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All quizzes MUST be taken online.

Questions will be ***available online October 14, 2019.***

Communication and Coordination Between the Examiner and the Department Analyst

True or False Questions — Submit Answers Online

1. The examiner should hold an in-person or teleconference planning meeting with the analyst, exam team members and Chief Examiner.

   a. True
   b. False

2. Examiners should provide the analyst with updates to the IPS as they occur during the examination.

   a. True
   b. False

3. The NAIC Accreditation Team and/or NAIC peer reviews of examination projects have recently noted appropriate reliance on the analyst's work by the examiners.

   a. True
   b. False

4. Examiners should provide and consult with the analyst prior to finalizing the Examination Planning Memorandum, the Risk Matrices and Exhibits CC, DD and V.

   a. True
   b. False

5. The SRM should represent a roll forward of the IPS that includes current examination issues, coupled with updating the analyst's branded risk assessment.

   a. True
   b. False

Navigating the NAIC Insurance Data Security Model Law

True or False Questions — Submit Answers Online

6. The NAIC Insurance Data Security Model Law (NAIC) exempts licensees with fewer than 12 employees.
   a. True
   b. False

7. One method to mitigate risk is to have a complete and accurate IT Asset Inventory listing that is maintained by someone.
   a. True
   b. False

8. The NAIC requires that companies provide security awareness training on current and relevant content.
   a. True
   b. False

9. Companies do not have to be concerned over their vendor's cybersecurity risk.
   a. True
   b. False

10. The NAIC requires that a notification be made within 72 hours from a determination that a cybersecurity event has occurred and involves 500 or more consumers.
    a. True
    b. False

Understanding the Terrorism Risk Insurance Program

Multiple Choice and True or False Questions — Submit Answers Online

11. Similar to natural catastrophe risks, terrorism catastrophe risks can be reliably underwritten due to relatively stable and statistically predictable laws of behavior.

    a) True
    b) False

12. Which of the following governmental agencies is not involved in declaring a Certified Act of Terrorism under the TRIA program?

    a) Secretary of the Treasury
    b) Secretary of Homeland Security
    c) Federal Emergency Management Agency
    d) U.S. Attorney General

13. The TRIA program's post-attack funding mechanism is appropriate for risks where frequency and severity are difficult to quantify.

    a) True
    b) False

14. Which of the following does not contribute to difficulty in underwriting terrorism risk?

    a) Absence of Meaningful Actuarial Data
    b) Random Nature of Terrorist Acts
    c) Risk Concentration
    d) Identical to Acts of War

15. An insurer's ability to exclude terrorism as a covered peril in workers' compensation policies has contributed to greater reinsurer participation in commercial markets.

    a) True
    b) False

Summer 2019 National Meeting Notes

True or False Questions — Submit Answers Online

16. The Reinsurance Task Force recommended that states begin adopting the 2019 revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) even though these models are not yet Accreditation requirements.
    a. True
    b. False

17. The Restructuring Mechanisms Working Group issued a white paper summarizing the work and recommendations of the Group.
    a. True
    b. False

18. The Financial Regulation Standards and Accreditation Committee adopted revisions to the Accreditation Program Manual to make principles-based reserving requirements applicable to fraternal benefit societies.
    a. True
    b. False

19. The Property and Casualty RBC Working Group adopted changes to RBC as a result of the 2019 revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to reflect adoption of the EU and UK Covered Agreements.
    a. True
    b. False

20. The Statutory Accounting Principles Working Group adopted a substantively revised SSAP 22R- Leases, which rejects ASU 2016-02 and retains the guidance that all leases are operating leases. SSAP 22R clarifies the guidance on sale-leaseback transactions, which may only be executed with property, plant and equipment, including computer software.
    a. True
    b. False

Communication and Coordination Between the Examiner and the Department Analyst

By Alex Quasnitschka, CFE and
Sara Schumacher, CFE
Risk & Regulatory Consulting, LLC

The financial examination is getting ready to start. The examiner may be pondering such questions as - How can I leverage the analyst's work? What additional knowledge can the analyst provide me that is not included in the exam files? How do I properly document the analyst's involvement in the exam and our coordination? Conversely, the analyst may be pondering such questions as - What do I need to do? What assistance can the examiner provide me from work performed during the exam?

The purpose of this article is to provide an overview of the various areas (required and not required) in which the analyst and the examiner should be coordinating efforts throughout the examination. In addition, this article will highlight some best practices to consider for effective coordination and communication between examiners and analysts.

Exhibit B Exam Planning Questionnaire (EPQ) and Exhibit C Evaluation of Controls in Information Technology (ITPQ)

While not required by the NAIC Financial Condition Examiners Handbook (the Handbook), the state insurance department (the department) personnel, including the analyst, may provide company-specific updates to the Handbook EPQ and ITPQ sent to the company. Updates by the analyst could include:

- Elimination of requests not applicable to the company
- Elimination of duplicative requests previously on file with the department
- Addition of requests addressing state specific procedures to be completed by the examiners
- Addition of requests specific to company's operations, and
- Addition of requests addressing analyst specific concerns and/or prior examination issues

Planning Meetings

As required by the Handbook, the examiner should hold an in-person or teleconference meeting with the analyst, Supervising Examiner and Chief Examiner. In addition, the examiner should obtain at least a written update on any concerns or issues from other department personnel. These communications with the department should occur as early in the planning phase as possible. The meeting(s) should be held after the examiner has a chance to review the Insurer Profile Summary (IPS) and the most recent Annual Statement filings. It may be best to coordinate the meeting to coincide with the kick-off meeting.

Most analysts and examiners have wondered: What do I need to prepare for the meeting? What information or materials should I bring to present to the examiner? How do I get an agenda together for my meeting with the analyst, especially when I do not know enough about the company yet?

The most recent version of the Handbook includes a new exhibit, Exhibit D: Planning Meeting with Financial Analyst. While optional for use, Exhibit D

helps resolve these dilemmas for both the analyst and the examiner. Exhibit D can help ensure an effective exchange of information to promote efficiencies in the financial examination process by allowing the examiner to leverage the knowledge and work performed by the financial analyst. It is highly recommended to use this as a starting point in constructing the agenda for meetings with the analyst. Below are topics included in the Handbook Exhibit D along with some other suggested topics:

Business Summary – The analyst should provide a summary of the business operations and lines of business of the insurer. The analyst may want to provide the examiner with:
- Most recent business plan on file
- Summary of any changes in licensing or business written
- Overview of any meetings between the department and the company
- Overview of corporate governance including any significant changes/ concerns, and
- Risks related to succession planning and significant turnover at the C-Suite level

Regulatory Actions – The analyst should discuss any significant recent steps taken in supervising the company such as permitted practices, issues of non-compliance, follow-up on items from the last financial examination, recent filings, or other.

Financial Snapshot/Overview of Financial Position – The analyst should discuss his/her most recent review of the company's filings including:
- Overview of significant balances
- Negative trends noted by the analyst
- Concerns on capital adequacy, liquidity, asset quality or other
- Overview of the company's investment strategy and holdings along with any recent changes, and
- Overview of reinsurance program including any significant reinsurance partners, changes to the reinsurance program and any concerns with the reinsurance program or the reinsurance partners

Branded Risk Assessments – The analyst should discuss the individual branded risk assessments with a focus on moderate and significant areas of concern. Examiners should request that the analyst provide updates to the IPS as they occur during the examination. This helps to ensure examination plans are updated for any significant changes in branded risk assessments.

It is also advantageous to discuss with the analyst:
- Risk mitigation strategies identified by the analyst that may need further verification
- Outstanding inquiries, concerns or issues noted by prior examiners and/or analyst(s)
- Risks specific to the company, the holding company, industry or other concerns, that while minor, may be escalating, and
- Upcoming legal or regulatory changes

Impact of Holding Company on Insurer – The analyst should discuss the impact of the holding company system on the domestic insurer, such as the Group Profile Summary, Corporate Governance Annual Disclosure (CGAD), Own Risk Summary Assessment (ORSA) Report (if applicable), and Form F reporting that may indicate a need for additional review during the exam. This may also be a good time to discuss any significant insurance subsidiaries or affiliates, as well as any significant related party or affiliated agreements and transactions.

Overall Conclusion and Priority Rating – Discuss the analyst's overall conclusion on the company's financial condition, strengths, weaknesses and priority rating. It may also be beneficial to gain some insight on the company's rating in comparison to other companies domiciled in the state and assigned to the analyst.

Supervisory Plan – The analyst should discuss the department's plans for the ongoing supervision of the company, including any specific examination follow-up procedures to be performed.

Access to Workpapers and Company Documents – The analyst or exam coordinator should discuss the most efficient way the examiner can review analyst workpapers. Ideally, the analyst and examiners should be sharing resources and communication relative to any noted issues throughout the examination. This level of communication can be accomplished through written status reports, recurring teleconference meetings, and copying each other on significant emails, exam developments, and requests.

In some cases, the analyst has already completed some aspects of standard Phase 1 and 2 work normally completed by the examiner. The NAIC Accreditation Team and/or NAIC peer reviews of examination projects have recently noted a lack of appropriate reliance on the analyst's work by the examiners. Some areas the NAIC has recommended for examiners to place reliance on the analyst's work performed include:

- Analytical reviews
- Review of filings with the state department (e.g., annual and quarterly filings, audit filings, significant agreements with affiliated and unaffiliated parties, the Own Risk Solvency Assessment filing, etc.)
- Initial branded risk assessment included in the IPS
- Review of mitigation work by the company related to prior examination findings

The risk-focused examination process is entering its second, and sometimes third, exam cycle for most companies. As such, the examiner should consider requesting certain files from the prior examination, including, but not limited to: the Exam Report, Management Letter, Summary Review Memorandum, C-Level Interview notes, Exhibit V, Exhibit CC, Exhibit DD, Risk Matrices, Exam Planning Memorandum and IT Summary Memorandum. These materials can be leveraged to determine areas of change since the prior examination and assist in the current examination's risk assessment process. Ideally, it is bene-

ficial for the examiner to obtain real-time electronic access to the analyst's workpapers or request that the analyst provide access to any new significant workpapers as they become available.

Input from Other Areas of the Department – The analyst should discuss any recent communications from other areas of the department regarding issues that could affect the financial examination.

General Observations – Depending on the information already provided, the examiner should determine whether there are any additional topics relevant for discussion. Some additional topics to discuss with the analyst may include:

- The department's main contact or contacts at the company and overall history/impression on whether company responses were not provided timely and/or were deemed inadequate in the past. Many times, the analyst can provide insight into individuals you may be working with during the examination.
- Awareness or suspicion of fraudulent activities.
- Update on recent target or market conduct examinations and if any findings are applicable in the financial examination.

Company Interviews

The NAIC Accreditation Team and/or NAIC peer reviews of recent examination projects have identified a lack of analyst attendance during the C-level interviews. The Examiner-In-Charge (EIC) should make every effort to involve the analyst in these meetings by providing them with agendas to review prior to forwarding to the company. The analysts should also be included on interview invites, giving them the opportunity to make comments and ask questions of senior management. While the analysts should be part of this process, it is the EIC who should typically be determining who comprises the C-Suite of interviewees.

Risk Assessments and Testing

Examiners should provide and consult with the analyst prior to finalizing the Examination Planning Memorandum, the Risk Matrices and Exhibits CC, DD and V. This meeting provides the analyst with a final opportunity to identify any significant areas the examination should address in testing and allow for dialogue regarding the overall risk assessments. This meeting helps to ensure that significant risks identified by the analyst are included in the testing phases of the examination - a key area of focus during NAIC Accreditation and peer reviews of examination files. Through written status reports and examination status teleconference calls, the examiner will be able to keep the analyst apprised of any significant testing developments.

Examination Completion

Many would consider the Summary Review Memorandum (SRM) to be the most critical deliverable that the EIC provides to the state department at the conclusion of the examination. The EIC should work with the state's personnel

to schedule a closing or wrap-up meeting to discuss the SRM and any other key deliverables. The EIC should make sure he/she has the most recent company IPS and related branded risk assessments available. The SRM should represent a roll forward of the IPS that includes current examination issues, coupled with updating the analyst's branded risk assessment. During this meeting, the EIC can review the SRM, as well as the Examination Report and Management Letter. This "pass the baton" meeting will also allow the analyst and state personnel an opportunity to raise any questions or concerns on their end and to help ensure an appropriate handoff from the examiners to the analyst for ongoing monitoring.

The Handbook recommends that information communicated in the SRM should include:

- Discussion on potential ongoing or future solvency concerns for the company.
- Brief overview and summary of the company's corporate governance.
- Overview of any prospective solvency concerns, examination adjustments, control/risk mitigation strategy issues, report findings and management letter comments, responses to issues raised by financial analysis, subsequent events and other residual risks or concerns the examiner may want to communicate to department personnel.
- Detailed overview on any recommended follow-up procedures that the analyst may need to perform after the examination is complete relating to the prospective solvency concerns, examination adjustments, control/risk mitigation strategy issues, report findings and management letter comments. A lack of appropriate detailed recommendations by the examiner to the analyst has been a concern noted by the NAIC Accreditation Teams and/or NAIC peer review project.
- Updates on any remediation(s) to date by the company and examples of any recommended materials to obtain from the company going forward.
- Recommendations for changes in the company's prioritization rating and/or to the Supervisory Plan. Depending on state requirements, the examiner may also need to prepare a stand-alone Supervisory Plan rather than just making recommended changes.

Closing Remarks

This article only presents a few ideas for some best practices to consider in ensuring effective coordination and communication between the examiners and analysts. Each analyst and examiner will likely need to determine what works best to suit the team, to ensure compliance with Handbook requirements, and to determine what works most appropriately for each specific examination.

The analyst and examiners need to remember that they must work together as a team throughout the examination, not just at the beginning and the end!

Lastly, the examiners and the analysts need to ensure they are getting credit for their efforts to coordinate and communicate together. An important piece is to make sure any efforts are documented in the examination workpapers and in the analyst's files to provide necessary supporting evidence.

About the Authors

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Alex has more than16 years of experience in the regulatory insurance industry. Alex coordinates, manages and leads a team providing all aspects of statutory examinations of insurance companies on behalf of state insurance departments. Alex conducts various external training sessions at the annual SOFE CDS and has authored or co-authored several articles included in SOFE's magazine, The Examiner, on topics ranging from liquidity risk identification and management to managing of exam team specialists.

In 2018, Alex participated in the NAIC Peer Review Program that consisted of three days of reviewing exam files, discussing various ways examinations can be performed more efficiently, and ensuring they meet Accreditation standards.

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Navigating the NAIC Insurance Data Security Model Law

By Phil Schmoyer, AES, CFE, Russel Sommers, and Dennis Schaefer, Baker Tilly Virchow Krause, LLP

In response to an increasing number of data breaches impacting the insurance industry, the National Association of Insurance Commissioners (NAIC) formulated the Insurance Data Security Model Law which was ratified during the NAIC Summer 2017 National Meeting. With the development of this national guidance, a uniform set of data security requirements, including a risk based information security program, has been established to help aid in the protection of personally identifiable consumer data. As more states adopt the model into applicable state law, insurers throughout the U.S. will need to continue to strengthen their cybersecurity programs.

Exemptions

An important detail to note is that the law exempts licensees with fewer than 10 employees, licensees compliant with the Health Insurance Portability and Accountability Act of 1996 (HIPAA), and agents of a licensee from Section 4 of the model. The model also does not create a private cause of action, nor does it limit an already existing private right of action.

Key considerations

To help insurers understand the regulation and develop their compliance assessment, the following is a list of the model law's provisions and key areas to consider when reviewing your information security management program:

Section 3. Definitions

When managing an information security program, the critical starting point is to align to a common set of defined terminology. When companies are looking to implement compliance programs, starting with an understanding of the key terminology and definitions is a good place to start. For well-developed information security programs, starting over with defining terms may be wasteful. Instead, organizations should look to map or align their definitions to that of the law. A document that includes a glossary of the company's cybersecurity policies and procedures that are aligned with the law will help demonstrate compliance.

Section 4. Information Security Program

4(A) Implementation of an Information Security Program and

4(B) Objectives of Information Security Program

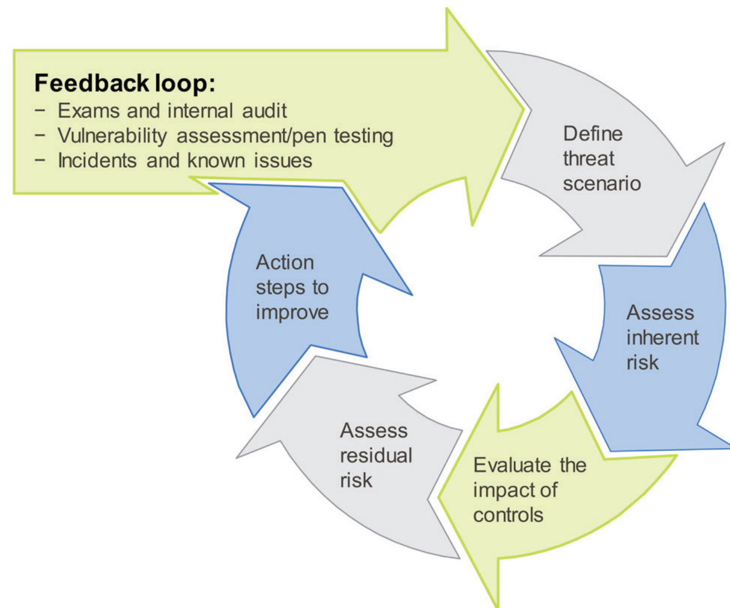
A **risk-based** information security program should be designed and implemented to:

- Protect the security and confidentiality of nonpublic information and the security of the information system.
- Protect against any threats or hazards to the security or integrity of nonpublic information and the information system.

- Protect against unauthorized access to or use of nonpublic information, and minimize the likelihood of harm to any consumer.
- Define and periodically reevaluate a schedule for retention of nonpublic information and a mechanism for its destruction when no longer needed.

4(C) Risk Assessment

Many sections of the law are risk-based, which is why conducting risk assessment exercises should be a significant undertaking. As businesses and the risks they are exposed to continue to evolve, it is imperative that companies maintain a feedback loop in their assessment process to ensure risks are being assessed with current information and resources are adequately deployed to the highest risk areas.



An important item to consider is the planned action steps stemming from the risk assessment. Considering the elements identified as planned improvements from the risk assessment process, it is important that companies illustrate how each of the identified items from the last assessment were addressed and how milestones for planned improvements will be monitored.

The risk assessment process should be tailored to your organization, but minimally include the following:

- Formally designate a person(s) or entity to be responsible for the execution of the risk assessment, as well as the implementation and operation of the information security program.
- Develop and implement risk assessment policies and procedures that address:
    - How and when risk assessments are performed

  - How risk is categorized and treated (e.g., accepted, avoided, mitigated, etc.)
  - How risk treatment is reported and managed (e.g., likelihood, impact, etc.)
- Investigate the systems and internal locations for the storage and movement of nonpublic information.
- Conduct a thorough risk assessment of information systems that process, store and communicate nonpublic information in accordance with risk assessment policy.
- Assess and treat identified risks in accordance with risk management policy.
- Assess the sufficiency of existing policies, procedures, information systems and other safeguards.
- Establish a system for tracking identified vulnerabilities and their risk treatment.
- Conduct annual control operational effectiveness testing and summarize the results.

4(D) Risk Management

For the purpose of managing risk, the law requires the information security program to address concerns associated with the protection of information systems that process, store or communicate nonpublic information, including:

- Control of user logical access to information systems.
- Maintenance of a complete and accurate IT asset inventory.
- Control of user physical access to information systems.
- Use of data encryption or approved compensating controls to mitigate data-at-rest risks and use of transmission encryption or approved compensating controls to mitigate data-in-motion risks.
- Establishment of security policy, standards and procedures for the development and procurement of secure applications.
- Control of changes made to all information systems that process, store or communicate nonpublic information.
- Implementation of multi-factor authentication for access to information systems.
- Regular assessment monitoring of all information systems for vulnerabilities and weaknesses, and continuous security event monitoring, annual penetration testing, and vulnerability scanning.
- Establishment of security event and financial transaction logging capabilities to create audit trails.
- Establishment of a backup strategy to protect information systems from loss due to technical and environmental issues.
- Creation and implementation of a data governance and classification policy.

The law also requires the establishment of a process to ensure the company is keeping up-to-date with emerging cybersecurity threats and countermeasures. Keeping current with emerging risks and threats may seem like an insurmountable task, but the key to doing this well is by establishing a process for in-taking information, analyzing its impact and responding accordingly.

Participating in the Financial Services Information Sharing and Analysis Center (FS-ISAC) and InfraGard are excellent sources of information and knowledge sharing. There are also countless resources from various government agencies, security service providers and industry websites and blogs. Companies need to define which information sources they will be using and remain diligent in applying their process of intake, analysis and response.

Surprisingly, despite cybersecurity being in the news and all the effort put toward educating personnel, people remain the biggest risk to maintaining a secure environment. Regular training of information security staff, executives, directors and personnel remains paramount to maintaining an effective cybersecurity program. Helping to round out a robust risk management program, the law requires security awareness training to be administered on relevant and current content. An effective training program also includes a mechanism through which completion is evidenced, and employee performance is assessed and evaluated. Ideally, employees illustrating deficiencies through evaluations should receive enhanced training to increase their cybersecurity awareness. An effective way to assess employee behavior is to consider combining social engineering exercises with security awareness training by creating a feedback loop that highlights and reinforces good behavior.

4(E) Oversight by Board of Directors

Boards need to establish the requirement for executive management or a delegate to develop, implement and maintain an information security program. Executive management must oversee any delegation of its responsibilities and ensure delegate compliance with the law. On at least an annual basis, executive management, or the delegate, is required to report to the board information about:

- The overall status of the information security program and compliance with the law
- Material matters related to the information security program, addressing issues such as risk assessment, risk management, control decisions and third party service provider arrangements
- Testing results
- Cybersecurity events or violations and management's responses
- Recommendations for changes in the information security program

4(F) Oversight of Third-Party Service Provider Arrangements

One of the largest undertakings in the compliance journey with this regulation is the improvement of a third party management program. A third party service provider policy should be established outlining the process for evaluating and monitoring third party vendors, as well as the minimum cybersecurity standards to be met by providers. To ensure a company meets the requirements of the regulation, organizations should:

- Maintain an inventory of third party service providers
- Define the risk factors to be used in evaluating third-parties:
    - o Type of data stored, transferred and processed (i.e., PII, PHI, PCI, etc.)
    - o Type of service
    - o Criticality to operations
    - o Financial impact (i.e., how much they are paid)
    - o Known issues, including breaches
- Assess the third party service providers using the defined criteria
- Perform a review cycle based on the risk ratings
- Ensure the process is followed for each new vendor

Due to the potential volume of vendors and difficulty to obtain the needed information to properly risk rank the vendors, the model law suggests a two (2) year lag for required effective date from date of adoption (compared to the standard one (1) year for the rest of the regulation).

4(G) Program Adjustments

The model law requires your information security program to evolve as the organization does. It requires organizations to assess, reassess and make adjustments based on changes in technology, the sensitivity of its nonpublic information, internal or external threats to information and changing of business arrangements (e.g., mergers and acquisitions, alliances and joint ventures, outsourcing arrangements, changes to information systems, etc.). In many circumstances, a formal risk assessment should be conducted to determine any necessary adjustments. Documentation supporting the completed assessment and adjustments to the information security program should be retained for future reference.

4(H) Incident Response Plan

The model law calls for the creation of an incident response plan. It's fairly standard to assume your organization will experience some level of data loss or breach, therefore the model law looks to enforce a well-developed response plan is in place. An effective incident response plan should address:

- The internal process for responding to a cybersecurity event
- The goals of the incident response plan
- The definition of clear roles, responsibilities and levels of decision-making authority
- External and internal communication protocols
- Assessment of impact to constituents
- Documentation and reporting regarding cybersecurity events and related incident response activities
- Conducting a post mortem on events and revision of the incident response plan following a cybersecurity event

It is also crucial to test the incident response plan. At a minimum, companies should conduct a table top exercise involving all relevant incident response team members and stakeholders. During the exercise, several mock incidents are introduced and the team is given a defined length of time to formulate a response. After the team discusses and modifies their responses, the incident response plan is reviewed to determine any necessary modifications or to add any addendums regarding planned responses to specific events.

4(I) Annual Certification to Commissioner of Domiciliary State

For the purpose of evidencing and certifying compliance with Section 4 of the law, companies are required to:

- Submit an annual written statement, certifying compliance by Feb. 15 of the subsequent year
- Retain schedules and data supporting annual certifications for a period of five years
- Retain documentation supporting material system improvements

Thus far, most of the states which have adopted the regulation have adopted the suggested implementation timeframes as well, which are one (1) year from the date of adoption to comply with all sections of the regulation with the exception being for Section 4F related to third party service provider oversight. These effective dates trigger the need for compliance certification on Feb. 15 of the year following "effective."

Section 5. Investigation of a Cybersecurity Event

Along the similar notion that most companies will experience some type of data loss or breach, the model law includes requirements around the investigation and notification of a cybersecurity event. A well-defined process for investigating cybersecurity events is crucial for mitigating damages associated with the unauthorized disclosure of nonpublic information due to a breach. The incident response plan (discussed in Section 4H) should define the roles and responsibilities, and outline the investigative procedures that need to be implemented. Investigative procedures must also be executed for both in-house systems and systems maintained by third party service providers. The records supporting the completed investigations need to be retained for at least five (5) years and must:

- Determine whether an actual cybersecurity event has occurred
- Assess the nature and scope of the cybersecurity event
- Identify nonpublic information that may have been involved in the cybersecurity event
- Take reasonable measures to restore the security of compromised systems and prevent reoccurrence

Section 6. Notification of a Cybersecurity Event

As any oversight body would advise, the model law requires a notification to be made to the governing body when a cybersecurity event was deemed to have occurred. To assist in making this process as seamless as possible, it is important to establish formal processes for determining whether a cybersecurity event requires notification to the commissioner, consumers, reinsurers to insurers and/or insurers to producers of record. Notification procedures must be applied to the unauthorized disclosure of nonpublic information contained both with in-house and third party service provider operated systems. Company management should also study the law and establish documented process flows for deciding who to notify and how to communicate that an incident has occurred. The process flows should identify key systems and data types contained within key stakeholders, technical staff and members of the internal/external legal teams who will be involved in the process. In general, the law requires notification to occur within 72 hours from a determination that a cybersecurity event has occurred and involves 250 or more consumers; however, as each state adopts the model law, these values are likely to differ from state to state.

Section 7. Power of Commissioner

With the adoption of the model law, the insurance commissioner is granted the power to examine insurance entities for compliance with their adopted data security regulation. Many states are performing these exams currently if their respective legislature has enacted the law. In order to comply with examinations initiated by the commissioner, companies should ensure that adequate evidence is retained to support compliance with each section of the law. The evidence should be stored so that it is accessible when needed and documented so a reasonable person can draw a similar conclusion. Ideally, companies will utilize internal audit to conduct a review of the documentation to provide feedback regarding the status of supporting documentation; this will help expedite the exam process and likely reduce the risk of areas being overlooked.

Wrapping up the NAIC Insurance Data Security Model Law

Now that states are in the process of adopting, or have already adopted the NAIC Insurance Data Security Model Law, it is vital for insurance organizations to take a fresh look at their cybersecurity management program, determine areas for enhanced security or compliance, and be prepared for your state's next cybersecurity examination.

Source

Insurance Data Model Security Law (2017), retrieved from https://www.naic.org/store/free/MDL-668.pdf.

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Understanding the Terrorism Risk Insurance Program

By Jon Bergner, National Association of Mutual Insurance Companies

INTRODUCTION

Since the events of September 11, 2001, the federal government has developed a robust and sophisticated counter-terrorism apparatus that has thus far succeeded in preventing large-scale terrorist attacks on the United States homeland. However, the threat of terrorism is continuing to evolve amid a changing, unstable, and dangerous international environment. Attacks such as the Boston Marathon bombing are stark and painful reminders that the United States must remain vigilant. Unfortunately, it will likely never simply be about prevention – response and recovery are also integral pieces of the country's national security. It is vital that we, as a nation, protect the U.S. economy from the financial devastation that could accompany a catastrophic terrorist attack and help get it back on its feet after an attack.

Insuring against the losses from such an attack could be one way to achieve that vital protection. However, simply put, terrorism is not an insurable risk as it involves strategic human behavior and represents a dynamic threat that is intentional, responsive to countermeasures, and purposefully unpredictable. The objectives of terrorists, the means and methods of achieving those objectives, and the propensity to collaborate with unknown national and international actors are not knowable or measurable in a commercial context. Compare this with hurricanes and floods, which, as forces of nature subject to relatively stable and statistically predictable laws of behavior, enable insurers to predict the frequency and severity of such risks, and therefore, to properly underwrite them on both a local and catastrophic basis. In short, insurers cannot underwrite risks that lack a statistically reliable foundation.

Following 9/11 it became evident that no self-sustaining private market for terrorism risk coverage was likely to develop. Therefore, in 2002, Congress passed the Terrorism Risk Insurance Act, or TRIA, creating a risk-sharing mechanism between the private and public sectors. This mechanism allows for a large and temporal transfer of risk that would not occur in a fully private market but does – potentially exclusively – utilize private capital.

The TRIA program creates the space to allow a viable private market to function. The unique structure of the program's recoupment mechanism takes losses that could render a single company insolvent and spreads them throughout the private sector and over time. This has created the certainty needed for the commercial insurance industry to effectively operate and policyholders to purchase coverage that would otherwise be unavailable. Now, losses from all but the largest terrorist attacks are completely borne by the private sector without involvement of the TRIA program.

The purpose of the program is to make sure that the economy can recover in as orderly a fashion as possible from a terrorist event. In order to encourage private-sector involvement in the terrorism insurance marketplace – and thereby protect and promote our nation's finances, security, and economic

strength – the U.S. needs a well-functioning terrorism loss management plan. Fortunately, the current TRIA program has proven to be such a plan.

CREATING THE TRIA PROGRAM[1]

Before the events of 9/11, the abstract possibility of a major terrorist attack on the U.S. was known but not understood by most people. At the time, terrorism was typically included in "all-risk" policies because the risk was deemed so small as to be incalculable. Then, in one morning, the 9/11 attacks caused roughly $45.5 billion in insured losses.[2]

Soon after the attacks, reinsurers and then insurers moved to exclude terrorism coverage from their new and renewing policies as this was a poorly understood risk that could potentially produce previously unimaginable losses. Consequently, the ability of commercial policyholders to purchase adequate coverage at affordable prices was severely constrained. As a result, many were forced to go without coverage or only partly insure their assets. In states that prohibited carriers from excluding coverage for terrorism and with reinsurance companies universally excluding terrorist acts in property/casualty treaties, most carriers only alternative was to offer less coverage or not write the business at all.

The lack of adequate insurance capacity and significant increases in pricing of commercial multi-peril business resulted in the postponement or cancellation of many construction projects. It was estimated at the time to have delayed or cancelled $21 billion[3] in real estate transactions and cost 300,000 construction workers their jobs.[4] Given the economic uncertainty this created and the insurance industry's serious concern about properly managing this risk, Congress passed and President George W. Bush signed into law the Terrorism Risk Insurance Act of 2002. It was quickly realized that without the program American businesses would be hard pressed to find or afford the coverage they needed, so TRIA was extended for two years in 2005, seven years in 2007, and again for six years at the beginning of 2015.

Essentially, TRIA limits an individual company's potential terrorism losses, which permits them to quantify their terrorism exposure and make coverage available. The program was purposefully designed to force insurers back into the terrorism insurance market in exchange for this loss limitation in the event of a certified terrorist event.

There are several key elements to the program:

- Required Offering of Terrorism Coverage: The current program requires all insurers selling covered lines to offer terrorism coverage, compelling many insurers that had previously exited that market to return and dramatically reducing the amount of potentially uninsured losses in the event of an attack. Insurers are required to offer coverage for acts of terrorism on the same terms and conditions as other coverages, although this does not

include coverage for nuclear, biological, chemical, and radiological-attacks. Currently policyholders are not required to purchase the offered coverage, and in the last few years take-up rates have plateaued in the 60 percent to 65 percent range.

- Certified Act of Terrorism: In order to involve the TRIA program, an individual act of terrorism must be certified by the secretary of the Treasury in consultation with the secretary of Homeland Security and the U.S. attorney general. To be a certified act, losses must exceed $5 million.

- Program Trigger: Best conceived of as a "light switch," the TRIA program is "switched on" only if the insurance industry's aggregate insured losses exceed $200 million in a given year. Once "on" the trigger level has no bearing on the federal government's share of the losses in a specific event.

- Deductible: Each insurer is responsible for paying out a portion of its claims – the "deductible" or "individual company retention level" – before any federal involvement. An insurer's deductible equals 20 percent of an insurer's annual direct earned premiums from the year prior to a certified event from covered TRIA lines. For some companies, these deductibles are in the billions of dollars.

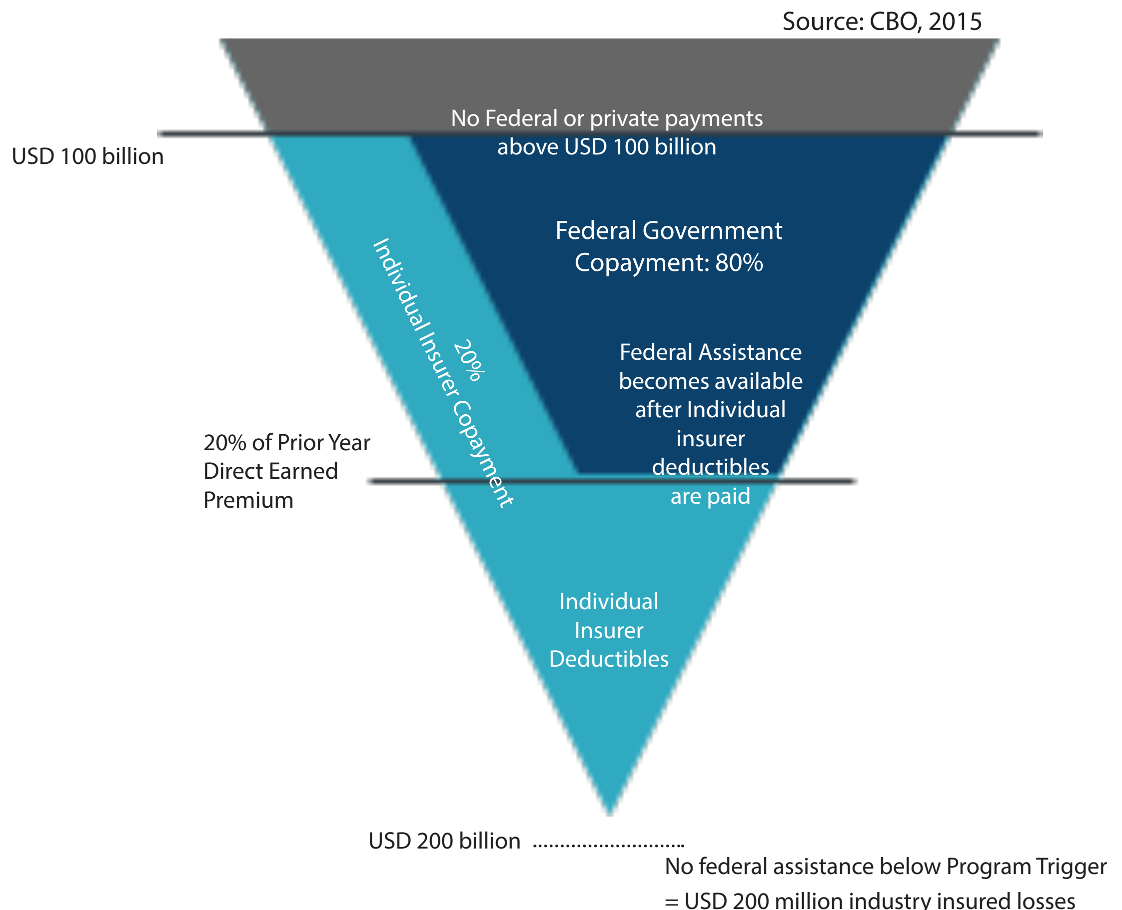
- Co-Share: For each insurer's losses above its deductible, the insurer covers 20 percent and the federal government covers 80 percent until the amount of losses totals $100 billion, after which there is no requirement that insurers or the government provide coverage.

- Mandatory Recoupment: By law, the federal government must recoup the difference between insurers' total costs and the industry aggregate retention level, which is calculated as the sum of all the individual company deductibles estimated at $46 billion. This recoupment takes place in the years following the federal sharing of insurer losses, with the Treasury Department establishing surcharges on all covered commercial policies and is required to recoup 140 percent of the initial outlays to insurers under the program. This mandatory recoupment will not apply for losses above the industry aggregate retention level. In that case, however, the Treasury secretary retains discretionary authority to apply recoupment surcharges for all losses above this level. Ultimately, every dollar spent by the federal government is recoupable under current law.

To reiterate, taxpayers are completely protected under TRIA. The program essentially acts as a post-funded payment mechanism for the catastrophic tail coverage of terrorism risks. This coverage is valuable but not priced explicitly nor paid for upfront – it is paid for in the event it is used and in effect pricing is determined after any event. This structure is common for risks that are more

difficult to quantify and where there is great uncertainty as to the range of possible outcomes – nuclear power plant disasters are another example.

It is this structure of the current TRIA program that has created space for a private market to operate under the umbrella of federal participation. Private-sector involvement reduces the unaddressed financial needs of victims, which, in turn, reduces the necessity of government intervention – thus taxpayer exposure – post-attack. Just as important, what TRIA does is define the government's role in advance of a catastrophe rather than relying on ad-hoc authorizations after the fact, thus allowing all parties to plan efficiently.



PUTTING THE TRIA PROGRAM INTO PRACTICE

Imagine a certified terrorist event in Chicago in 2020 that causes $25 billion in total losses for covered lines, such as workers' compensation, property, and business interruption. Determining coverage and payment proceeds as follows:

STEP 1: Determine which losses are covered.

For workers' compensation insurance, no terrorism exclusions are allowed, so all losses will be covered, but for property or other lines the policyholder had a choice to accept or reject terrorism coverage. Review of the policies and coverages will determine whether the losses are covered. Let us assume for illustration purposes that $20 billion of the $25 billion in losses are covered.

STEP 2: Determine if TRIA program is triggered.

The $20 billion in covered losses exceeds $200 million program trigger level so the program is triggered.

STEP 3: Insurance companies process claims and pay all insured losses.

Each individual insurer that sustained losses processes its policyholders' claims and pays all insured losses, which, in this example, total $20 billion.

STEP 4: Insurance companies calculate their share of insured losses.

First, each insurance company calculates its deductible based on the formula – 20 percent of applicable 2019 premium, the year prior to the certified event. For purposes of illustration, imagine all insurance companies involved have deductibles that equal $5 billion.

Second, each insurance company calculates its 20 percent share of losses above its deductible up to the total program cap of $100 billion. In this example, the insurance companies co-share is another $3 billion, which is 20 percent of $15 billion, the amount of the sum of $20 billion in covered losses minus $5 billion in deductibles.

STEP 5: The federal government reimburses insurers for a portion of the insured losses.

The federal government reimburses insurers for losses not covered by the insurers' deductibles and co-share. In this case, the federal government's share is $12 billion: $20 billion in losses minus $5 billion in insurer deductibles minus $3 billion in insurer co-share.

STEP 6: Determine recoupment by the federal government.

Because the total insurance industry cost of $8 billion exceeded the estimated industry aggregate retention of $46 billion, the federal government is required to recoup 140 percent of the $12 billion in TRIA outlays through premium surcharges, or $16.8 billion.

(NOTE: If the event had been big enough that the total insurance industry costs met or exceeded the industry aggregate retention of $37.5 billion, the Treasury secretary has the discretion to pursue further recoupment of all monies).

SUMMARY: Under this $25 billion loss scenario ($20 billion in covered losses), policyholders who made a conscious choice not to purchase terrorism coverage would end up paying or absorbing $5 billion. Affected insurers would be responsible for paying $8 billion and the federal government would pay $12 billion initially. All policyholders and commercial insurers would be assessed $16.8 billion through surcharges on policies going forward to repay the government.

Net to the federal government:	+$4.8 billion
Total Covered Losses	$20B
Insurer Deductibles	$5B
Insurer Co-Sharing	$3B
Total Industry Losses	$8B
Initial Government Outlay	$12B
Mandatory Recoupment	$16.8B (140% X $12)
Net to Federal Government	+$4.8B

WHY IS THE PROGRAM NECESSARY?

Managing terrorism risk defies the normal underwriting practices of insurers. Terrorism involves strategic human behavior and represents a dynamic threat that is intentional, responsive to countermeasures, and purposefully unpredictable. Immediately following 9/11, some held out hope that, given time, modeling and underwriting methods could be developed and utilized to help insurers manage terrorism risk. And indeed, much has been done to develop modeling tools to manage aggregate loss exposures that are based on a predetermined event of a certain magnitude in a given area. However, due to the nature of terrorist events, it is not possible to use history to model where an attack is likely to happen or the potential frequency of attacks.

The reasons for the difficulty of underwriting terrorism risk are numerous and profound:

- Identical to Acts of War – Acts of war have always been considered uninsurable events, with either an implicit or explicit expectation that financial responsibility resides with the governments involved. War-related damage has never been covered by insurers and no one has suggested that something must be done to maximize private-sector capital to be used to provide such coverage. Simply because stateless, transnational groups are perpetrating these acts of terror does not categorically change their warlike nature.

- Absence of Meaningful Actuarial Data – The data that insurers normally rely on when considering whether coverage can be offered and, if so, at what price, either does not exist or is not available. In the case of natural catastrophe risk, a company can rely on decades of relevant event data

that can be plugged into mathematical models to quantify risk – there is no comparable historical record on which to draw for large-scale terrorist events. Further, much of the relevant data that might be used by an insurance company is appropriately kept secret by the federal government for national security reasons. Without access to this type of information insurers cannot meaningfully calculate the likelihood, nature, or extent of a potential event, making pricing and reserving virtually impossible. Although in theory access to classified information might paint a more accurate picture of the threat matrix facing targets in the U.S., insurers should not – and are not asking to – be given state secrets to write terrorism coverage.

- Intentional Acts – Terrorist acts are deliberate acts and do not occur randomly. Because of this, there is no way to determine the probability that a particular property or asset will experience a terrorism-related loss. Part of the difficulty in assessing terrorism risk stems from the fact that, because of response measures taken in the wake of an attack, the next event is unlikely to follow a similar pattern. Unlike criminal acts, such as robbery, where the goals are predictably targeted, the goal of maximizing death and destruction can be accomplished in countless ways, anywhere and at any time. And terrorism is not comparable to a random event – a hurricane does not study wind-damage mitigation efforts and then think up new ways to get around them. The only truly effective mitigation tools – if there are any – reside within the government's national security apparatus, but as noted above, these are understandably kept secret.

- Risk Concentration – Terrorism risk is highly concentrated and incredibly difficult to effectively pool across geographical locations and policyholder type, particularly in an age of mass-casualty terror. Acts of terrorism on the scale of 9/11 are what are known as a "clash events," meaning they cause significant losses across multiple lines of insurance. These types of events directly threaten the solvency of both insurers and reinsurers and are not typically covered risks. In a fully free market, it would likely be the case that highly concentrated urban areas in particular would find it difficult to find or afford coverage for terrorism.

- Interdependencies – At the very highest level, the nation's foreign policy decisions and the effectiveness of its homeland defense have a direct impact on the likelihood and success of an attack. At the policyholder level, the vulnerability of one organization is not simply dependent on its own security decisions, but also on the decisions of other organizations and agents beyond its control.

In the end, it is more accurate to think of the TRIA program's purpose not as providing reinsurance for losses resulting from "acts of terrorism," but as protection from losses that result from a failure in the government's systems for

detecting and preventing acts of terrorism. With respect to natural catastrophe risk, it would be absurd to assign to a government agency the task of preventing hurricanes, tornadoes, and earthquakes. But it makes perfect sense for citizens to expect their government to prevent attacks by America's enemies, and that is precisely what Americans have come to expect from their government in the aftermath of 9/11. It is now widely recognized that one of the federal government's fundamental duties is to prevent terrorist attacks through effective counter-terrorism measures. Only if the government is unsuccessful in interdicting terrorist plots will Americans incur terrorism losses. "Terrorism risk" is best understood as the risk of government counter-terrorism failure.

Accordingly, while the private insurance industry is willing to assume a substantial portion of this risk within the limits of its capability, the ultimate responsibility for managing the risk of counter-terrorism failure does and should rest with the federal government.

TRIA STRUCTURE DESIGNED FOR INDIVIDUAL COMPANY PARTICIPATION

Discussions surrounding the private terrorism risk insurance market tend to focus on aggregate numbers – i.e. how much market capacity exists, industry exposures, etc. However, the design of the TRIA program focuses on something entirely different and more appropriate for its purpose: the individual company. The program is structured this way to take into account the unique risk discussed above and the fact that losses are not likely to be spread evenly among a large number of insurers even in a catastrophic attack.

This is especially so in the case of terrorism because perpetrators have the ability to precisely target particular properties or assets. Hence, a single terrorism event could affect insurance companies with similar books of business in very different ways: one company might suffer no losses from the event, while another company could suffer losses sufficient to threaten its very existence. The TRIA program – through the mechanism of initial federal outlays recovered through recoupment – allows this "bet the company" risk to be spread throughout the private sector and over time in a manner that cannot be duplicated by the private sector alone.

Further, the individual company retention and co-share percentages are all set at levels with the individual companies in mind, not the overall industry. A single company's capacity to absorb losses cannot be exposed beyond a reasonable level without failing in its primary purpose – supporting the economy by protecting against non-terrorism-related losses and events. In the event of a major attack, substantially depleted reserves and surpluses, as well as insolvencies, could mean that policyholders of non-covered lines could go unprotected. A company that engages in business that endangers the ability to pay on existing or future claims is violating its duties to existing policyholders, another reason the TRIA program is designed the way that it is.

WHAT WOULD HAPPEN IF TRIA EXPIRED OR WAS MATERIALLY CHANGED?
Termination of the TRIA program threatens the space in which a viable private market for terrorism insurance has grown. In considering what is likely to happen if the program were to terminate on December 31, 2020, the immediate aftermath of 9/11 in commercial property/casualty insurance markets for terrorism coverage as described above is instructive.

The effects of a termination of the TRIA program also extend beyond the property/casualty insurance industry. As we saw, commercial development can grind to a halt in the absence of terrorism coverage if the financial institutions financing projects require the coverage as a condition of their loans. In fact, many outstanding loans that require developers to maintain coverage would be thrown into technical default if the program were terminated and if insurers had made arrangements to exclude or limit coverage in the absence of TRIA. The impact on the broader economy was one of the key reasons the program was first put into place and why it has continued to be reauthorized. Nothing has fundamentally altered this dynamic.

Similarly, it is not at all clear that scaling back the TRIA program would lead to more involvement in the market by private insurers. In fact, the opposite is likely true. Increasing the nominal amount of private-sector involvement in the current TRIA structure does not automatically translate into an increase in private-sector capital in the marketplace. Increased company retentions, co-shares, and an increased trigger level may cause market participants – particularly small- and medium- sized companies – to exit, thereby reducing total private capital. An effective terrorism loss management plan depends on participation by insurers of all sizes and structures.

UNDERSTANDING THE TRIGGER LEVEL
Consideration of just one proposed change is illustrative of this dynamic. It has been suggested that raising the event trigger level will further the goal of taxpayer protection. As a practical matter, however, a higher trigger would do nothing to reduce taxpayer exposure in the event of an attack.

The trigger level is the point at which insured losses are high enough to activate the TRIA program but does not ultimately determine the level that the program begins making initial outlays. In other words, there are scenarios in which the program is triggered and makes initial outlays for losses below the trigger level. Conversely there are scenarios in which the program is triggered and must make zero outlays.

First, consider a $200 million terrorist event involving a single, smaller insurer that writes approximately $200 million in TRIA- covered lines of business:

$200 M Event	**$200 M Trigger**
(Company deductible = $40 million)	
Program Triggered?	Yes
Insurer Losses (Deductible + Co-Share)	$72 M
Initial Government Outlays	$128 M
Mandatory Recoupment (Private-Sector Loss Sharing)	$179.2 M (140% X
$128 M)	
Net Gain/Loss to Fed. Government	**+ $51.2 M**

As you can see, in this specific scenario, despite the trigger level being set at $200 million, the TRIA program becomes involved after losses around $70 million. The way the TRIA program operates is based entirely on the specifics of the event and the insurance companies involved in the event.
Consider another $500 million scenario with a single impacted company with an individual retention level of $1 billion:

$500 M Event	**$200 M Trigger**	**$1 B Trigger**
(Company deductible = $1 billion)		
Program Triggered?	Yes	Yes
Insurer Losses (Deductible)	$500 M	$500 M
Initial Government Outlays*	$0	$0
*Worst possible case		
Mandatory Recoupment	$0	$0
(Private-Sector Loss Sharing)		
Net Gain/Loss to Fed. Government	**$0**	**$0**

Despite the program being triggered in one instance and not the other, the federal government does not make any initial outlays. Here, the trigger level has no impact. Where it does have a very significant impact is in cases involving smaller or regional insurers. Consider the same scenario for a single company with a retention level of $100 million:

$500 M Event	**$200 M Trigger**	**$1 B Trigger**
(Company deductible = $100 million)		
Program Triggered?	Yes	No
Insurer Losses (Deductible + Co-Share)	$180 M	$500 M
Initial Government Outlays	$320	$0
Mandatory Recoupment	$448	$0
(Private-Sector Loss Sharing)		
Net Gain/Loss to Fed. Government	**+ $128 M**	**$0**

While raising the trigger level does impact initial government outlays, we can see that ultimately, the cost to the taxpayer is not reduced. Furthermore, a $500 million loss could easily render such a company insolvent. Therefore, the only impact of raising the trigger would be on smaller, regional, and niche insurers whose deductible – and even total exposure – falls under a level set too high.

Potential exposure like this would cause these companies to pull out of markets. Because many of these smaller regional carriers play an important role in ensuring there is available coverages across lines of insurance, this would not just impact the terrorism risk insurance market but also the general insurance market. Because it is not at all clear that remaining companies could or would provide this missing coverage, the probable effect of a higher trigger would be to reduce competition by reducing the amount of total private capital allocated to all risks in certain areas.

In short, raising the trigger does nothing to reduce taxpayer exposure while simultaneously having the potential to drive private capital from the market.

WORKERS' COMPENSATION

Workers' compensation insurance is particularly challenging when it comes to terrorism risk. Workers' compensation writers are not permitted to exclude any peril from their coverages and are particularly susceptible to having highly concentrated losses in the event of a major terrorist attack. In the absence of a private-public risk-sharing mechanism, workers' compensation carriers will retreat from having highly concentrated losses in the event of a major attack. There would almost certainly be a simultaneous and significant increase in the cost of these policies and decrease in their availability for employers based in the major metropolitan areas and industries involved with, or adjacent to, symbols of America. The only way a workers' compensation writer could eliminate its terrorism exposure in high-risk markets would be to completely withdraw from those markets. In the absence of the TRIA program, or an increase in the deductibles and/or co-pays, we would expect to see a shift from the private workers' compensation writers to the insurer of last resort – usually a state fund or residual market pool, causing ripple effects throughout the business community. These public options for workers' compensation are not designed to handle a catastrophic terrorist event. Injured workers and their families would face potential disruption in benefits, delays in payment, or hardship because of the lack of an efficient compensation system.

Although individual market players may indicate willingness to take on greater exposure in the abstract, the private market has consistently demonstrated an unwillingness to accept a significantly larger portion of this potentially devastating risk, in particular when it comes to offering affordable limits to protect the solvency of workers' compensation insurers.

CONCLUSION

The TRIA program is a risk-sharing model between insurers, policyholders, and the federal government that – in addition to providing an immediate stabilizing effect in the short-term following a terrorist attack – has acted to create space for a robust private market for terrorism insurance to form where it would not have otherwise. With the TRIA program in place, the private sector has a tremendous amount of capital deployed in the terrorism risk insurance market, and, under current law, every penny the federal government pays out may be recovered. By all accounts, the TRIA program has been a tremendous success and should be reauthorized long-term without changes to the current structure.

FOOTNOTES

[1] This paper will be using the Terrorism Risk Program's statutory numbers for the year 2020 throughout.

[2] All dollar amounts in this paper are calculated using 2019 dollars.

[3] Real Estate Roundtable, "Survey Confirms Economic Toll of Terrorism Insurance Gap: Over $10 Billion of Real Estate Projects Affected Across U.S.," September 4, 2002.

[4] President George W. Bush, "President Reiterates Need for Terrorism Insurance Agreement," October 3, 2002.

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PwC NAIC Newsletter

August 2019

The National Association of Insurance Commissioners held its Summer National Meeting in New York City. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there and includes subsequent conference calls through August 22. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

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Executive Summary

- The Statutory Accounting Principles Working Group adopted new guidance on income taxes, leases, affiliated transactions and collateral and bank loans. The working group also exposed for comment proposed guidance on life and health reinsurance, goodwill and investments in collateralized fund obligations.
- The Blanks Working Group adopted a new Schedule DB, Part E to report derivatives hedging variable annuity guarantees and added “NAIC designation modifiers” to the investment schedules for the planned implementation of the 20 NAIC bond rating classes for RBC purposes.
- The Capital Adequacy Task Force will review the “comprehensive fund proposal” to treat all SVO-designated bond mutual funds consistently for RBC purposes, which could result in using the bond RBC factors versus the common stock factor for such funds. The Life RBC Working Group continues progress on implementing longevity risk for annuities for year-end 2020. The P/C RBC Working Group finalized its proposal for revised bond factor charges using the proposed 20 NAIC rating classes, but the Investment RBC Working Group has not met publicly since November of 2018, as the regulators are deliberating next steps on the Life RBC bond factor project.
- The VOS Task Force proposed revoking the filing exempt status for rated “principle protected notes.” The task force continues to consider new guidance for “non-traditional credit tenant loans,” but has not reached any tentative conclusions.
- The Reinsurance Task Force gave final approval to revisions to the credit for reinsurance models to reflect adoption of the EU and UK Covered Agreements.
- The Life Actuarial Task Force adopted numerous Valuation Manual amendments, including interim guidance related to the contentious YRT reinsurance reserve credit issue.
- Many NAIC groups contributed to the completion of guidance for the Valuation Manual and Life RBC to implement to the Variable Annuities Framework as of January 1, 2020, with early adoption for year-end 2019 permitted.
- The Restructuring Mechanisms Working Group heard detailed presentations on state and international activities on insurance business transfers and corporate division statutes, which will inform its white paper recommendations scheduled for the summer of 2020.
- The Casualty Actuarial and Statistical Task Force completed work on its years-long, controversial Appointed Actuary project with significantly revised annual statement instructions for the Statement of Actuarial Opinion, effective for 2019 opinions.

PwC NAIC Newsletter

August 2019

All documents referenced can be found on the NAIC website naic.org.

Executive Committee and Plenary

Since the Spring National Meeting, and as discussed in detail in this Newsletter, the commissioners gave final adoption to the revised credit for reinsurance models to reflect the Covered Agreements with the EU and UK. They also adopted revisions to the PBR Valuation Manual, including new guidance to adopt the VA Framework, and CARVM for variable annuities (AG 43).

The commissioners also approved model law development requests to 1) consider developing a new NAIC model to establish a licensing or registration process for pharmacy benefit managers, and 2) provide guidance to those states that have adopted both the HMO Model (#430) and the revised Life and Health Insurance Guaranty Association Model (#520), which added HMOs as members of the guaranty association. Guidance is needed to address conflicts and redundancies between the two models.

Innovation and technology initiatives

At the Summer National Meeting, the Innovation and Technology Task Force adopted a recommendation to appoint a new working group, the Artificial Intelligence Working Group, to study the use and impact of artificial intelligence in insurance including impacts on consumer privacy.

Cybersecurity and privacy initiatives
Eight states have now adopted the Insurance Data Security Model Law (#668) (AL, CT, DE, MI, MS, OH, NH and SC), with Nevada considering adoption this legislative session. At the Summer National Meeting, the chair encouraged other states to adopt the model without amendments to ensure consistency. The task force also adopted a recommendation to the Market Regulation and Consumer Affairs Committee to review state privacy protections regarding information obtained by insurers.

Anti-rebating
The Innovation and Technology Task Force continues to discuss anti-rebating, which relates to rebates of premium or other consideration associated with the use of smart home devices and telematics to mitigate risk. The subgroup has noted uncertainty in the application of state specific anti-rebating laws to new technology, whether they are impediments to innovation and whether additional guidance should to be provided. At its June conference call the task force heard presentations from regulators and interested parties on their perspectives including whether these devices need to be explicitly included in the policy forms, demonstrate risk mitigation, and do not result in unintentional discrimination.

At the Summer National meeting, a draft guideline from the North Dakota Insurance Department as well as the potential use of a practice bulletin were proposed as alternatives to an anti-rebating model law. However, the task force instead adopted a motion to develop a model law request to amend the NAIC's Unfair Trade Practices Act (#880) to address anti-rebating and requested comments on the North Dakota guideline by September 6.

CIPR Summer Program
The Center for Insurance Policy and Research conducted a program at the Summer National meeting titled, "Demystifying the Use of Artificial Intelligence in Insurance" intended to provide the regulators with a more sophisticated understanding of the risks and opportunities of the use of artificial intelligence in the insurance industry. The two presentations made during the program are posted to the CIPR's webpage. PwC insurance thought leadership on AI includes the following: Machine learning in the cloud and How InsurTechs are transforming (re)insurers.

Statutory Accounting Principles Working Group

Significant actions taken by the working group during its May conference call and the Summer National Meeting are summarized below. (Appendix A to this Newsletter summarizes all actions taken by the working group since the Spring National Meeting.)

SSAP 101 revisions (#2019-09 & #2019-10) – The SAP Working Group approved SSAP 101 guidance revisions which focus on two areas: 1) necessary "housekeeping" revisions to reflect the Tax Cuts and Jobs Act, particularly in the Q&A's illustrative examples (#2019-09), and more substantively, 2) new clarifying guidance related to the issue of the reversal patterns of deferred tax items and admissibility under paragraph 11.c. (#2019-10).

(The Summer National Meeting materials have combined the proposed changes into one document.)

The adopted guidance related to scheduling of reversals patterns of deferred items, considered in the context of the DTA admissibility test under paragraph 11.c of SSAP 101, reinforces that "no scheduling is required beyond that necessary in determining the need for a statutory valuation allowance adjustment." This concept had previously been included in the guidance; however, interpretation of the additional language regarding consideration of "significant and relevant historical and/or currently available information" resulted in diversity in practice.

As clarified, the revisions essentially treat the consideration of "readily determinable" knowledge regarding a fixed straight-line reversal pattern as "scheduling" in cases where the reporting entity did not consider reversing DTLs in the statutory valuation allowance assessment. Therefore, if the reporting entity did not rely upon reversing DTLs for the statutory valuation allowance, the 11.c. admissibility test need only consider the character of deferred tax items in assessing the admitted DTA.

For an entity that does rely on reversing DTLs in the statutory valuation allowance assessment, the revised guidance continues the need to consider additional information that is considered "significant and relevant historical and/or currently available information [that] may exist specific to the remaining amount of total adjusted gross DTAs and gross DTLs" for purposes of the application of paragraph 11.c. However, as before, any scheduling of existing DTLs should be consistent with that performed for the statutory valuation allowance assessment.

These revisions are applied with recognition that a reporting entity may consider scheduling in the statutory valuation allowance for only one type of DTA: ordinary or capital. The decision to consider reversing DTLs and the extent of scheduling triggers the application of the revised guidance.

Additional clarifying guidance confirms that the starting pool of DTAs for each admissibility test may consider all of the adjusted gross DTAs. However, adjustments must be made to ensure that the summation of the three tests does not result in over/double counting of the net admitted DTA.

The revisions are effective as of December 31, 2019, and any change in income tax balances as a result of implementing the guidance is to be accounted for as a change in accounting principle per SSAP 3.

SSAP 22, Leases (#2016-02) – A substantively revised SSAP 22R was adopted at the Summer National Meeting, which rejects ASU 2016-02 and retains the guidance that all leases are operating leases. No changes to the guidance were made as a result of comments received. SSAP 22R clarifies the guidance on sale-leaseback transactions, which may only be executed with property, plant and equipment, including computer software. SSAP 22R is effective for all new leases entered into, and for existing leases with changes in contractual terms, on or after January 1, 2020, with early adoption permitted.

SSAP 25 and Investment SSAPs – Affiliated Transactions (#2019-03) – The regulators adopted proposed guidance that transactions with affiliated entities or with investments issued by affiliates that involve an unrelated intermediary are still considered related party transactions and should be accounted for and disclosed in accordance with SSAP 25.

Affiliated investments are subject to different rating methodologies by the SVO, increased capital charges by some rating agencies and may be subject to separate state investment limitations. In July the North Carolina legislature approved a new law that restricts any domestic insurer from investing more than 10% of assets in affiliated entities, in response to scrutiny over the alleged $2 billion of investments made by insurance companies of ELI Global LLC to other affiliated entities through intermediaries. In June, control of Global Bankers Insurance Group, owned by ELI Global, was taken over by the North Carolina Department of Insurance.

SSAP 21 - Other Admitted Assets (#2018-04) – As part of its investment classification project, the working group adopted changes to SSAP 21 that include the statement that "investments captured in SSAP 26R that are also secured by collateral shall continue to be captured within the scope of SSAP 26R." As part of this discussion, NAIC staff noted that some fixed income instruments scoped explicitly into SSAP 26R may not meet the U.S. GAAP definition of a "security." (This definition has been explicitly adopted in SSAP 26R.) One example of an SSAP 26R instrument that may not meet the definition of a security is bank loans.

Life reinsurance risk transfer (#2017-28) – The informal life reinsurance drafting group provided a proposal to the SAP Working Group for suggested

changes to SSAP 61R related to identified risk transfer and group YRT "excessive premium" issues. The working group voted to expose the guidance for comment which would

1) expand SSAP 61R disclosures to capture "risk limiting" reinsurance contracts, modeled on the SSAP 62R disclosures in paragraphs 113-119,

2) add three new criteria to A-791 guidance for insurers to demonstrate that a non-proportionate contract does not provide "significant surplus relief" including that there is "no initial reserve credit for ceding policy reserves,"

3) add a new Q&A providing guidance on medical loss ratios and reinsurer participation in the MLR rebate, and

4) add a Q&A to paragraph 2c of A-791 that would limit premiums charged by reinsurers for YRT reinsurance: "so long as the reinsurer cannot charge premiums in excess of the premium received by the ceding insurer under the provisions of the YRT reinsurance agreement, such provisions would not be considered unreasonable."

The YRT proposal is not supported by industry members of the drafting group; the SAPWG chair noted it is being exposed to receive comments from a broader audience.

SSAPs 68 and 97 goodwill reconsiderations – The regulators re-exposed for comment two issues related to goodwill, as follows:

- Consideration of ASU 2014-17, Business Combinations-Pushdown Accounting (#2019-12) was expanded to three options for public comment: rejection of pushdown accounting for all entities, permitted for non-insurance entities only, or permitted for SEC registrants only. The proposed revisions would also clarify that goodwill that has been pushdown to an acquired entity is subject to SSAP 68's 10% goodwill limitation by direct and indirect parent insurers. The intent of the working group is to have this change effective for year-end 2019 financial statements.

- Proposed revisions to SSAP 68 were clarified, that in connection with the acquisition of a holding company, purchase price and goodwill amounts must be assigned to the entities that the holding company directly owns for disclosure purposes only (#2019-14). The guidance revisions are not intended to affect the accounting for the entities.

A third goodwill issue related to the SSAP 97 "look-through approach" (#2019-13) was disposed at the Summer National Meeting. The regulators voted to allow look through for multiple levels of holding companies for purposes of the audited financial statement requirement, as along as all entities meet the look through criteria. NAIC staff will draft wording to document this conclusion in SSAP 97 for consideration at a subsequent meeting.

SSAP 43R – Collateralized Fund Obligations – The working group exposed for comment proposed changes to SSAP 43R which would:

1) scope out CFOs and similar structures so that SSAP 43R does not "include equity instruments, investments with underlying assets that include equity instruments or any structures representing an equity interest (e.g. joint ventures, limited liability companies, partnerships) in which the cash flow payments (return of principle or interest) are partially or fully contingent on the equity performance of an underlying asset," and

2) would not allow existing equity assets such as investments in LLC, JVs and LPs that have been securitized as debt instruments and re-acquired by the insurer as being reported as Schedule D bonds.

Industry representatives expressed concerns that these proposed changes represent very significant changes to SSAP 43R, noting that the proposal should be classified as substantive with an issue paper drafted, versus the current "non-substantive change" classification. The proposed guidance does not suggest how these investments would be accounted for, if excluded from SSAP 43R.

Future SAP Working Group projects

Loss portfolio transfers versus run-off agreements

The regulators briefly discussed a letter from the AAA's Committee on Property and Liability Financial Reporting, which has identified diversity in practice related to the accounting for intercompany loss portfolio transfers (paragraph 36 (d) of SSAP 62R) and unaffiliated "run-off agreements" (paragraphs 102-105). COPLFR notes the differences can result in materially different Schedule P presentations. NAIC staff will work to prepare examples of each for further discussion.

YRT cash flows – The Life Actuarial Task Force has been discussing issues related to YRT cash flows (see page 9) and has asked for input from the SAP Working Group related to YRT reinsurance credits in modeling YRT reinsurance cash flows under PBR.

NAIC staff for the two groups will develop recommendations for later review.

Blanks Working Group

The working group met by conference call in June and August and adopted 18 proposals, which include the following significant items, and are effective for 2019 annual statements (unless stated otherwise).

- Revise the instructions to Part 1 of the VM-20 Reserves Supplement to provide clarifying guidance on specific line item reporting for product group types (2019-02BWG).
- Add an NAIC Designation column (column 18) for bond mutual funds to annual Schedule D, Part 2, Section 2, and provide instructions to facilitate reporting the designations of these funds as part of the SVO's comprehensive fund project (2019-03BWG).
- Add additional lines to the categories "Fixed or Variable Interest Rate Investments that Have the Underlying Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument" and "Joint Ventures or Partnership Interests for Which the Primary Underlying Investments are Considered to Be Fixed Income Instruments" to distinguish between those have been reviewed and approved by the SVO and those that have not, and to provide consistency in reporting on Schedule BA across statement types. The proposal also adds an interrogatory for Schedule BA non-registered private funds with FE designations acquired prior to 1/1/2019 (2019-04BWG).
- Modify the Investment Schedule General Instructions for changes to SSAP 26R and SSAP 43R to include mortgage-referenced securities in scope of SSAP 43R in the "U.S. Special Revenue and Special Assessment Obligations" category and delete Note 5O on structured notes (2019-09BWG).
- Modify the instructions for question 2 of the supplemental investment risk interrogatories to exclude diversified foreign mutual funds and add a new interrogatory to require disclosure of the top 10 fund managers determined by aggregating by fund manager across all types of funds and on all schedules, allocated between diversified and non-diversified funds (2019-13BWG).
- Revise the instructions and illustrations for Note 8-Derviatives to incorporate disclosures required by SSAP 108 and add a new 19-column Part E to Schedule DB, Derivatives Hedging Variable Annuity Guarantees, along with other extensive revisions to Schedule DB and instructions (2019-14BWG).
- Add a new column "YRT Mortality Risk Only" to the Analysis of Operations by Lines of Business and Analysis of Increase in Reserves to disclose YRT reinsurance where mortality is the only risk covered (2019-16BWG).
- Add an NAIC designation modifier to the quarterly and annual Schedules D, DA, DL, BA and E to reflect the 20 NAIC rating classes for RBC purposes as part of the bond factor project of the Investment RBC Working Group. At the request of interested parties, the effective date was delayed from the first quarter 2020 to year-end 2020. (2019-18BWG)

Adoption of the revised P/C Statement of Actuarial Opinion instructions by the working group is discussed on page 15 of this Newsletter.

The working group also exposed the following significant proposals until October 8:

- Would modify the illustration to Note 33 to disclose individually separate accounts with guaranteed products and separate accounts without guaranteed products so that the information can be data captured, effective for the 2020 annual statement (2019-21BWG).
- Would add a quarterly Schedule DB, Part E and revisions to Note 8 – Derivatives, which are required by SSAP 108, effective the first quarter of 2020 (2019-23BWG).

Risk-based capital

The regulators made the following significant progress on RBC projects. (Appendix B summarizes other actions taken by the various RBC Working Groups since the Spring National Meeting.)

<u>Comprehensive fund referral</u>
The Capital Adequacy Task Force agreed to take on a project to review the RBC charges for mutual funds that predominantly hold bonds that have been designated as such by the SVO. The recommendation came from the VOS Task Force, which believes this suggestion is consistent with

their recently adopted guidance in the P&P Manual for consistent treatment across all reporting schedules of funds that only hold bonds. RBC charges for bonds are significantly lower than the 30% charge for mutual funds held by life and health insurers and the 15% charge for P/C and health entities.

Investment RBC

The Investment RBC Working Group has not met since the 2018 Fall National Meeting. There is uncertainty as to status of the working group's bond factor proposal for life insurers (in process since 2011) and whether further independent validation of the AAA-proposed model should be performed. However, other projects to implement the 20 rating classes for bonds are still in process, such as the Blanks Working Group adoption of the "NAIC designation modifiers" in the 2020 investment schedules as discussed on page 4. The next meeting of the IRBC Working Group has not been scheduled.

Life RBC

C-3 for variable annuities – The Capital Adequacy Task Force adopted proposal 2019-10-L, Interest Rate Risk and Market Risk, which is the RBC portion of VA Framework; see the summary on page 10 for additional discussion.

Longevity risk – During its July conference call the Longevity Risk Subgroup heard comments on the AAA's Longevity Risk Task Force proposal to capture this risk in RBC for certain annuity products. The proposal would apply longevity C-2 factors to base statutory reserves. The "working version" of the anticipated factors would apply an after-tax factor of 1.35% to the first $250 million of total reserves of in-scope products, .85% and .75% to the next $250 and $500 million, respectively, and .70% for reserves over $1 billion. The subgroup had an extensive discussion of the inclusion of covariance between longevity and mortality risks, with industry in support of including a covariance factor and subgroup members not in favor of this concept.

At the Summer National meeting the AAA Longevity Risk Task Force presented their correlation recommendation of -33% between longevity and mortality consistent with a 95% percentile outcome; there was significant discussion among the subgroup and industry related to this recommendation, but the report was not officially exposed for comment. The subgroup hopes to expose a formal longevity risk RBC proposal at the Fall National Meeting (or slightly ahead of the meeting). The goal of the subgroup is to finalize the proposal for implementation for 2020 RBC filings, effective for all in-force business as of year-end 2020, which would apply to payout annuity products and pension risk transfers. Other products such as variable annuities, long-term care, and traditional deferred accumulation annuities "are out of scope at this time."

Mortality Risk – The AAA's C2 Work Group is reviewing the assumptions and methodology for life insurance (individual, industrial, group and credit life) to update the original 1993 factors. During its June conference call, the working group heard an update from the Academy; the work group plans to quantify capital requirements using a Monte Carlo simulation resulting in a factor-based approach applied to net amount at risk. The regulators hope to have preliminary factors by this year-end but that may be an aggressive goal.

Long-horizon equity investments – The Life RBC Working Group agreed to take on a project proposed by Allstate to consider revising the RBC charge for unaffiliated common stock supporting long horizon contractual commitments, which would "integrate the concept of time diversification into the equity RBC framework." The proposal recommends a 15% credit to the RBC charge for equity investments held 7 years or longer. (The current RBC charge for common stock is 30%.)

The proposal includes significant "guardrails:" a fixed cash flow requirement that reserves must not be subject to discretionary withdrawal; an asset and liability management strategy requirement; actuarial certification and supporting memorandum; segmentation of the assets; and capitalization ratio amortization. The chair noted that the proposal is a long term project which will take much deliberation. A working group member asked for an analysis of theory behind the proposal in addition to the history of stock market returns over time, which had provided. The working group exposed the proposal for comment until September 20.

P/C RBC

Bond granularity – During its May conference call the P/C RBC Working Group exposed for comment proposed changes to the Bond pages to implement the bond granularity proposal, increases the 6 bond rating classes to 20 (for RBC purposes only), using the factors determined by the Academy's Joint P&C/Health Bond Factor Analysis Work Group. The proposed factors represent an increase to some investment grade securities. Compared to the proposed life bond factors (as of September 2017), the proposed P/C factors are lower for the two highest credit quality classes and lowest three, but

higher charges for the remaining 13 rating classes in between.

The P/C bond factor proposal includes updating the time horizon (default measured over 5 years instead of 10), and bond size factor, which assumes a portfolio of 802 issuers. At the Summer National Meeting, the working group adopted the proposal and forwarded it to the Investment Risk-Based Capital Working Group.

Review of underwriting risk component – The working group continued its discussions around the planned approach by the Academy to support the NAIC's efforts to update the calibration factors used to calculate underwriting risk. The Academy plans to review the investment income adjustment, the loss concentration factor and premium concentration factor, and the line of business underwriting risk factors. The Academy will provide a timeline for its work at a future meeting.

Covered Agreement - The working group also discussed possible future changes to RBC as a result of the Covered Agreement implementation; it may no longer make sense to cap the R3 factor for uncollateralized reinsurance recoverable from unrated authorized reinsurers at 10% while having a 14% charge for unauthorized and certified reinsurers. The working group will consider whether to make changes to the factors and how to phase-in any revisions.

Catastrophe risk: OEP vs AEP – The Catastrophe Risk Subgroup added a project to consider whether the catastrophe risk calculation should have a separate factor for the Aggregate Exceedance Probability (AEP) and the Occurrence Exceedance Probability (OEP) basis; both are currently set at 1.0. At the Summer National Meeting, the subgroup heard presentations from AIR Worldwide and RMS on how the AEP and OEPs are calculated and a comparison of the results. Both presentations noted that the AEP and OEP curves can vary based on peril insured (e.g. hurricane vs earthquake), a company's book of business (e.g. regional vs national), composition of insured structures (e.g. construction materials, year built) and coverages (e.g. deductibles, etc.)

<u>Health RBC</u>
Health care receivable factors – The Health RBC Working Group re-exposed for comment a proposal (2019-04-H) to apply an additional charge for health care receivables accrued in the prior year but not received in the current year. The current exposure adds the detailed instructions for the proposal, but comments on the structure are also encouraged. Pharmaceutical rebate receivables would receive a 5% charge, and all other healthcare receivables would be assessed a 19% charge. The proposal is that the charges would be informational only for 2020 and 2021 with full implementation in 2022. Per comments from the AAA, the factors could be adjusted downwards as the working group assesses the information received during 2020-21.

Bond granularity – The Health RBC Working Group exposed for comment in June proposed changes to the bond structure and related RBC factors to implement the 20 rating classes of the bond granularity proposal. Compared to the P/C proposed factors, the health factors are lower for what is currently referred to as NAIC 1 and 2 rated bonds, and higher for NAIC 3-5 bonds.

Growth risk – The working group also exposed the referral letter from the Operational Risk Subgroup on alternatives to improve the growth risk charge methodology. Both exposures are to be discussed on the working group's next conference call, which is scheduled for September 9.

Valuation of Securities Task Force

The task force had significant adoptions and exposures on the following projects.

<u>P&P Manual amendment adoptions</u>
Structured notes – The task force adopted a recommendation from the SAP Working Group to amend the Manual to delete the definition of structured notes and instead refer to the guidance in SSAP 86. The revisions also clarify that structured notes are ineligible for being filing exempt.

<u>P&P Manual amendment exposures</u>
Principal Protected Notes – The task force exposed for comment until September 19 a significant proposal to revise the definition of principal protected notes and remove this class of security from eligibility for filing exemption. The proposed definition is as follows:

> PPN (sometime called "Principal Protected Securities," "Principal Protected Loans," or "Combo Notes") are a type of structured security where a portion of the underlying assets are dedicated to ensure the repayment of principal at maturity or a third party may guarantee the repayment of principal at maturity. The remaining assets in the structure, the performance assets, are intended to generate

additional returns and may be of a type (ex. derivatives, equities, commodities, non-CRP rated debt, loans, funds, private equity, real estate, affiliated, undisclosed, etc.) that would not be eligible for reporting on Schedule D. Investments in PPNs must be submitted to the SVO for analysis.

The chair of the task force stated that the debt rating of the PPNs "obscure the overall risk of performance assets." Some of these instruments may be eligible for Schedule D reporting, if designated as such by the SVO. The task force did not discuss whether they would expect these securities to be filed for year-end 2019 reporting, if the proposal is adopted by the task force.

Regulatory transaction designations – The task force exposed for a comment proposed designations and guidance for regulatory transactions: RTS will apply to a regulatory transaction for which a state insurance department requested assistance from the SVO in reviewing the security, and the SVO provided an analytical value, e.g. 3RTS. RT securities do not follow this process and are not eligible for an SVO analytical value and would receive an NAIC 6 designation. The task force hopes to implement these new designations for year-end 2019.

CTLs and lease-based transactions

The task force is continuing to work with industry and SVO staff on reviewing credit tenant loan guidance and developing new guidance for other lease-based transactions, also referred to as "non-traditional CTLs." At the Summer National Meeting, the chair reported that the task force and staff are still evaluating materials submitted by industry and haven't reached any conclusions or drafted a proposal. The chair directed insurers to report other-lease based transactions for year-end 2019 as they have done in prior years. It was also emphasized in several discussions that CTLs meeting the four criteria specified in the P&P Manual, and eligible for Schedule D reporting, should be filed with the SVO to confirm that the criteria are met. Companies are encouraged to file "the sooner, the better" given year-end deadlines.

Bespoke securities

The task force heard a presentation from two SVO directors on "bespoke" securities, which they characterize as investments structured specifically for an investor and for which the risk "does not appear to be appropriately represented." An example given is a security issued by a trust which holds 45% of assets in publicly rated bank debt and 55% in "unknown and unrated additional assets." SVO staff believes the transactions are often done with related parties and the credit rating is a private rating from only one CRP. They noted that these securities are difficult to uncover since they are designated by insurers as filing exempt.

The SVO directors' recommendation to the task force is to continue their research on this "critical developing issue" and prepare an issues paper with a proposed regulatory analysis framework. Discussion will continue at future meetings.

Group capital calculation

Group capital calculation field-testing begin in May with 30 volunteer insurers and 14 lead states participating, along with "shadow testers" as unofficial participants. During the Summer National Meeting the working group indicated the testing was on track and they expected to receive submissions from the volunteers by the end of August, which will be followed by a 60 day review period. The expectation remains that the calculation will be ready for implementation in 2020, using either 2019 or 2020 data.

During the Summer National Meeting, the working group discussed a memo prepared to address guidelines for maintaining confidentiality during the group capital calculation process. The memo will be referred to the Group Solvency Issues Working Group with a recommendation to incorporate the changes into the confidentiality provisions of the Insurance Holding Company System Regulatory Act.

Following the Summer National Meeting, a revised group capital calculation template and revised instructions were posted to the working group webpage (under the GCC Field Testing section) reflecting comments received since July. Volunteers in the pilot are not expected to redo their calculations in the revised template. The next meeting of the working group is scheduled for August 29; the agenda is to continue discussions regarding the necessary confidentiality protections once the calculation has been finalized. Another significant open item is how the GCC will be implemented by individual states.

Reinsurance Task Force

Credit for Reinsurance Model revisions
Since 2017, the Reinsurance Task Force has been deliberating proposed changes to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to reflect adoption of the new Bilateral Agreement between the U.S. and EU. Recent revisions have included addressing concerns related to a level playing field for all jurisdictions, specifically related to the allowance of commissioner discretion and ensuring consistency with the Covered Agreements with the EU and UK.

On June 25 the amended models with final revisions were adopted by Executive Committee and Plenary. At the Summer National Meeting the task force discussed the process to implement the revisions into the models adopted by all NAIC jurisdictions. The task force encouraged states to adopt with little modification as soon as possible within the 60-month timeframe set in the Covered Agreement to avoid potential federal pre-emption. The task force committed to provide support and be as active as possible in the process.

The chair of the task force provided a memorandum to the Financial Regulation Standards and Accreditation Committee recommending that the committee recognize that states that begin adopting the 2019 revisions to Model #785 and Model #786 should still be considered in compliance with the accreditation standards. The task force plans to provide a formal recommendation to the Accreditation Committee at the 2020 Spring National Meeting.

Principles-based reserving

Applicability to fraternals
At the Summer National Meeting, the Financial Regulation Standards and Accreditation Committee adopted revisions to the Accreditation Program Manual to explicitly scope in fraternal benefit societies into the principles-based reserving requirements. The effective date is January 1, 2020, consistent with the requirement for life insurers.

Valuation Manual amendments
Following the Spring National Meeting the Life Actuarial Task Force remained focused on VM Amendment Proposal Forms. LATF members met in sixteen conference calls during which the task force exposed, re-exposed or adopted over forty APFs, perhaps most significantly the adoption of the new VA reporting framework (VM-21). Many of the APFs deliberated in these meetings address recommendations from the Valuation Analysis Working Group's (VAWG) October 2018 memorandum titled "Principle-Based Reserves Recommendations and Referrals to LATF" (the "PBR Report memorandum"). The majority of these APFs provide clarifying revisions to VM-20, while others relate to VM-G, VM-21, VM-22 and VM-31. At the meeting in New York the only valuation item adopted was Actuarial Guideline 52, Variable Annuity Early Adoption, which provides for early adoption of the VA Framework for year-end 2019.

APF 2019-38 was adopted in May and reverts the 2017 Commissioners Standard Guaranteed Issue Mortality Table (2017 CSGI) back to the 2001 Commissioners Standard Ordinary ultimate mortality table as the valuation standard for Guaranteed Issue (GI) business issued after December 31, 2019. Following adoption of the 2017 GSGI table in 2018 some companies noted significantly higher deficiency reserves, which had not been considered in the study underlying the 2017 CSGI table. Regulators considered this change to be a temporary solution until a more principle-based approach to GI reserves is developed.

APF 2018-45 clarifies procedures for grading to the industry basic table when company mortality experience is worse than the industry table. LATF introduced this topic at the 2018 Summer National Meeting and deliberated it in several subsequent LATF meetings. The ultimate decision reflected in the adopted APF requires the testing of company experience at the mortality segment level (rather than at an aggregate level) to determine the upward adjustment required to the industry table such that expected claims of the mortality segment using industry mortality are greater than the expected claims using company experience. Testing company experience at the mortality segment level addresses regulator concerns that testing at the aggregate level would mask situations where mortality for a segment is worse than the industry and would warrant higher reserves.

LATF members also discussed and exposed examples of mortality aggregation. Regulators noted variation in industry practice for mortality aggregation in review of 2017 PBR reports and practice variations continue to be an issue noted in 2018 reports. VM-20 permits two approaches for aggregation: top-down and bottom-up. Illustrative examples are available on the LATF Industry page.

Reinsurance considerations
In June LATF adopted APF 2019-39 as an interim solution to the yearly renewable term (YRT) reinsurance reserve credit issue identified in the VAWG PBR Report memorandum. Various interpretations of VM-20 guidance regarding non-guaranteed YRT reinsurance premiums that should be reflected in the deterministic and stochastic reserves led to a variety of methods for projecting future YRT premium rates, with the potential for inconsistent results. This matter has been a topic of discussion for the past year, during which time insurers, the MN Department of Commerce, NAIC staff and the California Office of Principle-Based Reserving submitted eight alternative proposals; however LATF members could not reach consensus on an acceptable approach. As a compromise, APF 2019-39 limits the YRT reserve credit to a simple ½ cx, with no modeling of the corresponding reinsurance cash flows.

The provision is applicable to policies issued on or after January 1, 2020, and may optionally be applied to policies issued on or after January 1, 2017 and before January 1, 2020. This amendment is intended to be a temporary measure until consensus can be developed around a principle-based methodology.

The Academy will conduct a YRT Field Test to study the impacts of proposed alternative methodologies. At the Summer National Meeting, LATF members heard an update from the Academy YRT Field Test Project Oversight Work Group on its progress. The work group has met bi-weekly and formed a Design Subgroup focused on considerations such as methodologies to include in the study, types of products and treaties to be tested, variation in instructions and data elements between direct writers and reinsurers, whether to use company specific models or a third-party models, and what quantitative and qualitative metrics to capture. A design document and list of participants has been drafted for LATF to review; an aggressive project timeline targets April 15, 2020 for submission of findings and recommendations to LATF, in hopes that LATF may adopt a recommendation in time to affect the 2021 Valuation Manual. LATF has also asked the SAP Working Group for its input.

Experience reporting
The Experience Reporting Subgroup provided a brief recap of the company selection process for companies subject to the mandatory VM-51 data call. Some 176 companies, representing 36 states of domicile, were selected to participate. LATF members also discussed and exposed APF 2019-56, which expands the required data elements within VM-51 to facilitate separation of mortality into segments covering the range of underwriting for individual life products, including simplified issues, guaranteed issue and fully underwritten with or without accelerated and algorithmic underwriting. This APF expands on APF 2018-59 (comments under discussion) but was submitted separately so as not to delay adoption of 2018-59.

Proposed timing for collection of the additional data elements is phased to begin with the 2021, 2023 or 2025 data calls based on the expected data availability and will likely require that carriers prioritize and program the collection of certain additional data elements. The APF is exposed until October 7.

VM-22 and VM-23 Fixed Annuity PBR
LATF heard updates from the VM-22 Subgroup and Academy work groups on activities related to fixed annuity PBR. During its July call, subgroup members discussed methodology and assumption guidance for income annuities that "marries" guidance in AGs IX-A, B and C with the valuation interest rate guidance in VM-22.

The need for expanded guidance was primarily variation in practice for non-level payment contracts such as structured settlements (AG IX-B). Key elements of the new guidance, which are still in draft and not yet available for comment, are that level and non-level payment contracts will be treated the same for purposes of setting the maximum valuation interest rate, and reinvestment risk is addressed with a valuation rate reset on every thirtieth anniversary of the premium determination date. The target effective date for this guidance is January 1, 2021; however, the subgroup plans to provide a considerations document for insurers to reference for 2019 valuations.

The SVL Interest Rate Modernization Work Group provided input regarding the treatment of non-level payment annuities under VM-22, and continued work on a methodology to establish non-SPIA valuation rates. The plan is to refresh current valuation rates using methodology similar to that underlying current rates. Contemplated changes to the framework include a new reference index (Treasuries plus VM-20 spreads) and differentiators such as surrender charge period, market value adjustments, and rate guarantee periods. The proposed effective date for this guidance is January 1, 2022.

The Academy Annuity Reserves Work Group has a new chairperson following the Spring National Meeting and is using the transition as an opportunity to increase focus on developing a fixed annuity PBR framework. The newly adopted VM-21 framework will be used to align the proposed methodology with VM-21 fixed account methodology. The work group shared an aggressive timeline that includes reaffirming objectives and vision during the fall 2019, creating the framework during spring and summer 2020, and Valuation Manual drafting in fall 2020 with adoption by June 2021 for valuations effective January 1, 2022.

Variable annuities framework

Following the Spring National Meeting, the final review of the VA Framework developed by the Variable Annuity Issues Working Group and the VA Capital and Reserve Subgroup was undertaken by the Life Actuarial Task Force as the framework concepts were integrated into the Valuation Manual.

VM-21, PBR Requirements for Variable Annuities
During the LATF meetings, several changes proposed by the ACLI were discussed, assessed, and ultimately adopted into the revised framework, including those noted below.

- Total Asset Requirement (TAR) will be used to assess whether a company's use of non-prescribed economic scenario generators results in a less conservative capital requirement than the use of the prescribed VM-20 economic scenario generator. Since this evaluation pertains specifically to stochastic scenarios, the ACLI proposed modifying the language to note that this assessment need only consider stochastic results, and thus can exclude any impact from smoothing or the additional standard projection amount.

- Specific guidance regarding the calculation of the phase-in amount was provided for instances where there is a material decrease in the book of business due to reinsurance or sale.

- The language was updated to reflect that early adoption for year-end 2019 can be elected, but will require the simultaneous adoption of all components of the revised framework. A separate actuarial guideline (AG 52) was adopted to effectuate the option to adopt early for 2019 reporting.

- The existing framework does not contemplate additional premium deposits beyond the valuation date. Despite this exclusion of flexible premium deposits, the existing framework requires companies to model riders past their contractual expiry in the standard projection in order to capture contract features that could maintain positive value with a nominal deposit of additional premium. This modeling requirement to keep the benefit guarantee inforce was revised in the new framework to reflect that while the benefit should not expire in the projection, certain product features - such as roll-up rates - are allowed to cease at contract expiry.

- The mortality basis used in the Alternative Method (AM) was updated to the 2012 IAM Table to align the AM with the rest of the framework.

On June 20, after a final exposure period with no substantial comments or proposed revisions, LATF adopted the new VM-21, with New York opposing adoption. It is expected that the NYDFS will be exposing for comment its version of VM-21 for New York domiciled VA companies in late August or September, which it hopes to have in place by year-end 2019.

RBC revisions
The Life RBC Working Group also convened to review the proposed framework in the context of RBC C-3 requirements. These meetings occurred concurrently with LATF's review, so several changes to the framework exposed by LATF (discussed above) were reviewed and approved to ensure consistency between reserve and capital requirements. Additionally, a correction was made to the post-tax formula for the Additional Standard Projection Amount.

The RBC proposal was adopted by the Life RBC Working Group, with New York again opposing adoption. (However, the NYDFS does not intend to propose a New York-modified version of the C-3 calculations.)

Implementation
With LATF's adoption, and subsequent adoption by Executive Committee and Plenary at the Summer National Meeting, the revised VA reserve and capital framework is now complete, and will be effective, as planned, as of January 1, 2020. Going forward, the prescribed assumptions used in the standard projection will be subject to review every three to five years. Companies will now decide whether to adopt

the new framework early for 2019 reporting, and whether to elect the optional three year phase-in.

Life Actuarial Task Force

IUL Illustration Subgroup
LATF members received an update from the Indexed Universal Life Illustration Subgroup on its study of the effectiveness of AG 49 and industry use of bonus or multiplier features to circumvent limitations on the AG 49 crediting rate, thereby providing more favorable illustrations of riskier products. During subgroup calls and at the meeting in New York, LATF members discussed several options for additional disclosures, clarifications or rules for IUL illustrations. One item discussed at length was the need for clarification regarding the limit on the assumed earned interest rate underlying the disciplined current scale. If an insurer engages in a hedging program for index-based interest, this limit is 145% of the annual net investment earnings rate.

Some companies apply the 145% to charges associated with bonuses and multipliers, thereby increasing the assumed earned interest rate and resulting in aggressive illustrations. Passionate discussion ensued among regulators, insurers, and industry and consumer representatives, culminating in a subgroup request for public comment on two questions:

- Should a product with a multiplier feature illustrate a higher scale than a product without multiplier features?
- To what extent should the 145% disciplined current scale factor apply to charges supporting bonuses and multipliers?

Comments are requested by August 30.

Retirement security initiative

The Life Insurance and Annuities Committee has been discussing the formation of a working group to promote retirement security education and consumer protection and encourage innovation. During its meeting in New York, the committee voted to create the Retirement Security Working Group chaired by Commissioner Taylor (D.C.) who will provide a work plan to the committee for consideration.

Long-term care issues

Long-Term Care Insurance (B/E) Task Force
The task force was formed earlier this year to address pressing issues facing the LTCI market. The regulators outlined six areas of focus including 1) multi-state rate review practices with the goal of developing a consistent approach, 2) restructuring techniques including exploring alternatives to guaranty funds given the limitations due to benefit caps, 3) state reviews of reduced benefits options resulting from rate increases and the associated notices provided to policyholders, 4) review of the adequacy of LTCI reserves, 5) review of non-actuarial inputs to state rate approvals with a goal of developing common practices, and 6) assessment of the data needed to support the task force's efforts and the related financial impact on states.

The chair noted that some of these workstreams will evolve into separate task forces and some may perform their work confidentially until closer to the final report date. The goal is to provide a proposal on the areas of focus to the Executive Committee at the 2020 Fall National Meeting.

The task force heard feedback from interested parties during the Summer National Meeting. The feedback included comments highlighting the complexity of the issue, the importance of consistency of rate reviews and related disclosures to policyholders, and concerns with the restructuring options in light of the recent adoption of insurance business transfer legislation in some states. In response to IBT concerns, a representative from the Oklahoma Department of Insurance indicated that they would not support the use of IBT for LTCI transactions.

LTC actuarial topics
The LTC Actuarial Working Group heard an update on Academy LTC activities; members of the Academy's LTC Reform Subcommittee met with a new federal LTC Interagency Task Force organized by Treasury's Federal Insurance Office. The new task force is charged with developing policies at the federal level to complement reforms by the states relating to the regulation of LTC insurance.

The working group heard a presentation of the draft Practice Note on LTC Combo Product Valuation, which has been exposed for comment until September 2. The Practice Note presents the results of a survey on the valuation practices of companies in the LTC combination product market.

A representative of the joint Society of Actuaries and Academy LTC Valuation Work Group updated the regulators on progress on their charge from the NAIC to develop proposed mortality and lapse tables for use as prescribed assumptions for statutory minimum reserves. The work group expects to provide its report by the end of the year.

The LTC Actuarial Working Group also heard a presentation on recent SOA LTC insurance research and the Hybrid/Combination LTC insurance product market. Two product designs previously discussed for possible LTC insurance expansion were the LifeStage Protection, term life to LTC, and Retirement Plus, an expansion of 401(k)'s. It was pointed out that 85% of LTC benefits recently sold are as a combo product of some type; 27% of life insurance policies sold include a LTC benefit.

The working group received a request from the Financial Analysis Working Group to consider whether any changes to the Long-Term Care Experience Reporting Forms or other schedules would improve the usefulness of the data provided, such as including key reserve totals that reflect the total reserve liability and addressing changes in the evolution of LTCI products. The LTCAWG agreed to form a drafting group to study the issue.

The LTC Pricing Subgroup continues to study various topics related rate increases. These include use of state specific data, use of attained age caps on rate increases, credibility procedures used, premium paying versus paid-up claim experience, aggregation of experience by policy form, and group LTC.

AG 51- The chair of the Valuation Subgroup discussed its review of 2018 AG 51 filings on LTC asset adequacy testing. Companies are now predominantly using 2012IAM as the mortality basis for asset adequacy testing. Older age mortality is currently a concern. Regulators are comparing morbidity assumptions across companies based on the calculations required in AG 51, noting an increase in the slope of morbidity assumptions relative to the published SOA experience data, and identifying a trend of using mortality improvement, but no morbidity improvement assumed. The subgroup will try to identify reasons for the range of assumptions used by companies for AAT and plan to develop an AG 51 guidance document for 2019.

Health Actuarial Task Force

The task force heard a report on CMS's audit report for Risk Adjustment Validation. This is the first year that RAV payments will be made under the Affordable Care Act, which are separate from other risk adjustment payments required by the ACA. The RAV payments within each state are budget neutral, as assessments will equal payments in the aggregate. The task force will issue a white paper on RAV later this year.

HATF heard an update on Academy health activities; the Academy has published its annual issues brief on factors effecting the 2020 ACA premiums, Drivers of 2020 Health Insurance Premium Changes. Key drivers include medical trends, recent and ongoing policy changes, incorporation of projected risk adjustment data validation audit adjustments into 2020 premiums and any adjustments to assumptions used to build the cost of cost-sharing reduction subsidies into premiums; state actions to implement reinsurance programs; elimination of the individual mandate penalties; and reinstatement of the health insurance provider fee.

The task force also heard an update from the Society of Actuaries on recent health insurance research, which is included in the SOA's Commercial Health Care Trends 2009-2015. The individual market total costs increased by more than 10% from 2013 to 2015 due to ACA requirements. Specialty drug costs increased significantly from 2009 to 2015 from $10 per member per month to almost $30 PMPM.

Financial Stability Task Force

Financial Stability Oversight Council developments

At the Spring National meeting, the task force discussed FSOC's proposed interpretive guidance for nonbank financial company designations issued in March, which would put in place a cost/benefit analysis requirement before any entity is designated as systemically important. (See PwC's views on this proposed change here.) The Council has only met once since that time, in closed session; they are considering the comment letters received on the proposed guidance.

Liquidity stress testing framework
The Liquidity Assessment Subgroup has formed an informal study group to continue development of the liquidity stress testing framework. Based on the scoping criteria adoption in 2018, 23 large life insurers would complete the stress testing. The study group is working to identify an initial list of liquidity sources and uses to be included in the cash flows, the types of assets to be monitored for asset sales data, and a comparison to market trading volumes.

The study group now plans to do the following: "1) identify a common set of assumptions underlying the 2008 financial crisis scenario; 2) suggest a few additional baseline stress scenarios; 3) identify what legal entities within the group should be included in the stress test; and 4) identify activities, in addition to the six activities used for the scoping exercise, that should be assessed for materiality when determining if a legal entity within the group should be part of the liquidity stress test." At the Summer National Meeting, the chair of the subgroup stated that its goal is to propose a liquidity stress testing framework by the end of 2019.

Leveraged loans
The task force heard a presentation from the director of the Structured Securities Group of the SVO regarding the SVO's concerns about insurers' investments in leveraged loans, which he defined as loans made to below investment grade companies, which are often re-packaged into structured pools known as collateralized loan obligations (CLOs). At year-end 2018, insurers owned $42 billion in leveraged loans, and most insurers invest in these loans through CLOs. The SVO believes that during the next down cycle, these loans will perform worse than in previous downturns. The SVO doesn't currently think there is significant risk to the insurance industry as a whole, but there may be significant risk to individual companies who are overinvested in leveraged loans. The SVO is doing additional research on this topic and hopes to release conclusions later this year.

Liquidity disclosures
NAIC staff reported that the deadline for the data call of premium and annuity considerations, year-end reserves and cash surrender value by product type was extended from May 31 to June 28. Information was received from 500 companies, and the NAIC had loaded data on 425 of these companies. The data filed will only be available to regulators; no summary or overall conclusions were discussed in New York.

Restructuring Mechanisms

The Restructuring Mechanisms Working Group met four times this spring and summer to continue educating themselves on the restructuring landscape. Since the Spring National Meeting the working group met to hear from various stakeholders including:

- Representatives from the states of Connecticut, Illinois, and Pennsylvania to discuss their corporate division laws including the safeguards in place to ensure the transactions are sound.

- Various companies that have experience executing restructuring transactions in the UK using its Part VII legislation, highlighting the benefits including allowing companies to create operational efficiencies and better manage capital while keeping the best interests of policyholders in mind. Comments were made on the potential for significant utilization of similar restructuring mechanisms in the US market; one company noted that they would not expect to see transfers of business with policyholder protection sensitivities like LTCI.

- Industry groups, guaranty fund representatives and other interested parties that expressed concerns with the use of restructuring mechanisms with a desire to ensure that policyholders are not harmed and appropriate review and approvals occur.

As part of this discussion, the ACLI has summarized the various NAIC, state and UK requirements for insurance business transfers and corporate division legislation. A goal of all these discussions is a white paper with recommendations from the working group by the 2020 Summer National Meeting, and proposed revisions to specific NAIC models as a result of findings from the white paper by the 2020 Fall National Meeting.

The working group's Restructuring Mechanisms Subgroup heard extensive discussion during its May conference call related to the definition of a "run-off company." One common theme from several of the interested parties is that run-off companies should not exclude entities which are still collecting premiums, even though an entity is not actively writing new business.

The next task of the working group is distribution of a survey to states to obtain key information on how regulators evaluate specific IBT and corporate

division transactions. The subgroup asked the following to help determine best practices:

- What lines of business do states consider for an IBT or corporate division transaction?
- Are there specific standards or procedures for approving these transactions?
- Do the states plan to use independent experts to help with the review?
- Are there minimum capital requirements or independent actuarial reviews?
- How are states defining companies in run-off?

Survey results will be discussed later this year. A goal of the subgroup is to provide best practices for the approval of proposed restructuring transactions for review by the Accreditation Committee by the 2020 Summer National Meeting.

International Insurance Relations Committee

At the Summer National Meeting, the IAIS provided an update on their key projects for 2019 including updates on the Holistic Framework, Insurance Capital Standards and the 2020-2024 Strategic Plan.

Holistic Framework
An overview was given on the key elements of the Holistic Framework as well as the timeline for implementation. The key elements are as follows:

- An enhanced set of supervisory policy measures for macroprudential purposes providing the pre-emptive part of the framework;

- A global monitoring exercise by the IAIS designed to detect the possible build-up of systemic risk in the global insurance sector at an individual insurer level and at sector-wide level;

- Where a potential systemic risk is detected, supervisory powers of intervention that enable a prompt and appropriate response;

- Mechanisms that help ensure the global consistent application of the framework by having a collective assessment of potential global systemic risk and a coordinated supervisory response when needed; and

- An assessment by the IAIS of the consistent implementation of enhanced on-going supervisory policy measures and powers of intervention.

The IAIS believes that it is currently on track to adopt the framework later this year and plan to begin implementation in 2020.

ICS and Monitoring Period
The ICS field testing exercise was launched in April. Submissions were received from 50 participants. The IAIS will take the next four months to analyze the submissions with a plan to adopt ICS Version 2.0 in November 2019 ahead of the five year monitoring period beginning in 2020. The goal following the monitoring period is to adopt ICS Version 2.0 as a group-wide consolidated Prescribed Capital Requirement.

Strategic Plan 2020-2024
In addition to finalizing its post financial crisis reform agenda as discussed above, the strategic plan of the IAIS for the next five years includes an increased focus on emerged/emerging trends and risks by building on existing work (FinTech, cyber risk, climate risk and sustainability), and pivoting from developing standards to focusing on the assessment and implementation of new standards. The full Plan in posted on the IAIS website.

Big data

Claims settlement and fraud detection
The Big Data Working Group heard presentations from representatives of the Insurance Services Office and National Insurance Crime Bureau on how to use big data and analytics to accelerate the claims settlement process, combat fraud, and enforce compliance activities. Examples include performing visualized claim searches against geospatial weather data and government watch lists as well as aerial imagery which allows pre and post loss comparisons of properties for investigative purposes.

Predictive models
Property/casualty underwriting - The Big Data Working Group heard an update on the work of the Casualty Actuarial and Statistical Task Force including addressing comments received on its draft whitepaper, Regulatory Review of Predictive Analytics, which includes a discussion of best practices for regulators when reviewing predictive analytics and the information the regulator may need to review the model. Policy issues being addressed include causality versus correlation and whether only correlation should be considered and confidentiality concerns over sharing competitive data with the states.

Recommended changes to the white paper were exposed for public comment at the Summer National Meeting. Newly drafted Section VIII includes proposed changes to the Product Filing Review Handbook, and Section IX includes proposed state guidance.

Life underwriting - During the Spring National meeting, the Big Data Working Group made a referral to the Life Insurance and Annuities Committee to consider the impact of the use of external data and data analytics in the underwriting of life insurance policies. Issues include whether these innovations warrant the development of additional regulatory tools, whether state insurance regulators should be examining vendors that are supplying data to insurers, and whether vendors are supplying similar data and models to multiple insurers. During the Summer National Meeting, the committee voted to create the Accelerated Underwriting Working Group to examine these issues. Additionally, the Life Actuarial Task Force has been asked to study the actuarial soundness of the new data being used and potential long-term solvency issues.

P/C Appointed Actuary project

The Casualty Actuarial and Statistical Task Force continued its work as part of the Appointed Actuary project on its three charges related to attestation, experience and continued competence. Efforts related to the attestation and experience charges are reflected in the proposed revisions to the Statement of Actuarial Opinion (SAO) instructions, for which the task force partnered with an ad hoc group of the Executive Committee to revise.

Several proposed changes to the Statement of Actuarial Opinion instructions were adopted in June, including a requirement for the Appointed Actuary to maintain workpapers explaining how the actuary meets the definition of a "qualified actuary." The Executive Committee adopted changes to the definition of "qualified actuary" and the results of an assessment of actuarial educational syllabi in a new "NAIC-Accepted Actuarial Designation" section of the SAO instructions, which requires the Appointed Actuary to be an associate or fellow of the CAS or a fellow in the SOA who has successfully completed the general insurance track. The instructions include detailed transition rules related to the basic education qualifications. In general, FCAS/ACAS actuaries qualified under the 2018 and prior Statement of Actuarial Opinion instructions can use the exam substitution rules to achieve qualification under the new instructions by demonstrating basic education of the required topics.

After adoption by the CASTF, the Blanks Working Group in June exposed the revised SAO instructions for public comment and received comments asking that the proposal be delayed until year-end 2020 versus effective for 2019 actuarial opinions and to require that the Appointed Actuary to be a member of the American Academy of Actuaries.

At the Blanks Working Group meeting August 20, the chair of CASTF noted that both of these topics have been extensively discussed by the task force during its deliberations; the chair also noted that the task force began its project seven years ago to consider the SOA's general insurance track and the current proposal has been adequately vetted. After extensive debate, the Blanks Working Group voted to adopt the proposal for year-end 2019, with four states voting against the proposal.

At the subsequent meeting of the Accounting Practices and Procedures Task Force, the proposal for the Statement of Actuarial Opinion instructions was adopted after lengthy discussion. A "friendly amendment" was incorporated to remove reference to the NAIC as part of the "Accepted Actuarial Designation" guidance, so as to not delegate final authority of authorizing the Appointed Actuary to the NAIC as opposed to the domiciliary commissioner. Interested parties including at least one state seem likely to ask the CASTF to reconsider the requirement for AAA membership since both the life and health appointed actuary requirements include Academy membership.

The proposal must still be adopted by the Financial Condition Committee to be considered final, which is scheduled for August 29.

Group solvency

During the Summer National Meeting, the Group Solvency Issues Working Group discussed proposed updates to the group-related analysis guidance, which was developed in response to questions that arose during the state examination peer review process. Topics addressed in the new guidance include expectations for non-lead states reviewing the Form F, how to efficiently document analysis of insurance groups that participate in an

intercompany reinsurance pooling agreement, and guidance on completing a combined Group Profile Summary and Insurance Profile Summary for insurance groups where an ultimate controlling entity is an insurance company. Following discussion, the proposed revisions were referred to the Financial Analysis Solvency Tools Working Group for adoption.

Climate change

The Climate Risk and Resiliency Working Group heard a presentation during its July conference call from HSBC Securities on insurers and sustainable investing; as an example, four global insurers have recently announced new investment policies to reduce their exposure to coal and increase investments in renewable energy. The presentation also discussed the integration of environmental, social, and governance (ESG) performance into the credit ratings of investments.

At the Summer National Meeting, the working group heard a presentation from One Concern, an American Family supported start-up, on how they are merging natural science with data and machine learning to create natural disaster resilient communities through the use of dynamic models. These models aim to provide a broader view of the impact of a disaster, allowing a better assessment of risk and increasing the preparedness of the community.

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The next National Meeting of the NAIC will be held in Austin, Texas December 7-10.

We welcome your comments regarding issues raised in this newsletter. Please provide your comments or mail address changes to your PwC LLP engagement team, or directly to the NAIC Meeting Notes editor at jean.connolly@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 meeting materials to industry observers at the meetings, it can be 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.

Appendix A

This table summarizes actions taken by the SAP Working Group since the PwC NAIC 2019 Spring National Meeting Newsletter on all open agenda items. Items exposed for comment are due October 11, 2019. For full proposals exposed and other documents, see the SAP Working Group webpage.

Issue/ Reference #	Status	Action Taken/Discussion	Proposed Effective Date
SSAP 22 – ASU 2016-02 - Leases (#2016-02)	Adopted	After several years of work, a substantively revised SSAP 22R and corresponding Issue Paper were adopted at the Summer National Meeting. See additional discussion in the SAPWG summary on page 2.	Years ending January 1, 2020, with early adoption permitted
ASU 2016-13 - Credit Losses (#2016-20)	Deferred	In light of the FASB's discussions to extend the effective of ASU 2016-13, the working group directed NAIC staff to continue monitoring the FASB's activities, which may inform the working group's consideration of the standard.	TBD
SSAP 41 – Surplus Note Amortization and Accretion (#2017-12)	Discussion deferred	The working group plans to work with industry to resolve issues and propose related accounting for surplus notes issued at a discount. There has been no public discussion of this topic in 2019.	TBD
SSAP 62R – Reinsurance Credit (#2017-28)	Adopted	The regulators adopted Issue Paper 16X, Property and Casualty Reinsurance Credit, to document its basis for conclusions for the recent changes to SSAP 62 related to risk transfer and the related appropriate reinsurance credit in various scenarios, which more explicitly incorporates U.S. GAAP guidance from FAS 113.	January 1, 2019
SSAP 61R – Reinsurance Risk Transfer for Short Duration Contracts (#2017-28)	Exposed	The working group exposed for comment proposed revisions to SSAP 61R recommended by the Informal Life and Health Reinsurance Drafting Group. See additional discussion in the SAPWG summary.	TBD
SSAP 86 – ASU 2017-12, Derivatives and Hedging (#2017-33)	Discussion deferred	This project will review the overall accounting and reporting changes required by this ASU as potential substantive revisions to SSAP 86. There was no discussion of this standard at the Summer National Meeting.	TBD
SSAP 43R – Reporting NAIC Designations as Weighted Averages (#2018-03)	Adopted	The working group adopted revisions to SSAP 43R Implementation Questions 8 to require that for SSAP 43R securities with different NAIC designations by lot, the reporting entity shall either report the entire investment in a single reporting line at the lowest NAIC designation that would apply to a lot, or report the investments individually by purchase lot in the investment schedules. Because of the elimination of the modified filing exempt process, this change is expected to affect much fewer securities.	August 3, 2019
SSAPs 21 & 26 – Bank Loan Referral (#2018-04)	Adopted	The working group adopted a revised recommendation providing clarification of collateral loans versus bank loans. See additional discussion on page 2.	August 3, 2019

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SSAP 41R – Surplus Notes Linked to Other Structures (#2018-07)	Exposed	In 2018, the SAP Working Group exposed for comment proposed revisions to SSAP 41R to disallow capital treatment for surplus notes which are linked to other structures that are not subordinate, which interested parties strongly object to. At the Summer National Meeting, the working group agreed to sponsor a data call in 2019 to obtain additional information on surplus notes. NAIC staff was instructed to draft proposed disclosures for data capture in 2020.	TBD
SSAP 37 – Participation Agreement in a Mortgage Loan (#2018-22)	Adopted	Revisions to SSAP 37 were adopted to clarify guidance for mortgage loan participation agreements, including allowing mortgage loan classification of "bulk purchases" in which an insurer's interest in each mortgage loan is "legally separate and divisible and the purchase just facilitates the acquisitions of multiple single mortgage loan agreements." Minor revisions based on input from interested parties during the comment period were also adopted.	August 3, 2019
SSAP 97 – SCA Loss Tracking/ Negative equity of SCAs (#2018-26)	Re-exposed	The working group re-exposed proposed revisions to SSAP 97 and SSAP 5 to: 1) clarify under which circumstances an SCA should be reported at negative equity when the insurance company parent has guaranteed obligations of the SCA or provided commitments, and 2) prevent double counting of such liabilities.	December 2019
SSAP 26R – Prepayment Penalties (#2018-32)	Adopted	The working group adopted proposed revisions to SSAP 26R on determining the prepayment penalty for called bonds when the consideration received is less than par. The guidance also allows investment income recognition when an insurer has a process in place to identify prepayment penalties; otherwise the entire difference between the consideration and the carrying value is a realized gain.	May 29, 2019
SSAP 55 – Prepaid Providers (#2018-38)	Re-exposed	The regulators re-exposed proposed changes to SSAP 55 to strengthen the existing guidance on nonadmitting prepaid assets for payments made to third parties. The newly proposed revisions clarify that the guidance does not apply to capitated payments under managed care contracts.	TBD
SSAP 25 and Investment SSAPs - Affiliated Transactions (#2019-03)	Adopted	The working group adopted significant guidance for related party investments and transactions. See the SAPWG summary above for additional discussion.	August 3, 2019
Investment Classification Project – Preferred Stock (#2019-04)	Exposed	The regulators exposed for comment substantive revisions to the preferred stock guidance to update definitions and provide guidance on accounting and valuation, dividends, impairments, and interactions with SSAPs 48 and 97. The exposure documents are an Issue Paper and Exhibit, which detail the specific proposed revisions to SSAP 32R. The revisions would significantly expand definitions of preferred stock, revise measurement guidance and clarify impairment requirements.	TBD
SSAP 103R – Repurchase Disclosures (#2019-05)	Adopted	The SAP Working Group adopted guidance to reduce disclosure requirements for repurchase and reverse repurchase agreements, which removes the counterparty and default disclosures and the minimum and average daily balance disclosure.	May 29, 2019

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SSAP 51 – ASU 2018-12, Targeted Improvements (#2019-06)	Adopted rejection of guidance	The SAP Working Group adopted a conclusion to reject the new GAAP standard for life insurance contracts, including all disclosures.	August 3, 20
SSAP 72 – Bonds Received as Dividends or Capital Contributions (#2019-07)	Adopted	Clarifications were adopted to SSAP 72 and SSAP 25 related to bonds received as dividends or capital contributions. Such assets should be valued at fair value at the transaction date when considered economic transactions under SSAP 25.	May 29, 201
SSAP 52 – Reporting Deposit-Type Contracts (#2019-08)	Re-exposed	Based on feedback received from industry, the SAP Working Group identified additional questions related as to why some guaranteed investment contracts and other deposit-type contracts are reported in Exhibit 5–Aggregate Reserves for Life Contracts or Exhibit 6–Aggregate Reserves for Accident and Health Contracts, as opposed to Exhibit 7 – Deposit-Type Contracts. The working group will consider whether further guidance is warranted.	TBD
SSAP 101 – Q&A Updates (#2019-09 & 10)	Adopted	The working group adopted extensive changes to SSAP 101 guidance; see the discussion of the SAPWG for additional detail.	December 31 2019 as a change in accounting principle
SSAP 62R – Reinsurance Credit Transition Guidance (#2019-11)	Adopted	The working group adopted transition guidance for the revisions to SSAP 62R that were adopted in 2018. The revised guidance applies to all contracts in effect as of January 1, 2019. Any change as a result of the clarified guidance is to be treated as a change in accounting principle.	January 1, 2019
SSAPs 68 & 97 – ASU 2014-17, Pushdown Accounting (#2019-12)	Re-exposed	The working group is now considering one of three options related to goodwill that has been pushed down. See discussion at the SAPWG summary above for additional detail.	TBD
SSAP 97 – Clarification of the Look-Through Approach (#2019-13)	Disposed	The regulators agreed to dispose of this agenda item; see additional discussion on page 3 above.	August 3, 20
SSAP 68 & 97 – Attribution of Goodwill (#2019-14)	Re-exposed	The working group clarified that this proposed guidance is for disclosure purposes, not accounting allocation. See the SAPWG summary for additional discussion.	TBD
Editorial Updates (#2019-15EP)	Adopted	The working group adopted minor changes to five SSAPs to update cross references and correct typos.	August 3, 20
Issue Paper 99 – Proposals to reject recent GAAP guidance	Adopted	The working group adopted rejection of the following GAAP guidance as not applicable to statutory accounting: ASU 2015-08, Business Combinations-Pushdown Accounting, SEC Paragraphs (#2019-16) and ASU 2019-02, Accounting for the Cost of Films and License Agreements (#2019-17).	August 3, 20

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SSAP 86 – Other Derivatives (#2019-18)	Exposed	At the Spring National Meeting, the SAP Working Group adopted guidance that structured notes for which contractual principal amounts are at risk for reasons other than failure of the borrower to repay should be classified and accounted for as derivatives under SSAP 86 and valued at fair value, effective December 31, 2019. At its meeting in New York, the regulators exposed for comment a conclusion that these "other" derivatives, if not used in hedging, income generation or replication transactions, should be classified as non-admitted assets.	December 2019
Investment Risk Interrogatories – (#2019-19)	Exposed	The regulators exposed for comment a proposal to require look-through to the underlying investments in non-diversified equity funds for purposes of disclosing the "10 largest equity interests" (line 13 of the Investment Risk Interrogatories). SVO-identified ETF funds and money market mutual funds would be excluded.	Year-end 2020
SSAP 2 – Rolling Short-Term Investments (#2019-20)	Exposed	As a result of concerns related to investments which have been structured to qualify for short-term or cash equivalent reporting, with an "anticipation that the investment will continuously roll forward, potentially for many years and avoid filing the security for an NAIC designation and/or reporting on the schedule with more appropriate RBC charges as a long-term investment," the working group exposed for comment a proposal to provide additional principle concepts in classifying investments as cash equivalents or short-term investments. The working group noted that many of these investments are executed among related parties.	TBD
SSAP 43R – CFOs and Equity Instruments (#2019-21)	Exposed	The working group voted to expose for comment proposed revisions to exclude "collateralized fund obligations" from the scope of SSAP 43R and would also exclude securitizations of assets that were previously reported as standalone assets by an insurer. See additional discussion in the SAPWG summary on page 3.	TBD
SSAP 103R – Wash Sale Disclosure (#2019-22)	Exposed	The working group exposed for comment proposed changes to clarify that only investments which are purchased or sold prior to a reporting period end and subsequently sold or repurchased after that reporting date would be subject to the wash sale disclosure.	Year-end 2019
SSAP 97 – Going Concern (#2019-23)	Exposed	The working group clarified that SSAP 97 and SSAP 48 investees for which either the audit opinion or financial statements or footnotes disclose substantial doubt as to the ability of the entity to continue as a going concern shall be nonadmitted.	TBD
SSAP 71 – Commission Financing (#2019-24)	Exposed	As a result of inquiries from a state insurance departments, the working group exposed for comment a proposal to prevent insurers from deferring the recognition of commission expense through the use of "financing transactions" including those in which a third party pays agents non-levelized commissions and an insurer pays the third party levelized amounts, and the third party is not guaranteed repayment on non-levelized amounts paid.	TBD

Appendix A

SSAP 105 – Working Capital Finance Investments (#2019-25)	Exposed	The working group considered a request from interest parties to revise SSAP 105 to relax some of the strict requirements, which would allow additional insurers to make investments in working capital finance notes. The working group agreed to some but not all of the industry requests, and directed staff to draft potential revisions to SSAP 105 for future consideration.	TBD
Appendix A-785 – Updates for Covered Agreements (2019-26)	Exposed	The regulators directed NAIC staff to propose revisions to Appendix A-785 in the APP Manual to reflect the changes adopted by Reinsurance Task Force to implement the Covered Agreements with the EU and the UK, including consideration of an effective date.	TBD
Editorial Updates (#2019-27EP)	Exposed	The working group exposed minor changes to three SSAPs to update cross references and increase readability.	December 2019
Issue Paper 99 – Proposals to reject recent GAAP guidance	Exposed	The working group exposed for comment proposed rejection of the following GAAP guidance as not applicable to statutory accounting: ASU 2019-05, Targeted Transition Relief (#2019-28), ASU 2019-06, Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities (#2019-29), ASU 2019-03, Updating the Definition of Collections (#2019-30), and ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made (#2019-31).	December 2019

Appendix B

This chart summarizes action on other proposals of the RBC Working Groups since the 2019 Spring National Meeting, i.e. those not discussed on pages 4-6 of this Newsletter. The detail of all proposals adopted for 2019 RBC are posted to the Capital Adequacy Task Force's webpage (under Related Documents).

RBC Formula	Action taken/discussion	Effective Date/ Proposed Effective Date
All/multiple formulas		
Rounding Function in Capitation Tables (2018-17-CA)	The Capital Adequacy Task Force **adopted** a proposal that would add a rounding function to the Health formula, making it consistent with the Life and P/C formulas. In addition, the proposal would make the tables captured electronic-only for all three formulas.	2020 RBC Filings
Life and Fraternal Combination (2018-18-L)	The Capital Adequacy Task Force **adopted** minor revisions to the Life RBC formula and instructions to reflect the elimination of the separate Fraternal annual statement and that fraternal companies will file the Life RBC formula starting year-end 2019.	2019 RBC Filings
Risk-Based Capital Preamble	The Capital Adequacy Task Force **re-exposed** for comment the RBC Preamble, which formally documents the background, purpose, history, objectives and critical concepts of risk-based capital.	2019 RBC Filings
P/C RBC	Action taken/discussion	Effective Date/ Proposed Effective Date
Underwriting risk line 1 factors (2019-05-P)	The Capital Adequacy Task Force **adopted** the annual update of the industry underwriting factors (premium and reserve).	2019 RBC Filings
Affiliated investments instructions (2019-08-P)	The Capital Adequacy Task Force **adopted** minor edits to the instructions to be consistent with the recent changes in the P/C affiliated investment calculations.	2019 RBC Filings
Lloyd's of London Instruction Clarification (2019-11-P)	The P/C RBC Working Group **exposed** for comment guidance to clarify that reinsurance recoverables from individual syndicates of Lloyd's of London that are covered under the Lloyd's Central Fund may use the lowest financial strength group rating received from an approved rating agency, as opposed to being classified as unrated.	2020 RBC Filings
Remove PR035 Adjustment for Reinsurance Penalty (2019-12-P)	The P/C RBC Working Group **exposed** a proposal to remove the reinsurance penalty for affiliates calculation since the RBC charge for reinsurance recoverable has been moved to Schedule F, Part 3.	2020 RBC Filings

Appendix B

Affiliated investments – ownership calculation	The P/C Working Group initially **exposed** for comment proposed revisions to the formulas in PR003, PR004 and PR005 so that the percentage ownership of an insurance affiliate is based on the ownership of common stock and preferred stock combined basis. After subsequent discussion, the proposal was referred to the Affiliated Investment Ad Hoc Group for their consideration.	N/A

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