among the bond and equity SSAPs with regard to classification and accounting, the working group agreed to a new comprehensive project to review the investment SSAPs and clarify definitions, scope, accounting methods and reporting guidance. This long-term project will be coordinated with the Valuation of Securities Task Force and other relevant groups and will likely expand beyond mutual funds, bonds and equity investments. The working group exposed for comment the overall proposal and also asked for identification of additional issues.

SSAP 97 Appendix B Flowchart (2013-31) – The working group exposed for comment a proposed clarifying statement for the Determining the Valuation Method under the SSAP 97 Flowchart: "For downstream holding companies, the sum of all investments in SCAs within (in accordance with the valuation methods by type of SCAs) are calculated as the investment in the downstream holding company as detailed in paragraph 21."

Emerging Accounting Issues Working Group

OPEB and Pension Transition Obligation Deferral Clarification – The working group addressed an unexpectedly important and controversial issue in the last few weeks of 2013. On November 20, the working group voted by email to expose INT 2013-03, Clarification of OPEB and Pension Transition Surplus Deferral; there was no public conference call prior to exposure of the proposed Interpretation. Because of many questions to NAIC staff during 2013, the working group concluded additional guidance is needed to address amortization of the deferred transition obligation to the extent the plan reflects a prepaid benefit cost or if circumstances result in subsequent gains attributable to the plan.

Per the INT, the accounting issue is whether a surplus benefit was intended to result from pension/OPEB changes or activities when an unrecognized pension/OPEB transition liability continues to exist. The regulators affirmed that it was never the intent that the deferral guidance in SSAP 92 and 102 to result (on a net basis for each plan) in more favorable, subsequent surplus pension/OPEB positions when there are remaining unrecognized liabilities as a result of the reporting entity's initial election for surplus deferral. The working group concluded that "if there is a plan curtailment, settlement, or other plan amendment resulting in a reduction of benefit obligations, or net benefit obligation gains due to revisions in assumptions (e.g., discount rates) or plan experience differing from assumptions, or plan asset gains due to the actual return on plan assets exceeding the expected return on plan assets, a corresponding amount of unrecognized liability from the surplus deferral shall be recognized."

The final consensus was adopted over strong objections from interested parties who argued that the proposed interpretation is contrary to the original purpose of the deferral option of the SSAPs and that the guidance is being proposed too late in the year to be effective for 2013 and would require some companies to take unplanned fourth quarter reductions in surplus. The working group was not persuaded and adopted the guidance effective for year-end 2013. Prior to the Fall National Meeting, the working group did agree to revise the INT to remove contributions to benefits plans from the list of factors that would trigger additional amortization of the transition liability.

Accounting for the 3Rs
At the Fall National Meeting, the working group voted to expose INT 13-04, Risk Sharing Provisions of the Affordable Care Act, to prescribe the statutory accounting treatment for the risk adjustment, reinsurance and risk corridor sections of the federal Affordable Care Act, which is effective January 1, 2014; the comment deadline is January 16. During the discussion in Washington, the working group noted that the tentative conclusions reached in the proposed Interpretation are generally consistent with those proposed by industry in their "informational exposure draft" released in November, which suggested specific accounting guidance for each component of the three programs. The working group noted that the "90 day rule" for admitting receivables will apply to amounts due under the programs, aged from when the governmental disbursement is due, not from the date of initial accrual. The working group also noted that the SAP Working Group may need to develop disclosures to address the use of significant estimates in accounting for the three programs, which is a significant concern for both statutory accounting and U.S. GAAP accounting. The working group hopes to finalize the accounting in the first quarter of 2014.

Capital Adequacy Task Force

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

Operational Risk Charge Proposal
After significant discussion, the task force voted to expose for comment until January 31 the SMI RBC Subgroup proposal for an operational risk charge for all three RBC formulas. See the summary of the SMI RBC Subgroup for additional discussion.

Connecticut RBC Letter
The task force had a spirited discussion of a letter written by task force member Richard Marcks, chief

actuary of the Connecticut Insurance Department, suggesting that the task force more strictly prioritize its work and assign specific resources to those priorities. He also suggested that too much time is spent on projects which have an immaterial effect on RBC, and four other task force members voiced support for this statement. The chair of the Life RBC Working Group commented further that RBC is being used for too many purposes other than identifying weakly capitalized companies and that the trigger levels should be increased to better identify those companies. Discussions on this topic will continue in 2014.

RBC Proposal Template

The task force exposed for comment a proposed RBC proposal template, similar to the template used by the Blanks Working Group and the SAP Working Group, to better track all RBC proposals.

Life Risk-Based Capital Working Group

The working group held conference calls September 18 and November 1 and met in Washington and discussed the following issues.

Formation of Stress Testing Subgroup

This subgroup held its first meeting via conference call December 4. Its charge, as assigned by the PBR Implementation Task Force, is to "evaluate RBC in light of PBR and consider changes to RBC as needed because of the changes in reserve values, contemplating "right sizing" of reserves, margins in the reserves, any expected increase in reserve volatility, and the overall desired level of solvency measurement." The subgroup is to "consider a total balance sheet approach (e.g. total asset requirement (TAR) type calculation and then subtracting out the PBR reserves) and application of stress scenarios."

The first phase of the subgroup's work will be educational. To that end, the December 4 conference call was a presentation from the AAA entitled "Stress Testing and Scenario Analysis," which included discussion of the use of stress tests by insurers and key considerations in deriving scenarios and stress tests. The meeting concluded with a representative of the Academy stating that insurance companies are at the very beginning of this journey and regulators shouldn't expect harmony and consistency in the way companies look at this stress testing and analyze data. There is growing interest from a company perspective of "doing it right," but it will take quite a bit of time to determine what the "right" way of performing stress testing is. A second educational session had been scheduled for the Fall National Meeting but was cancelled by the subgroup to allow additional time to prepare.

Possible C-3 Phase I Modifications

The working group discussed during both its September 18 conference call and at the Fall National Meeting potential alternatives to update C-3 Phase I for the current interest rate environment. The four alternatives being considered are the following:

1. Leave the current C-3 Phase I structure in place
2. Use the VM-20, *Requirements for Principle-Based Reserves for Life Products* Economic Scenario Generator updated for current conditions to replace the current generator
3. Include equity-indexed annuities on an information-only basis for 2014
4. Make use of the AVR and the IMR consistent for all C-3 Phases.

The initial recommendation from the AAA is option 2, with a refinement to allow companies to use proprietary interest rate generators. The chair noted that he is hoping any changes could be effective for 2014, but there is still a lot of work to do to achieve that goal. The chair also noted that the Stress Testing Subgroup might consider a "more holistic approach to risk assessment, which could entail the possible elimination of C-3 Phase I and Phase II." Work on these proposals will continue into 2014.

"Conflicting Use" of AVR

At the Summer National Meeting, the working group exposed for comment a proposal from a consulting firm suggesting that AVR should not be permitted to be used simultaneously in both RBC as Total Adjusted Capital and in asset adequacy analysis and recommended three alternative solutions. During its November 1 conference call, the working group discussed comment letters from the ACLI and the AAA, both of which recommended that the working group take no action on the proposal at this time. At the Fall National Meeting, the working group heard a presentation from the AAA on "Life RBC and the AVR," which was a condensed version of the presentation given to the Investment RBC Working Group. Discussion on this proposal will continue in 2014.

Unauthorized reinsurance proposal

In connection with an issue raised by Canadian insurance regulators, the working group exposed during the Summer National Meeting a proposal from New York to revise the RBC instructions as follows: "risk ceded to an unauthorized reinsurer may reduce RBC only to the extent collateral is established in the same proportion as collateral for reserves is required. For example, if risk is ceded to an unauthorized reinsurer which is also not certified, collateral equal to 100% of the reduction in RBC must be established."

The working group received comment letters from the ACLI, the AAA and two international trade associations, all of which expressed significant concerns with respect to the proposal. The ACLI comment letter noted that the proposal would materially modify what has been accepted RBC treatment for reinsurance cessions for more than 20 years and would require collateral for RBC in addition to the collateral already required for reserve credit for unauthorized reinsurers. During its November 1 conference call, the working group acknowledged the significant concerns discussed in the comment letters; they are working to schedule a conference call with the Canadian regulators to discuss the issues further. An updated proposal from New York is also expected.

C-3 Phase II/AG 43 Subgroup
See the LATF meeting summary for discussion of the activities of this group.

New Chair
The current chair of the working group, Mark Birdsall of Kansas, announced in Washington that he has asked the Capital Adequacy Task Force to find a new chair of the working group for 2014. Mr. Birdsall will stay on as chair until a replacement is found and will continue to be a member of the working group after he retires as chair.

Investment Risk-Based Capital Working Group

The Investment RBC Working Group continues to consider the recalibration of C-1 factors used in the life RBC calculation, which have not have revised since 1992.The working group generally meets bi-weekly, and much of the discussion continues to be focused on the corporate bond modeling project being led by the AAA.

Corporate Bond Factors
During 2012, the AAA developed a bond model which replicates the 1992 model, such that when using the 1992 scenarios and assumptions, the new model generates the either the same, or very similar, C-1 factors. During 2013, the AAA deliberated on the relevant modeling assumptions for corporate bonds and the construction of the representative corporate bond portfolios to be used in the current bond modeling project. The AAA is using Moody's default rate cohort experience from 1983-2012; for recovery, S&P data by instrument type for 1987-2012 is used. The purpose of the representative portfolios is to create generic life insurer portfolio structures, as it is impractical to model every insurer's portfolio.

In November, the AAA begun running the bond model using current assumptions and the representative bond portfolios; preliminary outputs were presented in Washington. The 2013 model uses investment grade default rates which are generally lower than those used in the 1992 model and below investment grade default rates are generally higher in the 2013 model. The AAA noted that the recovery experience data used in the 2013 model is more granular than the 1992 model; as a result the AAA was able to model recovery rates by rating and level of seniority. The 1992 model varied recovery rates by rating only.

While the AAA is still validating the model outputs to ensure there are no errors in the model, the preliminary data would indicate that current C-1 factors are too low for investment grade securities and too high for below investment grade securities. (Note that this is not a proposal to revise the factors, but just what preliminary data indicates.) The results also highlight the need to move beyond the current NAIC rating (1-6) framework to a vector rating approach (based on rating agency credit ratings) or matrix approach (based on both credit ratings and level of subordination). For example, the current C-1 factor (after tax) for an NAIC-1 rated corporate bond per the NAIC RBC instructions is 0.30%, while the 2013 model indicates an expected C-1 factor of 0.37% for an AA rated senior secured bond and 1.01% for an A- rated junior subordinated bond. The current C-1 factor (after tax) for an NAIC-5 rated corporate bond is 16.96%, while the model indicates an expected C-1 factor of 7.83% for a CCC+ senior secured bond and 9.08% for a CCC- junior subordinated bond.

A key decision for the working group in 2014 will be whether to recommend a vector or matrix based approach and to what extent the 19 credit rating classifications used in the bond model should be compressed. The AAA is also expecting to perform a sensitivity analysis on material assumptions, including time horizon, discount rate and RBC protection level, and will further review the outputs for inconsistencies and anomalies. Since to-date the bond modeling has focused on the corporate bond life C-1 factors, the working group will also need to determine how C-1 factors for non-modeled fixed income classes (municipal bonds, private placements, preferred stock, and other invested assets) should be developed. Additionally, the working group will need to determine to what degree consistency is desired between the life, health and P/C investment RBC formulas. The working group has previously discussed that the time horizon should be shorter and the composition of the representative portfolios should be different for health and P/C companies.

<u>Asset Valuation Reserve</u>
The working group's December 5 conference call was dedicated to understanding the relationship between the asset valuation reserve and RBC. The AAA gave a presentation which noted that the purpose of the AVR liability is to absorb losses and protect statutory surplus against large fluctuations (i.e., to act as a smoothing mechanism). It was noted that there is no interdependency between AVR and RBC as AVR must be added back to unassigned surplus for RBC purposes, thus AVR effectively disappears from the RBC framework. However, as AVR is established using estimated future losses similar to RBC, the AAA believes that the NAIC should consider updating the AVR factors when the investment risk factors are updated in the RBC formula.

<u>Real Estate Factors</u>
The working group discussed proposed recommendations for changes to the real estate C-1 factors in Washington. The proposal would:

- Revise the C-1 factor for all categories of real estate with a base factor of 8%,
- Apply adjustments to the base factor to reflect specific characteristics of the insurer's holdings,
- Implement an new adjustment within RBC for unrealized gains/losses, and
- Revise the RBC charge on encumbrances to 6.25% from 12%.

The proposed base factor of 8% represents a significant reduction from the current base factor of 15% which has been in effect since 2000. The proposed factor is based upon a price variation analysis of the National Property Index of the National Council of Real Estate Investment Fiduciaries and is supported by actual life insurance industry loss experience (which was approximately 3.5% for the 5 year period between 2008 and 2012) and by simulated life company portfolio performance under statutory accounting. The recommendations and supporting analysis, which are intended to more accurately reflect the underlying risks of this asset class, were exposed for a 45-day public comment period.

<u>Derivatives</u>
In Washington, the working group discussed an addendum prepared to the previously approved recommendations for derivative factors contained in the Life Insurer RBC Derivative Report dated March 29, 2013. The addendum was prepared by industry representatives with oversight provided by working group members to further consider the treatment of replications and derivative collateral for over-the-counter centrally cleared derivatives. The addendum concludes that the risks inherent in replications, particularly the RBC treatment of the C-1 charge applied to the cash instrument component, are already sufficiently addressed by the initial report and are addressed by current RBC instructions. With respect to collateral for OTC centrally cleared derivatives, the addendum recommends changes to both the RBC and AVR calculations to align them with the associated risk and transactional changes resulting from the Dodd-Frank Wall Street Reform and Consumer Protection Act. The working group exposed the addendum for a 45-day public comment period.

<u>Timeline</u>
The timeline for implementing any new life RBC C-1 factors remains uncertain given the work that remains to complete bond modeling analysis, the likelihood of a new vector or matrix rating framework for bonds, further consideration of related changes to AVR, and subsequent changes to the SVO Purposes and Procedures Manual, the APP Manual and investment reporting schedules which are expected to be necessary. The working group now anticipates that the 2015 life RBC calculation is earliest any changes could be implemented. The working group has not developed a formal work plan with specific target completion dates or deadlines to finalize its considerations.

SMI RBC Subgroup

Since the Summer National Meeting, the subgroup held four conference calls, with the goal of completing its study of operational risk and a preliminary proposal for the three RBC formulas, as well as its correlation with other risk categories. The subgroup's stated objective is finalizing a charge effective for 2014 RBC, which some believe is too aggressive.

The subgroup reviewed the Operational Risk Charge chart which lists proxies and factors used in Solvency

II, Australia, Singapore, Canada and Bermuda based on business volume (premiums); loss reserves (net or gross); excessive growth and required capital. All regimes on the chart use business volume except for Bermuda. Solvency II, Australia and Singapore also use reserves. Solvency II compares the higher charge for operational risk between business volume and loss reserves; Solvency II, Australia and Bermuda use excessive growth. Bermuda surcharges required capital to determine operational risk charge. The subgroup discussed at length the similarities and dissimilarities in proxies and factors by regime in trying to determine a proposal for a simple factor-based approach to incorporating operational risk into the 2014 RBC formulas. The subgroup also discussed a comparison method of the higher of two operational risk charges derived from premiums vs. loss reserves which may be a way to address companies in run-off that have little to no premium volume. The comparison method would also work for life companies that sell products that do not have a level premium volume each year.

Following comments heard on its December 6 conference call, the subgroup adopted an RBC proposal for exposure for each of the three RBC formulas based on the comparison method. The proposal consists of an example of how operational risk would be incorporated into the RBC. The example includes factors, but the subgroup emphasized that the factors are for illustrative purposes only and not specific factors being suggested. The proposed P/C and health formulas are similar (with amounts being net of assumed affiliated premiums and reserves), with the P/C formula being the greater of 3% of gross written premium or 3% of loss and LAE reserves plus 1% of gross written premium in excess of 120% of prior year gross written premium, and the health formula being the greater of 3% of gross written premium or 3% of loss and LAE reserves plus 3% of gross written premium in excess of 120% of prior year gross written premium.

The proposed life operational risk formula is also similar but uses several factors: a 3% factor is used for non-investment linked product premium, .5% for account values for segregated funds and .1% for account values for mutual funds, universal life, annuities in accumulation stage, and GICs plus 3% of gross written premium in excess of 120% of the prior year gross written premium. The charges for all three formulas would be assessed after covariance. Again, however, specific percentage factors used are for illustrative purposes only.

The RBC proposal was presented to the Capital Adequacy Task Force in Washington and the task force voted to expose the subgroup's proposal, after significant discussion, for a 45-day comment period ending January 30 (with all comments directed to the subgroup). The chair of the Life RBC Working Group stated his belief that 2014 adoption would likely not allow adequate time for discussion and that a 2015 effective date seems more reasonable. Several industry representatives commented that the proposed charge does not actually capture operational risk and should not be adopted.

Property/Casualty Risk-Based Capital Working Group

The working group met by conference call on November 19 and in Washington, and discussed the following topics.

<u>Reinsurance Credit Risk Charge</u>
The working group continued its discussion of the reinsurance credit risk charge and the AAA's Report on Reinsurance Credit Risk Charge. Currently, a 10% reinsurance credit risk charge is applied to the ceded balances except for the recoverables from U.S. affiliates and mandatory pools. The reinsurance credit risk charge is included in the R3 component, which could be impacted significantly for those companies relying heavily on reinsurance. AAA reported that when the RBC formula was adopted in 1994, the selection of the 10% risk charge reflected expert opinion at the time and that a number of policy considerations played into that decision.

On its November 19 conference call, the working group discussed comments received on previously exposed Reinsurance Association of America proposal with respect to the R3 charge. The RAA has previously stated that the existing R3 factor is 4 to 7 times higher than the credit risk factors used by S&P for an A-rated reinsurer, which are based on historical default rates for reinsurance recoverables. The RAA's proposal outlines a framework for determining the R3 charge consistent with the NAIC's use of credit ratings and treatment of collateral in the revised credit for reinsurance model. The proposed framework begins with the credit default risk factors used by S&P that are based on historical default rates associated with the financial strength rating of the reinsurer. Those factors are then multiplied by 3 to reflect risks other than credit such as commutation, coverage dispute, risk transfer and extent of reinsurance usage which were identified by the AAA as additional risk components of the R3 charge. Under the RAA framework, the R3 charge for uncollateralized recoverables would vary between 1.8% for an S&P AAA-rated reinsurer to 23% for an S&P NR-rated reinsurer.

Some regulators on the working group continue to be lukewarm about the proposal, citing the need to consider the increase in complexity the proposed change would create and the view that the current 10% charge is rarely the trigger of an RBC action level event. Another comment was a suggestion from the AAA to use an additive approach instead of a multiple of the default rate to account for risks other than default. The RAA agreed to consider comments received and plans to update its proposal for further consideration by the working group.

Underwriting Risk Charge
In Washington, the working group received a presentation from the Casualty Actuarial Society on its current research regarding underwriting risk charges in the P/C RBC formula. The CAS analyzed 14 years of annual statement filings (1997-2010) which included 24 accident years of loss ratios (from the 10-year tables) for 3700 companies in total across all lines and years. The data was grouped and analyzed by product line, by size of insurer and by significance of the product line to the insurer (major vs. minor line). The effect of insurance pooling was also considered and adjusted for, because one data point captured 20 times (assuming 20 participants in a pooling) would skew the analysis. Based on its analysis, the CAS noted that premium risk charges and reserve risk charges could be developed based on the relevant groupings and supported by historic experience to more accurately reflect the risk of insolvency. The CAS found that adjusting for pooling typically resulted in a higher risk charge, though the results and significance varied by product line. Filtering out the experience of smaller companies typically resulted in a lower risk charge. Filtering out the experience of insurers with limited exposure to a given product line (minor lines) had little effect on the risk charge for standard lines, but resulted in a lower risk charge for specialty lines. Additional discussion is expected on the working group's January conference call. The AAA is reviewing the CAS research and has noted that the research will provide a basis for the AAA to develop a specific proposal to improve the methodology used to estimate underwriting risk.

Catastrophe Risk Subgroup

The subgroup met by conference call in September, and met in person at the Fall Meeting. On its interim conference call, the subgroup discussed the U.S. Hurricane and U.S. Earthquake lists, prepared to enable insurers to exclude actual historical U.S. catastrophe losses so that appropriate R5 Underwriting Risk factors can be developed on an ex-catastrophe basis. The subgroup exposed both lists for a 30-day comment period. No comments were received during the exposure period. Subsequently, the Hurricane list was revised to remove storms with less than $25 million and storms prior to 2003. Following an email vote, the subgroup approved the lists on November 14. The lists can be found on the subgroup's webpage.

In Washington, the subgroup discussed concerns raised on its interim conference call about the confidentiality of its Attestation for Catastrophe Modeling, which had been adopted at the Summer National Meeting. The subgroup heard that the concerns relate to 2013 submissions only, pending additional confidentiality protection that will apply for 2014 submissions, but which will not apply for 2013 due to timing considerations. At the subsequent meeting of the Capital Adequacy Task Force, NAIC legal staff suggested that the best solution for 2013 will be for domiciliary states to collect the voluntary attestations and share them with the NAIC so that other states may also have access.

The subgroup also requested interested parties to submit proposals for a revised contingent credit risk charge for R6 and R7. The subgroup heard that proposed revisions to the reinsurance credit risk charge for the R3 component of the P/C RBC formula had indicated that the R6 and R7 charges may also be too high, but that no proposals had yet been made for reduced charges. The subgroup noted that the Capital Adequacy Task Force would need to consider new charges by the end of April 2014 in order for them to be effective for 2013 filings.

Finally, the subgroup discussed preliminary observations on its proposed Catastrophe Risk PR025 instructions for 2014, and agreed to expose the document for a 30 day public comment period. The subgroup's planned discussions in Washington on PR017A Underwriting Risk Factors issues did not take place, and were deferred to its January 23 conference call.

Health Risk-Based Capital Working Group

Since the Summer National Meeting, the Health Risk-Based Capital Working Group held six conference calls and discussed the following topics:

ACA Fee Sensitivity Test
The working group discussed the Affordable Care Act (ACA) fee sensitivity test that is proposed for the 2014 health risk-based capital formula. One of the charges of the working group is to assess the impact

of the ACA on the health RBC formula. Because of regulatory concerns of the effect on solvency of the ACA fee payable in the subsequent year but not accrued as a liability in the current year (as discussed on page 5), the working group developed an ACA fee sensitivity test proposal that would provide a "what-if" scenario that would exclude the ACA fee from total adjusted capital. The sensitivity test does not change an insurer's actual RBC ratio, but it does provide regulators with an additional tool to assess the effect on solvency of the subsequent year's fee and take corrective actions if necessary. After hearing comments and a discussion of revisions, the working group adopted the proposal effective for 2014 RBC. At the meeting of the Capital Adequacy Task Force in Washington, the chair noted that the task force will not act on this proposal until the accounting for the fee has been finalized.

Underwriting Risk – Experience Fluctuation Risk
During its September 17 call, the working group adopted for 2014 a previously exposed proposal to page XR012 - Underwriting Risk - Experience Fluctuation Risk that would break out premiums, incurred claims and underwriting risk claims ratio by individual, small group and large group for informational purposes. This segregation will allow for future analysis of the impact of the ACA on the underwriting risk within the current health RBC formula. The analysis is for informational use only and will not impact the actual RBC and the RBC risk requirement will remain based on total premiums reported on the Analysis of Operations in the annual statement filing.

Health Care Receivables Collected and Accrued
The working group discussed and exposed for comment and later adopted additional guidance for Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued in response to questions regarding the reporting of accruals in the exhibit. At its meeting in Washington, the Blanks Working Group adopted the guidance.

Premium Concentration
The working group discussed a 2011 charge to evaluate the industry segment (premium) concentration risk. The AAA has developed a model which indicated that additional RBC is needed for insurers which have a business concentration, e.g. large employers or large number of similar employers, such as auto dealers. Following the study, the NAIC staff developed a proposal for health insurers, similar to the P/C premium concentration charge, and the working group exposed the proposal for a 30-day comment period this fall. In response to comments received, the working group asked the Academy to do additional work to address entities whose concentration results from a single contract or within a single industry. Work on the project will continue in 2014.

Valuation of Securities Task Force

2013 RMBS & CMBS Modeling Process
The proposed macroeconomic assumptions and scenarios to be used in the 2013 year-end RMBS and CMBS modeling were exposed for public comment on September 11; that data suggests a stable-to-modestly declining model of losses compared to 2012 taken as a whole. Three comments letters were received; the principal concern raised in the comment letters was the need for greater transparency into the modeling assumptions and scenarios. Both the task force and the SVO Structured Securities Group recognize this need and committed to providing additional information next year to the extent an agreement can be reached with PIMCO and BlackRock, each of whom use proprietary models. The SSG prepared a question-and-answer document to provide responses to additional questions raised in the comment letters, which was adopted in October. In Washington, the SSG provided an update on the 2013 year-end modeling results noting that approximately 5,800 RMBS deals with 24,000 CUSIPs and 4,100 CMBS CUSIPs were modeled. This represents a decrease in the number of CUSIPs modeled as compared to 2012; however the face value of the modeled securities increased by $20 billion across the industry.

Working Capital Finance Investments
The task force met via conference call on December 2 to consider a proposed amendment to the SVO Purposes and Procedures Manual concerning the filing application for working capital finance investments (WCFI). The proposal was exposed for a two-week comment period and subsequently adopted at the Fall National Meeting. The amendment provides filing instructions for insurance entities who wants to invest in WCFIs. That investor will need to complete an application and submit it to the SVO for consideration. The applications must include:

- The obligor's audited financial statements if the obligor is not rated for credit risk by a CRP;
- A memorandum from the insurance company's investment committee for the proposed working capital finance program (WCFP);
- Audited consolidated financial statements of the group in which the finance agent for the WCFP is a part of as described in paragraph 16 of SSAP

105, the new accounting standard for these investments;

- A certification from the insurance company's Chief Investment Officer that, the insurance company, in its capacity as an investor, is not affiliated with the obligor or with any supplier in the WCFP, and a certification from the insurance company's legal counsel; and

- The various agreements between the obligor, supplier, finance agent and investor

The amendment also includes subsequent reporting requirements for previously approved WCFI.

Structured Agency Credit Risk Securities
At the Summer National Meeting, the task force charged its Invested Asset Working Group to consider the accounting and reporting classification for Freddie Mac's Structured Agency Credit Risk (STACR) securities and also to review the regulatory reporting framework for structured notes in general; the working group held three interim conference calls to address these charges.

The working group determined that, under existing guidance, the STACR is an issuer obligation of Freddie Mac and, therefore, should be classified as a bond under SSAP 26, rather than as an RMBS under SSAP 43R. Assuming no changes to the authoritative guidance, by default, the STACR would be appropriately designated NAIC 1. However, after consultations with several groups, including representatives of Freddie Mac, Fannie Mae, federal regulators, broker-dealers and insurers, the working group concluded that such designation would be unacceptable given the inherent risk associated with the STACR, and a similar Fannie Mae product. The payment obligation of Freddie Mac and Fannie Mae on these products is adjusted for defined credit events in a referenced pool of mortgages, thus the transactions are similar to non-agency RMBS; however, they are not backed by the residential mortgages in the reference pool.

The working group proposed that changes be made to the definitions of structured notes and mortgage-referenced transactions within the Purposes and Procedures Manual. The changes are intended to exclude Mortgage-Referenced Transactions from any exemption from filing with the SVO. Further, the working group recommended that these transactions be treated as Non-Agency RMBS, and thus subject to the modeling process for assignment of an NAIC Designation. These recommendations were exposed for a 14-day public comment period in November, no comments were received. The task force adopted the recommendations in Washington, effective December 31, 2013. As a result, these mortgage-referenced securities are not eligible for filing exemption; modeling for year-end 2013 is expected to be done by the SVO.

The working group intends to hold further discussions on the reporting and valuation of mortgage-referenced transactions in 2014, along with more comprehensive discussions of structured notes in general.

Residual Tranches of Securitizations
On its November 7 conference call, the task force discussed a proposed amendment to the SVO P&P Manual to add instructions for the filing of residual tranches of securitizations. A "residual" is a junior and contingent economic interest in an RMBS, CMBS, ABS or other securitization that is designed to absorb credit or non-credit cash flows from the underlying assets. The proposed changes would clarify that a residual should be reported as an equity instrument on Schedule D. However, an insurer would have the ability to request an SVO assessment of a security for possible bond treatment.

SVO staff acknowledged that the exposed proposal was unclear and that the SVO was requesting instruction from the task force to update the P&P Manual regarding residuals to be consistent with the statutory accounting guidance. The SVO then presented a revised proposal, making this clarification, which was exposed for comments for a two-week period. Based on comment letter responses and discussion with NAIC accounting staff, it was noted that terminology differences exist between SSAP 26, SSAP 43R and SSAP 103, with respect to "residuals" and "beneficial interests." Interested parties noted that there is confusion as to the proposed interpretation of the accounting guidance, and most insurers classify residuals as bonds.

In Washington, the SVO and NAIC accounting staff provided an update on their considerations as to whether statutory accounting guidance requires residuals to be classified as debt or equity. It was noted that SSAP 103 directs the accounting for beneficial interests to be accounted for under SSAP 43R, i.e. as debt. However, it was acknowledged that there a clearer definition of residuals is needed. NAIC staff recommended that the task force consider a referral to the SAP Working Group to revise SSAPs No. 103 and 43R regarding residuals to define them more clearly and possibly change their accounting treatment.

One task force member expressed his opposition to the referral, noting that residuals do not meet the criteria of a bond provided by SSAP 26 as they do not have scheduled cash flows, and therefore cannot be considered a bond. He further argued that if residuals are not bonds, then they cannot be considered for treatment under SSAP 43R. He believes that residuals should be reported as Other Invested Assets on Schedule BA and that no changes are required to the SSAPs. Following additional discussion by task force members, NAIC staff, and interested parties, the task force agreed that the SAP Working Group should weigh in on the discussion and the referral recommended by NAIC staff was adopted. SVO staff noted that once the SAP Working Group completes its consideration, the SVO would put this item back on the task force's agenda to make conforming changes to the Purposes and Procedures Manual.

NAIC Designation Recalibration Project
The SVO discussed two reports on the possible impact that changes to NAIC designations and designation categories would have on NAIC operations and procedures and state investment laws. With respect to the NAIC, the most significant impact is expected to be on the organization's information systems, though numerous changes would also be required to the SVO P&P Manual, the APP Manual, RBC, annual statement instructions and blanks. Additionally, it was noted that there is lack of uniformity in the terminology contained within state insurance laws with respect to NAIC designations; some lack sufficient specificity. The SVO stated that changes to the NAIC designations would require significant modification in state laws. The task force directed the SVO to continue discussions within the NAIC and to collaborate with the state attorneys roundtable. The Investment RBC Working Group is currently considering whether to recommend that NAIC designations be expanded for RBC and AVR purposes. See further discussion on page 10.

Classification Methodology Conflicts
In Washington, the SVO reported that several instructions within the P&P Manual conflict with the classification methodology that became effective January 1, 2013 whereby the SVO can no longer has the authority to reclassify securities, but instead must reduce (or notch) the NAIC designation to reflect additional risk. The task force instructed the SVO to propose alternative procedures for principal protected notes and for catastrophe-linked bonds and to remove the remaining conflicts from the manual.

The task force received reports from SVO staff regarding the treatment of mutual fund investments under SSAP 30, Investments in Common Stock, and Schedule BA assets. SSAP 30 requires that shares of a mutual fund be treated as common stock regardless of the type or mix of assets held in the fund's portfolio. However, the P&P Manual indicates that, in many instances, mutual funds should be treated as bonds; there are also exceptions within SSAP 30. The SVO is concerned these policies lead to inconsistent treatment for structurally identical investments. Additionally, the P&P Manual currently permits life and fraternal insurance companies to seek permission from the SVO to report a Schedule BA asset as a fixed-income investment. However, this SVO activity was never properly integrated into NAIC guidance or processes, including the SSAPs. The task force referred the mutual fund and Schedule BA issues to the SAP Working Group, who agreed at this meeting to start a long-term project to address these consistencies.

Solvency Modernization Initiatives Task Force

After receiving reports from its working groups, the task force noted that, having completed most of its projects, it would be disbanded at the end of 2013. The solvency modernization initiatives will continue, such as work on the Corporate Governance Annual Filing Model Law, but such projects will be monitored directly by the Financial Condition Committee. Those in attendance at the task force meeting in Washington D.C. received a Solvency Modernization Initiative Phase I 2008-2013 commemorative chocolate bar!

Principles-Based Reserving Implementation Task Force

The task force held conference calls September 12 and December 2 and met in-person at the Fall National Meeting and discussed the following issues below. (The December 2 call was regulator-only during which the task force discussed the Rector & Associates Initial Report on captives.)

Initial Report on Captives
The task force engaged the insurance consulting firm Rector & Associates to assist them in its charge to consider the recommendations from the Captives and SPV White Paper in the context of the proposed PBR system. The initial report was exposed for comment after the September 12 conference call, and nearly all of the meeting in Washington D.C was spent discussing the report and related comments.

The report discusses two alternatives to address the issues: Alternative A would revise the requirements for captives and Alternative B would provide relief to the direct insurer through reduced reserve requirements or other mechanisms so that captive transactions would not be seen as necessary. The task force could adopt both alternatives allowing companies to choose on a transaction by transaction basis, or regulators could choose to allow just one of the two alternatives. The report suggests the two most important questions, in developing a consistent methodology that would apply to all transactions, are as follows:

1. what actuarial standard should be used to evaluate all transactions i.e. to determine the dollar amount of reserves that have a reasonable probability of being needed to pay claims (often called "economic reserves") and the dollar amount of reserves that have a low probability of being needed to pay claims (often called "excess reserves")?
2. what "primary assets" should be required to support reserves under the actuarial standard above and what "other assets" should be permitted?

At the Fall National Meeting, a representative of Rector & Associates reported that said that based on their discussions with the regulators, the sense of the task force is that 1) the XXX and AXXX transactions can continue until PBR becomes effective, subject to meeting the criteria and requirements described in the report's framework, such as having a uniform actuarial standard, having uniformity in primary and other assets, and increasing disclosure; and 2) PBR should remove the financial incentive for these transactions. The consultant suggested that the actuarial standard would be close to that required under VM-20.

In response to these statements, the co-chair of the task force (Superintendent Torti of Rhode Island) stated that his preference is Alternative B, which would provide relief to life insurers from the XXX and AG 38 requirements; he also stated his desire to end captive transactions now. Other views expressed by task force members included the following:

- Captive transactions should continue in some form but with more transparency or subject to accreditation. The status quo is not adequate and discrepancies in regulatory practices need to end (Vermont).

- The task force needs to ensure uniformity and transparency in the use of standards and a level playing field is critical (Missouri and Virginia).

- The Credit for Reinsurance Model Act should also be revised (Virginia). The provision of "any other collateral permitted by the commissioner" for reinsurance is too broad and its authority needs to be limited (Rhode Island).

The task force then heard from industry. A representative from the ACLI stated that properly regulated captives are not a problem, but such regulation needs to include "transparency, disclosure, qualitative assessment and uniform guidelines." He also suggested that the standard be a capital standard not a reserving standard. The ACLI comment letter includes detailed proposals for increasing the transparency of ceding company transactions with captives.

The meeting had to conclude before other interested parties were able to speak to their comment letters, which were submitted by the AAA, Northwestern Mutual Life, New York Life, USAA, the Connecticut and Vermont Insurance Departments and the Center for Insurance Research. The views expressed in the comment letters varied, but many support increased transparency and uniform application of new requirements to all parties.

The next step is for the task force to consider forming a technical group to evaluate whether VM-20 is appropriate for the actuarial standard contemplated by the report. Future meetings will also include discussion of PBR issues for small companies.

PBR Review Working Group

The PBR Review Working Group was established to coordinate financial analysis, examination, and actuarial review procedures as outlined in the PBR Implementation Plan. During its half hour meeting at the Fall National Meeting, the working group provided a brief update on progress against its charges. The working group has held two closed calls to discuss activities in support of the charges, including review of proposed sample interview questions for the Financial Condition Examiners Handbook to assess PBR pre-Implementation preparations, discussion of the Statistical Agent Framework needed to collect required data submissions from the states, and development of procedures for the Valuation Analysis Working Group.

The working group also established two subgroups: (1) PBR Review Procedures Subgroup to focus on developing review procedures, recommending tools for obtaining and testing data, and identifying other data and reporting needs and (2) PBR Blanks Reporting Subgroup to focus on potential changes to the annual statement blanks as a result of PBR implementation. Each subgroup held two closed calls during the interim period to work on their respective charges. The PBR Blanks Reporting Subgroup focused significant discussion on what information should be publicly available in the annual statement considering information available to regulators in the confidential PBR Actuarial Report and plans to discuss a draft PBR blanks reporting document on public call prior to the 2014 Spring National Meeting.

At this session, the working group also heard from a member of the PBR Implementation Task Force about activities related to company outreach. Recent focus has been on developing a company survey to ascertain companies' preparedness for PBR and to give them ideas of what they should be thinking about. The survey will also point them to the implementation guide that includes three case studies reflecting different company sizes and products. The survey is targeted for distribution in March with compilation of results to follow in time for discussion at the Summer National meeting.

Corporate Governance Working Group

Corporate Governance Annual Filing Model Act

The working group held a conference call November 8 to discuss the working group's newly drafted Corporate Governance Annual Filing Model Act. The working group noted that the draft is similar to that proposed by industry at the Summer National Meeting with some differences, the most significant of which is the addition of a Guidance Manual which is meant to act as the detailed filing instructions for the model. NAIC staff noted that most of the content for the draft Guidance Manual was taken from the filing instructions discussed during the adoption process of the "Proposed Responses to a Comparative Analysis of Existing U.S. Corporate Governance Requirements." Despite this, industry representatives expressed strong opposition during both the November 8 call and in Washington to the use of a Guidance Manual as part of the corporate governance filing requirement, because use of a manual would allow changes to be made to the corporate governance filing requirements outside the legislative process that is required for the model law.

Because of these concerns, the draft model was not exposed during the November 8 call as was hoped by the working group. However, it was exposed for comment at the Fall National Meeting even as industry reiterated its concerns. The working group responded that the use of the Guidance Manual is "critical" to regulators and steps have been taken to restrict the frequency with which the manual can be updated and to prohibit adding new sections without updating the model law. The working group asked interested parties to comment during the exposure period how these changes have not mitigated their concerns and to propose solutions.

With respect to draft Corporate Governance Annual Filing Model Law itself, the exposed document includes a requirement for the filing to include the following: Description of Corporate Governance Framework, Description of Board of Directors' and Committee Policies and Practices, Description of Management Policies and Practices and Description of Management and Oversight of Critical Risk Areas, with a proposed effective date of January 1, 2016. The working group will continue to discuss whether a complete filing is required each year or whether a company would just file significant changes after the first filing. The documents are exposed for comment until January 31.

Internal Audit Requirement

During its November 8 conference call, the working group exposed for comment proposed changes to the Model Audit Rule which would require large insurers (greater than $500 million in annual premium) to maintain an effective internal audit function, with a proposed effective date of January 1, 2016. At the Fall National Meeting, the working group heard comments on the draft and agreed to the following changes, among others:

- More broadly define the types of work that the internal audit function should perform
- Revisions to the requirement for audit committee review of the work of internal audit to "at least annually" from "at least quarterly"
- Clarified that the requirements may be satisfied on an aggregate basis at the group level, and
- Added the word "reasonable" to "assurance" when discussing the internal audit function.

The working group did not agree to add confidentiality provisions for the information prepared by internal audit as no reports would be required to be filed with the regulator. They also did not agree with a proposed change from one year to two years for the time allowed to implement an internal audit function after the premium threshold is exceeded. The working group voted to expose the revised language for another comment period ending January 31.

ORSA Subgroup

The subgroup's primary project in 2013 has been the second ORSA pilot, and the subgroup released a public report with results of the pilot on November 6, after holding individual feedback meetings with the 22 participating insurers. The report and its recommendations were adopted by the Financial Condition Committee in Washington.

The report noted year-on-year improvements in the quality of the ORSA Summary Reports reviewed for those insurers that had participated in the 2012 pilot. In particular, the reports submitted for the 2013 pilot were generally complete, rather than containing placeholder data. In general, the subgroup considered that the reports submitted met the requirements of the ORSA Guidance Manual, and that material improvement was necessary for only 3 of the 22 reports submitted.

In common with the 2012 pilot, the subgroup identified components of the ORSA Summary Reports reviewed that they considered enhanced the reports. As in 2012, these recommendations have not been included in the ORSA Guidance Manual, but were provided in the subgroup's report for insurers to consider. The 2013 report reaffirmed and reiterated the findings of the 2012 pilot, and suggested the following additional components to be considered for inclusion in insurers' summary reports:

- A table of contents.
- Discussion of changes to risk appetites, limits and tolerances.
- Prospective discussion of potential risks and possible developments, including both known and potential future risks.
- Discussion of risk mitigation activities.
- Discussion of how correlation and diversification adjustments in the insurer's capital model(s) are developed, tested and updated.
- Summary discussion of model validation
- For international groups, discussion of overall group capital and interconnectedness with the US business.
- A table identifying risk owners, assigned risks, roles, responsibilities and reporting lines.
- A flowchart or other explanation of the risk management and control system.
- An appendix of reports and tools used for ERM purposes, with descriptions to aid the regulator's understanding of the reports.
- Detailed liquidity stress scenarios.
- Identification of key emerging risks, and discussion of how those emerging risks are elevated to current risks.
- Rating or ranking of risks.
- A placeholder for the filing attestation and signature.

More generally, the report notes that the ORSA Summary Report should be based on the insurer's own internal ERM reporting to its board of directors, and that the summary report provided to the regulator should contain the same basic elements as the board reporting, rather than being a compliance-focused report assembled purely for the regulator. The report should also be produced using the most current available data (including quarterly data for quarterly ERM processes).

Further, the report recommends that insurers should reach an understanding with their regulator on the filing date in advance of the filing year, and that insurers should plan to schedule a meeting following each filing to walk the regulator through their summary report and answer questions.

The subgroup recommended conducting a further pilot in 2014, and plans to consider some minor edits to the ORSA Guidance Manual arising from the 2013 pilot. The subgroup now also intends to begin developing regulatory guidance recommendations for the Financial Analysis Handbook Working Group and the Financial Condition Examiners Handbook Technical Group.

The updated SMI Dashboard shows that seven states (California, Iowa, Maine, New Hampshire, Pennsylvania, Rhode Island and Vermont) have fully or substantially adopted the Risk Management ORSA Model Law and five additional states have it under consideration.

Group Solvency Issues Working Group

The working group met in Washington, and heard an update on the activities of the IAIS in relation to ICP 23: Group Wide Supervision. The IAIS's Insurance Groups and Cross-Sectoral Issues Subcommittee (IGSC) has continued its redrafting work on ICP 23, having completed its reviews of overlaps with other ICPs and alignment to the Joint Forum's Principles for the Supervision of Financial Conglomerates. The IGSC also consulted with other IAIS working groups on its proposed revisions to ICP 23, and is expected to provide a comprehensive report to the IAIS Technical Committee for consideration in January 2014. The working group heard that issues being discussed at the IAIS include the scope of the group, and in particular whether requirements, including, for example, requirements for supervisory authority at holding company level, should apply at the ultimate holding company or ultimate insurance holding company level.

EU-U.S. Dialogue Project

At the start of its Fall National Meeting in Washington, the NAIC hosted a public forum of the EU-U.S. Dialogue, on the topic of supervisory colleges' best practices. The forum hosted panel discussions on current and future practices for supervisory colleges, with speakers from both the EU and U.S. and from regulators and insurers, and noted the common level of agreement among regulators internationally on the value of colleges. Notwithstanding their value, colleges were also recognized as a developing regulatory tool, and one panel member suggested that colleges, in conjunction with ORSA, should be allowed to develop for a number of years before decisions are taken at the IAIS on further regulatory tools such as ComFrame and the Insurance Capital Standard (ICS).

The panels discussed the evolution of colleges from formulaic meetings to ongoing dialogues. The number and level of attendees at colleges was also discussed extensively, with participants discussing the need to balance a focus on key issues and territories with inclusion of smaller jurisdictions. The benefits of having senior regulators in attendance to enable constructive dialogue were also discussed, along with the importance of active meeting facilitation and clear ownership of regulatory actions to ensure continuing progress by the college.

Confidentiality at colleges was also discussed at length, with participants recognizing the significant upfront work to establish confidentiality agreements. However, participants also discussed the need to move beyond confidentiality concerns through mechanisms such as the IAIS's Multilateral Memorandum of Understanding. The benefit of representation by insurers at colleges was also recognized, to allow them to authorize discussion of confidential information that regulators may otherwise not be able to discuss.

The value of colleges as a communication and forward-planning tool was also discussed, with participants noting that a significant potential benefit of colleges would be greater advance consideration of supervisory actions in the event of specific risks materializing, for example how capital fungibility may be treated in the event of capital strain. Relationships between insurers and supervisors and the increased knowledge of groups developed through colleges were also seen as valuable groundwork that would support supervisory response in the event of another financial crisis.

Panel members also discussed advantages and disadvantages of participation by the European regulator EIOPA and FIO in colleges. Participants heard that EIOPA's current participation in colleges is recognized as valuable in Europe, but that EIOPA has regulatory powers and defined responsibilities at colleges, providing a clearer role than might be the case for FIO. It was also suggested that the Federal Reserve Board may logically attend colleges in a similar role to EIOPA.

In addition to its discussions on supervisory colleges, the EU-U.S. Dialogue Project Steering Committee also provided an update on the progress and future work of the EU-U.S. Dialogue. The committee reaffirmed its commitment to the EU-U.S. Dialogue and to the approach set out in its December 2012 document, *The Way Forward*, which it hoped would provide certainty to insurers on the relationship between the EU and U.S. The committee described the dialogue project as proceeding in 3 phases, firstly the development of mutual knowledge and understanding, secondly the building of comfort around differences, and thirdly the identification of an appropriate legal framework to move forward. The committee noted that the first phase is almost complete, and that progress has been made on the second phase. With respect to the third phase, the committee noted the range of legal options that are available to the project, beyond just provisional equivalence, and confirmed that it will be considering legal mechanisms over the coming year. Participants also heard that recent agreement in Europe on the Omnibus 2 Directive has provided certainty around Solvency II's implementation date (January 1st, 2016) and timetable, which participants were informed will not change again. This may change the relative prioritization of some of the project's workstreams, but the committee noted that *The Way Forward* remains the basis for its work.

The EU-U.S. Dialogue Project Steering Committee then provided an update on the activities of its technical committees in 2013, and their planned activities for 2014 including comparative analysis of laws surrounding confidentiality, group supervision, solvency and capital requirements and reinsurance.

Moving forward, the steering committee noted that it is not attempting to create a harmonized EU/U.S. regulatory system, but to build ways for the two systems to work together collaboratively. Participants heard that Solvency II may also continue to evolve over the coming years as necessary to meet international standards. The steering committee intends to hold its next public forum during 2014 in Europe.

International Solvency and Accounting Standards Working Group

The working group met by conference call in September, followed by an in-person meeting in Washington. On its September conference call, the working group continued discussions on its document summarizing the working group's views on key issues with the IASB's insurance contracts exposure draft, which is intended to support the NAIC's input to discussions at the IAIS's Accounting and Auditing Issues Subcommittee (AAISC). The working group had discussed the document at the Summer National Meeting, and had since received additional comments from two industry associations. The working group agreed to several modifications intended to clarify and strengthen the points, and adopted the revised document.

In Washington, the working group's discussions were focused primarily on ComFrame and the IAIS's planned work on international capital, both of which are discussed further in the International Insurance Relations Committee summary below. The committee heard that groups participating in field testing will be required to produce balance sheets under multiple valuation bases, including an internal economic assessment, applicable GAAP, and GAAP modified to revalue assets to fair value and remove margins in reserves, and that the balance sheets will be subjected to a small number of simple stresses to see how they respond, and whether they are risk sensitive. Interested parties continued to express concern about the workload that may be involved for volunteers in field testing.

The working group also discussed the IASB's Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, to which it heard the AAISC is drafting a response letter. The working group heard that more clarity is needed on the objectives of the conceptual framework, including if, and if so, how, it will be enforced. However, the working group also heard that the framework is at an early stage of its development.

Finally, the working group heard that the AAISC had also received an informal request from the Financial Stability Board to consider incorporating some of the Basel Committee's draft guidance on the external audit of banks into the ICPs. However, the working group heard that insurance supervisors may lack authority to impose standards on auditors, which would be necessary to implement some of the Basel Committee's suggestions, and that the request may therefore need to be made to relevant auditing standard setters.

International Insurance Relations Committee

The committee met by conference call in November and in Washington, and discussed the following topics:

<u>Common Framework for the Supervision of Internationally Active Insurance Groups</u>
The IAIS released its third consultation draft of ComFrame on October 17, with comments due by December 16. The committee provided comments to the IAIS on the consultation. The committee itself received comments on the ComFrame draft from several industry associations, which the committee heard were used to help develop the NAIC's comments.

The IAIS's consultation contains the full current draft of ComFrame, with the exception of Module 3 Element 3 (Crisis Management and Resolution Measures among Supervisors) which the IAIS plans to consult on in 2014. The IAIS also requested participating insurers to provide comments on Module 2 Element 5 (Capital Adequacy Assessment) in the context of its planned work on an Insurance Capital Standard (ICS), which is expected largely to replace the current Module 2 Element 5 text (the NAIC's current position on the IAIS's work on group capital standards is summarized below).

The NAIC's comments are consistent with its comments on previous drafts of ComFrame. While remaining supportive of the concept of ComFrame as a tool to enhance supervisory efficiency and cooperation, and to enhance supervisory focus on major risks faced by IAIGs, the comments stress the importance of a flexible, outcomes-based approach, without creating duplicative layers of global regulatory requirements, mandating changes to supervision to align to a single set of rules that may not be in the best interests of local markets, or prescribing IAIG operating or management policies at a detailed level. They also stress the distinction between IAIGs/ComFrame and the identification and supervision of systemically important financial institutions, which the NAIC considers should be kept clearly separate worksteams, albeit work on the two topics should be coordinated.

The comments also highlight the value of supervisory colleges, and suggest that ComFrame should evolve as colleges mature over the field testing phase. The comments also suggest that ComFrame should be used to help identify potential regulatory gaps, and to bring developed and developing markets to a common level of supervisory outcomes. The comments also repeat the NAIC's previously-expressed position that a single group regulator with group-level authority would be neither advantageous nor necessary in the context of U.S. insurance group supervision, and that ComFrame should not remove authority or responsibility from supervisors other than the group supervisor.

With respect to Module 2 Element 5, the NAIC's comments are based on its newly-adopted position statement on international capital proposals, and also suggest that the determination of core capital should consider the impact of supervisory measures over capital, including with respect to surplus notes in the U.S. The comments also draw attention to existing legal entity-level powers of U.S. regulators to prevent capital being moved around a group without the approval of the concerned legal entity supervisors, and suggest that ComFrame should not circumvent such existing legal entity-level authority.

The comments further draw attention to several areas in the draft which require "opinions" to be provided by the actuarial function (Module 2 Element 4-8-2 and Module 2 Element 2-11). The comments suggest clarification of the relationships and distinctions between the various opinions, and suggest that actuaries should not be required to opine on matters beyond their professional standards of practice.

The committee heard that the current draft will be the final version of ComFrame to be issued for consultation before the framework enters its field testing phase, expected to start in 2014 and continue over four years. The IAIS is expected to develop a revised draft in March 2014, based on the results of the current consultation, which will be the version taken into field testing. Notwithstanding this, the committee heard that the document is expected to continue to evolve over the field testing phase.

<u>Position Statement on International Capital Proposals</u>

The committee discussed, and adopted in Washington, a position statement on current international capital proposals. The position statement articulates U.S. regulators' current views on international capital initiatives underway at the IAIS. It is intended to guide regulators in their input to the IAIS, and to identify the characteristics of the new initiatives that would be necessary for state regulators to support their implementation in U.S. state-based regulation.

The statement addresses the IAIS's work on a global Insurance Capital Standard (ICS) for IAIGs, in addition to Basic Capital Requirements (BCR), and the Higher Loss Absorbency (HLA) requirements for which the BCR will form the basis for systemically important insurers. While measures applicable to systemically important insurers are not applicable to IAIGs, the IAIS's work on the BCR, which is expected to go before the G20 for endorsement in November 2014, is expected to inform its future work on the ICS, which is expected to be developed by the end of 2016 and implemented as part of ComFrame from 2018.

The IAIS released a first consultation paper on BCR in December 2013, and the committee heard that a second consultation is expected in 2014. The balance sheet approach supporting the capital assessment is expected to be tested as part of ComFrame field testing in 2014, with the calibration and specification of the capital benchmark tested from 2015.

The current committee statement positions include:

- U.S. regulators will be fully engaged in the IAIS's work, despite serious concerns about the timing, necessity and complexity of the project. Nonetheless, U.S. state regulators support the need to assess capital adequacy at group level, and recognize calls for international capital standards or benchmarks from emerging market regulators.

- Any capital standard should reflect the risk characteristics of the underlying business. The differences between insurance and banking should be recognized, as should the differences in business model, risk management and insurance product risk, even within the same line of business, between different insurers.

- A group-level capital standard should be in addition to, not replace, legal entity-level capital requirements, and RBC will remain in place. Free movement of capital within an insurance group should not be presupposed, and a flow of capital out of an insurance entity should remain subject to those approvals required by the relevant legal entity regulator. Measurement should be against available capital resources, rather than existing jurisdictional requirements.

- Diversity in regulatory approaches can reduce systemic risk, and supervisory colleges should be the central coordinating forum for setting and assessing group capital.

- International capital proposals will need to take into account differences in accounting and valuation between jurisdictions.

- HLA should not be applied to insurers not designated as systemically important, and should address specified activities which may pose systemic concerns, not traditional insurance business itself.

The committee heard that there are still many decisions to be made in relation to international capital initiatives, and that the statement will continue to evolve throughout these developments.

Financial Stability Task Force

The task force met in Washington, and discussed the IAIS's current and planned work on the Basic Capital Requirement (BCR), Higher Loss Absorbency (HLA) requirements, and global Insurance Capital Standard (ICS). To demonstrated group capital concepts, the task force heard a presentation from Prudential Financial on its proposals for the group capital calculation, which stress the need for the calculation to clarify the character of capital on the balance sheet (for example, capital embedded in margins), recognize risk exposures and their impacts on capital, and to define reasonable and economic risk-based metrics to assess capital adequacy, which should recognize the risks to which insurers are exposed, the unique nature of many insurance products and legal structures, long-duration asset-liability matching, and insurance accounting requirements.

The task force also discussed in detail the FSOC's process for the designation of non-bank SIFIs, and the objection by several members (those with insurance expertise) on the designation of Prudential Financial as a non-bank SIFI. Roy Woodall, Independent Member with Insurance Expertise and the Director of the Federal Housing Finance Agency, both voted against the designation. Director John Huff of Missouri Department of Insurance, designated by the NAIC as a non-voting advisor to the FSOC, also advised against the council's decision.

The task force was informed that the application of enhanced supervision and prudential standards to insurance institutions may have unintended consequences for companies, consumers, and the broader insurance industry, and that the FSOC should have withheld the application of these standards to provide time to develop a more appropriate supervisory response, which it is permitted to do irrespective of any determination that the company poses systemic risk.

Reinsurance Task Force

The task force discussed the following topics in Washington.

Qualified Jurisdictions
The Qualified Jurisdiction Working Group reported that it had completed its expedited review process and recommended that the task force approve the following countries as conditionally approved qualified jurisdictions for a 1-year period:

- **Bermuda––**Bermuda Monetary Authority (BMA)
- **Germany––**Federal Financial Supervisory Authority (BaFin)
- **Switzerland––**Swiss Financial Market Supervisory Authority (FINMA)
- **United Kingdom––**Prudential Regulation Authority of the Bank of England (PRA)

The task force approved the working group's recommendation, and subsequent approval by all regulators was obtained during Plenary. The working group will perform a full review of these conditionally approved qualified jurisdictions in 2014; Ireland and France will also be considered for qualified jurisdiction status.

Reinsurance FAWG
The Reinsurance Financial Analysis Working Group met six times in regulator-only meetings to provide advisory support to states in the review of reinsurance collateral reduction applications. The working group's chair discussed the process for reviewing the applications which have already been certified by Connecticut, Florida and New York, noting that 21 reinsurer applications have been peer-reviewed and approved with "passport" status; two more applications are pending. Without passport status, reinsurers will need to seek approval for collateral reductions on a state-by-state basis. For 2014, the working group plans to develop a standard application for reinsurance collateral reduction to create uniformity among the states. The working group also plans to standardize the analysis and renewal process.

Another issue the working group will be addressing in 2014 is analyzing slow-pay information for each certified reinsurer based on its U.S. ceding insurers' annual financial statement filings. State insurance regulators have been communicating with reinsurers with respect to any discrepancies between information provided by the reinsurer and information reflected within the U.S. ceding insurers' financial statements. The working group has been asked to consider a *de minimis* proposal with respect to reconciling any such discrepancies in the future.

Reinsurance Modernization Implementation
The task force received an update on the adoption of the revised credit for reinsurance models by the states, noting that no additional states have adopted the revised models since the Summer National Meeting. The number of states which have adopted the revised models remains at 18, which represents 53% of U.S. direct premium. Five additional states have action under consideration.

NAIC/AICPA Working Group

The working group forwarded a referral dated November 13 to the Casualty Actuarial and Statistical Task Force for its views on reconsideration of the "testing of Schedule P" requirement that is part of the audited statutory financial statement requirements. The AICPA prepared a letter discussing its rationale as to why the work is duplicative of other requirements. See the summary of the CASTF's meeting in Washington for additional discussion.

Blanks Working Group

The working group held a conference call on October 15, where it adopted modifications to the illustrations and instructions for Note 5 and Note 11 to facilitate improved reporting of Federal Home Loan Banks investments (2013-23BWG), which will be effective for 2014 quarterly and year-end statements. The working group also adopted recommended editorial changes from the SAP Working Group to clarify the derivative reporting instructions on the assets and liabilities pages of the blanks. Guidance for completing the previously approved Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued (2012-12BWG) was exposed for public comment. This guidance was subsequently adopted at the Fall National Meeting.

In Washington, the working group adopted two blanks proposals as final; both proposals are effective for 2014 annual statement reporting. The adopted proposals will:

- Add instructions and illustrations for new disclosure to Note 5, Investments for Working Capital Finance Investments (2013-13BWG); accounting guidance for these investments was also adopted by the SAP Working Group effective January 1, 2014.
- Add a contact email address to the list of information included on the Combined Statement title page (2013-22BWG).

The working group rejected two previously deferred blanks proposals, both of which are expected to be resubmitted once other NAIC groups complete their related work. The rejected proposals sought to:

- Eliminate the requirement to file the Reinsurance Attestation Supplement and Exceptions to Reinsurance Attestation Supplement and related instructions (2013-03BWG). The proposal has been deferred at the request of the Reinsurance Task Force, until the task force completes its related work with the Financial Analysis Working Group.

- Modify Schedule F to a) develop and report the Provision for Overdue Reinsurance by reinsurer rather than in aggregate, and (b) clarify certain aspects of the schedule (2013-09BWG). The proposal was previously referred to the SAP Working Group, as the working group is currently considering a similar issue with respect to presentation and calculation of the Schedule F penalty.

Five blanks proposals were exposed for a public comment period which ends February 28. The proposals include the following:

- Modify the Supplemental Compensation Exhibit and add instructions to facilitate the collection of additional detail on the nature of compensation paid to top executives and directors (2013-20BWG). The working group previously adopted this proposal at the Summer National Meeting despite interested party requests to defer its consideration because of the pending draft model for corporate governance reporting. Interested parties requested that the two projects be considered concurrently. The proposal was subsequently deferred by Accounting Practices and Procedures Task Force and referred back to the working group to give further consideration to the interested parties' request.

  In Washington, the working group noted that they had gotten input from the Corporate Governance Drafting Subgroup, which is developing the new Annual Reporting of Corporate Governance Practices of Insurers Model Act. The subgroup's view is that they do not see any redundancy between the two projects and see no reason for the blanks proposal to be delayed while the Model Act is being developed. There have been no changes to the proposal since its initial adoption at the Summer National Meeting; however it is being re-exposed to further solicit any specific input from interested parties.

- Change the column description for the "Federal ID Number" Column on Schedule Y to read only "ID Number" and add instructions to clarify that for reinsurance entities a Certified Reinsurer Identification Number or Alien Insurer Identification Number may be entered, if such number has previously been assigned (2013-24BWG).

- Add new questions to the Supplemental Exhibits and Schedules Interrogatories related to the Actuarial Memorandum required by AG 38 and Regulatory Asset Adequacy Issues Summary required by Actuarial Opinion and Memorandum Regulation (2013-25BWG).

- Add additional lines for commercial mortgage loans to the AVR Default Component and Equity and Other Invested Assets Component blanks pages and modify the related instructions. The purpose of this proposal is to implement an AVR treatment for commercial mortgages that is consistent with the new methodology used for life RBC (2013-27BWG).

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 Insurance and Annuities Committee

The committee held three conference calls this fall and met in Washington D.C. to discuss the following issues:

Unclaimed Benefits
After sometimes contentious debate during the fall, the committee adopted during its December 4 conference call the following charge for 2014: "the Life Insurance and Annuities (A) Committee should undertake a study to determine if recommendations should be made to address unclaimed death benefits." Members of Executive Committee had considered a more specific charge during its October 25 conference call to "determine whether a model law, guideline, regulation or other vehicle should be developed to ensure fair and uniform claims settlement practices," but the vote on that proposed charge failed. The adopted charge is supported by many in industry, which are asking for more uniform regulation related to the duties of life insurers to beneficiaries when an insured's name appears in the Social Security Death Master File (DMF) as deceased but a claim has not been filed.

At the Fall National Meeting, as part of the federal legislative update, the committee learned that one provision of the adopted Federal budget relates to use of the Social Security DMF. Under this provision, access to an individual's information contained in the DMF is prohibited for three years after the individual's death unless a person is certified under a new certification program to be established by the Department of Commerce. The specifics of the certification program will need to be developed by the Commerce Department, and the life insurance industry has expressed concerns about the time it could take to accomplish this, which could potentially restrict access during that time.

Annuity Disclosure Guideline
During its November 8 conference call, the committee adopted a proposed guideline amendment to the Annuity Disclosure Model Regulation (#245). The guideline amendment is intended to address a possible issue with a provision in the model that may conflict with the National Securities Markets Improvement Act of 1996.

Longevity Risk
During the Fall National Meeting, the chair Commissioner McPeak of Tennessee suggested that the committee should start to monitor the longevity risk issue especially in light of the anticipated release by the Joint Forum of its final report in January 2014 entitled, "Longevity Risk Transfer Markets: Market Structure, Growth Drivers and Impediments, and Potential Risks." One suggested outcome by the committee could be a referral to the Life RBC Working Group to consider whether an explicit factor for longevity risk should be developed.

Life Actuarial Task Force

PBR Valuation Manual
Critical Operative Items
During PBR discussions, LATF members speculated that the earliest possible operative date for PBR and concurrent implementation of the VM is now assumed to be January 1, 2016. At the request of Commissioner McPeak, co-chair of the NAIC's PBR Implementation Task Force, LATF developed a list of items that must be completed before the VM can become operative. The ten items identified include a maintenance process to annually update VM-20 asset spreads and default costs, targeted for completion in Spring 2014, while items targeted for completion by Summer 2014 include an accounting smoothing mechanism to address reserve volatility, changes needed to support the experience data

collection process, governance revisions regarding the process for updating the VM, additional small company considerations and additional guidance on net premium reserves for products other than term and universal life with secondary guarantees. Completion of the 2014 VBT and CSO tables is targeted for Spring and Summer 2015, respectively. Commercial mortgage default costs and VM-31 documentation requirements are targeted for Spring 2015. All items must be completed and approved by Summer 2015 to be effective January 1, 2016.

PBR Implementation Charges

The PBR Implementation Plan includes specific charges for LATF related to actuarial and accounting valuation matters. Several of these charges are addressed by ongoing work of LATF subgroups. One charge is to "determine whether specific continuing education requirements should be established for PBR actuaries and whether those should be regulatory requirements or actuarial professional requirements." LATF requested and received a commitment for assistance from the AAA Committee on Qualifications to address this item, including consideration of what curriculum should be included in a potential PBR Qualifications Standards seminar.

Valuation Manual Amendments

LATF continued discussion of several VM amendment proposals. The Academy Life Reserves Work Group submitted a report containing updated interest rate spreads for inclusion in VM-20. The report compares current spreads as of 2013-09-30 with original VM-20 spreads as of 2009-09-30. The current spreads were developed using the same process used to prepare the 2009-09-30 spread tables. LATF voted to expose this report for comments until January 31.

Amendment proposals previously exposed for a 30-day comment period and still under discussion include clarifications regarding treatment of due premiums in expected future cash flows when calculating deterministic and stochastic reserves, inclusion of individually underwritten certificates under group life insurance, a change in the way the pre-tax investment maintenance reserve is reflected in the deterministic reserve and a direct iteration method to calculating the deterministic reserve. Discussion of these proposals will continue during interim conference calls. Discussion also continued on a proposed amendment regarding the treatment of letters of credit in the reserve calculations.

Another previously exposed amendment proposed an extended transition period for small companies, to address concerns about the cost of implementing PBR. In addition, the Kansas Insurance Department had submitted amendment proposals providing for safe harbor demonstrations based on a company's asset adequacy testing, and a higher threshold for the stochastic exclusion ratio tests coupled with use of the company's cash flow testing models to meet the criteria. During this meeting LATF heard a presentation from the ACLI regarding small company considerations relative to PBR implementation. The ACLI proposal includes a small company definition focused on the amount of ordinary life business, and recommends a risk-based exclusion test that if met, would allow relief from certain PBR requirements such as stochastic and deterministic reserve tests and computation as well as VM-31 documentation. Some LATF members expressed support for the concept while others spoke out against it. The ACLI plans to submit amendment proposals in January to address small company considerations.

LATF adopted an amendment clarifying the exclusion of industrial life contracts from VM-20 minimum reserve requirements.

Standard Nonforfeiture Law and Low Interest Environment Considerations

At the Spring and Summer National Meetings, LATF discussed a proposed amendment to floor the maximum nonforfeiture interest rate at 4%, the rate used to demonstrate that a life insurance contract meets the requirements of IRC Section 7702 to qualify as life insurance for federal tax purposes. Currently, the maximum nonforfeiture rate, as with the valuation interest rate for reserves, is a dynamic formula based on the Moody's Corporate Average Yields. Without such a floor the potential exists for the statutory nonforfeiture interest rates to drop below 4%, whereby traditional life insurance contracts would fail to comply with IRS requirements for favorable tax treatment. In September, LATF voted to expose proposed amendments to the VM and the *Standard Nonforfeiture Law for Life Insurance (#808)*. During its October conference call, LATF unanimously adopted the amendments, which were then subsequently adopted by the Life Insurance and Annuities Committee.

Related Matters

In response to a referral from the Corporate Governance Working Group to incorporate into regulation a requirement for life insurance appointed actuaries to present the full actuarial report to the board of directors on an annual basis, consistent with the requirements for appointed actuaries of health and P/C entities, LATF discussed proposed edits to the actuarial opinion instructions in the life blank. Some LATF members commented that they didn't think the current Actuarial Memorandum, with hundreds of pages of detailed information, is useful to company boards. LATF will schedule a conference call to develop a formal recommendation for incorporation into the 2014 blanks.

Actuarial Guideline XXXIII (AG 33)
LATF heard a report from the AAA's AG33 Non-Elective Task Force on the topic of non-elective non-mortality benefits that can be more valuable than the contract accumulation value. An example of such benefits is waiver of surrender charges for specified contingent events such as confinement to a nursing home, disability, or diagnosis of a terminal illness. The issue is that reserves may be understated when incidence rates are applied after the surrender charge period or after the account value is depleted but elective benefits (e.g. Guaranteed Lifetime Income Benefits) are still available. The task force presented numerical examples of possible alternatives to amending AG33 to address this issue and recommended one option in particular. No action was taken at this meeting and further discussion will continue in a conference call early in 2014 to allow for revised language to be exposed and adopted before year-end 2014.

C-3 Phase II/AG 43 Subgroup
This subgroup of both the Life Insurance and Annuities and Financial Condition Committees is charged with developing more consistency between RBC's C-3 Phase II and AG 43 reserves. The subgroup held interim conference calls to continue discussion of a report from the AAA C-3 Phase II RBC/AG-43 Work Group on equity return calibration criteria, and to discuss AG43 amendment proposal forms (APFs) previously submitted by New York regulators and another APF more recently submitted by the ACLI.

The NY APFs address equity market volatility as reflected in the standard scenario and policyholder behavior for deep in-the-money guarantees, and would generally make the prescribed assumptions for these items more conservative. The ACLI's APF suggests a change in the definition of the basic adjusted reserve to include language that ensures the largest basic adjusted reserve and the largest accumulated net revenue amounts are evaluated as of a consistent date. These APFs were exposed for comment through November 7, but no additional action was taken at this meeting. Discussion will continue into 2014.

The AAA report on equity return calibration criteria suggests that the current scenario model fits the historical data extremely well even over longer periods of time, and does not support a conclusion that there is more volatility. The AAA suggested that a defined process be established to define the scope of any additional analysis to be performed. The C-3 Phase II/AG 43 Subgroup continued discussion about whether or not the calibration criteria should be modified, but more work is needed to understand variations in results and no specific action was taken during these calls.

VM-22 Fixed Annuity PBR
LATF received a report from the Academy Annuity Reserve Work Group (ARWG) on activity related to development of a PBR methodology for non-variable annuities. The proposed methodology sets the reserve equal to the greater of a "Floor Reserve" and a "Modeled Reserve," where the floor reserve is expected to generate results comparable to current CARVM requirements while the modeled reserve is scenario-based. Recent efforts have focused on development of appropriate utilization assumptions for Guaranteed Lifetime Income Benefits in the Floor Reserve calculation.

The floor reserve introduces the concept of "Listed Benefits" for purposes of qualifying additional benefits (e.g. GLIBs, annuitizations) for consideration in the valuation. Floor reserves would be defined as the greater of the cash value, reserves excluding listed benefits (alpha) and reserves including listed benefits (beta). Prescribed dynamic lapse rates would be applied in determining every Integrated Benefit Stream, and such lapse rates would reflect in-the-moneyness (ITM) adjustments. Considering variations in value of single life and joint life withdrawal options, the ARWG plans to blend the values of these options in the determination of the ITM ratio and resulting reserve present value calculation.

Following the Summer National Meeting, the ARWG held several conference calls and has worked diligently to develop prescribed incidence rates for GLIBs in the calculation of beta. The ARWG is developing a utilization "rate generator" that considers GLIB product design features that might influence when a contract owner may elect the benefit, recognizing the value of the benefit relative to the account value.

The Kansas Insurance Department is conducting a field test of the practicality of the proposed approach for VM-22. Work is underway to test the calculations for a sample of five products offered by two companies, which are intended to be representative of today's variety of products. The first phase of testing was to replicate CARVM calculations, and currently calculations for alpha, beta and the floor reserves are being programmed. Following internal testing, the valuation software will be distributed to the participating companies to check results for their own products, and several members of the ARWG will test results for their respective companies' products. Work is also underway to program the modeled reserve, with plans to complete the model reserve testing and verification before the Spring National Meeting. The ultimate goal is that the field tests provide sufficient information to support consensus about what the "right-sized" reserve is and how to move forward.

Valuation Mortality Tables
LATF received a report from the Society of Actuaries & Academy Joint Project Oversight Group on the status of work related to development of a 2014 Valuation Basic Table (VBT), 2014 Commissioners Standard Ordinary (CSO) table and Guaranteed Issue/Simplified Issue/Preneed (GI/SI/PN) mortality tables. A report on the 2014 VBT gender distinct and smoker status tables was targeted for September 2013, but progress was delayed due to anomalies noted in the slopes of the smoker/non-smoker mortality at older ages. The current plan is to complete these tables by the end of March 2014, and the relative risk tables will follow. Work has begun on the CSO table, developing margins to be used for purposes of developing nonforfeiture values, tax reserves and net premium reserves. Evaluation of margins appropriate for gross premium or principles-based reserves is pending a decision regarding aggregate or individual margins on assumptions in VM-20. Work on the GI/SI/PN tables has stalled until the 2014 VBT is completed but is expected to resume quickly following release of the 2014 VBT.

Nonforfeiture Modernization
LATF received a brief update from the Academy Nonforfeiture Modernization Working Group. This group is currently focused on nonforfeiture considerations for guaranteed lifetime withdrawal benefits (GLWBs) for fixed deferred annuities, from the perspectives of both non-forfeiture reform and the Kansas field test of the proposed methodology for principles-based reserves for fixed deferred annuities. The Academy working group's recommended approach to establishing nonforfeiture benefits for GLWBs would essentially provide a reduced paid-up deferred life annuity benefit. The working group is still evaluating the implications of this recommendation and a conference call will be held in early 2014 to continue the discussion.

Experience Reporting
At the Summer National Meeting, the LATF Experience Reporting Subgroup presented a case statement supporting mandatory expense data reporting to enable regulators to benchmark expense data and to establish a consistent basis for comparability. The statement discusses the need for expense information, alternative approaches for collecting the relevant information and advantages and disadvantages of mandatory data collection, and the statement was exposed for comment for a period of 60 days. Discussion at the Fall National Meeting focused on comments from the Medical Information Bureau (MIB) suggesting that the SOA Expense Study format could be used for comparability purposes. Using the SOA Expense Study format, the MIB recommends that ten additional policyholder behavior data items (e.g., premium payment behaviors) be collected in order to calculate the Total Expense Units to facilitate unit expense comparisons. These data items could be included in the policyholder behavior data calls and need not be included in an expense data call. LATF voted to expose for comment the MIB's proposed expense report and additional data elements for comment.

Actuarial Opinion and Memorandum Regulation Communication Group
LATF heard a report from the AAA Actuarial Opinion and Memorandum (AOM) Regulation Communication Group. This discussion group is focused on opening lines of communication between regulatory actuaries and appointed actuaries in order to improve practice and understanding. Three distinct subgroups including both regulatory and company actuaries were formed to discuss consolidation and standardization of AOMs, communication of assumptions and enhanced Regulatory Asset Adequacy Issues Summary, and addition of links in the AOMs for key issues. The groups have met several times since the Summer National Meeting, including two sessions at the Valuation Actuary Symposium. The communication group has finalized viewpoints on these issues and is drafting a report to share with the profession, with the intent to facilitate further discussion. The group is considering alternatives for distributing the report such as an "Academy Alert," webcast and/or articles in AAA or SOA professional publications. The group is also considering requesting that regulatory actuaries promote the report to member companies. The report is targeted for completion in early 2014 and the group plans to present more information at the Spring National Meeting.

Joint Qualified Actuary Subgroup
In December 2012, LATF, HATF and the Casualty Actuarial and Statistical Task Force formed the Joint Qualified Actuary Subgroup (JQA) 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.

During the LATF session in Washington, there was discussion around the importance of identifying the problems giving rise to the need for a uniform definition of qualified actuary and questioning whether a uniform definition would adequately address the perceived problems. During the JQA Subgroup meeting, the subgroup discussed the definition of a "qualified actuary," including the potential for consistent definitions across the three actuarial bodies rather than a single uniform definition, and discussed considerations around requirements for membership in a professional actuarial body. The subgroup also discussed whether the definition should be promulgated through model law or regulatory process or through the annual statement instructions, noting that the current P/C, Life and Health definitions are each currently established through different channels.

Subsequent to the Fall National Meeting, a conference call of the JQA Subgroup was held on January 8 to discuss comments received regarding the definition of a qualified actuary for actuaries providing opinions for NAIC Annual Statements and proposed definitions for Life and Health qualified actuaries consistent with the P/C definition. The proposed definitions mirror the current P/C definition and retain language referencing the requirements of the U.S. Qualification Standards, but key changes proposed in the consistent definitions are a requirement that qualified actuaries be Fellows of either the SOA or CAS, instead of just a "member" of these societies, or that AAA members be approved as qualified for signing actuarial opinions by the Life, Health or Casualty Practice Council of the AAA. Currently, the Life and Health Practice Councils don't grant such approval, so such processes would need to be established. An open call will be scheduled on January 22 to continue discussion of the proposed definitions. The subgroup chair requested that any comments be provided in the form of edits to the proposed definitions or revised definitions altogether.

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. Following the Summer National Meeting, the working group held interim conference calls to discuss interpretive responses to questions submitted by practitioners. During these calls and in Washington, the working group adopted previously exposed interpretations and voted to expose responses to pending questions or questions for which responses had not yet been exposed.

Recent interpretations addressed questions related to the determination of net investment returns, funding ratios, and the basis for reported reserves under 100% coinsurance agreements (excluding funds withheld or modified coinsurance treaties). Interpretations adopted at the Fall National Meeting will note that use is encouraged for 2013 but not required until 2014. Submitted questions, exposed responses and adopted interpretations are available on the NAIC website.

Health Reform Solvency Impact Subgroup

The subgroup reported that its Health Reform Reconciliation Technical Subgroup had completed development of a reconciliation tool to highlight the differences between the U.S. Department of Health and Human Services medical loss ratio forms and the NAIC Supplemental Health Care Exhibit. The tool is for use by regulators only. In response to concerns from industry, the subgroup noted that if and when the tool is being considered for inclusion in the Financial Analysis or Financial Examiners Handbooks, there will be additional discussion of the tool.

Health Actuarial Task Force

Long Term Care (LTC)

The Long-Term Care Pricing Subgroup of the LTC Actuarial Working Group reported progress on charges from the Senior Issues Task Force to review revisions to the *LTC Model Act (#640)* and *LTC Model Regulation (#641)* and make recommendations for changes related to pricing issues. Following the Summer National Meeting, the subgroup held weekly conference calls to address matters related to benefit options (including nonforfeiture benefits), loss ratios and margins. The subgroup recommended several revisions to the LTC Model Regulation; these were exposed by the Senior Issues Task Force in November. The subgroup believes there is more work to be done to strengthen the pricing of LTC products and requested that the LTC Model Regulation remain open so that the subgroup may have sufficient time to develop proposals for additional changes, benefiting from the momentum established in recent months. The subgroup anticipates completing its work on proposed changes prior to the 2014 Summer National Meeting. Both the LTCWG and HATF adopted the subgroup's proposed plan for future work and the plan was forwarded to the Senior Issues Task Force for consideration.

The Long-Term Care Valuation Subgroup reported on continued discussion of LTC valuation issues, specifically contract reserves, claim reserves and premium deficiency reserves. The subgroup held bi-weekly conference calls to discuss these issues, focusing on mortality assumptions used to establish contract reserves and future rate increases assumed in evaluating the need for premium deficiency reserves. The subgroup has solicited comments on the appropriateness of the 2012 Individual Annuity Reserving tables as a basis for LTC reserving and has drafted an alternative definition of premium deficiency reserves for LTC Business, for potential inclusion in a model regulation, SSAP, Actuarial Guideline or Actuarial Standard of Practice. The alternative language requires consideration of the likelihood of approval for rate increases. The subgroup expects to report on premium deficiency reserve recommendations by Summer 2014.

The LTC Actuarial Working Group received a status report from the Academy State LTC Principle-Based Work Group. The work group is developing and testing a model to examine the impact of stochastic analysis under a principle-based approach to LTC reserve valuation. The current prototype models mortality, morbidity, lapse and interest on a stochastic basis, but the work group has had difficulty reconciling the stochastic interest results to the deterministic model. The models are in Excel and to speed up run-time a "hazard rate" approach is used whereby intermediate calculations are bypassed in periods when there are no claims. Next steps include sensitivity testing for a smaller block of policies and complete analysis for a larger block of policies, with a written report summarizing results targeted for July 2014.

The Academy LTC Credibility Monograph Work Group is drafting various sections of a monograph intended to establish the applicability of credibility procedures to LTC insurance and to establish the importance of incorporating credibility into LTC-related actuarial work. The draft monograph has been delayed and is now expected to be submitted in May 2014.

The Academy Long-Term Care Terminations Work Group reported on its progress to provide analysis of LTC termination, voluntary lapse and mortality experience. Data collection from target companies is underway with assistance from the SOA. Results of the study are expected to be reported sometime in 2014.

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 new table would replace the 1985 tables which are outdated and which many companies no longer use in favor of their own experience. Problems with the data submissions delayed progress and the work group anticipates having preliminary analysis completed sometime in 2014.

Group Long-Term Disability Table

Following re-exposure and adoption in early December by the Academy Group Long-Term Disability Work Group of the 2012 Group Long Term Disability Valuation Table, related Actuarial Guideline and proposed changes to the *Health Insurance Reserves Model Regulation (#10)*, HATF adopted the revised materials and will forward the package to the Health Insurance and Managed Care Committee for consideration. Upon adoption, the table will be effective for claims incurred on or after October 1, 2016, but may be used for claims incurred on or after October 1, 2014.

Individual Disability Table

HATF heard a presentation from the Academy Individual Disability Table Work Group on the proposed 2013 Individual Disability Income Valuation Table, related Actuarial Guideline and proposed changes to the *Health Insurance Reserves Model Regulation (#10)*. This is the first major table change for individual disability income valuation in many years and the recommendation proposes allowing the tables to be applied retroactively in determining both active and disabled life reserves. The recommendations are based on experience presented to HATF in December 2012, at which time the task force charged the work group with developing the valuation recommendation. The task force voted to expose the materials until June 30.

Contingent Deferred Annuity Working Group

In April 2013, the CDA Working Group finalized its recommendations regarding the regulation of contingent deferred annuities. These recommendations, which included suggestions for numerous additional projects with respect to the regulation of CDAs, were subsequently adopted by the Life Insurance and Annuities Committee. The committee subsequently developed charges and referrals to several existing NAIC groups with relevant subject-matter expertise to perform various tasks related to the CDA Working Group's recommendations with some revisions to those charges adopted in Washington. Those groups and related charges include the following:

<u>CDA Working Group</u> – The working group will consider revisions to the *Annuity Disclosure Model Regulation (#245), the Suitability in Annuity Transactions Model Regulation (#275), the Advertisements of Life Insurance and Annuities Model Regulation (#570), and the Life Insurance and Annuities Replacement Model Regulation (#613)* to specifically address the applicability to CDAs. The working group will also develop NAIC guidelines and/or model bulletin that can serve as a reference for states interested in modifying their annuity laws to clarify their applicability to CDAs.

<u>Life Actuarial Task Force</u> – The task force will evaluate Actuarial Guideline 43 to determine whether the reserve guidance as it applies for variable annuity guarantees would be deficient when applied to CDAs and recommend changes, as appropriate. The task force will also consider revisions to the *Standard Nonforfeiture Law for Individual Deferred Annuities (#805)* to specifically exclude CDAs from the scope of the model.

<u>Financial Condition Committee</u> – The committee will consider the development of a template or checklist of questions that state insurance departments could use to facilitate the review of an insurer's risk management program at the time of a policy form filing related to a CDA. The committee is also being asked to review and determine whether revisions to the *Synthetic Guaranteed Investment Contracts Model Regulation (#695)* are needed to clarify its relationship with CDAs.

<u>Life Risk-Based Capital Working Group</u> – The working group will consider developing guidance for states as to how current RBC requirements, including C-3 Phase II, should be applied to CDAs.

<u>Receivership and Insolvency Task Force</u> – The task force will review the proposed revised definition of CDA and determine whether amendments to the *Life and Health Insurance Guaranty Association Model Act (#520)* are warranted in light of that revised definition.

<u>Producer Licensing Task Force</u> – The task force is asked to review the types of producer licenses, including appropriate provisions in the *Producer Licensing Model Act* (#218), required to sell CDAs to determine if those licenses are consistent with the licenses required to sell variable annuities and recommend any necessary changes and/or revisions.

The CDA Working Group will serve as the coordinating body with all of the NAIC technical groups with projects related to CDAs, and will provide updates to its parent committee throughout 2014. The working group has established an aggressive timeline, with proposed revisions to existing NAIC model regulations applicable to CDAs to be provided to the Life Insurance and Annuities Committee for adoption at the 2014 Fall National Meeting.

Separate Account Risk Working Group

The working group held a conference call November 13 to continue discussion of its draft Non-Variable, Insulated Product Characteristics/ Proposed Recommendations document, which had been exposed for comment in January 2013. Most commenters disagreed with the exposed product characteristics and conclusions in the document and suggested that an alternative approach would be the development of principles to address "equity and solvency concerns for insulated products." After holding regulator-only calls this fall to discuss the comments received, the working group identified actions and recommendations which were exposed for comment. These include the following:

1. Incorporate the ACLI/CAI Suggested Principles for Insulating Assets, which include the following:

    - For assets to be considered insulated, the contract must contain provisions to that effect.

    - Insulated assets should derive only from funds contributed by customers, plus earnings thereon, less any withdrawals and fees. If assets deteriorate, then the insulated value would be the reduced asset value and not the original amount contributed to acquire the assets. Seed money, risk-charges, spread and guarantees would not be insulated.

    - Every product should be initially filed with an opinion provided by a qualified actuary as to the sufficiency of the pricing. Subsequent to initial filing, an updated opinion by a qualified actuary should be completed upon regulator request. For guaranteed separate account products, opinions should represent that the general account is adequately compensated for its provision of a guarantee related to the contract liabilities.

- For book value separate account assets, all reserves, including investment reserves should be calculated on the same basis as if they were issued through the general account, adjusted in accordance with any unique contract attributes. For fair value separate accounts, reserves should be calculated to correctly reflect the nature of the liabilities and the underlying assets as well as to the adequacy of the assets, including risk charges, to meet future expected payouts.

- Any reserves in excess of the amount held as insulated in a separate account must be held as a non-insulated amount, or in the general account, or in a noninsulated supplemental separate account.

2. Review and consider updating revisions to SSAP 56, Separate Accounts and the *Modified Guaranteed Annuity Model Regulation (#255).*

3. Review and consider updating revisions to the *Separate Accounts Funding – Guaranteed Minimum Benefits under Group Contracts Model Regulation (#200).*

The proposed recommendations were exposed for comment until December 13.

A second set of longer term project recommendations was also exposed for comment: 1) consider guidelines for bank-owned life insurance and company-owned life insurance and 2) consider regulatory requirements for individual products; the comment period ends January 10.

Financial Regulation Standards and Accreditation Committee

The committee met in Washington and took the following actions:

Revisions to Part A: Standards for RRGs
The committee adopted a referral from the Risk Retention Group Task Force to remove a Part A accreditation standards requirement, applicable only to RRGs, for the Note 1 reconciliation of GAAP equity to statutory surplus to be audited. Regulators of captive RRGs had expressed concern regarding including the reconciliation in the audited financial report, noting that in order to audit the reconciliation, the auditors must perform additional procedures at added cost to the RRGs. The unaudited reconciliation will continue to be disclosed in the annual statement. Five comment letters were received on the previously exposed proposal, all of which were in support of eliminating the requirement from the accreditation standards.

Revisions to Part A: Corrective Action Standard
At the Summer National Meeting, the committee exposed a referral from the Corporate Governance Working Group requesting that Section 4B(10) of the *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in a Hazardous Financial Condition (#385)*, be added to the list of critical elements required to be adopted as part of the NAIC Accreditation Standard for Corrective Action. Section 4B(10) allows the commissioner, upon a finding of hazardous operation, to issue an order requiring the insurer to correct corporate governance practice deficiencies. This element represents the strongest, most specific authority available to a commissioner to require correction of corporate governance deficiencies and has been identified as critical to the effective regulation of an insurer's corporate governance.

In Washington, the Committee noted that no comments had been received on the prior exposure; however, NAIC staff had requested clarification from the Corporate Governance Working Group regarding its referral. Specifically, the NAIC has asked the working group whether:

> In assessing compliance with the state's adoption of Section 4B(10) of Model #385, is it the Working Group's intent that the state adopt language that is specific to the commissioner's ability to issue an order requiring the insurer to correct corporate governance practice definitions or is it sufficient that a state have broad and general authority to take action that could reasonably include (although not specifically delineate) the ability to issue an order requiring the insurer to correct corporate governance practice deficiencies?

The committee deferred taking any action on the proposal changes to the accreditation standard until a response is received.

2010 Revisions to Insurance Holding Company System Models
The committee discussed a referral from the Risk Retention Group Task Force regarding the applicability of the 2010 revisions to the *Insurance Holding Company System Regulatory Act (#440)*

and the *Insurance Holding Company System Model Regulation (#450)* to RRGs. The task force concluded that all revisions to the significant elements of the model act and regulation should be applicable to RRGs for accreditation purposes. The committee adopted a motion expressing its intent that the 2010 revisions to Model #440 and Model #450 will be required for both traditional companies and RRGs, effective January 1, 2016.

<u>Definition of Multi-State Insurer</u>

The committee discussed a memo from Rhode Island Superintendent Joseph Torti regarding the definition of "multi-state insurer" for accreditation purposes. Superintendent Torti noted that the current definitions of "multi-state insurer" included in the preambles to Part A: Laws and Regulations and Part B: Regulatory Practices and Procedures are unclear as to whether reinsurers organized under captive laws and reinsuring business in accordance with the *Valuation of Life Insurance Policies Model Regulation (#830)* and Actuarial Guideline XXXVIII— The Application of the Valuation of Life Insurance Policies Model Regulation (AG 38) are considered multi-state insurers under the accreditation program and, therefore, subject to the Part A and Part B accreditation standards.

While the Superintendent's memo was not formally exposed for public comment, it was distributed in advance of the Fall National Meeting; several interest parties submitted written comments on the topic. The principal concern raised by interested parties was that changes to the definition proposed by Superintendent Torti might cause traditional captive insurers that reinsure risks located in a state other than the captive's domiciliary state to be subject to the accreditation standards. Additionally, the ACLI commented that they do not believe the current definitions contained in the preambles are in conflict. However, several members of the committee agreed that the intent of the current language needs to be clarified regarding which companies are included in the scope of the standards. The committee directed NAIC staff to draft proposed revisions that will clarify the definition of "multi-state insurer" for review at the Spring National Meeting. The committee discussed that any changes to the definition would be applied prospectively and will provide sufficient time for impacted jurisdictions to comply. The committee chair also stated his intent that this would not impact traditional, pure captives that provide only self-insurance.

Casualty Actuarial and Statistical Task Force

The task force met by conference call in October and November, and at the Fall National Meeting and discussed the following issues.

<u>Schedule P Issues</u>

On its interim conference call, the task force agreed to expose revised annual statement instructions regarding Schedule P. The updates were intended to clarify when restatement of Schedule P is needed after a change to pooling percentages, and to reinforce Schedule P's aim to present meaningful development patterns. The task force received one comment that suggested restatement of Schedule P should also occur following material changes to the pool composition. However, the task force considered that the comment was out of its project scope, and moved to adopt the revised Schedule P instructions at the Fall National Meeting without incorporating the suggested change. The changes will be considered by the Blanks Working Group for 2014 annual statements.

At the Fall National Meeting, the task force also discussed a referral related to the audit procedures performed on Schedule P from the NAIC/AICPA Working Group, which had received a request from the AICPA to consider removing the Schedule P Testing Requirement from the annual statement instructions. The AICPA considers this testing to be duplicative of other Schedule P testing requirements, without increasing the level of assurance obtained by the auditor on the data used by the Appointed Actuary. The task force discussed the importance of Schedule P to regulators and the need for validation; one task force member noted that Schedule P "needs to be audited by someone," i.e. either the independent CPAs or the examiners. The task force agreed to draft a response to the referral to discuss on a future conference call.

<u>New Subgroups</u>

The task force adopted its 2014 charges in Washington, which included the creation of an Actuarial ORSA Subgroup and an Actuarial IRIS 11-13 Subgroup. The task force had discussed the ORSA Subgroup on its November conference call, and heard that greater coordination with the task force had been proposed during the 2013 ORSA pilot. The task force discussed the role of regulatory actuaries in the context of the ORSA, including the potential need for actuarial ownership, review, attestation or opinion over actuarial-based sections of the ORSA, including stress testing. The task force heard that the role of regulatory actuaries for the ORSA is not yet fully clear, although actuaries are not expected to own or drive the ORSA overall. However, the task force agreed that it should learn about the ORSA requirements and be prepared to assist as needed, in anticipation of a role for actuaries in the ORSA regulatory review process.

The task force's new Actuarial IRIS 11-13 Subgroup was created to verify that the formulas for IRIS ratios 11, 12 and 13 are accurate and efficient calculations in light of proposed revisions to the ratios by the Financial Analysis Research and Development Working Group. In response to a request by the task force, the working group agreed to delay the implementation of the revised ratios to 2014 to provide more time for the task force's input.

LAE Definitions

The task force also discussed the definitions of loss adjustment expenses (LAE) used for statutory financial reporting. The definitions were updated in the early 2000s to replace the previous classification of LAE into allocated and unallocated LAE with the categories of "defense and cost containment" and "adjusting and other." The task force agreed to do research into whether this change has met its objectives and to assess regulatory review of compliance with the definitions, in order to determine whether to revert to the previous definitions. The task force also discussed assessing whether insurers use the revised definitions internally, or whether they are purely used for financial reporting purposes. The task force therefore drafted surveys to address these questions to send to regulators and regulatory actuaries as an initial step.

Actuarial Opinion Guidance

The task force adopted its Regulatory Guidance on Property and Casualty Statutory Statements of Actuarial Opinion for the Year 2013 and Regulatory Guidance on the Property and Casualty Actuarial Opinion Summary for the Year 2013. The task force had exposed both documents at the Summer National Meeting, and received no comments, although a few updates were subsequently made by the Actuarial Opinion Subgroup based on discussions with interested parties.

Risk-Focused Surveillance Working Group

The working group met September 10 and discussed the following issues.

Adoption of Critical Risk Categories

The working group reported that the critical risk categories for use in financial examinations has been adopted for inclusion in the Financial Condition Examiners Handbook and will apply to all exams with a December 31, 2013 "as of" date. Early implementation for 2012 exams is "strongly discouraged." The 45 page document is also posted to the working group's webpage.

Focus on Prospective Risks

The working group summarized its efforts on increasing the focus of examinations toward prospective risks and eliminating unnecessary financial statement verification. The working group has prepared a referral to the Financial Examiners Handbook Technical Group to consider revisions to the Handbook in the areas of Exam Objective, Exam Report and Exam Repositories. With regard to the Exam Objective, the working group suggests that the Handbook "clearly define the primary objective for on-site financial examinations." Work on this project by the Handbook Technical Group will continue into 2014.

Industry Sound Practices Document

The working group discussed its revised Sound Practices for Risk-Focused Exams Generated by Industry Feedback document which includes recommendations to increase the efficiency of financial exams based on feedback from a 2012 survey of industry. The document includes recommendations in the areas of exam management, interviews, using the work of others, budgeting, and confidentiality, with a focus on good communications and advance planning. The working group adopted the two-page document, which has been posted to the working group's webpage.

Referral from the Corporate Governance Working Group

The working group discussed the referral which suggests that they work with the Financial Analysis Working Group and the Handbook Technical Group to consider development of a common assessment methodology for insurer's corporate governance practices. This recommendation was controversial when it was discussed at the Corporate Governance Working Group, and interested parties repeated the concern that such a common assessment methodology or template could create a "checklist mentality." The chair stated the working group does not plan to take any action on the referral at this time.

Mortgage Guaranty Insurance Working Group

Since the Summer National Meeting, the working group developed a draft of revised *Mortgage Guaranty Insurance Model Act (#630)*. On November 25, the working group exposed the

proposed model law for comment through January 9 (which was subsequently extended to February 15). Proposed changes to the current model are systemic, proposing changes in many functional and operational areas.
The proposal introduces a new state geographic concentration provision that imposes limitations on the amount of business companies can underwrite that triggers additional capital requirement should companies exceed the limits. To minimize the risk of companies being overly exposed to the real estate market, companies will be restricted from investing in notes or other financial instruments secured by a mortgage or real property lien; additional capital is required should companies invest in collateralized mortgage obligations and other non-permitted instruments.

The proposal introduces a two-tier capital adequacy measurement standard comprising an RBC model and a loan level capital model. Additionally, dividends will be restricted should a company's RBC fall below the company action level. The proposal strengthens the requirements of contingency reserve by increasing the allocation of reserves, extending the reserve retention period from 120 months to 180 months, and increasing limitations to early withdrawals of reserves. Companies will also need to disclose components of premium deficiency reserves in the actuarial report and actuarial opinion summary. The proposal introduces underwriting guidelines companies will need to comply with as well as establishment of a formal internal quality control program which provides an early detection warning system for potential solvency issues. Within the scope of the program, companies will need to document, monitor, evaluate, and report on the integrity of the ongoing loan origination process, and address the following provisions: segregation of duties, senior management oversight, board of director oversight, policy and procedures documentation, underwriting risk review, lender performance reviews, problem loan trend reviews, underwriting system change oversight, pricing and performance oversight, internal audit validation, and regulator access.

The proposed revised model also includes a prohibition on the formation of captive reinsurers and a requirement that all affiliated reinsurance agreements are approved by the domiciliary regulator. The revisions also propose development of a Mortgage Guaranty Insurance Standards Manual which would include underwriting and quality assurance standards and other information that the NAIC "deems appropriate."

The working group received extensive comments on the exposure draft in a nine-page comment letter from an industry group comprising seven mortgage insurers. One working group member (Pennsylvania) commented that, given the "severe condition of the mortgage guaranty industry," he was surprised to see the extent of industry comments to the proposed revisions. This comment was followed by discussion of the need of industry and regulators to work together to develop a high quality model.

The working group then heard a presentation of summary comments by the industry group.
The industry group emphasized that it appreciates the formidable task the working group faces, noting that the working group's challenges include:

1) the need to effectively manage overlapping authorities, namely the NAIC, Federal Housing Finance Agency (FHFA), and Consumer Financial Protection Bureau (CFPB)

2) defining the proper location of detailed requirements, taking into consideration existing guidance from the NAIC Model Act, CFPB Regulations of Insured Lenders, NAIC Examinations & Standards Manuals, FHFA/Government-Sponsored Entity (GSE) Mortgage Insurance Eligibility Standards (including capital requirements) & Servicing Guides, Mortgage Insurance Master Policies

3) finding a proper regulatory balance which on one scale, fosters strong policyholder protection, provides regulatory clarity, and addresses lessons learned from the crisis, and on another scale, provides capacity to attract additional capital, offers less regulated mortgage insurance alternatives, provides regulatory flexibility for future changes, and the need for broad adoption of the law.

The industry group commented on its primary concerns which are focused on the capital and reserving framework, risk limits, investment limitations, and placement of detailed requirements. The industry group reminded that recent changes at the federal level by the GSEs and FHFA deserve attention; changes include new eligibility and capital standards that are expected to be exposed shortly. A representative of the industry group informed that due to the short timeframe between when the proposal was exposed and the Washington meeting, the industry group did not have a revised industry proposal; however, the group intends to submit a mock-up of a proposed draft revised model if additional time was provided. Pursuant to the industry group's request, the working group extended the comment period to February 15.

Also in Washington, a representative from the Center of Economic Justice suggested that general requirements should be contained in the model law and specific requirements should be included into the Mortgage Guaranty Insurance Standards Manual; this would allow for the Manual to be quickly updated if deemed necessary. The speaker also noted that a formulaic approach has limitations and the draft proposal appears to be enhancing the formulaic approach rather than going to a more principle-based approach.

After hearing comments, the working group agreed to set up a committee of financial regulators to study the capital model and hold a meeting with industry representatives and an actuarial firm.

Terrorism Insurance Implementation Working Group

The working group held conference calls on August 29 and September 4 and met in Washington to continue its efforts to address insurance coverage for acts of terrorism. The working group is currently focused on the need for Congress to renew the Terrorism Risk Insurance Act (TRIA) which is set to expire on December 31, 2014. The NAIC's Government Relations Leadership Council has previously adopted a resolution in support of the reauthorization of TRIA. The working group noted that, at the direction of Congress, the U.S. Government Accountability Office is preparing a report which will consider the need to reauthorize TRIA. The GAO has already reached out to the NAIC to assist in providing information for its report. The leadership council will be seeking support from the working group as the NAIC provides input to the GAO, the Federal Insurance Office, other federal agencies and Congress.

On its interim conference calls, the working group prepared a letter on behalf of the NAIC in response to the FIO's July 16th Federal Register notice, which requested comments on many issues related to terrorism insurance, including the effects of the potential termination of TRIA. Specific comments were requested on the availability and affordability of insurance for terrorism risk in the United States. In its September 16 response letter, which was approved by the leadership council, the NAIC makes the following observations:

- The availability of TRIA provides stability to commercial policyholders, lenders, builders, and the businesses that operate in urban centers and other areas prone to a terrorist attack.

- There is no evidence to suggest that the insurance market place is capable or willing to voluntarily take on a substantial portion of the risk of providing terrorism risk coverage due to the difficulty in accurately determining the frequency, severity, and loss costs for acts of terrorism.

- If TRIA were allowed to expire, some insurers might place limitations on commercial insurance policies to exclude terrorism coverage or choose to withdraw from the market completely.

In Washington, the working group received a presentation from the American Bankers Association regarding the need for Congress to reauthorize the TRIA. The ABA noted that TRIA obligates the U.S. Treasury to guarantee terrorism-related losses incurred by insurers, and that it is critically important that terrorism insurance be available to support commercial mortgage loans.

Title Insurance Task Force

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

Title Insurance Escrow Theft White Paper
The task force adopted the Title Escrow Theft and Title Insurance Fraud Whitepaper on October 3; the whitepaper serves to raise awareness and as a tool for regulators to research methods for combating and preventing escrow theft, title insurance premium theft and other forms of fraud associated with title insurance and closing services.

Title Insurance Risk-Based Capital
In support of the Title Insurance Risk-Based Capital Subgroup's conclusion not to move forward with the development of RBC standards for title insurers, the subgroup issued a memorandum to its parent task forces, the Title Insurance Task Force and the Capital Adequacy Task Force documenting that conclusion. The subgroup also requested that the Financial Analysis Research and Development Working Group consider the development of IRIS ratios and FAST scores for title insurers. The task forces adopted the subgroup's recommendation. Having completed its charge, the subgroup is disbanded.

Title Guaranty Fund
The Title Insurance Guaranty Fund Working Group met by conference call October 7 to discuss comments received on the model guideline to assist states considering a guaranty fund. The working group had exposed two draft options, a stand-alone title insurance guaranty association model guideline

and an expanded version of the existing *Property and Casualty Guaranty Association Model Act* to include title insurance. During the conference call, the working group discussed comments received from three trade organizations, which all supported the stand-alone option due to differences between title insurers and property and casualty companies.

The trade association ALTA suggested an option 3, which is to look at states that have adopted a guaranty fund for title insurance (e.g., Texas), take the best of what they have to offer and apply it to other states. After hearing comments, the chair informed industry that they may submit additional technical comments including a detailed option 3 draft.

Risk Retention Group Task Force

The task force continues to assess whether, and if so, how changes to the NAIC Financial Regulation Standards and Accreditation Program should apply to risk retention groups and their affiliates. The task force held a conference call in October and met in Washington. The applicability of following model regulations was discussed during these meetings.

2008 Revisions to the *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385)*
This model regulation is already applicable to RRGs under current accreditation standards; however, the applicability of the 2008 revisions to the model regulation is now being considered and exposed for comment. The revisions relate to the definition of hazardous financial condition set forth in Section 3901(a)(7) of the federal Liability Risk Retention Act of 1986, which will become effective for accreditation purposes on January 1, 2014. No comments were received from interested parties during the public comment period. The task force concluded that no action was necessary as there are no issues with applying the model revisions to RRGs.

2010 Revisions to the *Insurance Holding Company System Regulatory Act (#440)* and the *Insurance Holding Company System Model Regulation (#450)*
On its October conference call, the task force finalized its recommendations to the Financial Regulation Standards and Accreditation Committee regarding the applicability of the 2010 revisions to RRGs, which is that all revisions to the significant elements of the act and regulation should be applicable to these entities for accreditation purposes. The 2010 revisions to the Regulatory Act and Model Regulation will be applicable for accreditation purposes effective January 1, 2016.

2011 Revisions to the *Credit for Reinsurance Model Act (#785)* and the *Credit for Reinsurance Model Regulation (#786)*
The task force discussed a question raised with respect to the grandfathering provisions included within the Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers. It was noted that some have questioned whether the grandfathering provisions apply to existing reinsurers or only to existing reinsurance contracts. The task force confirmed that the grandfathering provisions apply at the reinsurer level; however, the task force agreed to modify the guidelines to clarify that a domestic regulatory may revoke the approval of the reinsurer. The task force referred the clarifying revisions to the Financial Regulation Standards and Accreditation Program.

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The next National Meeting of the NAIC will be held in Orlando March 29-April 1. 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.

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