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Society of Financial Examiners®
12100 Sunset Hills Road | Suite 130
Reston, Virginia 20190
703.234.4140
800.787.SOFE (7633)
Fax 703.435.4390

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The questions are on the following page. Good luck!

CRE READING PROGRAM QUESTIONS

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The Reading Program Test from this issue and future issues of the *Examiner* will be offered and scored online. Please see the details on the previous page.

Supervisory Colleges: Considerations for the Financial Examiner and Adding Value

True or False Questions — Submit Answers Online

1. Supervisory colleges are held only for insurance groups that have both Life and P&C entities.
2. The chairman of the Supervisory College is responsible for proposing the agenda for the meetings.
3. Company management is not invited to attend any of the Supervisory College meetings.
4. Examiners can assist in preparation for a Supervisory College meeting by preparing documents to share such as prospective risk summaries, corporate governance assessments, lists of key findings and exam adjustments, key reports used by management to mitigate risks, etc.

Corporate Governance Guidelines, Principles and Implications for Examiners

True or False Questions — Submit Answers Online

1. The Examiners Handbook does an excellent job in dictating what an insurer's management oversight, corporate governance and internal control structure or documentation should include.
2. The Corporate Governance Working Group suggests additional guidance to Exhibit M.
3. Exhibit M now provides guidance on assessing the Board of Directors and in the future will provide guidance on assessing the competence of management.
4. The International Association of Insurance Supervisors (IAS) has a framework of 26 Insurance Core Principles (ICP) as guidance for global regulators. In 2014 the U.S. will be evaluated by the International Monetary Fund.

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CRE READING PROGRAM QUESTIONS

(continued)

All quizzes MUST be taken online

Overview of HIPPA Omnibus Final Rule

True or False Questions — Submit Answers Online

1. Since the HITECH Interim Final Rule was implemented in September 2009, it was found that 1 in 10 breaches were cause by a Business Associates.

2. Prior to the HIPAA Omnibus Final Rule Business Associates were regulated by each states insurance department.

3. The HITECH Breach Notification rule expanded the definition of breach to include "unauthorized acquisition, access, use or disclosure of protected health information which compromises the security or privacy of such information."

4. The final rule requires that the Secretary of HHS conduct a compliance review where an initial review indicates the covered entity or business associate performed a violation due to "willful neglect".

Skills of an Effective Insurance Examiner

True or False Questions — Submit Answers Online

1. An effective insurance examiner utilizes the NAIC Financial Condition Examiners Handbook as a key source of regulatory knowledge.

2. Effective examiners focus on the most important and high-risk exam areas first.

3. Examiners protect confidential and sensitive data received during examinations by ensuring physical and logical security.

4. Computer Aided Audit Techniques create additional manual work for examiners when testing large data files for regulatory compliance.

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CRE READING PROGRAM QUESTIONS

(continued)

All quizzes MUST be taken online

Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry

True or False Questions — Submit Answers Online

1. Most homeowners do not buy flood insurance because they do not perceive value according to the authors.
2. Insurers tend to view low probability losses as improbable and therefore tend not to explicitly mention or price for the risk in the policy.
3. Multiyear policies, while higher cost, would provide better price stability and encourage policyholders to invest in protective measures.
4. Means testing and vouchers would not be a good way to address low-income consumers' availability to CAT coverage.

Supervisory Colleges: Considerations for the Financial Examiner and Adding Value

By: Shawn Towchik, Jan Moenck, and LeeAnne Creevy

Overview of the Supervisory College Process

The current insurance marketplace crosses multiple borders which has fueled the creation of multinational insurance holding companies. As a result, the increased utilization of Supervisory Colleges for group supervision has become more critical.

The International Association of Insurance Supervisors (IAIS) defines a supervisory college as "A forum for cooperation and communication between the involved supervisors established for the fundamental purpose of facilitating the effectiveness of supervision of entities which belong to an insurance group; facilitating both the supervision of the group as a whole on a group-wide basis and improving the legal entity supervision of the entities within the insurance group. (Source: http://www.iaisweb.org)

The NAIC supports the increased use of Supervisory Colleges and has developed a web-based request form that allows for international regulators to be able to request the participation of domestic insurance departments. Additionally, the NAIC has created a Supervisory Tracking document to monitor the activity of Supervisory Colleges. (Source: http://www.naic.org)

One of the challenges that domestic insurance departments face today is the coordination of activities with other insurance departments within the U.S. for domestic insurance holding companies. Add in foreign regulators, and now the issue is further magnified. The supervision of large multinational insurance groups requires more than just local supervision of the domestic entities within the group. Supervisory Colleges are an avenue in which information can be shared with multiple parties on a coordinated basis.

For anyone who is new to Supervisory Colleges, a great reference that covers multiple aspects of the Supervisory Colleges is the IAIS Insurance Core Principles (ICP) 25, "Supervisory Cooperation and Coordination." Throughout ICP 25, you will notice two key terms referenced the majority of the time—cooperate and coordinate. Simply put, without either one, Supervisory Colleges will not be nearly as effective.

According to ICP 25.1.13, the primary purpose of a Supervisory College is to discuss supervisory issues and exchange information that is relevant to a group focusing on the following:

- Agree on the cooperation and coordination process including the planning and setting of procedures for supervisory cooperation during emergency situations;
- Produce an overview of the group, setting out its formal and operational structure;

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Supervisory Colleges: Considerations for the Financial Examiner and Adding Value (continued)

- Carry out a risk analysis on a group-wide basis, identifying the most relevant entities and the most important relationships in the group;
- Discuss issues supervisors have found within the entities they supervise that they believe could be systemic throughout the group;
- Where practicable, agree on areas of supervisory work to avoid unnecessary duplication; possible joint inspections could also be decided;
- Agree on the information supervisors should gather from the group and exchange with other members of the supervisory college, including the form and the frequency with which this happens; and
- Agree on whether the Supervisory College should set out any arrangements in respect of group-wide supervision in written form (bilateral or multilateral agreements).

Effective communication among regulators is the key to a successful Supervisory College because without this level of communication, the focus items mentioned above may result in ineffective supervision. The chairman of the Supervisory College has a major role to play in the Supervisory College since he/she is responsible for proposing the agenda for the meetings (ICP 25.4.11) that incorporates the views and opinions of other members. In order to achieve this task, the chairman needs to communicate with the other members to find out what their concerns are in relation to the group. ICP 25.4.12 indicates that "Supervisory College meetings should be planned with clarity of the outcomes that are being sought and, based on this, should clearly record the outcomes that are achieved". Without adequate and effective planning and communication, the outcome may be more heaving weighted toward that of the organizer.

Supervisory College meetings should function to allow members of the Supervisory College to fully understand the major risks to which the group is subject (ICP 25.5.1). According to ICP 25.6.15, the key functions of a Supervisory College includes a supervisory review of the group's own risk and solvency assessment (ORSA), transparency of the group structure and suitability of the group's senior management and its independent board of directors. The review may also cover capital adequacy, large intra-group transactions and exposures, corporate governance (including risk management and internal controls), group crisis management arrangements and review of the effectiveness of these functions. It is also important to have a group-wide understanding of how key management decisions are vetted and agreed upon and how enterprise risk management (ERM) frameworks and internal models are established and operated to complement legal entity level supervision of the entities within the group (ICP 25.6.20). Domestic insurance

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regulators can provide a significant amount of subject matter as a result of the output from risk focused examinations. Prospective and financial reporting risk summaries (e.g., "dashboard" reports) and corporate governance assessments are some materials that can have been shared prior to or during the Supervisory College meeting to provide foreign regulators greater insight into the group's management and operations. Going forward, Company ORSA and Form F (ERM) filings, or excerpts thereof, will also be an excellent resource for Supervisory College discussions.

Trust is another critical aspect of a successful Supervisory College. According to ICP 25.5.18, each member is expected to make every reasonable effort to cooperate and coordinate in a spirit of mutual trust to ensure the protection of confidential information shared and to avoid unwarranted supervisory duplication and unnecessary supervisory burden for both the insurers and members involved. If proper communication occurs, there should be no trust issues as any areas of concern should be vetted prior to the meetings. As information is shared and exchanged in a secure and controlled environment, it both requires and encourages mutual trust (ICP 25.6.17).

Insurance company management is invited to the open sessions of the Supervisory College meetings which provide the Supervisory College members an opportunity to discuss any group level concerns with management directly (ICP 25.6.24). This forum allows management to speak directly about the company's business strategy, changes in senior officers, ERM, etc., at a group-wide level. It is up to the members of the Supervisory College to make the most of each meeting which means asking the companies to provide specific details regarding the areas that are critical to the concerns of the members. In some Supervisory College meetings, the companies have come in and presented the same (or similar) information that is shared with the rating agencies or provided to the SEC regarding financial information. Although this type of information can be great information to obtain, Supervisory Colleges should be utilized to get the critical information directly from the companies, including information about significant and emerging prospective risks, the company's corporate governance environment, and its "tone at the top." The agendas should be structured to allow for the proper information (both the right material and the right level of detail) to be shared by the company's senior management. Domestic regulators can play a key role in developing the agenda for the companies considering the key reports/documents that are vetted during the risk-focused examinations. Communication with the chairman of the Supervisory College is important to provide for the knowledge transfer to allow for the company's management to be adequately prepared for the meetings.

This forum allows management to speak directly about the company's business strategy, changes in senior officers, ERM, etc., at a group-wide level.

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As an example, an insurer that is the subject of the meeting could present its most significant or "top risk" listing, which is a consolidated view of risk derived from various risk assessments and other assurance activities. This is great high level information to receive; however, in some cases a deeper dive is necessary to fully understand the information contained in the risk report. The domestic regulator, as a result of a recent risk-focused examination, would know the names of the key reports to provide for a deeper dive into each of the areas referenced in the risk listing. As a result, this insider knowledge could foster deeper conversations with management regarding issues or risk areas within the group. A domestic regulator also would have an indication as to which risks on the top risk listing may not be as critical to regulators, allowing for the majority of the time with the company's management to be more focused solely on the risks or areas of concern identified by the members of the Supervisory College. Simply put, this type of knowledge and planning will help steer the meeting toward the highest areas of interest for the regulators.

Preparing for a Supervisory College—How the Examiner Can Assist

If a Supervisory College is occurring during or shortly after the examination, examiners may be called upon to assist in the preparation of documents for the Supervisory College. As mentioned above, prospective risk summaries/dashboards and corporate governance assessments are a great place to start. If you have significant findings or exam adjustments, these are something the participants might be interested in. Other key documents that may be helpful would be key reports that management uses to manage/monitor prospective and/or key financial risks, the Company's strategic plan, a listing of what the Company considers to be its key risks, etc. As Form F (ERM) and ORSA become commonly used regulatory tools it is expected that they will play a key role in Supervisory College discussions as well.

It is important to understand who the audience will be and the stature of the company as part of the group as a whole.

When preparing these documents, it is important to understand who the audience will be and the stature of the company as part of the group as a whole, and then prepare materials accordingly. If the company you have examined is one of the lead companies in the group, you may want to prepare significant amounts of information and supporting documentation; however, if the company is immaterial to the group as a whole you may want to contain your documentation to high level critical information.

Another thing you may be asked to do to prepare for a Supervisory College is to host an examiner from one of the countries involved in the group supervision. This occurred on one of the exams that we were working on shortly before the Supervisory College. The examiner joined us on the exam, and we walked him through the prospective and financial reporting risk matri-

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Supervisory Colleges: Considerations for the Financial Examiner and Adding Value (continued)

ces, the corporate governance assessment, the Company's ERM results, our exam approach, etc. This helped him better understand the risks facing the Company under examination, and allowed him to better understand the risk-focused examination methodology.

Utilizing Information Obtained from a Supervisory College in the Exam

Perhaps the Supervisory College will occur either shortly before, or during, your examination. If that is the case, even if you do not attend the Supervisory College personally, you should obtain information that was distributed in the Supervisory College for consideration in your exam. This information should be reviewed, along with the rest of the documents considered in Phase 1 to identify significant risks facing the Company, including key risks at the holding company level which may present risk to the Company under examination. If the Supervisory College occurs in the middle of the exam, the examiner should consider risks identified, and modify examination planning as necessary.

Conclusion

Preparing for the Supervisory College is just as important as conducting the meeting itself. Without proper preparation for the Supervisory College, the risk exists that it may become "just another meeting" (similar to when companies visit the insurance department periodically). In this were to occur, there may be a significant missed opportunity to truly accomplish the objectives of a Supervisory College. Instead, if all of the members of a Supervisory College take to heart the two key terms mentioned throughout ICP 25—cooperate and coordinate—then the Supervisory College meetings will be beneficial to all of the parties involved and will contribute in a much more meaningful capacity to effective group supervision and an effective risk surveillance process.

About the Authors

Shawn Towchik is a Director at Risk & Regulatory Consulting, LLC (RRC) and holds the CFE designation. He is a member of the SOFE Board of Governors and has been a member of the SOFE Professional Standards Committee for the past two years. Shawn has over 13 years of experience in insurance regulation of which 7.5 years was spent as a Financial Examiner for the Texas Department of Insurance.

Jan Moenck, a Partner in Risk & Regulatory Consulting's (RRC) Minneapolis, Minnesota office has over 25 years of experience providing examination and internal audit services to clients in the financial services industry. For over 15 years, Jan served as the lead engagement manager working with the Min-

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nesota Department of Commerce, Insurance Division (Minnesota) by providing co-sourced financial examination services. Jan assisted Minnesota in the development and deployment of its risk-focused examination process and has served as the Examiner in Charge on risk-focused financial examinations for over twelve years. Jan has also provided hands-on and classroom training on risk-based examination techniques to several states, the Society of Financial Examiners (SOFE), and RRC employees.

LeeAnne Creevy, a Partner in Risk & Regulatory Consulting's (RRC) Hartford, Connecticut office, has over 18 years of professional experience. LeeAnne has participated in leadership roles on a number of risk-focused financial and information technology (IT) examinations as well as operational/internal controls reviews. This experience includes serving as a subject matter resource on several large insurance company risk-focused examinations related to the assessment of corporate governance, enterprise risk management (ERM) and internal audit functions, and risks and controls documentation. LeeAnne has also helped to lead the RRC team's development and enhancement of risk-focused examination methodology, including developing a "toolkit" with practical "hands on" guidance and resources. In addition, LeeAnne leads RRC's team of IT resources dedicated to insurance regulatory examinations and has led the team in developing methodology and approaches on IT risk-focused examinations.

Corporate Governance Guidelines, Principles and Implications for Examiners

By: James E. Stangroom, CPA

Corporate governance practices are an important aspect of an insurer's overall risk management framework. Corporate governance involves the oversight by the Board of Directors and senior management of an insurer's risk management, including the identification of risk, the establishment of risk limits and risk monitoring procedures, and the implementation of policies, controls and risk mitigation strategies. The assessment of an insurer's corporate governance practices is one of the most critical aspects of the regulatory risk-focused surveillance cycle, and in particular, of a risk-focused financial examination.

NAIC Corporate Governance Working Group Principles

Both U.S and international insurance regulators have been busy in recent years evaluating regulatory requirements over corporate governance principles. The NAIC's Corporate Governance Working Group is charged with outlining corporate governance principles for use in U.S. insurance regulation and developing regulatory guidance. In connection with these charges, the Working Group released a paper entitled Existing U.S. Corporate Governance Requirements, which was formally adopted by the NAIC in December 2011. Then, in August 2012, the Working Group exposed for public comment a follow-on paper that compared U.S. corporate governance standards with international standards, identified insurance company best practices and proposed certain regulatory enhancements. The Working Group plans to finalize its response to this comparative analysis of U.S. corporate governance requirements in the Spring of 2013. The regulatory enhancements being proposed by the Corporate Governance Working Group are categorized into seven Principles.

Principle 1: Regulatory reporting, disclosure and transparency – Recommendations include confidential insurance company filings of their corporate governance practices and revising the Model Audit Rule to require certain size insurers to maintain an internal audit function.

Principle 2: Off-site monitoring and analysis – Recommendations include expanding guidance in the Financial Analysis Handbook regarding corporate governance and holding company analysis. In addition, the Working Group is proposing a long-term project to enhance the regulatory review and assessment of corporate governance performed in the state level financial examination and financial analysis processes through the development of a common corporate governance assessment methodology.

Principle 3: On-site risk-focused exams – In addition to recommending the common corporate governance assessment methodology referred to above, proposed enhancements include additional guidance in the Financial Condition Examiners Handbook (Examiners Handbook) on corporate governance,

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Corporate Governance Guidelines, Principles and Implications for Examiners (continued)

risk management and internal controls. Such guidance would incorporate certain elements of the International Association of Insurance Supervisors' Insurance Core Principles.

Principle 4: Reserves, capital adequacy and solvency – Proposals include a requirement for the appointed life actuary to annually present the actuarial report to the insurer's Board of Directors.

Principle 5: Regulatory control of significant, broad-based risk-related transactions – This principle recognizes that certain significant transactions require regulatory approval. Proposed enhancements include disclosure of the Board's role in the oversight of an insurer's reinsurance strategy, risk management and compliance.

Principle 6: Preventive and corrective measures – This principle recognizes that regulators have the authority to take timely corrective action to cause insurers to address any corporate governance deficiencies identified. Recommendations include recognizing this authority as a critical element for accreditation purposes.

Principle 7: Exiting the market and receivership – This principle emphasizes that Boards of Directors of large groups have a responsibility for oversight of affiliate relationships and should take action to reduce the potential risk and impact on an insurance entity resulting from an affiliate's failure. Recommendations include developing guidance for examiners to use when considering such Board oversight.

As referred to in Principles 2 and 3 above, the Corporate Governance Working Group has drafted referrals to the NAIC's Financial Analysis Handbook Working Group and the Financial Examiners Handbook Technical Group asking both groups to collaborate on developing a common corporate governance assessment methodology, including related Analysis and Examiners Handbook guidance. The Corporate Governance Working Group made several specific suggestions for the Handbook groups to consider, including:

- The development of separate assessment categories to address areas such as the Board of Directors, organizational structure, management, ethics, compensation, strategy and risk management.
- The development of a common format to document and continually update the corporate governance assessment.
- Guidance on how the assessments can be used for regulatory surveillance prioritization and incorporated into the Insurer Profile Summary and/or Supervisory Plan.

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Corporate Governance Guidelines, Principles and Implications for Examiners (continued)

Industry groups and other interested parties have expressed concerns over the potential for examiners and analysts to take a checklist or template approach to assessing and grading the effectiveness of corporate governance at any company. The primary industry concern appears to be that such a standardized approach may not recognize that one size does not fit all and that effective governance practices can, and should, vary from company to company depending on a variety of factors, including size and complexity.

The Corporate Governance Working Group is also proposing that regulators receive more regular and timely information on corporate governance practices of insurers through the filing of a confidential supplement on insurer governance practices with the domestic state of each insurance legal entity. Acknowledging that governance practices can vary significantly from company to company based upon the size, type, complexity and structure of a company, the Working Group has proposed that these confidential filings include five broad areas:

- A general description of the insurer's corporate governance framework, including the oversight responsibilities of the Board.
- A description of Board and committee policies and practices, including the composition of the Board and committees and how an appropriate level of independence is maintained by the Board.
- A discussion of any changes in corporate governance practices from the prior year.
- A description of management policies and practices, including compensation practices and the suitability of officers and other key persons in positions involving internal control functions.
- A description of the processes by which the Board and senior management provide oversight to the insurer's critical risk areas and business activities.

Industry groups and other interested parties have expressed concerns over how confidentiality will be maintained and that such an additional regulatory filing might be duplicative and overly burdensome.

Industry groups and other interested parties have expressed concerns over how confidentiality will be maintained and that such an additional regulatory filing might be duplicative and overly burdensome.

The Corporate Governance Working Group will be continuing its deliberations into 2013. Regulators have a desire to gain an even better understanding of, and make some assessment of, insurer corporate governance practices. As a result, whether through formal filings with state regulators, through enhanced financial examination and analysis procedures, or both, insurers will likely be required to share more information about their governance practices in the not too distant future. Insurance examiners and financial analysts will have a responsibility to evaluate the adequacy of corporate gov-

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ernance and to determine how their assessments will influence the actions they take throughout the regulatory risk-focused surveillance cycle.

IAIS Insurance Core Principles

The International Association of Insurance Supervisors (IAIS) has adopted a framework of 26 Insurance Core Principles (ICP) as guidance for global regulators in the conduct of their supervisory responsibilities over the insurance sector. For example, ICP No. 7 states that insurance regulators should require insurers "…to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business…" In addition, ICP No. 8 "…requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit."

The ICP's are significant for U.S. regulators, not only because they provide additional guidance on sound corporate governance practices, but also because in 2014 the U.S. will be evaluated by the International Monetary Fund in connection with its Financial Sector Assessment Program (FSAP) review of the U.S. financial regulatory system. In connection with this review, the effectiveness of the U.S. insurance regulatory system will be judged to a large degree against these ICP's. Some of the key corporate governance principles included in ICP No. 7 include:

- Board involvement in setting and approving business objectives, strategies and risk appetite.
- Board oversight of senior management.
- A Board composed of individuals with appropriate knowledge and expertise and a sufficient level of independence and objectivity.
- Board oversight of sound risk management and internal controls.
- Board oversight of reliable financial reporting processes and effective internal controls over financial reporting.
- A senior management structure that promotes sound risk management and compliance practices, internal controls and performance monitoring.

Corporate Governance Assessment and the Risk-Focused Exam

An assessment of corporate governance and its role in a company's enterprise risk management (ERM) process is increasingly becoming one of the most critical aspects of a risk-focused financial examination. This is one aspect of the exam where examiners can leverage information from the insurer to gain an understanding of its key solvency risks, including prospective risks and other than financial reporting risks. Experience has shown that companies with strong enterprise wide controls, including corporate gover-

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Corporate Governance Guidelines, Principles and Implications for Examiners (continued)

nance and risk management, are more likely to have a strong overall system of internal controls at the functional activity, operating and financial reporting process levels. The NAIC Corporate Governance Working Group initiatives described above will require examiners to become even more knowledgeable of corporate governance principles and best practices. These initiatives will also provide examiners access to more information about the corporate governance practices in place at individual insurers and; therefore, be in a better position to assess the adequacy of corporate governance during the course of a financial exam.

The Examiners Handbook already provides a significant amount of guidance on how the risk-focused examination process should include an assessment of the quality and reliability of the corporate governance structure and risk management programs. Exhibit M of the Examiners Handbook provides extensive guidance to assist examiners in conducting an assessment of the corporate governance structure and risk management functions including guidance on:

- Assessing the Board of Directors.
- Evaluating the appropriateness of the organizational structure to manage business activities and fulfill control responsibilities.
- Understanding the delegation of authority throughout the organization.
- Assessing management competence.
- Reviewing the effectiveness of the risk management function.

The Corporate Governance Working Group is proposing that the Financial Examiners Handbook Technical Group consider developing additional guidance to Exhibit M, including further examiner review of the background of Directors, senior management and others in key internal control functions; further review of insurer remuneration policies; and assessment of Board oversight of contingency planning in large groups with significant affiliate relationships.

The guidance in the Examiners Handbook does not dictate what an insurer's management oversight, corporate governance and internal control structure or documentation should include; however, the Handbook does indicate that "… examiners must consider and evaluate the insurer's corporate governance and established risk management processes" and suggests that examiners should maximize the utilization of the corporate governance and risk management information made available by the company in completing the examination. Based on his or her review and corroboration of the evidence provided, an examiner should reach a conclusion as to the overall effectiveness of the insurer's corporate governance and risk management. A determination that corporate governance and risk management is effective can influence an examiner's judgment when assessing the effectiveness of

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Corporate Governance Guidelines, Principles and Implications for Examiners (continued)

risk mitigation strategies and controls at the functional activity level in Phase 3 of the exam as well as the residual risk assessment in Phase 4. For example, in a situation where an examiner is having difficulty making a judgment as to whether a specific identified control is a moderate or strong risk mitigation strategy and a directly related corporate governance practice is deemed to be effective, then the examiner might be justified in concluding the control under consideration is strong. On the other hand, if the corporate governance practice is deemed to be ineffective, then a rating of moderate might be more appropriate. In either situation, the examiner's thought process should be documented in the risk matrix.

It bears repeating that experience has shown that companies with strong enterprise wide controls, including corporate governance and risk management, are more likely to have a strong overall system of internal controls at the functional activity, operating and financial reporting process levels. This is one reason why so much attention is being directed towards these activities in connection with the risk-focused surveillance process. Guidance in the area of corporate governance will continue to develop and evolve. As a result, it would be beneficial for examiners and analysts to begin now to enhance their professional skills within this discipline.

About the Author:

Jim Stangroom, CPA, is a Managing Director with Invotex where he is responsible for assisting the firm's insurance industry and regulatory clients in the areas of financial examinations, financial reporting, solvency and risk management. Invotex provides accounting, examination, financial analysis, risk management and other financial consulting services to help the insurance regulatory community achieve its goals with respect to the financial oversight of insurers and with respect to the supervision, rehabilitation and liquidation of financially troubled insurers.

Overview of HIPAA Omnibus Final Rule

By Denise Mainquist, CISA, CPHIT

After nearly two years of waiting, the Health Insurance Portability and Accountability Act (HIPAA) final rule was published on January 25, 2013. This new regulation is referred to as the HIPAA Omnibus because it incorporates four final rules, including significant changes to HIPAA Privacy and Security Rules with enforcement and breach notification requirements under the Health Information Technology for Economic and Clinical Health Act (HITECH), as well as strengthening privacy protections for genetic information under the Genetic Information Nondiscrimination Act of 2008 (GINA). There is little wonder as to why it took several years to pull together this final rule.

Business Associates

One of the biggest changes in the HIPAA Omnibus is the expanded definition of a Business Associate (BA). A BA is defined as "one who, on behalf of a covered entity, creates, receives, maintains or transmits Protected Health Information (PHI)." (A covered entity is the organization that is the primary creator or user of PHI, such as a hospital, physician's office, health insurance company or government agency.) Subcontractors of BAs are also now included in the definition of a business associate. Previously, BAs were regulated indirectly through the use of BA agreements, but now business associates will be directly regulated by Health and Human Services (HHS). The new rule clarifies the definition of a BA as: "(1) A Health Information Organization, E-prescribing Gateway, or other person that provides data transmission services with respect to protected health information to a covered entity and that requires routine access to such protected health information; and (2) a person who offers a personal health record to one or more individuals on behalf of a covered entity." There are many types of BAs used by a covered entity ranging from billing companies and claims clearinghouses to website hosting and technology providers.

As PHI began to be shared or accessed more broadly by these third-parties, the number of breaches caused by third-parties increased significantly. Since the HITECH Interim Final Rule was implemented in September 2009, requiring covered entities to report breaches of 500 or more PHI records to the Secretary of Health and Human Services (HHS), it was found that 1-in-5 breaches is caused by a BA. Yet, the liability for the breach including costs of notifying patients, penalties and reputation damage fell to the covered entity. HIPAA also clearly spells out that BAs are now directly liable for compliance to the HIPAA Security and Privacy Rules and they can be directly investigated for compliance and breaches. This change is intended to lessen the burden on covered entities for assessing security controls at these third-parties.

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Overview of HIPAA Omnibus Final Rule

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Breach Notification

Another major change to the HIPAA Omnibus package is the incorporation of the HITECH Breach Notification rule. First, the definition of a breach was expanded to include "unauthorized acquisition, access, use or disclosure of protected health information which compromises the security or privacy of such information." The interim final rule contained a controversial provision referred to as the "harm standard," which required covered entities, in the event of a breach of PHI, to perform a risk assessment to determine the likelihood of financial, reputational or other harm to the individual whose PHI was breached. If there was a significant likelihood of harm to the individual, and over 500 records were breached, the covered entity was required to report the incident to the Secretary of HHS immediately. The final rule replaces the harm standard with a presumption that any use or disclosure of PHI not permitted by HIPAA is a breach unless the covered entity or business associate demonstrates that there is a low probability that the PHI has been compromised. This change has been mostly welcomed since it is a more logical approach to assessing a possible breach. The intent of the breach was to reduce the number of reported breaches, but there is some uncertainty as to whether this will be the case.

Enforcement

In the past, there was no situation where a compliance review of an organization was mandatory. The final rule requires that the Secretary of HHS conduct a compliance review of the covered entity or business associate where initial review indicates a violation due to "willful neglect." Willful neglect is defined as "conscious intentional failure or reckless indifference," which basically means the organization didn't take appropriate steps to prevent or correct the issue. A determination of willful neglect results in an automatic fine of $10,000-$50,000 per violation and total penalties may be as high as $1.5M. Each entity involved in a violation may be fined individually, which of course now includes business associates. The Secretary of HHS has already assessed significant fines against covered entities and business associates, so it is likely this provision will continue to be exercised.

Additional Changes

Additional changes in the rule include the following:

- Individuals will have better access to their own Personal Health Records (PHR) in electronic format.
- If a patient requests a restriction on disclosure of PHI, the covered entity must comply with the request. This may happen if an individual pays cash for medical services and does not want the claim to be filed with the insurance company.

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Overview of HIPAA Omnibus Final Rule

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- Covered entities are restricted from making communications aimed at encouraging the use of a service or product, especially when the covered entity may profit from increased usage.
- Covered entities may no longer sell PHI without explicit authorization from the patient.
- Patients must be allowed to opt-out of the use of their PHI for fundraising activities by the covered entity.
- Notices of Privacy Practices (NPP) must be updated to advise individuals of these increased privacy protections. NPPs must be redistributed to all households.
- Individuals must specifically authorize the use of their PHI for research purposes.

What's Missing

A final rule on Accounting of Disclosures is one of the main components that is missing from the omnibus rule. This is the rule that requires all covered entities to be able to provide, at the patient's request, a log of all disclosures of their PHI, including disclosures to third-parties. This is a nightmare for most organizations to track, especially when there may be multiple electronic systems used throughout an organization. There's been a lot of push-back on this part of the interim rule so it's not surprising this was not addressed in the current rule.

Effective Dates

The final rule is officially called "Modifications to the HIPAA Privacy, Security, Enforcement, and Breach Notification Rules Under the Health Information Technology for Economic and Clinical Health Act and the Genetic Information Nondiscrimination Act; Other Modifications to the HIPAA Rules; Final Rule" and becomes effective March 26, 2013. The compliance date is September 23, 2013, which gives covered entities and business associates 180 days to make needed adjustments to come into compliance. The Secretary of HHS has said that compliance penalties will not be assessed until after September 23, however enforcement actions will continue in the meantime.

About the Author

Denise Mainquist, CISA, CPHIT, is a Certified Information Systems Auditor (CISA), and a Certified Professional in Health Information Technology (CPHIT) with over 10 years of experience in Information Technology and related quality, standards and controls management, as well as experience defining and auditing IT controls, computer validation, software testing and managing implementations of policies, procedures and systems, document management/retention and ISO 9001 quality management systems. Denise was a Payment Card Industry Qualified Security Assessor (QSA) from 2007 to 2012. She is the founder of ITPAC Consulting and is a partner to NHA Services, a subsidiary of the Nebraska Hospital Association.

Skills of an Effective Insurance Examiner

By Joanne Smith and John Humphries

Part 1: Who is an Effective Insurance Examiner?

The Composition of an Effective Insurance Examiner

In order to be an effective insurance examiner, one must combine equal parts of regulatory knowledge, insurance industry knowledge, and a professional approach to the examination.

Composition of an Effective Insurance Examiner

1) Regulatory Knowledge

A basic and fundamental requirement for an insurance examiner to be effective and efficient when conducting statutory examinations of insurance companies is to have a solid knowledge of applicable state insurance laws and regulations. Without a strong understanding of the general requirements mandated by the state of domicile, the examiner could inefficiently spend too much time and resources reviewing areas that do not have statutory requirements. Or worse, examiners could entirely overlook areas with specific requirements in the state statutes, codes, laws and regulations. In order to be an effective examiner, one must have a deep understanding of state insurance laws. This deep understanding can be obtained through careful study of the insurance laws and through exam experience. Even though the NAIC releases Model Laws to provide suggested content for state legislatures, each state's insurance laws and regulations are enacted with different verbiage which reflects the unique viewpoints of each state.

Other sources of regulatory knowledge can be found from the National Association of Insurance Commissioners (NAIC) and the various handbooks and guidelines promulgated by the NAIC as reference materials. For example, the guidelines in the NAIC Market Regulation Handbook, NAIC Financial Condi-

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Skills of an Effective Insurance Examiner

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tion Examiners Handbook, and the NAIC Market Analysis Handbook provide excellent information regarding best practices and suggested generic examination procedures.

2) Industry Knowledge

Effective insurance examiners possess insurance industry knowledge about specific components and risk areas which make the insurance industry unique from any other business model. The fundamental concepts of insurance and the technical jargon used in insurance policies are highly specialized for the insurance field. For example, it is essential that insurance examiners have a strong understanding of insurance products, how they work, and most importantly, how they affect consumers.

In addition, insurance examiners should understand modern policy administrative and claims systems. A working knowledge of past systems is also useful for many issues that may have originated decades ago. Examiners should understand the flow of information from policy issue to claim is reported, and how the policy and claim systems interact with the accounting function. This understanding of the IT functions is crucial to effectively tracing the premium and loss amounts from source data to the Annual Statement.

3) Professional Approach

Effective insurance examiners always approach each examination with a professional attitude. By treating the Company management and employees with respect, and by staying professional in emails, phone conversations, and face-to-face meetings, examiners are able to more effectively and efficiently proceed through examination procedures. The Company management is more likely to be cooperative and respond quickly to information requests that are made with a professional and non-accusatory tone. Effective examiners are "politely persistent" when following up on requests, and are firm when necessary, but always professional.

Another key component of taking a professional approach to an examination is to do your homework and learn key facts about the Company. Effective examiners take the time to know a little bit about the Company's products, markets, and key issues from the very beginning of the examination. Examiners can coordinate with the Department Analyst to determine key areas of concern and high risk. In addition, a review Market Analysis Report at the beginning of the exam can provide valuable insight and knowledge about the Company. Taking the time to perform some basic research prevents the Company management from having to explain basic details of the Company to the examiner and helps maintain the examiner's credibility as an educated professional.

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Skills of an Effective Insurance Examiner

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How to Become a Highly Effective Insurance Examiner

In the bestselling book, "The 7 Habits of Highly Effective People" by Stephen R. Covey, seven ways to become a highly effective person are described. These same principles can be applied to almost any life situation, including becoming a highly effective insurance examiner.

1) Be Proactive

Highly effective insurance examiners recognize that each individual exam team member is responsible for the success of the exam. All should take action to make sure that all aspects of the examination are completed in a timely manner.

2) Begin with the End in Mind

Highly effective insurance examiners create clear exam objectives and communicate these objectives to all exam team members at the beginning of the exam. Furthermore, highly effective examiners do not allow themselves to be distracted with immaterial side issues.

3) Put First Things First

Highly effective insurance examiners carefully plan, prioritize, and execute examination procedures based upon importance and not urgency.

4) Think Win-Win

Highly effective insurance examiners work to get the right answer even if it is not "your" answer. In addition, highly effective examiners work on behalf of all parties to find win-win solutions when possible.

5) Seek First to Understand, Then to be Understood

Highly effective insurance examiners work to understand all sides of an issue before reaching conclusion.

6) Synergize

Highly effective insurance examiners focus on the strengths of each exam team member and allocate tasks according to each individual's strengths and areas of expertise.

7) Sharpen the Saw

Highly effective insurance examiners keep learning and keep growing in insurance and auditing knowledge since they recognize that the world of examinations will continue to change over time. For example, in a dynamic

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Skills of an Effective Insurance Examiner

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internet age of social media, new insurance products, a changing economy, and many other socio-political factors, examiners need to stay abreast of changes to effectively and efficiently conduct examinations.

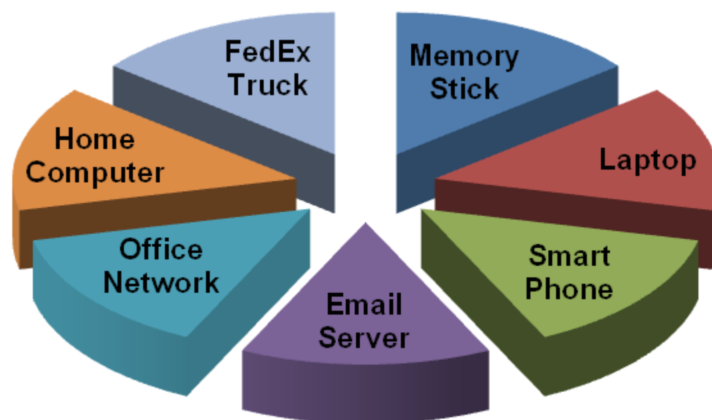
Part 2: Effective Examiners Secure Data

Data Security

Insurance examiners receive large amounts of extremely valuable data. In order to be an effective examiner, an examiner must maintain control of the security of this data that they have been entrusted with at all times. Data from insurance companies can be extremely sensitive in nature. For example, examiners are often entrusted with information about insureds or claimants which contains private information about personal health, finances, etc. that must be kept private. Examiners also have access to confidential information about the Examined Company's corporate strategy or competiveness that cannot be released to its competitors.

How do you protect this data?

The first step in protecting data is to be aware of the physical location of the data at all times. Data can be stored on personal computers, laptops, office network servers, memory sticks, email servers, smart phones, or on a CD being shipped across the country.



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Skills of an Effective Insurance Examiner

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Physical Security

The most basic method to secure data is to simply not leave the data unattended at any time, but this is not always practical or possible. When traveling on business trips, a best practice is to put laptops in the hotel room safe or use a cable lock to secure the laptop to a heavy piece of furniture to discourage theft. Another method is to place a "do not disturb" sign on the hotel room door to minimize entry by hotel staff. Additionally, keeping the laptop and/or memory stick containing the data out of sight I provides another level of protection. And above all, use common sense when traveling with sensitive data and take necessary steps to protect your data.

Logical Security

After ensuring the physical security of the data, the next step is to protect the data from logical threats of hacking, manipulation, and theft. The most fundamental method of providing logical protection, is through the use of passwords to access the laptop, network, database, spreadsheet, or document. Use "strong" passwords to properly secure the data. According to the article, "What Every IT Auditor Should Know About Access Controls" published in the ISACA Journal, Vol. 4, 2008, strong passwords are composed of 8 characters or more, and are a mixture of uppercase, lowercase, numbers, and special characters. In addition, these strong passwords should be required to be changed every 90 days or other regular interval. Strong passwords should also be used for team members in TeamMate, or any other audit software used to conduct the examination.

In addition to strong passwords, sensitive data can be protected using encryption. There are many varieties of encryption software, and h examiners must carefully consider which type would be best suited to their needs. Microsoft Office provides standard encryption of single files. Compression programs, such as WinZip, can provide encryption for groups of files while also reducing the size of the space needed to transport the data. Encryption software, such as TrueCrypt, has the ability to encrypt an entire volume of a memory stick or computer hard drive.

Finally, examiners must backup data to preserve the work that they have performed.

Bottom Line

Effective examiners recognize that examination data must be protected and that they should consider where the data is "stored" at all times. The world of technology is ever changing and creating new advancements and also new threats. Examiners are responsible for the data they receive and must find

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a way to navigate the changes. Effective examiners take steps to secure the data that they have been entrusted with and always use common sense.

Part 3: Effective Examiners Utilize CAAT

Computer Aided Audit Techniques (CAAT)

Effective insurance examiners recognize that computer aided audit techniques (CAAT) are an effective regulatory tool that provide concrete evidence for examinations issues and findings, especially during market conduct examinations. CAAT analysis and monitoring by regulators can provide: tangible and concrete results, statistics to effectively determine true compliance rather than just anecdotal evidence, and assist examiners to find "needles in the haystack" within large volumes of data.

Sources of Data

In order to successfully implement CAAT analysis, effective examiners must first consider the source of the data that they want to analyze. Is the data produced routinely by the Company? Does the analysis require a highly tailored file layout? Standard Data Request specifications provide a good starting point noting that any data request should be tailored to meet examination objectives and avoid unnecessary work on the part of the exam team and the examined company.

Large Data Files

Effective examiners should expect and prepare for very large data files from the examined company. The first step is to know how to transfer the data from the company to the examiner. Oftentimes email servers have size limitations and lower levels of data security that make email transmittal an unattractive and not a feasible method to transfer the large data file. Saving the large data file to a CD, DVD, memory stick, or external hard drive and shipping it via FedEx or USPS is another option for data file transfer; however, examiners must take into consideration the size limitations of these media and data security. Always encrypt sensitive data before shipping to protect the data during transit. A more direct approach that should be considered is direct file upload via secure internet connection using a file upload site such as SharePoint. Direct file upload provides advantages such as a fast turnaround and avoidance of loss during shipping. However, examiners should be aware that direct file transfer requires close attention and management of access rights.

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Examples of CAAT Applications

Two practical examples of the application of computer aided audit techniques can be found in prompt pay analysis of health insurance claims and in market conduct examinations of insurance companies to determine if race was ever used as an underwriting factor for life insurance policies even if the business was sold decades ago. Of course, the opportunities to implement CAAT analysis to examine insurance companies are endless. Effective examiners contemplate new situations which would benefit from CAAT analysis to enhance the effectiveness of their examination results.

Source: Article adapted from the "Skills of an Effective Insurance Examiner: How to become a highly effective examiner" webinar presentation for members of the Insurance Regulatory Examiners Society (IRES) on December 7, 2011, presented by John Humphries.

About the Authors

John Humphries, ASA, MAAA, CFE, CISA, AES, MCM, is the Managing Partner of AGI Services, where he has worked exclusively with State Insurance Departments for the past twenty years as a consultant on examinations of Managed Care Organizations, Life and Accident companies, Property & Casualty companies, as well as numerous other regulatory projects covering both financial and market conduct issues. Because John's work is focused on the needs of regulators, he understands the regulatory process and works hard to identify both problems and solutions. John can be contacted at Humphries@agiservices.net or 770-774-1102.

Joanne Smith is an Examiner at AGI Services, where she works exclusively with State Insurance Departments on financial examinations of Risk Retention Groups, Property & Casualty, Life, and Health insurance companies. Joanne also serves on the Publications Committee of the Society of Financial Examiners (SOFE). Joanne can be contacted at smith@agiservices.net or 770-774-1101 ext. 219.

Insurance and Behavioral Economics:

Improving Decisions in the Most Misunderstood Industry

By: Howard Kunreuther and Mark Pauly, Wharton Risk Management and Decision Process Center

Editor's Note: This article expounds upon the Flood Insurance Reform Act of 2012 and the Affordable Care Act, and provides suggestions for improvement in the flood insurance and healthcare industries from an behavioral economic perspective.

Behavioral biases can cause consumers, insurers and regulators/politicians to make poor insurance decisions for low-probability, high-consequence events.

- People have a tendency to estimate the likelihood and consequences of future disasters by focusing on recent past experience.
- Residents in hazard-prone areas fail to take protective measures prior to a disaster if its perceived likelihood is below their threshold level of concern.
- People focus on short time horizons when comparing the expected benefits of reduced losses from investing in protection with their upfront costs.
- These behaviors are common for low-probability, high-consequence events, but not for insurance purchased against other kinds of losses.

Consumers: Focus on recent past experience.

Example: Many homeowners do not buy flood insurance because they misperceive the risk of damage as being extremely low. They are likely to buy insurance after a flood, and then several years later, cancel their policy.

Insurers: Correlated losses pose challenges.

Example: Prior to 9/11, insurers viewed losses from terrorism as so improbable that the risk was not explicitly mentioned or priced in any standard policy despite the attempted bombing of the World Trade Center in 1993. After 9/11, most insurers refused to offer terrorism insurance at all rather than calculating a premium reflecting their best estimate of the risk.

Regulators: Concerned with re-election as well as fairness and equity

Example: Insurance regulators aided Florida homeowners in hurricane-prone areas by setting up a state insurer – the Citizens Property Insurance Corporation – that offered coverage at prices lower than insurers would have charged at premiums reflecting risk.

We propose these guiding principles for insurance to overcome behavioral biases and to make insurance more transparent and equitable, and to encourage investment in protective measures.

Principle 1: Premiums reflecting risk. Insurance premiums should be based on risk to provide proper signals to individuals for buying insurance, and to encourage them to invest in cost-effective mitigation measures to reduce their vulnerability to catastrophes.

Principle 2: Dealing with equity and affordability issues. Any special treatment given to homeowners currently residing in hazard-prone areas (e.g., low-income or inadequately insured homeowners) should come from general public funding and not through insurance premium cross-subsidies.

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Principle 3: Multi-year insurance. To encourage investment in protective measures, insurers should design multi-year contracts with premiums reflecting risk. The price of this insurance may be higher than single year coverage, but would provide consumers with price stability. Regulators would have to allow insurers to charge premiums that reflect risk, and allow them to modify contracts if regulatory rules change during the contract period.

Strategies to alleviate consumers' behavioral biases with respect to low-probability, high-consequence events:

- Provide better information on the role of insurance: Highlight that the best return on an insurance policy is no return at all.
- Focus on consequences of being uninsured: Describe the financial problems one would face if her home were destroyed by a disaster or if she were hospitalized due to a serious illness.
- Stretch the time horizon to make the event for salient: If an event such as a flood has a 1 in 100 chance of occurring next year, present the probability as a greater than 1 in 5 chance of happening in the next 25 years.
- Offer multi-year flood insurance policies. Because regulations in many states prevent insurers from setting premiums that reflect risk, multi-year insurance should be initiated under the federally-run National Flood Insurance Program with coverage tied to the property rather than to the current homeowner. When the property is sold, the multi-year insurance contract would be transferred to the new owner.

Strategies to alleviate insurers' behavioral biases with respect to low-probability, high-consequence events:

- Construct worst-case scenarios that characterize potential disaster losses so that insurers focus on the consequences of these extreme events in their pricing and coverage decisions.
- Assign likelihoods to these worst-case scenarios and specify uncertainties surrounding these and other scenarios to determine under what conditions a particular risk is insurable.
- Consider providing flood coverage in certain markets using more accurate flood maps to determine areas where the private insurance market can provide flood coverage at competitive rates.

Strategies to alleviate regulators' and politicians' concerns with equity and re-election:

- Design equitable ways to assist low-income consumers in purchasing insurance using a means-tested insurance voucher provided by the federal government or at a state level.
- Appoint civil servants as regulators so they don't focus their attention on short-term policies that increase their chance of being re-elected.

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Improving Decisions in the Most Misunderstood Industry

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- Require regulators to hold hearings and provide full disclosure before rendering decisions. Regulations should make transparent who is expected to benefit and who is likely to pay a greater share as a result of these actions.

Evaluation of the New Flood Insurance and Health Care Legislation within the Framework of the Guiding Principles for Insurance

With the signing into law of the Biggert-Waters Flood Insurance Reform Act in July 2012 that renews the National Flood Insurance Program (NFIP) for five years, there is an opportunity to encourage those residing in flood-prone areas to take steps to reduce their losses in advance of the next disaster by modifying the program to reflect the above guiding principles for insurance. The Affordable Care Act (ACA) legislation taking effect in 2014 in some ways follows the guiding principles and in some ways does not.

Source: This article appeared in the Winter 2013 Issue Brief published by Wharton Risk Management and Decision Process Center of the University of Pennsylvania. Reprinted with permission.

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Table: How well does the new legislation align with the guiding principles for insurance?

	Flood Insurance Reform Act of 2012	***Affordable Care Act (ACA) ("Obamacare")***
Principle 1: **Premiums reflecting risk**	YES: The Reform Act phases in risk-based pricing over a period of five years and removes rate subsidies for vacation homes.	NO: The ACA forbids insurance premiums to be based on risk (given age). Low risks cross-subsidize the higher risks by being charged prices that exceed their risk- based premiums. The law does permit premiums to be adjusted to reflect smoking behavior and participation in workplace wellness programs.
Principle 2: **Dealing with equity and affordability issues**	PARTIALLY: The Reform Act authorizes the Federal Emergency Management Agency and the National Academy of Sciences to examine the use of a means-tested insurance voucher system for homeowners who cannot afford to pay risk-based rates without financial assistance. The legislation does not address the immediate affordability issues for those who will see premium increases this year and next.	YES: The ACA is designed to satisfy equity and affordability considerations, the most important failing of current health insurance markets.
Principle 3: Multi-year insurance	NO: Multi-year insurance should be feasible, since the federal government is the provider of almost all flood insurance policies for homeowners. When the property is sold, then the multi-year flood insurance contract should be transferred to the new owner.	YES: Almost all private individual medical insurance carries a provision guaranteeing renewal in the following year at premiums that are not altered based on any exogenous change in the person's risk. In other words, there is multi-year protection against reclassification of a person's risk. This provision is required for all individual insurance under the ACA.

Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry

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About the Wharton Risk Center

Established in 1984, the Wharton Risk Management and Decision Processes Center develops and promotes effective corporate and public policies for dealing with catastrophic events including natural disasters, technological hazards, terrorism, pandemics and other crises. The Risk Center research team—over 50 faculty, fellows and doctoral students—investigate how individuals and organizations make choices under conditions of risk and uncertainty under various regulatory and market conditions, and the effectiveness of strategies such as alternative risk financing, incentive systems, insurance, regulation, and public-private collaborations at a national and international scale. The Center actively engages multiple viewpoints, including top representatives from industry, government, international organizations, interest groups and academia. More information is available at http://www.wharton.upenn.edu/riskcenter.

About the Authors

Howard Kunreuther is a Professor of Decision Sciences and Business and Public Policy at the Wharton School, and co-director of the Wharton Risk Management and Decision Processes Center. He has a long-standing interest in ways that society can better manage low-probability, high-consequence events related to technological and natural hazards. He is a member of the National Research Council's panel on Increasing National Resilience to Hazards and Disasters and serves the Intergovernmental Panel on Climate Change (IPCC) as a chapter lead author of the IPCC's 5th Assessment Report on Integrated Risk and Uncertainty Assessment of Climate Change Response. He is a Fellow of the American Association for the Advancement of Science, and a Distinguished Fellow of the Society for Risk Analysis, receiving the Society's Distinguished Achievement Award in 2001. He can be contacted at Kunreuther@wharton.upenn.edu.

Mark V. Pauly is a Professor in the Department of Health Care Systems at the Wharton School of the University of Pennsylvania. Dr. Pauly is a former commissioner on the Physician Payment Review Commission and an active member of the Institute of Medicine. One of the nation's leading health economists, Dr. Pauly has made significant contributions to the fields of medical economics and health insurance. His work in health policy deals with the appropriate design for Medicare in a budget-constrained environment and the ways to reduce the number of uninsured through tax credits for public and private insurance. He is an appointed member of the U.S. Department of Health and Human Services National Advisory Committee to the Agency for Healthcare Research and Quality, and co-editor-in-chief of the International Journal of Health Care, Finance, and Economics. He can be contacted at Pauly@wharton.upenn.edu

NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2012 Fall National Meeting

The National Association of Insurance Commissioner held its Fall National Meeting in National Harbor, MD November 27-December 2. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. This Newsletter also covers conference calls held throughout December. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

Executive Summary

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

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

- The Valuation of Securities Task Force adopted the controversial assumptions for 2012 financial modeling of RMBS and CMBS investments in October; the new assumptions mark a shift toward a more conservative bias. The task force also adopted the proposed statutory accounting framework for Working Capital Finance Investments. (page 21)
- The Reinsurance Task Force exposed for comment the draft "NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions," a document that includes an evaluation methodology covering the industry, regulatory framework and measures applicable to U.S. reinsurers operating overseas, until January 16, 2013. The task force heard an update on the adoption of the revised credit for reinsurance models by the states. The task force was informed that New York and Florida have each approved more than a dozen entities as Certified Reinsurers. (page 23)
- The Captives and Special Purpose Vehicles Subgroup continued work on its controversial white paper on the use and regulation of captives and SPVs, which may recommend significant changes to the current regime. The subgroup received and discussed comments on the draft white paper in National Harbor, and a new draft of the white paper is expected shortly. (page 24)
- The Blanks Working Group exposed 10 new blanks proposals for public comment at the Fall National Meeting. (page 25)
- The Life Actuarial Task Force continued its discussion of proposed revisions to VM-20, PBR for Life Products. The task force also discussed options to address the perceived reserve redundancies created by AG 33, but no conclusions were reached. (page 26)
- The Emerging Actuarial Issues Working Group, formed this fall, reviewed and approved interpretations from questions received on the recently adopted revisions to AG 38 for universal life products with secondary guarantees. (page 28)
- The Health Insurance and Managed Care Committee heard an update from the Center for Consumer Information and Insurance Oversight on the Affordable Care Act implementation activities. (page 28)
- The Contingent Deferred Annuity Working Group heard comments on its draft proposed recommendations regarding the regulation of contingent deferred annuities. (page 29)
- The Financial Regulation Standards and Accreditation Committee voted to include the Credit for Reinsurance Model Law and Model Regulation as accreditation requirements effective immediately for states which are considering collateral reductions. (page 29)

Executive Committee and Plenary

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

Election of Officers

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

Adoption of New or Revised Models

The Executive Committee and Plenary held a joint conference call in September at which both committees adopted the Risk Management and Own Risk and Solvency Assessment Model Act (#505), and the amendments to Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation (AG 38).

The Executive Committee and Plenary also adopted the following items:

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

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

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

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

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

Appointment of NAIC Interim CEO

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

Statutory Accounting Principles Working Group

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

Adoption of New Standards or Revisions to SSAPs

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

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

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

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

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

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

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

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

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

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

Policyholder Loyalty Program Obligations (2012-15) and Actuarial Calculation of DDR Reserve (2012-16) At the Summer National Meeting, the working group exposed for comment proposed amendments to SSAP 65, P&C Contracts, to address loyalty program benefits and additional guidance on reporting the death, disability and retirement (DDR) reserve. Based on the significant number of comment letters received from interested parties and the Casualty Actuarial and Statistical Task Force, the working group asked staff to collect additional information and report back to the working group.

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

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

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

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

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

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

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

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

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

Restricted Asset Issues – The working group discussed a referral from the Financial Analysis Working Group requesting research of certain guarantees and other financial activities that have pledge-like restrictions. The working group asked NAIC staff to begin work on addressing the issues including consideration of enhanced disclosures. The working group briefly discussed Interrogatory 24 of the annual statement which summarizes assets "not exclusively under the control of the reporting entity," and questioned whether this interrogatory captures all such restricted assets. Note that the Capital Adequacy Task Force had significant discussion of a proposed higher RBC charge for restricted assets; see that discussion on page 7.

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

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

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

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

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

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

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

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

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

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

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

Emerging Accounting Issues Working Group

At the Fall National Meeting, the working group voted to nullify fourteen INTs issued in 2002 and fourteen INTs issued in 2003-2004, and include the guidance directly in the relevant SSAPs. The working group exposed a proposal to move thirteen INTs from the 2005-2009 interpretations into the SSAPs. Comments are due February 8. The working group also discussed a referral from the Derivative Investment Reporting Subgroup regarding the treatment of assets pledged under derivative contracts, particularly for centrally-cleared, non-exchange traded derivatives. As the referral was not yet finalized at the time the working group met, no action was necessary.

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

Capital Adequacy Task Force

Low-Income Housing Tax Credit

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

Confidentiality

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

Revision to Timetable for Changes to RBC

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

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

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

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

Restricted Assets
During its October 29 conference call, the task force discussed a referral from the Financial Analysis Working Group concerning a potential increase to the RBC factor for restricted assets. The current charge is 1.3% of the carrying value of restricted assets as disclosed in Interrogatory 24 in the annual statement. After significant discussion the task force voted to expose for comment a proposal that three RBC formulas be modified to incorporate a C0/R0/H0 charge for insurers with a large proportion of restricted assets on their balance sheets. The specific charges were not being proposed, but rather the concept of an increasing charge based on the level of restricted assets held, e.g. no additional charge if less than 5% of assets are restricted, an additional 2% charge if 5-10% of assets are restricted or pledged, an additional 5% charge if 10-25% of assets are restricted and a 10% charge if greater than 25% of assets are pledged or restricted.

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

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

C-1 Factor Review Subgroup

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

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

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

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

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

SMI RBC Subgroup

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

In response to a request from the working group to identify risk correlation methodologies used to determine regulatory solvency capital requirements in advanced jurisdictions outside the U.S., the AAA issued its report in November entitled "Dependency Structures in Risk-Based Capital: Summary of Methodologies Used by a Variety of Jurisdictions to Reflect Risk Correlation in Property/Casualty Standard Formulas." The report indicates that the U.S. RBC formula is simple to use; however, to an outsider, it is not easy to understand and requires a significant amount of data including some that is not available in the NAIC annual statement. The current RBC correlation structure constitutes judgments and if correlation factors could be calibrated with sufficient accuracy, the formula becomes more risk sensitive. Bermuda's overall correlation structure is similar to the U.S. The AAA report also reviews the methodologies used by Canada, Australia, Solvency II and the Swiss Solvency Test.

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

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

Life Risk-Based Capital Working Group

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

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

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

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

Property/Casualty Risk-Based Capital Working Group

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

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

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

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

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

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

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

Catastrophe Risk Subgroup

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

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

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

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

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

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

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

Health Risk-Based Capital Working Group

The working group met by conference calls on November 13 and December 17, and did not meet in National Harbor. During the calls, the working group continued its discussion of health care receivable factors including the American Academy of Actuaries' recommendation to augment the reporting of these receivables in the Underwriting and Investment Exhibit Part 2B, by adding a new Section B entitled Analysis of Health Care Receivables. The proposed change would provide additional detail on the six types of health care receivables, and would provide data for a follow-up study of the health care receivables. The proposal would provide information for future analysis to the sufficiency of the current RBC factors, higher quality financial disclosures, and provide for a more meaningful study of claims. AAA is recommending a proposed implementation date of 2013. AAA will then use the year-end 2013 data for analysis of the health care receivable factors in 2014. The proposed new Section B has not yet been exposed for comment.

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

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

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

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

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

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

IAIS 2012 Annual Conference

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

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

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

It was recognized at the conference, however, that further work will be required to establish the policy measures that will be applied to Global Systemically Important Insurers. Shortly following the conference, the IAIS released its proposed policy measures, for public consultation until December 16.[1] The proposed policy measures are described further under the International Insurance Relations Committee, below.

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

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

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

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

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

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

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

Further updates on the EU-U.S. Dialogue Project were discussed at the NAIC Fall National Meeting, and are summarized under the International Insurance Relations Committee.

Solvency Modernization Initiatives Task Force

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

SMI White Paper

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

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

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

PBR Working Group

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

[2] https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/EU_US_Dialogue_Project_Report_for_Consultation.pdf

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

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

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

New York presented both technical and structural arguments against PBR at the meeting, consistent with a letter that it sent to the NAIC on November 26, urging commissioners not to vote in favor of PBR.[3] New York questioned the timing of PBR, which it expected to result in reserve reductions in the aggregate at a time of economic stress and low interest rates. New York also argued that a principles-based reserving regime had resulted in lower reserves for banks, which contributed significantly to the financial crisis. New York also suggested that the implementation of PBR may be perceived as deregulation and the lessening of consumer protection, and insurance regulators would likely be blamed in the event of any future insurer insolvency. New York also questioned whether the lower reserves that it expects to be permitted by PBR would provide any benefit to consumers in an already highly competitive and aggressively priced life market.

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

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

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

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

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

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

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

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

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

Group Solvency Issues Working Group

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

The final version of the model act was substantially unchanged from the version discussed in Atlanta. New wording was introduced to strengthen confidentiality protection where the ORSA Summary Report is shared with the NAIC or third party consultants, which requires the commissioner sharing the report to obtain written agreement from the recipient to maintain confidentiality, and confirmation that the recipient has legal authority to do so. Sharing with other state regulators is also restricted to states in which the group providing the report has a domiciled insurer. The adopted draft also retains the requirement, discussed extensively on working group conference calls over the summer, for an insurer subject to the act to maintain a risk management framework.

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

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

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

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

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

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

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

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

ORSA Subgroup

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

The subgroup recommended that the language should be aligned between the ORSA Guidance Manual and the Risk Management and Own Risk and Solvency Assessment Model Act (#505), and proposed a number of other drafting suggestions to clarify technical language and intent. These included proposed guidance for insurers to include a summary of material changes to the ORSA from the prior year and that the insurer should provide a comparative view of risk capital from the prior year. During its November conference call, the subgroup voted to expose the amended draft for a 60 day comment period.

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

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

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

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

Corporate Governance Working Group

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

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

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

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

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

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

Exhibit B: Proposed annual statement schedule covering compensation paid to officers, employees and directors, aggregate compensation, and interrogatories. The exhibit would require disclosures similar to those currently required by the SEC with narrative discussion of compensation practices covered by Exhibit A.

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

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

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

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

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

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

International Solvency and Accounting Standards Working Group

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

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

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

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

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

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

International Insurance Relations Committee

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

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

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

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

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

- Effective resolution – G-SIIs should be required to establish Crisis Management Groups, develop Recovery and Resolution Plans, conduct resolvability assessments, and adopt cross-border cooperation agreements.

- High Loss Absorption (HLA) – G-SIIs should have higher HLA capacity, applied first to NTNI activities if effectively separated, and then at the whole group level. The paper notes that HLA at the whole group level may not necessarily be needed after NTNI measures have been applied.

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

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

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

EU-U.S. Dialogue Project

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

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

Joint Forum

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

The committee further heard that the Joint Forum's Principles for the Supervision of Financial Conglomerates were issued in September 2012, and that the forum is now considering pilot testing the principles. The Joint Forum is expected to ask 2 to 3 countries to take place in the pilot.
The committee also heard that the forum is considering potential future mandates, which it will discuss further in February 2013. Potential future areas of focus include convergence, asset encumbrances (for example, assets pledged as collateral), compensation best practices, and fit and proper requirements. Finally, the committee heard

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

ComFrame

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

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

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

ComFrame was also discussed in National Harbor by the International Solvency and Accounting Standards Working Group. The working group heard that the IAIS Technical Committee, at the suggestion of the NAIC and others, had now agreed to change ComFrame's valuation standard to recognize other accounting frameworks, and that IFRS or any equivalent set of accounting standards could now be used, including specifically U.S. GAAP or Japanese GAAP. However, recognizing the differences between these frameworks, and also the differences that remain in the valuation of insurance contracts between different countries that have adopted IFRS, in the absence of a single standard for insurance contracts, the IAIS Accounting and Auditing Issues Subcommittee (AAISC) intends to require adjustments to narrow, but not attempt to eliminate, the differences between different GAAP figures.

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

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

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

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

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

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

International Regulatory Cooperation Working Group

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

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

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

Valuation of Securities Task Force

2012 Year-End RMBS & CMBS Modeling

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

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

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

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

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

Preferred Stock Exchange Traded Fund Category

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

Quarterly Reporting of Modeled Securities

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

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

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

Working Capital Finance Investments

During a September 6 conference call, the task force unanimously adopted the previously exposed, proposed statutory accounting framework for Working Capital Finance Investments (WCFI) developed by New York. The final proposal was referred to the Statutory Accounting Principles Working Group and related proposals to the Blanks Working Group and the Capital Adequacy Task Force. The proposal recommends that WCFI be admitted asset. The referral by the task force also included two additional recommendations: (1) WCFI should be reported on Schedule BA and (2) under the corporate methodology developed by the SVO, WCFI should be assigned either NAIC 1 or NAIC 2 designations based on the credit risk associated with the corporate obligor.

Local GAAP Financial Statements

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

NAIC Designation Recalibration Project

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

Mandatory Convertible Securities

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

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

Reinsurance Task Force

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

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

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

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

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

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

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

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

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

Captive and Special Purpose Vehicle Use Subgroup

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

- Confidentiality – The subgroup could not reach a consensus view so delineated both views and will likely ask its parent E Committee to decide. Some subgroup members support continuing to allow confidential treatment of captive transactions and financial statements while others support more transparency and public disclosures.

- Additional discussion on credit for reinsurance and accredited reinsurance was added.

- Captive database – The October 17 draft includes a suggestion that consideration be given to developing a database including NAIC company code, name, and domiciliary information with respect to all captives "to ensure that data on the universe of all such entities is available to allow regulators to quickly respond to questions on the same."

- Conclusions – the subgroup tried to provide more clarity around the recommendations including a proposal to form a new group to "develop possible solutions for addressing the remaining XXX and AXXX perceived redundancies." The recommendations also include the following statement: "The Subgroup held a consensus view that captives and special purpose vehicles should not be used by commercial insurers to avoid statutory accounting prescribed by states. If the liabilities are retained by the insurer, they should not be granted favorable treatment merely for carrying the liabilities on the books of an affiliate rather than directly."

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

At its meeting in National Harbor, the subgroup held a public hearing to discuss comments on the draft white paper; two states commented (Nebraska and Vermont), along with six trade associations and one large life insurance company. The debate was very contentious at times, including comments among regulators. It also included significant discussion of whether the white paper is "an attack on the captive industry."

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

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

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

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

NAIC/AICPA Working Group

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

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

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

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

Blanks Working Group

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

- Add a requirement to the Annual Audited Financial Reports for auditors to include testing of underlying data provided to the actuary for estimating reserves to the statutory audit process for title insurance. This requirement would be similar to the current requirement for P&C insurance. (2012-31BWG)

- Add instructions to the Property and Casualty Line of Business Appendix to indicate that the write-ins line should include all types of business that are placed by a lender ("force-placed or lender placed"). For all force-placed business, a separate line should be used for each annual statement line of business that is written by the reporting entity. (2012-33BWG)

- Separate the State Low Income Housing Tax Credit (LIHTC) categories on Schedule BA into guaranteed and nonguaranteed similar to the Federal LIHTC. (2012-34BWG)

- Modify the illustration for Note 17C to allow for disclosure of unrated securities and securities other than bonds and preferred stocks. (2012-35BWG)

- Add a new line and modify instructions for certified reinsurers to page 3 of the Trusteed Surplus Statement. (2012-36BWG)

- Add instructions and an illustration to Note 22, Events Subsequent, to disclose assessments under the Affordable Care Act not being recognized in the financial statements. (2012-37BWG)

- Add category lines to Schedule BA for Working Capital Finance Investments and a description for those lines in the annual and quarterly statement instructions. (2012-38BWG)

- Modify various parts of Schedule F (property) and Schedule S, (life, health and fraternal) moving bank information for letters of credit to the footnote table. (2012-39BWG)

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

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

Life Actuarial Task Force

PBR Valuation Manual

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

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

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

VM-20 Mortality
LATF adopted during an interim call a proposal to change the mortality table in Section 9 (Assumptions) of VM-20 used to grade from company experience to industry experience. The amendment requires using a table with more stringent credibility requirements for valuations on or after January 1, 2015.

VM-20 Economic Scenarios
LATF adopted a proposal that clarifies that the Valuation Manual does not specify a required number of scenarios. The change also clarifies how the economic scenario generator is to be used for the purposes of calculating deterministic and stochastic reserves, defines the mean reversion parameter and provides the website location at which the economic scenario generator can be accessed. The ACLI suggested that LATF continue to study the impact of the scenario generator and mean reversion rate. The ACLI will continue to do testing related to the reserve volatility.

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

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

Actuarial Guideline XXXIII (AG 33)

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

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

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

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

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

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

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

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

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

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

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

Emerging Actuarial Issues Working Group

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

Health Insurance and Managed Care Committee

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

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

Health Actuarial Task Force

Long Term Care

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

Cancer Claim Cost Table

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

Group Long Term Disability

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

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

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

Contingent Deferred Annuities Working Group

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

1. Recommend to A Committee that CDAs be regulated as variable annuities for the purpose of market regulation and consumer protection. Existing laws that apply to variable annuities may need to be revised to clarify that they also apply to CDAs.

2. The adequacy of existing laws and regulations applicable to the solvency of annuities, as such laws are applied to CDAs, should be referred by the A Committee to other working groups with appropriate subject matter expertise.

3. A contingent deferred annuity shall be defined as an annuity contract that establishes an insurer's obligation to make periodic payments for the annuitant's lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually defined amount due to contractually permitted withdrawals, market performance, fees and/or other expenses.

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

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

Separate Account Risk Working Group

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

Financial Regulation Standards and Accreditation Committee

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

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

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

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

CPA Audit Standards

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

Viatical Settlements Working Group

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

Annuity Disclosure Working Group

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

Casualty Actuarial and Statistical Task Force

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

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

Risk-Focused Surveillance Working Group

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

Climate Change and Global Warming Working Group

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

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

Title Insurance Task Force

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

Title Insurance Risk-Based Capital
The Title RBC Joint Subgroup of the Capital Adequacy Task Force and the Title Insurance Task Force held a conference call on November 14 to discuss the pros and cons of developing risk-based capital standards for title insurers. In order to determine if RBC standards are needed for title insurers, the subgroup acknowledged that it needs to identify unique risks of title insurers, examine causes and impacts of insolvencies, and identify challenges in implementing RBC standards for title insurers. The subgroup discussed contacting the Financial Examiners Handbook Technical Group and the Financial Analysis Research and Development Working Group to understand financial tools that have been developed for analyzing title insurers. The subgroup also discussed contacting domiciled states of large title insurers to identify prominent risk factors that title insurers face.

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

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

- There have not been a large number of title insolvencies. The data suggests that there were some problems in 2008 when five title companies were declared insolvent and since then, insolvencies have slowed and there does not appear to be any single state with a significant problem.

- Although a majority of states have adopted laws substantially similar to the Title Insurance Agent Model Act (#230) and the Title Insurers Model Act (#628), only six states have implemented a guaranty fund or alternative mechanism.

- Of the six states that have established guaranty funds, only two state title guaranty funds have paid claims for insolvent title companies, which have been very small in relation to the title net premiums earned.

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

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

Risk Retention Group Task Force

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

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

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

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

Disclaimer

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

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

Additional information

If you would like additional information, please contact:

Jean Connolly
Managing Director, National
Professional Services Group
Tel: 1 440 893 0010
jean.connolly@us.pwc.com

PwC's Insurance Practice Leaders

Jim Scanlan
Insurance Practice Leader
Tel: 1 267 330 2110
james.j.scanlan@us.pwc.com

Paul McDonnell
Insurance Advisory Co-leader
Tel: 1 646 471 2072
paul.h.mcdonnell@us.pwc.com

James Yoder
Insurance Advisory Co-leader
Tel: 1 312 298 3462
james.r.yoder@us.pwc.com

David Schenck
Insurance Tax Leader
Tel: 1 202 346 5235
david.a.schenck@us.pwc.com

www.pwc.com/us/en/insurance

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Society of Financial Examiners®
12100 Sunset Hills Road | Suite 130
Reston, Virginia 20190

703.234.4140
800.787.SOFE (7633)
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Interested authors should contact the Publications Committee Chair, **Jenny Jeffers**, via **sofe@sofe.org**.