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"2016 Emerging Cybersecurity Risks and IT Examination Updates"

True or False Questions — Submit Answers Online

1. Health data can be kept more secure by ensuring that the information is diligently updated, ideally at least once per month.
2. Financial gain is the primary factor that motivates data theft.
3. Passwords are no longer considered useful to protect data due to the sophistication of modern hacking techniques.
4. Diligent and timely application of leading edge technological security solutions is the most effective strategy to defend against escalating cybersecurity threats.
5. Cybersecurity risks at third-party service providers utilized by the insurer should be considered and addressed by the insurer.

"Evaluating the Audit Committee of Insurance Companies"

True or False Questions — Submit Answers Online

1. The five most frequent crimes cited in the PWC 2016 Economic Crime Survey were asset misappropriation, cybercrime, bribery and corruption, procurement fraud, and accounting fraud.
2. According to the author, Board members can be relied upon to be independent all most 100% of the time
3. According to the author, pointed questions to the Audit Committee could provide more in depth information than talking to the management team when it comes to understanding the governance and oversight structures.
4. The author thinks that asking, "Did the external auditors report any company controls to you that they had concerns about?" is a great question to ask the Audit Chair or Committee person.
5. PWC's study indicated that CFO and controllers were responsible for detecting fraud and had better success than being burdened by outside independent directors.

CRE READING PROGRAM QUESTIONS

All quizzes MUST be taken online

(continued)

"Projections and Stress Testing: Key Tools for Analysts and Examiners"

True or False Questions — Submit Answers Online

1. The use of projections and stress scenarios are not relevant for Own Risk Solvency Risk (ORSA) requirements.
2. Stress testing can aid with the evaluation and quantification of prospective risks.
3. An insurer's overall risk management framework should include, as fundamental elements, models and/or stress tests.
4. Reverse stress tests are used to look forward in order identify the probability of insolvency based scenarios and how they will be prevented.
5. The following items can be used to develop and assess critical assumptions of projection and/or stress testing models: Historical data and results; Consistency of assumptions over time and Opinions of independent experts

"Ethics"

True or False Questions — Submit Answers Online

1. Ethics can be taught to an individual.
2. Many states have outlawed the practice of Price Optimization.
3. Ethics are influenced by peer pressure when we are teens and young adults.
4. Insurance policy terms are easily understood by the average consumer.
5. The Sunlight Test is a series of 5 questions you ask yourself when you have an ethical dilemma.

"The NAIC Spring (2016) Meeting Updates"

True or False Questions — Submit Answers Online

1. The Financial Condition Committee adopted a proposal to require all insurers using TPAs to conduct an annual in-person audit of the TPA.
2. The Financial Regulation Standards and Accreditation Committee adopted a proposal to require adoption by all states of the certified reinsurer provisions of the Credit for Reinsurance Model Act by January 1, 2019.
3. The Risk-Focused Surveillance Working Group voted to require that financial examinations of single state domestic insurers that are part of a multi-state group be performed in accordance with the Financial Condition Examiners Handbook.
4. The Statutory Accounting Principles Working Group adopted a proposal to require full investment schedules for quarterly reporting.

2016 Emerging Cybersecurity Risks and IT Examination Updates

By **Thomas Cook, CISA, MCP, AFE, CIA**

As we begin a new year it is a good time to review developments and trends in cybersecurity in order to determine the appropriate response for regulators. State insurance regulators partner with the industry by developing uniform standards and providing guidance in areas of concern for insurers and policyholders. In response to the escalation of cybersecurity risks, the NAIC Cybersecurity Task force and the NAIC IT Working Group have been reviewing information and updating standards and procedures regarding the security of information assets of regulated insurers.

Cybersecurity threats to insurers sharply escalated in 2014 and continued to escalate last year resulting in the cybersecurity breach at insurers Anthem and Premera, both large corporations with well-funded state-of-the-art information technology capability.

"With the frequency and sophistication of security incidents continuing to advance at what seems like breakneck speed, it is essential that companies increase their data breach preparedness. Not only that, but the landscape has changed with hackers targeting organizations for different types of data that could be used for extortion or to simply cause harm. While traditional data breach threats remain, it is important that business leaders take note of emerging trends and update their data breach response plans accordingly."

– Experian 2016 Data Breach Industry Forecast [i]

Historically, banks and payments systems were the target of choice for hackers because there was a ready market to sell stolen credit card and bank account information and the schemes to exploit the data were well known and easy to use. As banks and payment processors reacted to the threats, the useful lifespan of stolen credit card and bank account information has been severely reduced. At the same time there has been an increase in the supply of stolen bank card information. These developments have caused the black market value of stolen American credit card information to fall as low as $1 per credit card account. [ii]

The quantity of available electronic health records has increased. More individuals have health insurance as a result of expanded coverage under the Patient Protection and Affordable Care Act. Health insurers and healthcare providers are also migrating to electronic health records for recordkeeping and reporting. The personally identifiable information in these records such as social security numbers, birthdates, and personal health information cannot be changed as readily as a credit card account can be closed and replaced. Data thieves are developing new ways to exploit stolen health information. As a result, stolen PII and PHI can be sold for 10 to 20 times as much as a stolen credit card number. [iii] The high and potentially increasing value of the stolen information will likely result in more attacks going forward.

Cybersecurity attacks and data theft are motivated by factors other than financial gain. Recent large scale attacks on health insurers are believed to have been perpetrated by groups controlled by nation states for purposes of intelligence gathering. These sophisticated well-funded groups operate from areas of the world where they are protected from United States and international law enforcement authorities. The highly publicized breach of the Ashley Madison website was motivated by a desire by the hackers to enhance their reputation as clever technology masters as well as an apparent contempt for the purposes of the website (see below). There has also been a rise in cyber extortion and the use of specially designed malware, called Ransomware, where hackers gain control over an entity's information and demand payment of a manageable sum of money in exchange for returning the information. A recent study found that 38% of companies had been targeted by cyber-extortionists. Going forward it is anticipated that organizations will begin to consider the potential of extortion in their cyber risk assessment that will include cyber risk insurance policies and protocols of how to negotiate with cyber criminals.[i]

Underlying Causes

There is a tendency for some to seek technology solutions to the escalating cybersecurity challenges. However investigations reveal that the major underlying cause in the vast majority of incidents is human error and employee negligence. Factors such as lost or stolen devices that contain sensitive corporate information, accidental disclosure, employee theft of data, errors made when printing or mailing, or a lack of diligence in performing existing controls, such as installing network devices without protective measures, are very often the primary underlying cause of data loss.

Insight into the state of computer user's security awareness is provided by analysis of the passwords revealed when a team of hackers known as Cynosure Prime breached the Ashley Madison website. [iv]

Ashley Madison is a web service that helps members find a partner in the neighborhood who is interested in having an extramarital affair. Ashley Madison users have a strong personal interest in keeping their account a secret. Here are the five most common passwords used by these clever cheaters to protect their personal secret:[v]

1. 123456
2. 12345
3. password
4. DEFAULT
5. 123456789

Lest you think Ashley Madison users are especially distracted or perhaps suffering from a cerebral circulatory deficiency, the list of most common passwords among all of the millions of passwords stolen and revealed last year is topped by these same stupid passwords.[vi]

It is also revealing to note that the programmers who created the Ashley Madison website did take the precaution to encrypt the user's passwords. The hackers found that about eleven millions of the passwords were encrypted with a weak encryption method. In June 2012 the Ashley Madison developers made a change that encrypted all passwords subsequently stored with a more robust method that is much more difficult to crack. Although they recognized the risk, the AM developers failed to be diligent and apply the improvement to all passwords. The information published about AM user's passwords was the result of breaking the encryption of the eleven million passwords that were encrypted using the weak method.[vii]

These examples illustrate the need to instill Cybersecurity awareness and the need for diligence in employees throughout the organization.

Phishing

Phishing attacks are a remarkably effective technique for hackers to gain access to the target system. Phishing is the term for using electronic communications that seem to come from a trustworthy source to lure a computer user to divulge valuable information such as a login username and password. Phishing is often carried out using emails or instant messaging in combination with a website created by the hacker that is a high quality copy of a website that is familiar to and trusted by the target, such as the login page at a bank or corporate employee website.

The security breaches at Anthem and Premera apparently resulted from successful sophisticated phishing attacks that used very similar tactics. viii There is evidence that the attacks originated with a group operating in China referred to as "Deep Panda".

For two years, more than two-thirds of incidents that comprise the Cyber-Espionage pattern have featured phishing.[ix]

The Anthem attackers created a bogus domain name, "we11point.com" using numeric "11" instead of the letters "ll". Anthem was formally known as Wellpoint, and the wellpoint name was still used as the domain for some corporate websites. (The technique of registering a domain with typographic tricks to mislead users is called Typosquatting.) Research into the Premera attack discovered suspicious look-alike domain "prennera.com". In the fonts used to display the

URL, the differences between the authentic and bogus domain names are not obvious to computer users.

The hackers used the bogus domain to set up a website that mimicked the Anthem corporate website, even going so far as to install a bogus VPN and Citrix server. The hackers targeted Anthem employees with phishing emails that looked like official company emails that told them they needed to log into their company account. When the employees clicked on the link in the phishing email it took them to the fake website, which looked exactly like the familiar corporate sites except for the bogus domain name. When the employees entered their username and password, the hackers captured the employee login information.

"One of the most effective ways you can minimize the phishing threat is through effective awareness and training. Not only can you reduce the number of people that fall victim to (potentially) less than 5%, you create a network of human sensors that are more effective at detecting phishing attacks than almost any technology." [x]

Hackers can obtain the email addresses of company employees from company press releases and corporate directories. Hackers can also discover company employee email addresses by generating a list of email addresses using common names and initials joined with the company domain name. They send an innocuous email to see if the made-up employee email account works; if the email does not bounce back then it is probably a valid employee email.

Employees in customer service or communications positions who have to routinely open emails from external senders as part of the job tend to be the individuals most vulnerable to phishing email. According to Lance Spitzner, Training Director for the SANS Securing the Human program, "One of the most effective ways you can minimize the phishing threat is through effective awareness and training. Not only can you reduce the number of people that fall victim to (potentially) less than 5%, you create a network of human sensors that are more effective at detecting phishing attacks than almost any technology." [x]

Time to Compromise, Time to Discover

It may require only a short amount of time for an attacker to gain access to the target's system. Most attackers gain access to the target system within days. Sometimes it may only be hours from the moment an attacker first comes in contact to the target system until they gain access and begin installing malware to collect information. As a result of this depressing statistic there is a school of thought among information security professionals that they should begin each day with the assumption that the systems have already been compromised. [x]

The time that it takes to discover that an attack has occurred is unfortunately much longer. The investigation into the Anthem breach reveals that the hackers began the attack in April 2014, well before Anthem discovered and announced it February 4, 2015. The delay is not unusual. As recently as 2011, over 45% of data breach incidents were not detected until years after the initial attack. By 2014 the discovery lag time had improved so that only 18% of breaches went more than a year without being detected, yet 31% of breaches were still not detected until months after the attack was initiated.[x]

In the course of breaking into the target's computers and stealing information cyber thieves often install their own programs or modified versions of standard programs to run on the target's computer system in order to gather information for the thieves. This activity can be detected by sophisticated automated integrity monitoring. File Integrity Monitoring systems periodically check and detect if any of the files that comprise the running programs and critical system data have been modified. It can be implemented to protect individual files and programs, or an entire directory or drive. FIM works by computing a number (called a hash or CRC) based on the original contents of the file or directory, and storing the baseline hash number in a secure storage location. (The challenge of identifying a storage location that remains secure after your system is breached is part of the complexity involved.) An automated process will periodically recalculate the hash for each protected file and compare it to the stored baseline value. If it does not match, then it will raise an alarm to notify system administrators that the file has been modified and the system integrity has been compromised. Like all controls, the decision to implement file integrity monitoring is based on the perceived risk and cost of cyber attack weighed against the cost to implement the control, except where a control is mandated by law.

Information Security

Data has three states with different vulnerabilities. Data at Rest is data that is stored on stable storage devices like a hard disk drive attached to a server. Data in Motion is data that is in transit from one location to another. Data in Use is data that is temporarily stored in the high speed random access memory attached to the CPU that is used to store running programs and live data as users are viewing and editing.

A long standing concept in cybersecurity is that of a secure perimeter. Corporate information assets are stored within a secure data center that is protected by strong physical and logical perimeter security. Dedicated data centers are often robustly constructed using concrete walls with few windows and doors and guarded by security guards and surveillance cameras to ensure that only authorized persons enter the secure inner sanctum. Inside the secure environment the machines and data are naked and vulnerable. If a malicious miscreant

does gain access to the computer room there are few additional measures to prevent him from damaging equipment or stealing information. The security of the information assets depends on the secure perimeter.

Encryption is the technique of protecting information so that only authorized persons can understand it. It works by transforming the stored information into incomprehensible gibberish, and transforming it back into the original information when an authorized user needs to read it. The history of computer science includes a battle of wits between those who design a new or improved encryption technique and those who find a way to break it. Enlightened computer scientists no longer expect that any encryption technique is impossible to defeat; the deterrence is in terms of how much it would cost to defeat the encryption. State-of-the-art encryption techniques protect information because it would take more than a lifetime using all feasible computing resources for an unauthorized person to recover the encrypted information.

There is a cost associated with employing encryption, both in terms of computer resources and system complexity. Therefore encryption is only used when the cost of utilizing encryption can be justified by the cost of the potential loss that could result from not using it. The standard of practice in 2015 was that valuable data that is transmitted outside the data center should be encrypted, whether it is transported electronically over communication channels or recorded on backup volumes and physically carted to an offsite storage location. Data stored on storage devices within the secure data center was usually not encrypted. Anthem did not encrypt the data stored on the systems within its data centers.

The risk of cyber attack faced by insurers has escalated in recent years so that the perimeter security concept may no longer be adequate to guarantee the security and integrity of the information stored on servers in the data centers. Insurers should be taking a fresh look at information security in the context of the elevated risk of a cybersecurity breach. The task to modify systems to encrypt all sensitive data is a complex and expensive undertaking, but it may be justified in the context of the escalated cybersecurity risk environment.

Regulatory Response

The NAIC Cybersecurity (EX) Task Force and the NAIC IT Examination (E) Working Group have developed and approved changes to the NAIC Risk-focused IT Examination procedures that will be included in the 2016 Financial Condition Examination Handbook, to help ensure that IT examiners consider cybersecurity risks and appropriate mitigating controls during the conduct of examinations.

Below is a summary of cybersecurity risks and controls that the IT examiners should consider during the course of the risk-focused IT examinations in order

2016 Emerging Cybersecurity Risks and IT Examination Updates

(continued)

to assess the insurer's exposure to cybersecurity risks and the adequacy of their mitigation strategies and controls to identify cybersecurity risks, prevent data breaches, detect cybersecurity attacks, and respond and recover following a cybersecurity incident. The 2016 Financial Condition Examination Handbook has been updated to incorporate these items into the IT Examination procedures and the Exhibit C Part 1 and Part 2 work programs.

Identification

- The insurer's risk assessment should include specific consideration for identifying cybersecurity risks.
- While not a specific requirement, participation in information sharing networks with other insures, such as the Financial Services Information Sharing and Analysis Center xi, is likely to enhance the cybersecurity risk assessment process.
- The insurer's staff should include individuals with sufficient levels of technical expertise to ensure that cybersecurity issues are understood and that mitigating responses are appropriate and adequate.

Prevention

- A robust cybersecurity risk mitigation strategy must include a combination of policies, access controls, and data security for data at rest, in transit, and in use as appropriate for the environment in which the insurer is operating, including the volume and type of sensitive information obtained, maintained, or transmitted by the insurer, the security laws and regulations to which it is subject, its size and complexity, and the nature and scope of its activities.
- Effective preventive measures should consider the risks associated with third party service providers utilized by the insurer.
- Employee training is a foremost opportunity to improve cybersecurity. It is of paramount importance that every employee understands how to recognize and respond to a cybersecurity threat, and the importance of diligence to ensure that controls are performed properly at all times.
- The insurer should periodically reassess cybersecurity risks to data security and employ encryption where appropriate to ensure the security and integrity of sensitive information.
- In situations where a company has recently acquired another company the examiner should pay special attention to determine whether an effective cybersecurity risk assessment was conducted in the course of the acquisition/merger. These events expose the entity to a number of risks that must be identified and addressed. In effect, the acquiring entity quietly inherits all of the cybersecurity vulnerabilities of the

acquired entity and its third party service providers and contractors. In addition, the merger may have resulted in displaced and disgruntled employees who may be motivated to commit adverse actions.

Detection

- The insurer should have effective strategies and controls to detect cybersecurity attacks in a timely manner. Employee awareness can contribute to more effective detection. Insurers may perform periodic vulnerability scans and penetration tests to identify weaknesses in preventive and detective controls.
- Where the insurer is exposed to a significant cybersecurity threat, they should give consideration to utilizing automated processes to detect unauthorized modifications to files and programs in a timely manner.

Respond and Recover

- A review of the insurer's incident response plan is an important consideration in the overall assessment of cybersecurity at an insurer. The response to a cybersecurity incident may leverage concepts from the insurer's broader disaster recovery plan, but may also require unique considerations since recovering from a cybersecurity incident requires a different response than recovering from an environmental incident.
- It is also important that people with assigned responsibilities within the disaster recovery plan have the necessary background/training to perform the assigned duties. Insurers should include in their plan the specific identification and contact information for who they need to contact following a security incident (regulators, affected parties, etc.) and how public relations will be managed to limit the impact of the incident on the organization's reputation. Importantly, response plans should be tested to ensure that the organization is ready to deploy the plan in the event of an actual incident.
- When incidents do occur, it is important that the insurer performs a thorough post-remediation analysis and that the insurer understands how it will restore services that were affected as a result of the incident in accordance with the response plan. Examination teams may consider reviewing incident reports to consider how the organization has learned and adapted as safety security protocols are breached.
- The plan should include established procedures for performing a forensic investigation of the security incident or crime if deemed necessary. Investigations should be performed by a qualified professional trained in incident detection and management (e.g. Certified Forensic Computer Examiner, Certified Ethical Hacker, etc.).

– The examiner should inquire whether the company has a process to incorporate lessons learned from ongoing incident handling activities into incident response procedures, training, and testing, and implements the resulting changes accordingly into the risk management controls.

End Notes

i. "Experian Third Annual 2016 Data Breach Industry Forecast", Experian, Jan 2016

ii. "The Russian Underground, Revisited", Trend Micro, April 2014

iii. "Your Medical Record Is Worth More To Hackers Than Your Credit Card", Reuters, Sept 2014

iv. "How we cracked millions of Ashley Madison bcrypt hashes efficiently", cynosureprime.blogspot.com, Sept 10 2015

v. "The Top 100 Passwords on Ashley Madison", Quartz, Sept 2015

vi. "The 25 Most Popular Passwords of 2015: We're All Such Idiots", Gizmodo, Jan 2016

vii. "Ashley Madison coding blunder made over 11 million passwords easy to crack", PCWorld, Sept 10, 2015

viii. "Premera, Anthem data breaches linked by similar hacking tactics", INFOWORLD, Mar 18, 2015

ix. "Verizon 2015 Data Breach Investigation Report", Verizon Enterprise Solutions, May 2015

x. "Verizon 2015 Protected Health Information Data Breach Report", Verizon Enterprise Solutions, Dec 2015.

xi. "Financial Services Information Sharing and Analysis Center", https://www.fsisac.com/

Evaluating the Audit Committee of Insurance Companies

By **Lewis Bivona, CPA, AFE**
Insurance Examiner, *The INS Companies*

A recent article in the Journal of Accountancy entitled "How Audit Committees Can Deter Fraud" got me thinking how the same committees function at insurance companies. One of the key aspects of the article was 36% of the 6,000 respondents of the 2016 PWC Global Economic Crime Survey reported that their organizations were affected by economic crimes; the five most frequent crimes cited were asset misappropriation, cybercrime, bribery and corruption, procurement fraud, and accounting fraud. The article also went on to say that while generally the CFO and controllers were responsible for detecting fraud, one of the most important tools for success were the outside independent members from industry that serve on the audit committee.

A lot can be said about "corporate governance" and "tone at the top" but ultimately the most important oversight of insurance companies is the audit committee. While other board members are not totally independent of management in all cases, the audit committee is comprised of independent members with a financial and/or accounting background. So, it is the author's opinion that the most telling interview for examiners probably would be the interview with either the audit chair or one of his colleagues; in some instances, the audit chair is not available so it helps to move the examination along to speak with a member of the audit committee. In several examinations, it was refreshing to hear from another member of the committee instead of the committee chair because you can uncover possible frustrations or issues of members which might not necessarily be revealed otherwise.

The most interesting perspective an examiner can derive from interviewing the audit committee is how engaged they really are in planning both the internal and external audits of the company. Many examiners just ask the rudimentary questions of how long have you been on the audit committee, how do you interact with management, do you help plan both the internal and external audits and so forth; the real value is asking probing questions that can reveal if they truly are engaged or are just there as a functionary committee which is required by the SEC or the Model Audit Rule. I might suggest that to be more effective in managing engagement time, the examiner may want to ask the audit committee interviewee the following more detailed, probing questions:

- On an annual basis, describe how involved are you in reviewing the insurer's compliance and financial reporting systems? This specific question gets closer to the meat of the matter when it comes to evaluation of how they view the company's vulnerabilities. Another important follow-up question in the same vein would be "How do you articulate these concerns to external auditors?" and, "Knowing these vulnerabilities, how do you incorporate them into the internal audit work plan for the year?"

Evaluating the Audit Committee of Insurance Companies

(continued)

- Did the external auditors report any company controls to you that they had concerns about?

- How often are you as a committee updated on insurance frauds and other issues evolving in the industry? If they are, the next question would be asking them how they are addressing those specific risks within the company.

- How aware are you of the following: The Foreign Corrupt Practices Act (FCPA)? Dodd Frank whistleblower rules? The UK Bribery Act? The US Patriot Act? Financial Industry Regulatory Authority guidance? A follow-up question would be to ask, "Have any instances arisen at your company where these regulations have impacted your thinking in the last five years?" (Author Note: FCPA was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business.; Dodd-Frank whistleblower - prevents retaliatory actions against employees reporting improper business practices; UK Bribery Act prohibits bribery in both government and private commercial transactions; US Patriot Act requires companies to conduct reasonable due diligence to ensure that transactions do not facilitate money laundering or other illegal activity and to report certain cash or currency transactions; FINRA monitors and regulates all securities trading, operations and records, exchange platforms, and personnel in the industry (primarily annuities in insurance companies).

- How do you receive information about issues coming across the company's whistleblower hotline? Were there any matters reported to you (what were they?) that were not addressed by the company?

- How involved is the audit committee in questioning third party vendor risks? What safeguards do you know of that the company deploys to address these risks? (Author Note: third party risk is especially acute in outsourced vendor agreements, particularly TPA agreements, fiduciary agreements, mailing and fulfillment operations, etc.). Has any vendor been terminated in the past five years for violating your company's contract with them or for ethical breaches?

- What types of discussions have you had related to cybersecurity? How do they pertain to protecting company resources and reputations? What measures do you know of that vendors are subjected to the same due diligence?

While the questions above are a starter, they are not necessarily all encompassing. As with any examination, tailor your questions to the audit committee to probe for vulnerabilities in areas where you have assessed the most risk!

Projections and Stress Testing: Key Tools for Analysts and Examiners

By **John Humphries, CFE, AES, CISA, ASA, MAAA, MCM**
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Financial projections and stress testing are key tools for regulators to measure the impact of adverse events and possible future scenarios. While stress and scenario testing are not new to regulators and risk management professionals, the use of projections and stress scenarios continues to accelerate under Own Risk Solvency Risk (ORSA) requirements, International Association of Insurance Supervisors (IAIS) principles, and Enterprise Risk Management (ERM) in general.

As analysts and examiners, we must review and understand projections and stress testing submitted by the companies we regulate so that we can challenge critical assumptions where necessary and maximize the regulatory value of these important tools.

Goals and Use of Stress Testing

Projections and stress testing are simply models of the firm's future results under various scenarios or assumptions to better understand possible outcomes. Often, these models are considered to be economic capital models because they measure, "the amount of capital an organization requires to survive or to meet a business objective for a specified period of time and risk metric, given its risk profile". [1] In other words, the goal of the model under adverse scenarios is to determine how much extra capital the firm should have today to weather adverse events that could occur in the future. Because adverse events are often related, the model should also account for the interrelationship of these events.

"… the goal of the model under adverse scenarios is to determine how much extra capital the firm should have today to weather adverse events that could occur in the future. "

A key goal of risk focused examinations is to identify prospective risks, and the appropriate use of stress testing can help regulators evaluate or quantify some of these prospective risks. [2]

Typical approaches used to quantify these risks include:

Stress Tests - Stress tests show the potential financial impact to the company if an adverse event occurs. This can include scenario tests which tend to be portfolio/event driven or sensitivity tests which focus on key assumptions. Often the stress testing includes a combination of scenario testing and sensitivity testing with Monte Carlo simulation and historical replays.

Reverse Stress Tests - Reverse stress tests identify scenarios that could cause an insolvency and then work backward to understand the likelihood that the scenario could occur and how the scenario could be prevented.

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[1] ASOP No. 46 Risk Evaluation in Enterprise Risk Management

[2] Effective Stress Testing in Enterprise Risk Management, Lijia Guo, Ph.D., ASA, MAAA, Society of Actuaries, 2008.

Stochastic Models - Stochastic models use random variables and statistical techniques to estimate the probability distribution of potential outcomes. Often this includes the use of an economic scenario generator to simulate potential results of financial markets and economies.

Reference to Standard Measures - Regulator and rating agency capital models often have standard measures of risk. Examples include the NAIC Risk Based Capital (RBC) formula which is factor based and assigns a risk load to reported amounts of financial exposure by category. [3]

Review of Models – So, how realistic are the results?

Any projection is only as good as the quality of the model and the reasonableness of the assumptions. There is no easy, bright line test to confirm the accuracy and completeness of the model used in stress testing, but there are a number of factors to consider. As you will see, the steps to review the completeness and accuracy are very similar to the steps used to confirm other financial statement items.

Corporate Governance – Models and stress tests should be a fundamental element of the insurer's overall risk management framework and not just a regulatory burden. It should provide the board, as well as the regulator, with a clear understanding of the risks facing the company. The regulator should receive the results of the most material stress test and a clear understanding of the underlying assumptions. While it may be difficult in smaller organizations, those involved in designing the stress tests should have a level of independence from those making related business decisions or benefiting from outcomes. [4]

Independent Validation – Considerable professional judgement is involved with any model, therefore independent validation is a key step in the risk evaluation process. Back testing and stress testing are commonly used to understand the strengths and limitations of models. Other factors to consider if the model is appropriate for its intended use include:

- The tradeoff between precision and simplicity
- Appropriate consideration of correlated risks
- The need to be reproducible

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[3] Insurance Enterprise Risk Management Practice Note, March 2013, American Academy of Actuaries.

[4] International Association of Insurance Supervisors, Guidance Paper No. 8, *Stress Testing by Insurers Guidance Paper*, 2003.

- Practical considerations including ease of use, transparency, reliability, timeliness and cost effectiveness
- Cash flow and discounting methods used.

Appropriate Controls – Regular assessment of the accuracy and completeness of data input into the model, software controls around the model, and resulting model outputs. Example of model risk controls include:

- Data reconciliation
- Peer reviews
- Reasonability checks
- Affirmation by key staff
- Supporting documentation
- Independent validation
- Controls over software, servers and the proprietary modeling

Reasonableness of Assumptions – Assessing the reasonableness of assumptions is not easy, but the following items can help when assessing critical assumptions.

- Historical data and results
- Fit of assumed distributions to available data in terms of expected value, variance, and extreme value
- Comparison to market data or peers
- Opinion of independent experts
- Sensitivity of results to changes from baseline assumptions
- Internal consistency of assumptions
- Consistency in assumptions over time [5]

Conclusion

Financial projections and stress testing of insurers provide valuable regulatory information, but the real value of this information is highly dependent upon the quality of the model and the reasonableness of assumptions.

To take full advantage of this valuable tool, examiners and analysts must be prepared to test the model and challenge the assumptions before accepting the outcomes shown in the projection.

[5] Insurance Enterprise Risk Management Practice Note, March 2013, American Academy of Actuaries.

Projections and Stress Testing: Key Tools for Analysts and Examiners

(continued)

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Ethics

By **Michael B. Kogut, CPA**
Chief Operating Officer,
The INS Companies

Hello, and good morning, good evening or good whatever time of day finds you sitting down to take a quick read of this article. Hopefully, the title of "Ethics" caught your attention. It's kind of funny, but deciding on the title was just as challenging as writing the article itself. After struggling with titles like "Ethics for Insurance Regulators", or "Ethics and You", or "Ethics in the Workplace", I decided to go with plain old "Ethics". Why? Because Ethics is extremely broad, yet individualistic, and just as applicable to our personal lives as it is to our professional careers. To place any limitations on the title just did not seem right, and even felt well, somewhat "unethical". Another interesting aspect of Ethics (at least in this author's opinion) is that it cannot be taught. Ethics, like human development, is evolutionary and based on a multitude of factors, some controllable and some not. To some extent ethical development is psychological, and to another extent cultural, and to yet another extent socioeconomic. We can attempt to teach Ethics, but in the end it all comes down to "what might one do".[1] The most we should hope to accomplish is to generate a positive ethical environment, demonstrate good conduct, offer presentations, write articles, provide encouragement, give reminders, and set good examples. How an individual ultimately reacts in a given situation simply cannot be taught.

What makes Ethics so interesting is its pervasive nature. As a matter of fact, it is very likely that you have been exposed to some ethical dilemma, issue or situation over the past-twenty four hours, and if you have not, please prepare yourself because one is on its way. Think about what has transpired in your life over the past day or so? What have you watched on television, viewed on the internet, read in a newspaper or publication, heard on the radio, dealt with at home, in society, at work? Chances are, you can recall a "sensitive", "controversial" or even "heated" situation that carried some type of ethical overtone. That's what makes ethics so relevant. Like taxes and death, ethical dilemmas are unavoidable. If you are having trouble remembering a recent ethical situation, let me help you. Do you remember the name of the Kentucky clerk who was jailed for refusing to issue same-sex marriage licenses? That's right, her name is Kim Davis. Ms. Davis unsuccessfully appealed to the high courts and continued to ignore orders to issue the licenses, until she was ultimately taken into custody for contempt.

As for a current regulatory issue, you need not look any further than "price optimization". Price optimization is the practice whereby companies (including insurance companies) utilize complex software and "big data" to identify those customers who will most likely accept price increases without changing suppliers. The NAIC issued a Price Optimization-Draft White Paper (dated 8/15/15) to address the controversial topic and many states have

outlawed the practice. Some consumer advocacy groups have used the term "unethical" to describe the practice and assert the tactic discriminates against low-income consumers who tend to shop around less frequently than wealthier consumers. Proponents argue that the practice is widespread, legal, ethical and ultimately benefits consumers, regulators and insurers. No matter what side you are on, price optimization will continue to impact insurance regulation and constitute an ethical dilemma. Both topics (Kim Davis case and Price Optimization) raise questions between Ethics and the Law. Can something be legal, yet unethical? Ethical, yet illegal? That my friends, lies in the eyes of the beholder. When it comes to insurance professionals, our minimum obligation is to abide by the law.

So let's take a peek at the ethical life cycle. As a child, our ethical DNA is influenced primarily by discipline and fear of punishment.[2] In our earliest years, our ethical make up is based primarily on what mommy, daddy or our legal guardian tells us is "good" or "bad" and most effectively, through the word "NO". "NO" is our very first indication that something is not right or not acceptable. And when we do not listen, or do not react positively to the command of "NO" as children, we are typically punished. As we mature however, our ethical fiber is influenced more by peer pressures, social norms and our innate desire to fit in. Even though we know an action or behavior may be wrong or unethical, as teens and young adults, the pressure to fit in often outweighs the logic and maturity to stick to our moral guns. By the time we reach adulthood and become parents, mentors and career professionals, we act less and less according to fear, punishment and peer pressure, and more according to the personal values that have developed over our lifetimes. In adulthood, it is our "core value system" that drives our behavior. A core value system that evolved based on a number of critical factors; family, ethnicity, religion, geographic region etc., and like our DNA, no two "ethical cores" are identical.

As "professionals", we are held to a high expectation of ethical conduct and trust. Most professions have published codes of conduct, one of which is the Society of Financial Examiner's (SOFE) Code of Ethical Conduct. As regulatory professionals, it can be argued that we are held to an even higher standard! Why ? Well, one justification for a higher standard is in direct correlation to the product that we market or regulate. First, insurance for the most part is no longer a discretionary product that consumers can simply choose to live without. In our current day and age, auto insurance is a must if we want to drive (legally that is), and unless we own our home outright, financial institutions require hazard and flood insurances. Even if you do not drive

or own a home, you must certainly deal with health insurance which has become even more "mandatory" if you will, with the advent of the Affordable Care Act. Therefore, we as insurance industry professionals have a significant obligation to market fairly and honestly, and to regulate just as honestly and diligently to protect the consumer. Second, insurance products can be extremely confusing and complex. Even the most simple lines and policies can be extremely difficult for the average consumer to understand. How many of us, as insurance professionals, can say we truly understand **all** definitions, specific coverages and limitations contained in our standard automobile insurance policy? Auto Liability Coverage, Basic Personal Injury Protection, Added Personal Injury Protection, Bodily Injury, Property Damage, Auto Comprehensive Insurance, etc. etc. If we, as insurance industry professionals, struggle to understand even one of the aforementioned terms or coverages, imagine how the typical consumer must feel! Insurance policy language and terminology can be lengthy, nebulous, intimidating and mired with inclusions and exclusions. Product complexity alone results in the requirement for insurance professionals to go above and beyond in the best interest of the consumers that we have vowed to serve and protect.

In general, insurance is purchased based on trust. So how has the insurance industry fared? According to a Walker Information National Employee Benchmark Study that issued 3,600 questionnaires (to random individuals) on the subject of integrity and ethics, the insurance and financial services industries came out on top. While there is no definitive reason why, experts speculate the positive assessments were driven by the industry's requirements for licenses, certifications and tight regulation. On the negative side of the survey result, was that one out of every five insurance industry respondents was aware of at least one ethical violation within the two year window prior to the survey. Some of what participants claimed to have witnessed were; lying to customers, falsification of records and conflict of interest. So how do we decide right from wrong, ethical from unethical? One tool you may add to your ethical toolbox is the Sunlight Test. [1] If/when faced with an ethical dilemma, first and foremost try not to react in a knee jerk fashion. Instead, take a deep breath and ask yourself the following questions before taking action:

- How would you feel if your action was revealed in the full light of public scrutiny?
- What if everyone did it?
- Does the action bring about a good result?

Ethics
(continued)

- What perception does the action convey of my character or organization?
- Is the action consistent with my core values?

In closing, ethics cannot be taught, but we sincerely hope this article has raised awareness and prompted you as an individual and an insurance industry professional to think about the topic, and how your individual actions and behaviors reflect upon yourself, your organization and on our close knit regulatory community. In the words (and in remembrance) of my very dear and recently deceased friends and colleagues Ralph Romano, Sr. and George Piccoli, Sr.:

> ***"If we do not carry our moral sense, ethical conduct/obligations into our work lives, we all lose. All goes into the toilet, and the market place will not function without chaos. All parties (consumer, business, government, regulators etc.) become predators toward one another"***
>
> **- The Honorable Ralph Romano, U.S Judge**

> ***"Always do the right thing"***
>
> **-George Piccoli Sr., founder of the INS Companies**

So what will you choose to do the next time you are faced with an ethical dilemma??

End Notes

1. St. James Ethics Centre
2. Cal Christian, presentation on North Carolina rules of Professional Ethics

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NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2016 Spring National Meeting

The National Association of Insurance Commissioners held its Spring National Meeting in New Orleans April 3-6. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there, as well as summarizes conference calls after the Spring National Meeting through April 29. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

Executive Summary

- The Executive Committee and Plenary held an election of officers in February to replace a departed commissioner and gave final approval to revisions of NAIC models and adopted other guidance.
- The Cybersecurity Task Force received comments from many interested parties regarding their first draft of the *Insurance Data Security Model Law*.
- The newly formed Big Data Working Group held a public hearing to gain an understanding of insurers' use of big data and the impact of predictive analytics.
- The Financial Condition Committee adopted a new charge to consider potential adverse effects resulting from covered agreement negotiations between the U.S. and the EU.
- The Statutory Accounting Principles Working Group adopted revisions to surplus notes guidance and new disclosures for risk corridor receivables. The working group also exposed three possible options for consideration of the FASB's new leasing guidance, held a detailed discussion of hedging variable annuity risks and continued discussion of revised proposals for insurers to report detailed investment information on a quarterly basis.
- The PBR Implementation Task Force reported a significant milestone that 43 states representing 76% of written premium have adopted PBR legislation.
- The Life RBC Working Group heard results of the 2015 XXX/AXXX reinsurance RBC filings and discussed instructional changes for the RBC shortfall calculation. The Joint Longevity Risk Subgroup will develop recommendations to address longevity risk issues by end of July.
- The Investment RBC Working Group exposed its new document "A Way Forward" that aims for finalization of bond and common stock revised factors for 2017 reporting.
- The Operational Risk Subgroup heard updated results of the growth risk test, results for the basic operational risk test, exposed the 2016 informational factors and requested comments on target capital and methodology for basic operational risk.
- The Catastrophe Risk Subgroup anticipates implementation of catastrophe risk charges in 2017 and discussed upcoming proposals to meet that goal.
- The Health RBC Working Group adopted four proposals for 2016 RBC filings and exposed two additional proposals.
- The Valuation of Securities Task Force discussed reporting exceptions involving private letter rating securities, exposed a proposal to amend SSAP43R, and exposed detailed guidance for filing bank loans.
- The Group Capital Calculation Working Group met for the first time and heard an industry joint proposal on the calculation of group capital based on an RBC aggregation methodology and local solvency measures calibrated to provide comparability of a group-wide solvency ratio.
- The ComFrame Development and Analysis Working Group discussed non-traditional/non-insurance products and features as contemplated by the IAIS and heard an update on field testing and the ComFrame revision process.
- The International Insurance Relations Committee and the Financial Stability Task Force received updates on various projects of the FSB and the IAIS and heard a presentation on the low interest rate environment.
- The Reinsurance Task Force adopted revisions to the *Credit for Reinsurance Model Law* to address certain life reinsurance transactions including ceded XXX/AXXX business and continued deliberations of the XXX/AXXX Credit for Reinsurance Model Regulation.
- The Variable Annuity Issues Working Group exposed a revised proposal for footnote disclosure of variable annuity captives and a detailed Interrogatory on variable annuities with guaranteed benefits.
- The Blanks Working Group adopted two proposals as final and exposed 22 new items for consideration.
- The Life Insurance and Annuities Committee heard an update on the DOL's new definition of "fiduciary" and discussed a referral on the

sufficiency of pricing of non-variable life insurance products in a separate account.

- With the adoption of PBR on the horizon, the Life Actuarial Task Force focused on the PBR Valuation Manual amendments and discussion of matters related to calculation of the Net Premium Reserve, considering the recent adoption of the 2017 CSO valuation table. Other highlights included adoption of proposed changes to AG 49 from the IUL Illustration Subgroup.
- The PBR Review Working Group adopted revisions to the proposed annual statement VM-20 Supplement and discussed the PBR pilot project.
- The Health Actuarial Task Force Long Term Care Actuarial Working Group heard several presentations on topics related to LTC research, experience studies, principles-based reserves for LTC and the Academy's credibility monograph.
- The Financial Regulation Standards and Accreditation Committee adopted a proposal to consider the certified reinsurer provisions an accreditation requirement effective 2019.
- The Mortgage Guaranty Insurance Working Group continues to work on the proposed *Mortgage Guaranty Insurance Model Act* and standards manual. The working group hopes to release the long-awaited capital model for public commentary soon.
- The Climate Change and Global Warming Working Group heard presentations on rising sea levels and discussed its 2016 tentative work plan.

Executive Committee and Plenary

Kentucky Commissioner Sharon Clark resigned as commissioner and NAIC President-Elect in January. The NAIC held an election in February and Superintendent Eric Cioppa of Maine was elected Secretary-Treasurer. Commissioners Ted Nickel and Julie Mix Mc Peak assumed President-Elect and Vice-President roles, respectively.

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

During the Spring National Meeting, the Executive Committee ratified the appointments of Commissioners Ted Nickel (WI) and David Mattax (TX) to the IAIS Executive Committee and approved the appointment of Andrew J. Beal as acting CEO of the NAIC.

Adoption of Revised Models and Other Guidance
The Executive Committee and Plenary adopted as final the following items at the Spring National Meeting:

- Amendments to the *Credit for Reinsurance Model Law* (#785)
- Valuation Manual amendments approving the 2017 Commissioners' Standard Ordinary (CSO) Mortality Table
- Price Optimization White Paper

Cybersecurity Task Force

Update Regarding Cybersecurity Legislation
Tony Cotto, NAIC's Financial Policy and Legislation Counsel, provided an update on federal cybersecurity legislation. He noted the federal Cybersecurity Information Sharing Act was passed by Congress, and adopted into law in December. The bill allows the federal government to share cyber threat indicators on how attacks have been perpetrated and what preventative measures could have been taken to mitigate the risk. He also noted that in February, President Obama signed an executive order, establishing a committee tasked to increase national cyber security. The order also created a new position, a federal chief information security officer, and the committee has been allocated $3.1 billion.

Draft Insurance Data Security Model Law
On March 2, a draft of the NAIC's Insurance Data Security Model Law was circulated for comment, which were due back to the task force by March 23. The task force received over 130 pages of comments from more than 20 interested parties, including 5 state departments of insurance, industry groups, insurers and consumer groups. Based on the amount of feedback, the task force had to limit verbal comments during the public hearing to three minutes per speaker.

The overall sentiment was that while the purpose of the model law, "to establish the exclusive standards for data security and investigation and notification of a breach of data security applicable to licensees in this state" was supported by many, in the eyes of

interested parties the 12-page model law requires extensive revision and clarification. Several industry groups stated they would oppose the law as drafted, noting “fundamental and foundational” revisions should be made. Many stated the scope of the law does not consider the relative size of an entity, placing undue burden on small producers. Others noted that several provisions are not risk-based and unmanageable to comply with. Several industry groups specifically cited concerns with the extent of provisions in Sections 7 and 8, Notification of a Breach of Data Security and Consumer Protections Following a Breach of Data Security, respectively. In addition, some commented that the model law may be duplicative with existing laws, while in other places inconsistent.

Collectively, interested parties emphasized a need for an open conversation and for the task force to hold in person meetings. Many emphasized their desire to be involved in subsequent drafting and revisions of the model law. Others suggested a section by section review is warranted, which would be best suited for public discussion.

At the conclusion of the public hearing, Chair Hamm noted that the task force will review all comment letters and consider the comments received; however he still voiced his desire to have the model law completed and approved in 2016.

Big Data Working Group

The newly formed Big Data Working Group held a public hearing during the Spring National Meeting to assist the working group in achieving its charge of 1) understanding insurers’ use of big data for claims, marketing, underwriting and pricing and 2) exploring opportunities for regulatory use of big data. The two-hour meeting provided an academic, industry, consumer and regulatory perspective on the use of big data and the impact of predictive analytics in the insurance industry. Each group included discussion on the definition of big data, sources and uses of it, as well as the positive and negative implications of its use.

The academic perspective included a discussion on how predictive analytics can summarize large datasets, and alter what is provided to consumers for purchase, including how insurers may use this information in determining rates to charge or how to settle claims. Industry noted that big data is the basis for insurance, and has historically been used in assisting with marketing, underwriting and claims settlement. The additional information that can be utilized could include identification of fraud, expediting claim estimation and settlement and reducing underwriting costs. Consumer groups presented their views on how consumers need to be educated, both on how big data is used, potentially via public disclosure, but also on the importance of personal information protection. Previous legal rulings were mentioned in how big data could be used against the consumer in price inflation and claim settlement, and it was suggested that regulators should determine how insurers use big data in the sales and marketing of products, claim settlements, loss mitigation, cybersecurity, privacy and promotion of competitive markets. Regulators also mentioned the potential benefits in analyzing trends and losses, including best practices for their review of the modeling of big data.

The chair concluded the meeting by stating that the working group would receive further comments and meet via conference call to prioritize topics for further consideration at future meetings.

Financial Condition Committee

Regulation of Third Party Administrators
At the 2015 Summer National Meeting, the committee discussed the Financial Analysis Working Group’s recommendation that the committee consider a requirement for insurers using TPAs for more than 100 certificate holders, subscribers, claimants or policyholders to conduct an annual in-person audit of the TPA. During its November 5 call, the committee agreed to allow interested parties to propose guidance and which would exempt insurers that receive an annual SSAE SOC 1 (Service Organization Controls) report from the TPA.

During the Spring National Meeting the committee discussed a letter from the trade association PCI which raised scope and other issues. The committee agreed to narrow the scope to TPAs of workers compensation insurers, and asked PCI to submit a revised proposal based on that and other feedback discussed in New Orleans.

Covered Agreements
The committee, at the request of its chair Superintendent Cioppa (ME), adopted the following new charge for 2016: “consider and develop contingency regulatory plans to continue to protect U. S. consumers and U. S. ceding insurance companies from potential adverse impact resulting from covered agreement negotiations.” The chair stated that his proposal is in response to the potential for changes to the U.S. system for determining credit for reinsurance as a result of the November 20, 2015 announcement from the U.S. Treasury Department and the Office of the U.S. Trade Representative regarding their intention to

begin negotiating a covered agreement with the European Union. The chair is especially concerned if reinsurance collateral is reduced to zero as the result of the covered agreement. Trade associations voiced support for the new charge, which was also adopted by Executive Committee and Plenary at the Spring National Meeting.

Update on Risk-Limiting Contracts Working Group
This working group has not met since July 2015 after the departure of its former chair. On April 26, interested parties were notified via email that the working group has a new chair (Kevin Fry of Illinois) and that NAIC staff has compiled a listing of "potential revisions and target improvements" that could be made to the APP Manual, the Financial Condition Examiners Handbook and Financial Analysis Handbook to address comments and issues identified last year by the working group. This listing provides a "Road Map" of how the working group can address its charge. A call of the working group and exposure of the Road Map are expected in June.

Statutory Accounting Principles Working Group

The working group met via conference call February 22 and at the Spring National Meeting and discussed the following projects. (After each topic is a reference to the Statutory Accounting Principles Working Group's agenda item number.)

Adoption of Revisions to SSAPs

SSAP 41 – Surplus Notes (2014-25) – At the Spring National Meeting, the working group adopted revisions to SSAP 41R and Issue Paper 151, Valuation for Holders of Surplus Notes. The adopted revisions include updated impairment guidance for surplus notes and expanded amortized cost accounting to include both NAIC 1 and 2 rated surplus notes. NAIC 3 through 6 rated surplus notes are valued at lower of amortized cost or fair value with changes reflected as unrealized gain or loss. Guidance on determining NAIC designations from CRP ratings was also moved from SSAP 41R to the IAO Purposes and Procedures Manual. The adopted guidance is effective January 1, 2017. Early adoption is not contemplated.

SSAP 1 – Clarification of Permitted and Prescribed Practices Disclosure (2015-52) – The working group adopted its proposal from the Fall National Meeting to clarify that disclosure in the financial statements is required for all permitted and state prescribed practices that differ from NAIC, not just those that affect surplus or RBC. During the Spring National Meeting, the working group also adopted a footnote to allow for references to multiple SSAPs if the permitted/prescribed practice impacts more than one SSAP.

The working group also exposed for comment proposed guidance that requires disclosure for permitted practices "that result in different statutory accounting reporting (e.g., gross or net presentation, financial statement reporting lines, etc.)." Related annual statement illustration and instructions changes were referred to the Blanks Working Group.

New Disclosures for ACA Risk Corridor Receivables (2015-54) – The working group adopted new disclosures related to risk corridor receivables starting with the first quarter 2016 statement (with data capture expected for the 2016 annual statement). The disclosure should include recoverables by program benefit year and also requires additional information to improve transparency of the recoverable amounts, specifically the amounts requested from the program and amounts reported gross and net of nonadmission.

INT 16-01: ACA Section 9010 Assessment 2017 Moratorium as an interpretation of SSAP 106, ACA Section 9010 Assessment (2016-01) – The working group exposed during its February 22 call a proposed interpretation of SSAP 106 to reflect the adoption by Congress in December 2015 of a moratorium in 2017 of the health insurance providers' fee (HIPF). The proposal was adopted in New Orleans; a summary of the guidance is as follows:

- Accrual of liability on January 1, 2016 for HIPF based on 2015 data year net written premiums.
- No segregation of surplus in 2016 for HIPF based on 2016 data year net written premiums.
- No accrual of HIPF liability on January 1, 2017 based on 2016 data year net written premiums, because no HIPF will be paid during 2017.
- Segregation of surplus for HIPF based on 2017 data year net written premiums resumes during 2017.
- Accrual of liability on January 1, 2018 for HIPF based on 2017 data year net written premiums.

SSAP 97 - Investments in Subsidiary, Controlled and Affiliated Entities (2015-49) – During its February 22 conference call, the working group adopted a clarification to SSAP 97 that ownership of an Exchange Traded Fund or mutual fund does not represent ownership in an underlying entity within the scope of SSAP 97, unless ownership of the ETF results in "control" of an underlying company.

SSAP 1 – Quarterly Reporting of Restricted Assets (2015-19) –The working group adopted a revision to

SSAP 1 clarifying that the restricted asset disclosure shall be included in the quarterly statements if significant changes have occurred since the annual statement disclosure. The quarterly disclosure shall include sufficient information on the significant changes and updated totals of restricted assets to ensure the information presented is not misleading. The revisions to the restricted asset disclosures, first effective for 2014 financial statements, were requested by industry, which does not see the need to include full restricted asset disclosures in the quarterly statements.

Asbestos and Environmental Exception Reporting (2014-28) – The working group adopted Issue Paper 153, Counterparty Reporting Exception for Asbestos and Pollution Contracts, which includes a new Appendix C; this appendix illustrates the reporting of such retroactive reinsurance on Parts 3-5 of Schedule F and a new Supplemental Schedule for aggregation regarding retroactive reinsurance for asbestos and environmental exposures. (The related SSAP 62R revisions were adopted in 2015 effective for year-end 2015.)

GAAP Cross Reference to Statutory Accounting
The working group adopted the rejection of the following GAAP revisions as not applicable to statutory accounting:

- ASU 2015-12 – Plan Accounting: Defined Benefit Pension Plans; Defined Contribution Pension Plans; and Health and Welfare Benefit Plans. (2015-38) (The guidance was rejected because the revisions are specific to "plan accounting," and not the accounting by the reporting entity for benefit obligations.)
- ASU 2015-15: Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (2015-40)
- EITF 99-1: Accounting for Debt Convertible into the Stock of a Consolidated Subsidiary (2015-48)
- EITF 99-3: Application of Issue No. 96-13 to Derivative Instruments with Multiple Settlement Alternatives (2015-48)
- EITF 98-12: Application of Issue 00-19 to Forward Equity Sales Transactions (2015-48)
- EITF 00-7: Application of Issue No. 96-13 to Equity Derivative Instruments that Contain Certain Provisions that Require Net Cash Settlement if Certain Events Outside the Control of the Issuer Occur (2015-48)
- ASU 2014-06 – Technical Corrections and Improvements Related to Glossary Terms (2015-50)

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

Comments on exposed items are due to NAIC staff by May 20, unless otherwise noted.

ASU 2016-02 Leases (2016-02) – In February, the FASB issued ASU 2016-02 – Leases, which is intended to increase the transparency across companies by recognizing all leases on the balance sheet and by disclosing key information about the lease agreements. At the Spring National Meeting, the working group exposed for comments three proposed options for accounting of operating and financing leases under SAP.

- Maintain existing statutory guidance with potential new disclosure guidance on the lease asset and lease liability required under GAAP.
- Recognize the lease asset and lease liability, but require nonadmittance of the lease asset as the right of use asset is not available for policyholder obligations.
- Adopt ASU 2016-02 with some modifications to recognize lease assets and lease liabilities for a lessee's operating and financing leases, which would allow the lease asset to be admitted for statutory purposes.

All the options above could be a significant effort for companies to implement; it is possible that the SAP Working Group could also consider maintaining the current accounting without the new disclosures of the lease asset and liability under ASU 2016-02.

SSAP 51 Life Contracts (2015-47) – The working group exposed proposed revisions to the life insurance guidance to incorporate references to the Valuation Manual and to facilitate the implementation of principle-based reserving, which is expected to be effective January 1, 2017. The proposed revisions are the result of NAIC staff's work with an informal PBR drafting group of regulators and life insurers. Although the adoption of PBR is very significant, the proposed changes to SSAP 51 are not pervasive, as the guidance references the adopted Valuation Manual.

The proposed implementation guidance is as follows:

> Substantive changes that reference the Valuation Manual in this statement are effective for January 1, 2017 and thereafter. However, the Valuation Manual provides for a 3-year period, starting from the operative date, during which companies are able to continue using the current reserve methodologies.

A forthcoming separate agenda item will address a possible change in valuation basis for PBR adoption; the SAP Working Group will coordinate with the Life Actuarial Task Force on this charge. See the summaries of the PBR Review Working Group and the PBR Implementation Task Force for additional discussions of PBR implementation.

SSAP 86 Variable Annuities (2016-03) – The Financial Condition Committee issued a high priority charge to the working group to develop and adopt changes to SSAP 86, Derivatives, for certain limited derivative contracts (e.g. interest rate hedges with counterintuitive effects) that otherwise do not meet hedge effectiveness requirements. Subsequent to the Fall National Meeting, interested parties had provided NAIC staff with an Industry Derivatives Proposal as a recommendation for "special accounting provisions" for these specific derivative contracts. The proposal was modified by staff and exposed by the working group in New Orleans. Interested parties asked for an extended comment period, which are due June 5.

The primary components of the proposal include:

- SAP Working Group support of revisions to explicitly address derivative transactions hedging AG 43 guarantee reserve calculations as a "special accounting treatment." Derivative instruments used in hedging transactions within the scope of this item that meet the criteria of a highly effective hedge shall be considered as qualifying for the "special accounting treatment" and are permitted to be valued and reported at amortized cost.

- The intent is to encourage risk-management transactions by insurers, which the existing derivative accounting guidance may hinder. The guidance would be separate and distinct from the "effectiveness" guidance in SSAP 86 and might be included in a separate SSAP to reduce or eliminate any confusion related to the "special accounting treatment."

- The working group will consider possibilities for the hedged items and hedging instrument to be a form of macro-hedging as the hedged item could reflect a portfolio of dissimilar items. Although all items within the pool would be related to variable annuity contracts, as the contracts have different terms and components, the portfolio would not be considered similar as required under U.S. GAAP.

- Concepts from qualifying hedges/hedge effectiveness from existing guidance in SSAP 86 and the "Clearly Defined Hedging Strategy" requirements of AG 43 would be incorporated.
- Reporting requirements to capture the hedges and related financial statement impacts would likely be necessary.

- Specific consideration is contemplated for the treatment of gain/losses upon termination of a hedge that qualifies under the special accounting provisions.

Prior to the vote to expose the proposal, the chair of the working group noted support for this "very key topic," but also remarked that in his view unlimited deferral of unrealized losses on derivatives (as a result of valuing the derivatives at amortized cost) is "pushing the envelope too far." The goal of the working group is to have the guidance adopted in 2016 and effective January 1, 2017.

Prepayment Penalties and Amortization on Callable Bonds (2015-23) –At the Fall National Meeting, the working group proposed amendments to SSAP 26 and SSAP 43R to clarify what portion of proceeds reflects the prepayment penalty of a callable bond with make-whole provisions. In New Orleans, the working group exposed for comment a proposed effective date of January 1, 2017 as suggested by interested parties, with earlier adoption permitted.

The working group also exposed for comment a proposed new disclosures for callable bonds: for securities sold, redeemed or otherwise disposed as a result of a callable feature, the following categories shall disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee from: 1) traditional call features; 2) make-whole call provisions and 3) other callable features.

Issue Paper 152 - Short Sales (2015-02) – At the Spring National Meeting, the working group voted to expose a revised Issue Paper 152, Short Sales, for comment, which would revise SSAP 103. The issue paper provides guidance for situations in which state regulations do not prohibit, or otherwise provide specific guidance for short-sale transactions. The issue paper proposes deviating from U.S. GAAP and would require a short sale to be recorded as a contra asset in the balance sheet. The more significant revisions to the previously exposed Issue Paper, which reflects comments from interested parties include:

- The revised draft removes language for the treatment of short sales in Schedule D, which will be included in the annual statement instructions.

- Additional guidance on short sales supported by a securities borrowing transaction has been added, with a specific request for input from interested parties. Revisions to clarify when the contra-asset from a short sale should be eliminated was also added.

SSAP 3 – Accounting Changes and Corrections of Errors (2015-46) – At the Spring National Meeting, the working group re-exposed revisions to clarify that the error correction guidance in SSAP 3 should not preclude companies from amending their annual or quarterly statement filings due to reporting/data validity errors.

Quarterly Investment Schedules (2015-27) – In New Orleans, the working group continued its discussion of possible filings of additional quarterly investment information by all insurers. Interested parties again reiterated their concern of the cost/benefit of providing additional data on a quarterly basis. The working group then exposed for comment three alternatives, which had been suggested by interested parties: 1) hire a consultant to aggregate NAIC investment data, 2) in the event the working group adopts additional quarterly reporting, extend the deadline to complete the electronic-only supplemental investment information, and 3) replace the quarterly acquisition and disposition schedules with a schedule of owned holdings. Although the interested parties have strongly recommended that full investment schedules are not be necessary for quarterly reporting, the working group would like to understand which schedules or columns from Schedule D might not be needed for quarterly reporting.

Investment Classification Review Project (2013-36)
Although the SAP Working Group has been studying the broader investment classification project since 2013, the regulators have been focusing on the Exchange Traded Fund issue for the past six months. During its February 22 conference call, the working group exposed for comment BlackRock's white paper entitled "A Proposed Approach to Calculating Amortized Cost for Fixed Income ETFs" and the working group received three comment letters in support of the proposed approach.

At the Spring National Meeting, after extensive discussion, the working group directed the staff to draft an issue paper for revisions to SSAP 26 for bond approved exchange-traded funds and also to include bond mutual funds. The revisions to SSAP 26 will propose the use of fair value (using NAV as a practical expedient) as the default accounting. However, insurers with a documented approach as a proxy for amortized cost (such as the BlackRock methodology) could use that option. The revisions will separately identify ETFs and bond mutual funds as separate from the standard definition of a bond.

Method for Applying Discount Rates to Measure Net Periodic Benefit Cost (2016-08) – At the Spring National Meeting, the working group exposed revisions to SSAP 92 and 102 to reflect the allowance of the Spot Rate method for measuring service cost and interest cost components of net periodic benefit cost. Currently, as permitted under ASC 715-30-35-45, the most commonly used approach is to develop a single weighted average discount rate. Recently, the SEC staff indicated that it would not object to the use of a Spot Rate approach, which provides for a more precise estimate and measurement of the cost. As a result, the SAP Working Group is proposing explicit adoption of this method for statutory reporting.

SSAP 26 (2015-41) – In response to the Valuation of Securities Task Force proposal to remove the SVO from the 5* process and have insurers self-designate all 5* securities held, the working group exposed a new disclosure to capture current and prior period information on the number of 5* securities and the book adjusted carrying value and the fair value for those securities by category: bonds, loan-backed and structured securities and preferred stock. This will "provide regulators sufficient information regarding 5* securities collectively in the financial statements, and allow transparency on any significant changes (particularly increases) with regards to insurer self-certification."

ASU 2016-01 – Financial Instruments (2016-06)
The working group discussed the new ASU issued in January, which amends guidance on the classification and measurement of financial instruments as well as certain disclosure requirements regarding the fair value of financial instruments. The working group exposed for comment a proposal to reject ASU 2016-01 for statutory accounting, with a request to interested parties to comment on whether any elements of the guidance should be considered for statutory reporting.

SSAP 97 SCA Appendix (2015-25) – The working group re-exposed a new appendix to SSAP 97 that will include the SCA Reporting/Filing process. As part of the re-exposure, the working group incorporated revisions to clarify that all non-insurance SCA entities with an equity interest, are subject to filing guidance. As joint ventures, partnerships and limited liability companies are accounted for under SSAP 48, the revisions clarify that those investments are not subject to the SCA filing guidance. The working group emphasized that there are no exclusions to the equity interest filing requirements for nonadmitted or immaterial assets

SSAP 97 Data Capture Disclosure (2015-25) and (2016-04) – The working group exposed a revised proposed data capture disclosure template to include the company's ownership percentage of the SCA and an inclusion of a code column to assist companies in completing the disclosure. A blanks proposal was submitted to the Blanks Working Group with a request for concurrent exposure, so the disclosure can be data captured by year-end 2016. The working group also clarified that the disclosure, effective for 2015 financial statements, does not include SSAP 48 entities (even those entities controlled by an insurer and therefore subject to other provisions of SSAP 97).

SSAP 1 - Collateral Received (2016-09) – The working group exposed a proposal for an additional disclosure to capture the aggregate total of collateral assets reported as assets on the insurer's financial statement and the corresponding recognized liability to return the assets. The staff is requesting feedback from regulators on the amount of detail that would be beneficial for their use. Currently, the location and classification of the corresponding liability may not be consistent across companies.

SSAP 1 - Insurance-Linked Securities (2016-11)
As a follow-up to the new 2015 disclosure requirement of insurance-linked securities, the working group exposed a proposed data-capture disclosure template for these securities and language clarifying how disclosure components should be completed.

SSAP 26 – Common Stock and SSAP 30 Preferred Stock - (2016-05) – The working group exposed necessary revisions to SSAP 26 and SSAP 30 to remove the Class 1 Bonds Funds in response to actions taken by the VOS Task Force as a result of the regulations adopted by the SEC to preclude the use of a stable value NAV for these money market funds.

Fees Incurred for Salvage and Subrogation (2015-21)
At the 2015 Summer National Meeting, the working group exposed for comment a requirement for fees to recover salvage and subrogation to be reported gross regardless of whether the fees are paid to third parties or are allocated internally. At the Fall National Meeting, the working group heard strong objection from insurers that this proposal is inconsistent with current guidance to record salvage and subrogation at net realizable value. In response, the working group has asked the Casualty Actuarial Task Force for its views and also asked for comments as to whether explicit netting of subrogation recovery expenses is supported by regulators and industry.
At the Spring National Meeting, the working group exposed proposed revisions to SSAP 55 based on comments received from interested parties to clarify that the reporting of salvage and subrogation should be net of associated expenses. NAIC staff also asked for direction from the working group whether additional disclosure would be beneficial.

Weather Derivatives (2015-43) – As part of its "catch-up" review of Interpretations of the Derivatives Implementation Group for FAS 133, the working group voted to expose for comment at the Fall National Meeting incorporation of the GAAP definition of weather derivatives and adopt, with modification, EITF 99-02: Weather Derivatives to require these derivatives to be reported and valued consistently with other derivatives under SSAP 86. At the Spring National Meeting, the working group re-exposed additional revisions to SSAP 86 to include language from ASU 815-45-12-2 as suggested by interested parties. The revision clarifies that the guidance on weather derivatives does not apply to insurance contracts written by insurance entities that entitle the holder to be compensated only if, as a result of the an insurable event, the holder incurs a liability or there is an adverse change in the value of a specific asset or liability for which the holder is at risk.

Definition of Notional Principal for Derivative Contracts (2015-51) – The working group re-exposed proposed revisions to SSAP 86 that reflect interested parties' proposed changes, which clarify the use of transaction/inception elements in determining notional amount. The intent of the proposal is to provide a broad definition of notional in SSAP 86 and provide examples on how to apply the definition.

Appendix A-820- Minimum Life and Annuity Reserve Standards (2016-10) – The working group exposed revisions to Appendix A-820, which incorporates relevant aspects of the 2009 Standard Valuation Law (PBR) amendments into Appendix A-820. The proposed effective date of the revisions is January 1, 2017, consistent with the proposed adoption of PBR.

ASU 2015-17 Balance Sheet Classification of Deferred Tax Assets (2016-07) – The working group exposed revisions to SSAP 101 to reject ASU 2015-07 and maintain the current reporting of deferred tax assets and deferred tax liabilities.

Appendix F Policy Statements (2016-12) and (2016-13) – The working group exposed policy statement revisions to address voting requirements to adopt interpretations, concurrent exposures, definitions of types of revisions, adoption of revisions, editorial

processes, issues papers for nonsubstantive revisions and other editorial revisions.

Additionally, the working group exposed new policy statements providing formal guidance detailing coordination between the SAP Working Group, the Valuation of Securities Task Force, and their related Manuals.

Report of the Restricted Asset Subgroup
The working group met March 15 to review comments on its previously exposed disclosure templates for repurchase and reverse repurchase transactions. Comments received from the ACLI are now reflected in the templates, which have been integrated into proposed changes to SSAP 103, Transfers and Servicing of Financial Assets. The proposed changes are extensive, and are exposed for a comment period ending April 29. The subgroup also asked for comments as to whether Schedule DL, Securities Lending Collateral Assets, should be expanded to include repo agreements (with possible subcategories in the schedule to identify collateral held under the different programs). No proposed effective date has been suggested for the disclosure as the proposal must also be exposed by the SAP Working Group after the subgroup makes its final recommendation.

Principles-Based Reserving Implementation Task Force

PBR Adoption by States and "Substantially Similar" Considerations
With Washington State's adoption of PBR on March 31 and South Carolina's adoption subsequent to the Spring National Meeting, the NAIC reached a very important milestone: 43 states representing 76.17% of written premium have now adopted PBR legislation. Another four states (AL, MA, MN, and PA) have presented legislation to adopt PBR. The task force heard comments from Kay Noonan, general counsel of the NAIC, regarding a process to "activate" PBR once the thresholds have been met because the Standard Valuation Law does not provide a mechanism for who determines if these thresholds have been achieved. About half the states that have adopted PBR require a regulation or bulletin to notify insurers that PBR will be implemented, and other states' requirements are not specific on the issue. As a result the task force is working on process to assist with implementation.

To achieve that goal, the task force plans to adopt a recommendation for a January 1, 2017 Valuation Manual Operative Date on its May 2 conference call. This will allow states time to evaluate what actions to take and allow Executive Committee and Plenary time to review before July 1 that the requirements have met.

Ms. Noonan also noted that the task force has made enormous progress in determining the "substantially similar" components of Standard Valuation Law using an "objective third party standard" versus an accreditation standard. The task force held a regulator only call April 18 to continue its work on this issue.

PBR Company Experience Reporting Framework
The task force heard an update from NAIC legal staff on data collection and dissemination under PBR, who noted that the NAIC has made a lot of progress on development of procedures for the NAIC to collect experience data using the Standard Valuation Law as the mechanism to collect data. Staff noted that not as much progress has been made on the related confidentiality issues, but that they are committed to resolving these issues. Comments from the ACLI included concerns that there is no written plan to respond to. The task force had hoped to have a formal proposal by January 2016, but nothing has yet been exposed for comment. The framework is expect to include procedures and timing for collection, cost control, dissemination of data and funding.

PBR Pilot Project
See the summary of the PBR Review Working Group for discussion of the pilot project.

XXX/AXXX Reinsurance Framework Update
See the summaries of the Life RBC Working Group and Reinsurance Task Force for updates on referrals by the task force to this groups.

Capital Adequacy Task Force

The task force met January 26 and at the Spring National Meeting to discuss the following projects.

2015-18-CA Asset Concentration
The task force adopted a proposal for 2016 RBC to properly reflect in all the formulas how asset concentration is calculated by removing the factor column from the Grand Total page within the RBC Forecasting Spreadsheet. No comments were received on the proposal.

Other 2016 RBC Proposals
The task force also adopted six P/C and Health RBC proposals for 2016 reporting; those items are discussed in their relevant working group summaries.

Asset Risk and Beta Adjustment
The task force discussed separate memos it received from the Health RBC Working Group on asset risk and P/C RBC Working Group on beta adjustment; refer to relevant working group summaries for details.

P/C RBC Affiliated Investments Charge
A project to reconsider affiliated investment risk across all formulas is still trying to find a home. The P/C RBC Working Group asked the task force in June 2015 to review the risk charge, and the task force referred the issue to the Investment RBC Working Group. In New Orleans, IRBC referred the issue back to the task force in light of its full agenda to adopt new bond and common stock factors for 2017 RBC. The task force did not reach a conclusion as to next steps at the Spring National Meeting.

Next Meeting
The task force is holding a conference call April 29 to consider adoption of the Individual Premium and Claim Footnote Proposal for 2016 (2016-01-H) discussed in the Health RBC Working Group summary below. The task force will also consider for exposure updating the receivable for securities factors for 2016 (2016-08-CA).

Investment Risk-Based Capital Working Group

The working group met for the first time in 2016 at the Spring National Meeting with its new chair, Kevin Fry of Illinois. The majority of the meeting was focused on the discussion of the working group's new document "A Way Forward" which proposes a process and related principles for the working group to complete its original charge to recommend revisions to the current asset risk structure and factors for each of the three formulas. The "Way Forward" document recommends focusing all of the working group's attention on finalizing revised factors for bonds and common stock with a goal of completion of revised factors for 2017 RBC filings. The "Way Forward" document includes principles for updating bond and common stock factors to meet that goal. Significant proposed principles include the following:

- The bond factors will be expanded from 6 to 20 designations, but for RBC only. For statutory accounting and reporting and state investment law purposes, the current six designation system would continue to apply. This would eliminate the difficulties created by attempting to change insurance law in all the states to adopt the new designations for valuation and investment limitations.

- The factors would be based on those proposed by the AAA in 2015, as a result of recommendations from their detailed analysis and modeling.

- The changes would not affect modeled RBMS and CMBS, but non-modeled SSAP 43R securities would be subject to the new factors.

- The working group will consider proposals for different factors for some asset classes such as municipals and sovereign debt, but the earliest implementation date of those factors would be 2018 RBC.

- The common stock factor should be the same for all statement types and the working group is proposing that the P/C and Health common stock factors be increased to 19.5, which is consistent with the after-tax Life factor.

- AVR factors would also be updated for year-end 2017.

- No other investment types will be discussed until the final changes for bonds and common stock are "adopted and ready for use."

The "Way Forward" document was exposed for public comment until May 19, with a subsequent conference call to discuss comments to be scheduled.

The remainder of the meeting in New Orleans was spent hearing from trade associations who disagree with some of the above principles, especially the concept that all insurers would have the same factors for common stock and bonds; this included ACLI, PCI, NAMIC and AHIP. In addition, a representative from the AAA who led the project to develop the corporate bond factors, commented that the bond factors proposed for life insurers would not be appropriate for all RBC filers. Discussion of these issues, including the transition to 20 factors for bonds, will continue throughout the year.

Operational Risk Subgroup

The subgroup has held monthly conference calls on January-April to continue its discussion on various topics relating to development of the operational risk charge.

Growth Risk Test Results
The subgroup heard an updated analysis that compared the existing growth risk charge results to those generated by the proposed informational-only methodology. The updated analysis involved moving the existing growth risk charge to its own RBC risk category and testing the factor both inside and

outside the covariance square root. For P/C and health, uncoupling the growth risk from R4, R5 and H4 inside the square root reduced the after-covariance growth risk RBC requirement; the reduction was more pronounced for P/C than health. The subgroup discussed the relative ability of the existing versus proposed growth risk charge in predicting action level companies and it was noted that while the results varied year over year for P/C, there was no clear pattern that one method was a better predictor than the other over the four-year period reviewed. For health, due to the significant increase in growth risk in 2014, another year of data is needed before initial conclusions can be offered. For both P/C and health, larger companies triggered the proposed growth risk charge compared to the existing charge.

Basic Operational Risk Test Results
The subgroup received an update on test results for basic operational risk for P/C, health and life. For P/C, the informational methodology uses a factor multiplied by net premiums and the same factor is multiplied by net loss reserves, with the greater resulting calculation becoming the basic operational risk RBC requirement. For health and life, the methodology uses a factor multiplied by net premiums and a different factor multiplied by net claims reserves, with the greater resulting calculation becoming the basic operational risk RBC requirement. In addition to the original informational factors, revised proxy-based factors (yielding an after-covariance target of approximately 3%) were tested. A 3% capital add-on option was also tested. For P/C and health, results indicated that the average and median RBC ratios for the revised factors were similar. The revised factors reduced the average RBC ratios by 20% each year when compared to the original factor, which led to fewer companies triggering an action level. The life results noted that the average and median RBC ratios for the revised factors were lower than the original factors by up to 28%. The life test utilized an offset for C-4a (business risk), which is justified based on a widely-held opinion that the C-4a includes some measure of operational risk.

Target Capital and Basic Operational Risk
The subgroup discussed whether to apply an exposure proxy versus an add-on methodology for the factor. The add-on approach is simpler and has a uniform impact on all companies. The subgroup discussed that the IAIS calculation, which favors the exposure-based approach for its treatment of operational risk in the development of its group capital formula, is also considering the capital add-on approach. The subgroup also discussed Bermuda's add-on approach, which yields between 1% and 10% of regulatory capital and Japan's add-on approach of either 2% or 3% based on the level of the company's retained earnings.

Additionally, the subgroup discussed whether the operational risk factors should be inside or outside of covariance. The chair stated that the subgroup is leaning on an outside square root approach which implies that operational risk is dependent on other risks within the RBC formula.

Revised Factors for Basic Operational Risk
During the April conference call, the subgroup discussed a proposal to update the factors for the life, P/C and health formulas on an informational-only basis for 2016 reporting after evaluating the results of the basic operational risk test results summarized above. The proposal includes the following factors:

- For P/C, a factor of 1.1% for net premiums and net loss reserves. The 2015 factor was 2%.
- For health, a factor of 0.2% for net premiums and 2.5% for net claims reserves. The 2015 factors were 0.3% and 3.5% respectively.
- For life, a factor of 0.6% for life and annuity premiums, 0.15% for life and annuity reserves, 0.2% for accident and health premiums, and 2.5% for accident and health reserves. The 2015 factors were 1.2%, 0.3%, 0.3% and 3.5% respectively.

The subgroup discussed the timeline for the proposal noting that it would need to be finalized by June 30. Following the discussion, the subgroup exposed the proposal for comment until June 6. In its motion for exposure, the subgroup asked industry and interested regulators to share comments on key discussion points relating to target capital and methodology for basic operational risk. The subgroup will continue its discussion on basic operational risk in May.

Life Risk-Based Capital Working Group

The working group met via conference call in December and February and at the Spring National to discuss its projects in process.

2015 XXX/AXXX Reinsurance RBC Filings
The working group heard a brief report in New Orleans on the first year of these filings. Of the 16 companies that filed the primary security shortfall exhibit, only one company had a primary security shortfall; none of the 10 companies filing the RBC shortfall exhibit had an RBC shortfall. The working group will have additional discussion after the XXX/AXXX Reinsurance Exhibits are reviewed.

RBC Shortfall Instructional Change (2016-03-L)
This winter and spring, the working group discussed a proposed change to the RBC instructions to clarify that "captive subsidiaries whose contribution to the ceding company's C-0 RBC component is based on the captive's carrying value are subject to the RBC shortfall calculation with a credit for the captive's actual C-0 contribution." According to comments from the Connecticut, there is a concern that a captive with a permitted practice with zero carrying value by its parent insurer would get an "unintended free pass on the RBC shortfall." The working group received a comment letter from New York Life on the exposure and Connecticut will work with the ACLI and New York Life to finalize the proposal for 2016 reporting.

Other XXX/AXXX RBC proposals
During its December 10 conference call, the working group discussed two other XXX/AXXX RBC proposals. The first is whether "having a full-fledged RBC calculation done by the captive subsidiary and included in the ceding company's RBC was a sufficient condition for sparing that subsidiary a shortfall calculation." The second is RBC treatment for "other securities" that had been deferred to 2016 RBC when the working group ran out of time for inclusion in 2015. Formal proposals have not yet been drafted for exposure, so these revisions will not be effective for 2016 RBC filings.

Stress Testing Subgroup
The subgroup held a conference call in February to discuss progress against its charges, which are 1) to consider changes needed to RBC in light of PBR, and 2) to consider a total balance sheet approach. A co-chair of the Academy Stress Testing Work Group supporting this effort provided an update on the call. The Academy group is focused on the first charge at this time, specifically looking at how VM-20 affects the level of required capital. Considerations include whether company-specific margins in reserves or the anticipated increase in volatility would affect the level of capital, and whether there are additional risks from implementing PBR that should be reflected in RBC. The co-chair noted that tentative conclusions of the work group are that VM-20 does not necessitate changes to RBC. Specifically, the work group believes that the introduction of VM-20 does not directly affect C1, C-2, C-3 or C-4 risks, and that if the four C factors are currently appropriate, they are appropriate before and after the implementation of VM-20.

Part of the discussion addressed the relationship between current prescribed statutory reserves and reserves under VM-20. The work group noted that formulaic statutory reserves based on prescribed mortality and discount rates are supposed to cover claims under moderately adverse conditions, or about one standard deviation around claims. This measure is roughly consistent with the VM-20 reserves set at CTE-70. This suggests that VM-20 reserves will cover claims under moderately adverse conditions and supports the conclusion that current RBC factors remain appropriate in light of VM-20.

Regulators also inquired about integration of C-3 Phase I, Phase II and ultimately Phase III into a principles-based approach, and the potential for movement in the direction of model-based RBC development. The work group plans to consider these items when it considers the subgroup's second charge, noting that one suggestion may be to expand ORSA to more companies. The ORSA report will contain information about how companies are managing risks and may alert regulators to risks they don't believe are addressed appropriately.

At the Life RBC Working Group meeting in New Orleans the subgroup chair noted that many other projects will provide insight to their work including consideration of operational risk, investment risk, the variable annuity quantitative impact study, Solvency II, the proposed IAIS capital requirements and AM Best's Capital Adequacy Ratio.

Joint Longevity Risk (A/E) Subgroup
During its December 10 meeting, the working group received a presentation from its New Jersey member on longevity risk, which concluded that in today's environment a 0% RBC charge may no longer be appropriate. The report suggested this risk be reflected in RBC, reserves or a combination of both. The Life RBC Working Group voted to form a subgroup to consider the issues and at the Spring National Meeting, the subgroup was being expanded to include interested members of the Life Actuarial Task Force. Preliminary work by the original subgroup indicates that this is a complex issue; the Academy Longevity Risk Task Force has agreed to help and is working on a framework to address the following:

- nature and scale of longevity risk in various products
- approaches used in other jurisdictions and by insurance companies
- margins in current statutory reserves
- diversification benefits associated with mortality risk, and
- severity, volatility and speed of onset of the financial impact of longevity risk.

The joint subgroup plans to have a recommendation by the end of July.

C-3 Phase II/AG 43 Subgroup
The subgroup is waiting for the results of the Variable Annuities Issues Working Group's Quantitative Impact Study before recommending its revisions to C-3 Phase II. Their goal is implementation for 2017 RBC. See the VA Issues Working Group summary for additional information on the QIS.

Property/Casualty Risk-Based Capital Working Group

The working group met by conference call on January 20, February 19 and in New Orleans to discuss the following projects.

Revised credit risk for recoverables (2016-02-P)
On February 1, the working group exposed via email a proposal to add several tables to PR012A- Credit Risk for Receivables to address concerns regarding "cross-checking" of factors applied to the reinsurance receivables. Under the proposal, available information from Schedule F will be used to compute the required credit risk for reinsurance receivables. No comments were received during the exposure period and the working group adopted the proposal.

Industry Average Factors (2015-20-P)
The working group continued its discussion of two alternative approaches for computing the industry average development factors (Line 1 of PR017) and industry average loss and loss adjustment expense ratios (Line 1 of PR018). It was noted that the current approach is subject to distortion as a result of intercompany pooling arrangement. The working group discussed the two alternatives noting that the industry average for the first alternative tends to be based on the larger size companies' experience while the second alternative leans toward the combination of the current and first alternative. Industry expressed support for the second alternative noting that it would fix intercompany pooling arrangement issues for smaller lines. Following the discussion, the working group adopted the second alternative for computing industry factors/ratios.

Multiple Financial Strength Ratings
The working group heard comments from the Reinsurance Association of America's representative that current RBC instructions require companies to use the lowest rating for the R3 credit for reinsurance component if an insurer has multiple ratings and as such, longer established companies are being notched to the lowest ratings. Among other options, the RAA suggested modifying the factor applied to the ratings category for NAIC Secure 4. The working group noted that there could be a competitive disadvantage for companies with two or more financial strength ratings as opposed to a newer company that only has one financial strength rating. The working group discussed the possibility of using the average and requested for additional information on companies impacted. The chair asked the working group to consider the appropriateness of using either the lowest rating as in the current RBC instructions or RAA's proposed solution. The working group will continue discussing this matter in future calls with a hope of finalizing any changes for 2016 RBC.

Options to Verify Financial Strength Ratings
The working group discussed two remaining issues related to PR012A – Credit Risk for Recoverables which are, 1) creating a centralized location to allow industry to obtain reinsurer financial strength ratings, and 2) verifying that ratings are assigned consistently and aggregated by category properly. The RAA noted that ratings are widely available and the NAIC will likely have access to rating feeds that could be used to create a central repository so insurers and regulators can use it to verify information in the RBC filings. Industry expressed support for the idea of a central repository. The chair informed that he will discuss with NAIC staff the feasibility of developing a centralized repository in the future. Another consideration proposed by the RAA is the addition of an "NAIC Equivalent Rating for RBC" column in the annual statement, Schedule F, Part 3 for verification purposes.

At the Spring National Meeting, the chair noted that the Blanks Working Group is considering an exposure of a proposal to add an electronic-only column to capture the reinsurer ratings on Schedule F, Parts 3, 5, and 6, and Section 1 (2016-08BWG). The working group will continue its discussion in future calls.

Common Stock Beta Adjustment
The working group discussed a request from the Capital Adequacy Task Force to consider whether the inclusion of a beta adjustment for non-affiliated, publically traded common stock would be appropriate for the P/C RBC formula. An informal drafting group reviewed the current factors in the formula, reviewed the current approach to beta in the Life formula, reviewed available historical documentation to understand the context of why the formulas are structured in their current format, and reviewed the results of an impact analysis. Based on the study, the working group concluded that 1) the addition of a beta adjustment in the P/C formula does not enhance a regulator's ability to identify companies with inadequate levels of capital; 2) the addition of a beta adjustment may not be consistently applied across all companies; and 3) the

addition of a beta adjustment may dissuade companies from investing in common stock. The conclusions were summarized in a memo submitted to the task force.

Next meeting
The working group is holding a conference call April 29 to consider exposure of a proposal to update the 2016 industry underwriting factors for premiums and reserves in the P/C formula. The working group will also consider exposure of a reinsurer ratings proposal to address concerns noted in the Multiple Financial Strength Ratings summary above. The working group plans to discuss the impact of PR012A (Credit Risk for Receivables) when companies report negative amounts in annual statement Schedule F.

Catastrophe Risk Subgroup

The subgroup met by conference call on February 19 and met in person in New Orleans to discuss its projects.

Implementation of the Catastrophe Risk Charges
The chair stated that he anticipates the implementation of the catastrophe risk charges into the RBC calculation for 2017 P/C RBC reporting, after four years of being informational-only filings.

Catastrophe Risk Event Lists
The subgroup adopted the 2015 U.S. and Non-U.S. Catastrophe Risk Event Lists on January 21, which were later adopted by the P/C RBC Working Group and the Capital Adequacy Task Force. The lists are used in reporting catastrophe data in PR037 and PR100+ of the catastrophe risk charge, and are posted to the subgroup's web page.

Annual Catastrophe Event Lists Update Process
The subgroup was informed of the current year challenge in generating the annual catastrophe event lists. There is currently no formalized process for developing and maintaining the catastrophe lists and industry was frustrated how late the lists were adopted for 2015 due to Q4 storms. The subgroup member who worked on the lists stated that he will draft a process, which will include having NAIC staff maintain the lists based on various databases on a quarterly basis. Industry requested that completion date be included in the draft document. The subgroup will continue discussing this matter in future calls.

Catastrophe Data Analysis
The subgroup discussed the results of the 2015 catastrophe data analysis. It was noted that the 1-in-100-year requirement in the current proposal resulted in no increase in companies falling into RBC action levels, and increasing the earthquake requirement to a 1-in-250-year requirement caused two companies to move into RBC action levels. Industry appears well protected against a 1-in-250-year event for earthquake and a 1-in-100-year event for hurricane. Approximately 70% of companies reported that their modeled losses were calculated using an aggregate exceedance probability (AEP) basis as opposed to an occurrence exceedance probability (OEP) basis. Inconsistent company responses within PR027 Interrogatories' questions revealed that companies are confused with the reporting requirements. The subgroup discussed possible changes for 2016 RBC reporting which are: a) switching from a 1-in-100-year requirement for earthquake to a 1-in-250-year standard; b) changing factors for OEP basis; and c) clarifying the PR027 interrogatories. Industry suggested utilizing a Frequently Asked Questions document as a tool to clarify the instructions. The subgroup will continue its discussion in upcoming calls.

AEP versus OEP
The subgroup discussed the 2015 catastrophe data analysis noting that a substantial number of companies modeled their losses on an OEP basis. A subgroup member commented that allowing companies to report modeled losses in a manner consistent with the companies' internal risk management process is worth considering in the near future. The Reinsurance Association of America informed that companies expressed concern over the additional effort needed to convert their modeled losses from OEP to AEP as the RBC instructions state that AEP as the preferred basis. An industry representative commented that there is no perfect answer for using AEP versus OEP and that it will depend on whether the factors remain the same for 2016 reporting. The subgroup will continue to discuss this matter in future meetings.

Other Catastrophe Risks in P/C RBC Formula
The subgroup discussed other catastrophe risks for possible inclusion in the P/C RBC formula. The chair noted the following matters to consider: 1) whether additional perils have the potential to create losses large enough to be a threat to solvency, 2) the availability and robustness of the models for developing estimated losses due to these additional perils, and 3) to what extent the perils are covered by insurance and will produce insured losses. Perils that may be considered include fire after earthquake, tornado, wildfire, terrorism and winter storm. The subgroup will pursue a study of ORSA reports filed with state insurance departments to see what can be learned about the use of models for other catastrophe risks and will continue its discussion in subsequent meetings.

Use of Other Models
The subgroup discussed the possibility of using models other than one of the five approved commercially available models noting that a subgroup member had previously submitted a document listing additional conditions and procedures that might serve as a basis to allow companies to choose to use their own internal catastrophe model. The document provides a good starting point for creation of a framework which would allow companies to use other models.

Next meeting
The subgroup is holding a conference call April 29 to consider exposure of the following proposals:

- Earthquake Model Losses (2015-22-CR) to revise the 2016 blanks and instructions to calculate the earthquake risk charge by using the worst year in 250 standard based on results from the catastrophe data analysis summarized above.
- 2016 Ex-Cat Factors (2015-24-CR) to update the 2016 Ex-cat factors for use on Lines 1 and 4 on page PR018A based on new data.
- Revised PR027 Interrogatories (2015-25-CR) to clarify the 2016 instructions and interrogatories based on results from the catastrophe data analysis summarized above.
- 2017 Rcat Implementation (2016-07-CR) to implement the catastrophe risk charge in the RBC formula for 2017 reporting.

Health Risk-Based Capital Working Group

The working group met monthly by conference call January through April and at the Spring National Meeting to discuss the following matters.

Medicaid Pass-Through Payments (2015-26-H)
The working group discussed a previously exposed informational-only proposal to add a new column for Medicaid pass-through payments to the Underwriting Risk Experience Fluctuation Risk page (XR012 and XR012A). The proposal would apply a 2% charge to these payments through the underwriting risk within the health formula. Following a discussion of comments, the working group instructed NAIC staff to make editorial changes to the proposal which was adopted on February 23. Subsequently, NAIC staff proposed corrections to add clarifying language to match the intent of the proposal which was exposed and later adopted by the working group in New Orleans.

Subcapitated Payments (2015-27-H)
The working group discussed a previously exposed proposal to allow payments that qualify as a subcapitated payment to be included under Category 3 – Capitations for a Managed Care Credit and provide a credit to companies through the Underwriting Risk component of the health formula for 2015 reporting. A comment was received to clarify the parenthetical reference in the instructions after Category 3 because there is no definition of “subcapitation” in the health RBC formula and instructions. Following the discussion, the working group agreed to modify the parenthetical to read: “(if they qualify as a capitation, as defined by the health RBC formula)” and adopted the proposal for 2015 RBC reporting.

Other Non-Health Factor Proposal (2015-14-H)
The working group had previously adopted a proposal to add a new column for Other Non-Health in the Underwriting Risk Experience Fluctuation Risk page (XR012 and XR012A). After the adoption, the working group continued discussion of this proposal to consider a factor for this column. NAIC staff was asked to analyze the impact of using the proposed 13% factor and industry’s recommendation to double the factor to 26% for non-health business over 5%. A review of the 2014 filed data noted that only 14 out of 943 companies reported non-health business and the largest percentage of non-health business to total premiums was 2.74%. An impact analysis using 13% versus 26% on the three largest companies of non-health business revealed minimal impact to the authorized control level and overall RBC. The working group adopted 13% as the factor for 2016 reporting during its February call and directed NAIC staff to continue to review the non-health business on an annual basis for material changes.

Individual Premium and Claim Footnote Proposal for 2016 (2016-01-H)
The working group discussed and exposed a proposal to add a new footnote to page XR012-A – Underwriting Risk-Experience Fluctuation Risk to identify the percentage of premiums and claims for individual plans that are inside and outside of the health exchanges. This information would be valuable to regulators in determining if the risk is different for individual plans that are on and off the exchanges and if separate factors would be appropriate. A working group member stressed the importance of identifying what is happening inside the exchanges because there is less control on the part of the companies. Following the discussion, NAIC staff advised that additional modifications were made to the proposal and a new footnote was added to identify the accrual allocation methodology that companies used in providing the percentage break-out. The working group exposed the revised proposal through April 14. No comments were

received and the working group adopted the proposal on April 20.

Health Entity Definition Proposal (2016-04-H)
The chair informed that the term “managed care organization” was replaced with the term “health entity” in the 2015 health RBC formula and instructions and the purpose of the proposal is to add a definition for “health entity” to Appendix 1 – Commonly Used Terms in the Health RBC instructions. Under the proposal, “health entity” is defined as any issuer of a policy or contract providing or offering to provide a plan of comprehensive medical and hospital; Medicare supplement; dental/vision; stand-alone Medicare Part D coverage or other health benefits through individual or group plans and which files the health annual statement blank. The proposal is exposed for public comment through May 4.

Health Care Receivable Factors (2016-06-H)
On April 20, the working group heard an update on health care receivable factors from the American Academy of Actuaries which was the result of their analysis of data from the 2013 and 2014 health annual statements. Based on their study, the AAA recommended increasing the 2016 health care receivables factors from 0.05 for five of the six health care receivables; the pharmaceutical rebates receivables factor would remain at 0.05. The working group discussed the results of the study noting that the Academy’s impact study reflected that increasing the factor to 0.50 would move only two companies from no action to an action level. The working group then agreed to expose two factors for consideration and comment, 0.19 and 0.50, for Claim Overpayment Receivables, Loan and Advances to Providers, Capitation Arrangement Receivables, Risk Sharing Receivables, and Other Health Care Receivables, with the intent to implement one factor. The exposure period ends May 20.

Asset Risk
The working group heard an update from the Health Risk-Based Capital Drafting Group that was formed at the 2015 Summer National Meeting to study the rationale and development of the asset risk factors in the health RBC formula. The drafting group reviewed the American Academy of Actuaries reports from 1994 to 2011 and NAIC minutes from 1993 to 2002. The drafting group concluded that over time, the working group had focused primarily on underwriting risks, which had been identified as the predominant risk for health entities, and that very little time and effort was spent on the investment/asset risk component. This was because asset risk for many health organizations has relatively little impact on the overall risk portfolio of the health formula and based upon the cost/benefit analysis, historically the working group did not consider it necessary or justified to deploy resources to study asset-related risks on its own. Instead, the working group, time and time again, decided to use the asset risk factors developed in the P/C formula due to similarities between health entities and P/C companies. Health entities typically have a smaller investment portfolio compared to the other risk components. Therefore, from a capital requirement perspective, investment/assets risks are generally not as significant for health entities. Following the discussion, the working group submitted a memo to the Capital Adequacy Task Force summarizing its findings.

Valuation of Securities Task Force

The task force met via conference call on March 17 and February 22 and in person in New Orleans and discussed the following projects.

Reporting Exceptions
The SVO staff provided a final report on its project to evaluate why a large population of securities are reported as filing exempt but do not appear on credit rating provider data feeds. The SVO reported that the securities included in the JumpStart Exception Report fall into three exception categories. The largest population involves private letter rating securities. The major NRSROs have told the SVO that the issuer in these transactions must agree not to disclose the rating before the NRSRO will agree to give it a private rating. SVO staff recommended that insurers file evidence of a monitored private letter rating or file the security with the SVO for an NAIC Designation. A second population involves securities shown on the NRSRO websites as rated but not in CRP data feeds. SVO staff recommended that the P&P Manual be amended to state that if a security is not found on NAIC systems, it should be considered not rated and should be filed with the SVO.

The third population involves securities where an insurer reported ratings obtained from Bloomberg, which is not a Credit Rating Provider recognized by the NAIC. SVO staff suggested that this population can be addressed by having the SVO become the source of FE determinations and recommended that the task force consider making the FE determination an administrative function of the SVO. The task force adopted a motion to release the SVO report for public comment until May 4 and form a working group to study the issues with the SVO and industry representatives, review comments received and make recommendations to the task force within four months of beginning work.

After exposure of the report, the task force heard from interested parties. A representative of the ACLI voiced support for the creation of a new group to analyze the issues and “other exceptions that some may not believe are entirely accurate.” A representative of the North American Securities Valuation Association stated that NASVA does not support the report or the various proposals in it based on their review of nearly 5,000 securities. The chair of the task force responded that many of the rules are complex and interactive, and that he is not sure if it is a compliance issue on the part of the industry or misunderstandings of the rules.

Consideration of Amending SSAP 43R

The SVO and NAIC staff are requesting a proposal to amend the definition of loan-backed and structured securities (LBaSS) in SSAP 43R. The proposal relates to concerns raised by industry with changes to SSAP 43R adopted in 2010. The amendment caused many fixed income assets such as trust or credit tenant loans that were previously accounted for as bonds under SSAP 26, to be classified as SSAP 43R securities. This change affected capital market pricing, risk assessment and raised questions as to whether the credit assessment methodology that existed previously would continue to apply. The concerns arose again as part of the SAP Working Group’s Investment Classification Project. SVO staff agreed to work with the statutory accounting staff to analyze the issues and propose a definition for LBaSS that might be responsive to the concerns expressed. The proposal was exposed for comment until June 3.

Definition of Loans

NAIC and SVO staff are coordinating a project to clarify how bank loans are treated under NAIC guidance and explain what loans are in scope of existing statutory accounting guidance, as well as add specific guidance in the P&P Manual. The proposed P&P Manual amendment contains definitions of different types of loans, reorganization of reference material and guidance regarding the proper documentation requirements. The proposed amendments were exposed for comment until May 22.

At the VOS Task Force meeting, staff for the SAP Working Group noted that the working group is not likely to release an issue paper or clarifications to SSAP 26, Bonds, for this issue until sometime after the Summer National Meeting.

RMBS/CMBS Assumption Setting

The Structured Securities Group of the IAO is proposing that the task force eliminate the existing requirement for a series of public meetings to set macro-economic assumptions, scenarios and risk weightings for the annual financial modeling of RMBS and CMBS. SSG representatives noted that after the financial crisis, the public process was important to ensure transparency as financial modeling was a new methodology to determine the rating classes of RMBS and CMBS. The SSG believes that the necessity of public meetings has decreased over the years as the methodology and process are both well understood by interested persons and capital market advisors. The NAIC also created an in-house analytical staff to administer the financial modeling methodology. At the Spring National Meeting, the amendment was exposed for comment until April 22.

IAO P&P Manual Relationship to the APP Manual

Consistent with a project being pursued by the SAP Working Group, the VOS Task Force discussed collaboration and coordination between the two groups and exposed for comment proposed policy level amendments to the P&P Manual to describe SVO and SAPWG staff interaction. Significant proposed guidance includes the following:

> The assignment of an NAIC Designation to an Obligation or asset, whether by the SVO, by an insurer under the filing exemption described in Part Two Section 4 (d) or pursuant to any other process specified or permitted in this Manual, does not determine the status of that Obligation or asset under the NAIC *Accounting Practices and Procedures Manual*. The assessment of credit risk as specified in this Manual is a separate and distinct process from the determination of the statutory accounting status under the *Accounting Practices and Procedures Manual*.
>
> Because SVO analytical determinations of credit quality do not convey opinions, conclusions or informational content relative to statutory accounting status, the SVO may assign an NAIC Designation to any Obligation or asset that is filed by an insurer provided its credit quality can be assessed consistently with the polices and methodologies specified in this Manual.

The proposed amendments are exposed until May 22.

Derivative Instrument Model Regulation

At the Fall National meeting, the task force exposed for comment a joint Investment Analysis Office/ ACLI recommendation that the *Derivatives Instruments Model Regulation* be retained as a national standard and that the model does not need updating as a result of the detailed study done by IAO, the ACLI and the task force. No comments were received during the comment period, and at the Spring National Meeting the task force adopted the

report as final. The Financial Condition Committee also adopted the recommendation in New Orleans.

Filing Process Modernization
The task force received a report from the SVO staff on a project to develop a new computer system to support SVO production of NAIC Designations and modernize rules governing how securities are filed with the Securities Valuation Office. SVO staff and industry representatives prepared a joint statement that identifies agreed-upon principles and objectives to guide system design of existing filing rules in a fully electronic (as opposed to a paper-based) filing environment. SVO staff and industry representatives requested that the task force approve the statement so it can be used as a guide during the initial stages of system design. A regulator-to-regulator session will be held to discuss internal NAIC issues related to the system redesign. The report was exposed for comment until June 3.

International Accounting Standard Considerations
At the Spring National meeting, the task force adopted an amendment to the P&P Manual to add Italian GAAP as a National Financial Presentation Standard, which will allow insurers to file securities with the SVO with audited financial statements prepared on the basis of Italian GAAP without a reconciliation to U.S GAAP or the IASB IFRS. The ACLI then requested that the SVO staff study Belgian GAAP with the goal to be added to the NFPS list. The task force approved the request to proceed with the analysis.

SEC Changes to Money Market Fund Rules
In 2014, the SEC adopted changes to money market fund rules, including a rule prohibiting institutional prime funds from using stable net asset value of $1.00 a share, effective October 14, 2016. During its March 17 conference call, the task force proposed an amendment to the P&P manual to remove instructions for the Class 1 List, which was exposed for comment. At the Spring National Meeting, the amendment was adopted, and is effective as of September 30, 2016. As a result, the Class 1 funds are completely removed (but U.S. government guaranteed money market funds are still list on the U.S. Direct Obligations/Full Faith and Credit Exempt List).

NAIC Bank List
The SVO maintains a bank list of approved issuers of letters of credit (LOCs) as collateral in reinsurance arrangements. Working with the Reinsurance Task Force, the VOS Task Force concluded that non-bank financial institutions (NBFIs) are regulated as strictly as banks and, therefore, should be considered for inclusion on the list of approved issuers of LOCs. The VOS Task Force has developed procedures and eligibility standards to determine which NBFIs should be included on the proposed List of Qualified U.S. Financial Institutions; these criteria include an NRSRO rating of Baa/BBB or better for LOCs or long-term debt obligations. The proposal was adopted by the VOS Task Force during its February 22 conference call and by the Reinsurance Task Force in New Orleans. The VOS Task Force will now work with the SVO to implement the proposal.

Group Capital Calculation Working Group

The newly formed Group Capital Calculation Working Group held its first public meeting in New Orleans. Its charge is to construct a U.S. group capital calculation using an RBC aggregation methodology. The objective is to develop a consistent method for calculating group capital and provide a "baseline quantitative measure for group risks" as a useful tool for state financial regulators to utilize in their group assessment work. The working group will liaise as necessary with the ComFrame Development Analysis Working Group on international capital developments and consider group capital developments by the Federal Reserve Board.

During the Spring National Meeting, the ACLI and the American Insurance Association provided an overview of their joint proposal of a group capital calculation, which will follow an approach based on aggregation of local solvency measures and calibration across measures to ensure comparability to provide a group-wide solvency ratio. (The proposal document has been posted to the NAIC's website.) The group capital calculation is not to be viewed as a model regulation or standard; instead, it would be a principles-based approach to assist state regulators and supplement group solvency rules. The aggregation and calibration approach must be comparable and transparent across regimes.

Some of the key policy issues to be addressed are which entities would be subject to the calculation, how state regulators will implement and coordinate assessment of the calculation, and the basis and scope of an insurance commissioner's authority to adopt the calculation. A representative from the trade association NAMIC asked how the regulators specifically intend to use the calculation and also recommended that the calculation be field tested before implementation, similar to significant changes to RBC such as catastrophe risk.
The ACLI and AIA will work with the NAIC to address the issues raised and will arrange conference call meetings in the coming months, but no calls have yet been scheduled. The chair noted that the

goal of the working group is to progress "very quickly" and he specifically encouraged insurers which have discussed group capital with the Federal Reserve to provide comments to the working group. No proposed timeline for completion of the calculation was discussed.

Group Solvency Issues Working Group

The working group met in February via conference call and in New Orleans to discuss its projects in progress.

Form F Survey
As a result of all states now adopting the 2010 revisions to the *Insurance Holding Company System Regulatory Act* (#440) and *Model Regulation* (#450), regulators now receive Enterprise Risk Reports (Form F) as required by the models. The working group asked NAIC staff to draft a survey for the states, to allow the working group to evaluate the effectiveness and value of the Form F process. The survey requests an overall evaluation of the Form F's value, specifically providing a rating from "valuable" to "not valuable," as well as comparing the information in Form F to the ORSA Summary Reports. The working group adopted the survey and requested member responses by May 20.

ORSA Implementation Subgroup
During the February 10 conference call, the chair noted that 35 states have adopted ORSA, and as such, the Financial Analysis and Financial Condition Handbooks have been amended to support the review of ORSA Summary Reports. To assist states further, and provide additional guidance in the Handbooks, the working group approved the creation of an ORSA Implementation Subgroup. The subgroup would likely gather and collect feedback on ORSA, enable consistent reviews, and incorporate actuaries in the ORSA review. Ten states have joined the subgroup, which represents a majority of states with ORSA fillings; the representatives include both financial and actuarial experts.

ComFrame Development and Analysis Working Group

Non-traditional Insurance Activities and Products
The working group met via conference call in December to discuss products or features that may be considered non-traditional/non-insurance (NTNI) by the IAIS, which would receive higher capital requirements in the IAIS capital framework, specifically the Base Capital Requirement (BCR) and Higher Loss Absorbency (HLA). In November 2015, an IAIS drafting group exposed for comment clarifications to its NTNI designation, which was originally published in 2013. The IAIS' intent is to gather information on common products for each jurisdiction, and determine how it would compare to the proposed framework. The discussion focused on five products with market and liquidity features, including variable annuities with guarantees, fixed index annuities, guaranteed investment contracts, stable value products and funding agreement-backed securities. It was noted that variable annuity products in Europe are often sold in banks, and therefore would be NT (non-traditional) for an insurance company, and in addition variable annuities with living benefits would likely be considered NT in Europe.

Update on IAIS ComFrame
During the Spring National Meeting, the working group heard an update on the field testing and ComFrame Revision Process. The IAIS working groups, Capital Development and Field Testing, were combined in 2016 to form the Capital, Solvency and Field Testing Working Group. The third round of quantitative field testing is planned to start in late May, and will be conducted in two phases. The first phase due in July will focus on discounting and will coincide with reporting of the BCR and HLA. The second phase due in September will include other ICS testing, including risk stresses. It was also noted that ICP 12, Winding–up and Exit from the Market, and ICP 26, Cross-border Cooperation and Coordination on Crisis Management and parts of ComFrame will likely be exposed for public consultation in June.

In addition, the working group heard a presentation on the discounting and margin over current estimates (MOCE) aspects of IAIS ComFrame field testing. The presentation considered the issues and questions arising from each approach, and compared, where applicable, to similar concepts in U.S. statutory and/or GAAP principles.

International Insurance Relations Committee

The International Insurance Relations Committee met by conference call each month between the Fall and Spring National Meetings, and discussed the following topics.

FSB's Document on Resolution Strategies
On a December conference call, the committee discussed draft NAIC comments on this consultative document issued by the FSB entitled "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers." The three areas of

focus in the NAIC's comments were 1) the need to acknowledge differences in jurisdictional regulatory authority; 2) noting that the NAIC's primary focus is policyholder protection and not financial stability; and 3) appropriate consideration of "policyholder protection schemes" or the value of guaranty associations, as a beneficial measure in resolution planning, rather than just a source of funding. The motion passed to submit the comments to the FSB, and interested parties on the call were equally supportive in their comments.

IAIS Consultations
On a January conference call, the committee discussed draft comments on two consultative documents issued by the IAIS: "Non-Traditional Non-Insurance Activities and Products" and "Global Systemically Important Insurers Proposed Updated Assessment Methodology." The NAIC comments on the first document focused on requesting the IAIS to elaborate on how products or product features equate to potential systemic risks to the financial system, and largely leveraged the ComFrame discussion on the topic (Refer to that section of the newsletter). On the second document, the NAIC comments focused on the desire for greater transparency to the firms participating in the G-SII assessment and to the public. The committee passed the motion to submit the comments to the IAIS.

IAIS Stakeholder Procedures
On a February conference call, the committee discussed if any improvements could be made to the IAIS stakeholder procedures. The chair, Commissioner McCarty of Florida, explained that the IAIS recently created a task force to consider potential improvements to stakeholder engagement. In comments provided by interested parties, most felt the IAIS should continue to improve coordination and communication with stakeholders. Other suggestions raised during the call included allowing stakeholders at the annual conference, 90-day comment periods, public listing of all IAIS committees and sub-committees, and transparency into deliberations in arriving at an ultimate position.

During the Spring National Meeting, the committee discussed the following topics.

Update on the IAIS
Standard Setting – Commissioner McPeak (TN) discussed IAIS consultations in process. Certain aspects of Module 2 and 3 of ComFrame are scheduled for release over the summer. There are a number of ICPs scheduled for public consultation in the fall: ICP 3–Information Exchange and Confidentiality, ICP 9–Supervisory Review and Reporting, ICP 10–Preventive and Corrective Measures, ICP 11–Enforcement, ICP 24–Macroprudential Surveillance, and ICP 25–Supervisory Cooperation and Coordination. In addition, issue papers on cyber risk is expected to be released in the late spring or summer.

Financial Stability – Director Hartt (NJ) spoke to three areas of focus for the IAIS in financial stability. The first reflects revisions of the indicators for the G-SII methodology, which will require additional data elements to be included in testing. The second is the ongoing efforts to update the definition of non-traditional/non-insurance activities. Lastly, he noted the IAIS continues to analyze the application of the loss absorbency capacity to G-SIIs in capital adequacy and resolution.

Implementation Activities – The committee heard that there are three reviews underway, specifically in market conduct, solvency and macroprudential surveillance and reinsurance. The IAIS is also expected to perform an assessment of supervisory cooperation and information exchange later in the year.

Update on the OECD
The international think tank, Organisation for Economic Co-Operation and Development, "provides a forum in which governments can work together to share experiences and seek solutions to common problems" is now studying insurance issues. The committee learned that the upcoming OECD meeting will include the following agenda topics: 1) a draft report on analytical tools in the insurance sector; 2) a draft report on policy considerations and consumer protection related to annuity products; 3) a new project on cyber risk insurance; 4) a draft report on the financial management of flood risks; 5) a report on the investment strategies of insurers and long-term investment and 6) revisions to the OECD Guidelines on Insurer Governance.

Financial Stability Task Force

The chair gave opening comments at the Spring National Meeting noting significant activities by FSOC, IAIS and the FSB, including work on resolution of insurers (discussed below) and the rescission by a federal judge of FSOC's determination that MetLife is a systemically important financial institution, which could have broad implications for the FSOC process and the companies assessed under it. The task force then heard detailed presentation on other projects as follows below.

FSB Consultation on Resolution Strategies
The task force, in addition to International Insurance Relations Committee which provided comments on the consultation, discussed the draft paper "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers." The chair noted that many of the FSB recommendations may not be implemented due to the NAIC's focus on policyholder protection (versus effective resolution). The Receivership Model Law Working Group is looking at the FSB's Key Attributes to determine if there are any aspects that the NAIC should consider incorporating into the NAIC model acts.

Low Interest Rate Environment
NAIC actuarial staff presented the latest low interest rate study of 713 U.S. life insurance legal entities from 2007 to 2014. The study indicated that the declining difference between net asset portfolio yield and the guaranteed interest rate on insurance liabilities resulted in reduced cumulative revenue in the life insurance industry of $100 billion. NAIC staff relayed some life insurer strategies to combat the low interest rate environment including lower credited interest rates on in-force policies, reduction of guarantees on new business, use of interest rate derivatives, extension of investment duration, lower credit quality of invested assets, and diversity into other lines of business. The U.S. life insurance industry is still in a positive cash flow environment in which income exceeds expenses. In the next five years, over $622 billion book value of invested bonds will mature and need to be reinvested. The NAIC is completing the 2015 annual interest rate study and will review the results for individual companies and focus on companies approaching a zero spread.

Reinsurance Task Force

The task force met in December and January via conference call and at the Spring National Meeting with the goal of completing the revisions to the credit for reinsurance models in 2016.

Credit for Reinsurance Model Law
During its December conference call, the task force exposed revisions to the Credit for Reinsurance Model Law (#785), providing regulators with model legislation for certain captive reinsurance transactions, including XXX/AXXX transactions. The exposed revisions to the model incorporated industry concerns regarding its scope, and specifically would apply to 1) life insurance policies with guaranteed non-level gross premiums or guaranteed non-level benefits; 2) universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period; 3) variable annuities with guaranteed death or living benefits; 4) long-term care insurance policies; and 5) other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance.

On its January 6 conference call, the task force discussed the six comment letters received from state regulators, industry groups and insurance companies, all of which were supportive of the revisions. The ACLI noted that the grandfathering language did not directly align with similar language in AG 48. The task force directly NAIC staff to send a referral to the Life Actuarial Task Force to consider amending the AG 48 sunset provision. The task force then adopted the revisions to Model #785 as exposed unanimously.

In New Orleans, the task force met to discuss the following topics:

XXX/AXXX Credit for Reinsurance Model Regulation
With the model law being completed, the task force focused on finalizing the related revisions to the model regulation. In previous national meetings, the task force discussed various options to determine to what extent the credit for reinsurance should be reduced if there is a shortfall relative to the Primary or Other Security collateral, as included in the proposed XXX/AXXX Model Regulation for transactions subject to AG 48. In a narrow vote in the fall, the task force approved the "all or nothing" credit, which only allows a credit for reinsurance if the entity maintains primary security holdings equal to the principal-based reserve. With this revision, the task force exposed the full proposed model regulation through March 27, and received seven comments, which were discussed during the Spring National Meeting.

Certain comments received focused on exempting smaller reinsurers that meet certain RBC thresholds, stating the model may be anti-competitive for small professional reinsurers. Discussion followed as to whether a wording exemption could be drafted to exclude such reinsurers, as the intent of the model was focused on captives. In addition, although initially voting for the "all or nothing" approach, Vermont's comment letter noted this may cause "unnecessary strain" on the cedant, and a proportional reduction in credit may be better.

During the meeting, a concern was raised as to whether the 15-day remediation period, the time period allowed to remediate a shortfall in collateral, was a sufficiently long period of time. A suggestion was made that potentially having the "all or nothing" credit consequence if compliance is not achieved after a quarter, while allowing a proportional approach in the interim. The ACLI also pointed out

potential unforeseen consequences the "all or nothing" approach may have on a risk transfer assessment, as well as noting a repeat of the recent financial crisis could have potential "catastrophic consequences" on meeting this requirement. ACLI suggested that either more time be provided to meet the shortfall, or move to a proportional approach. To this point, the ACLI pointed out the difference in this proposed model as compared to AG 48, which does call for a dollar for dollar reduction in credit for reinsurance. Others, including two large mutual insurance companies, supported the model as written.

As a result of the comments received and discussion during the meeting, the task force requested NAIC staff to work with the XXX/AXXX Captive Reinsurance Regulation Drafting Group to revise the model regulation. An interim call to discuss a new draft has not yet been scheduled.

Status Report of the 2011 *Revised Credit for Reinsurance Model Law* and *Model Regulation* (#785 and 786, respectively)
The task force received a status report of the states' implementation of model #785 and #786; as of the end of March, 32 states have passed #785, and 22 of those enacted #786. This represents 66% of the direct written premium written in the U.S.

Report of the Reinsurance Analysis Working Group
The working group recommended three renewals for certified reinsurer passporting status, bringing the total to 27. In addition, the working group made mostly clarifying revisions to the Uniform Application Checklist for Certified Reinsurers, which is exposed for comment through May 6.

Variable Annuity Issues Working Group

The working group's met via conference call on February 12 and April 25.

Proposed 2016 Disclosures
At the Fall National Meeting, the working group exposed for comment a "first draft" proposal of potential disclosure changes that would require a new disclosures in the 2016 financial statements for annuities with the objective of "providing all stakeholders (e.g., regulators, consumers, and investors) with more transparency and additional insights into how the contractual obligations could change over time as well as the insurance company's ability to manage those obligations." The proposal included additional detail on variable and fixed annuity contractual obligations and the impact of changes in factors on variable and fixed annuity liabilities.

The working group received comments letters from the ACLI, the American Academy of Actuaries, the Connecticut Insurance Department and the Insured Retirement Institute and held a brief call on February 12 to form a drafting group to study the comment letters and prepare a revised proposal. The drafting group includes New Jersey (chair), Connecticut, Iowa, Missouri, the ACLI, and the Center for Economic Justice.

During its April 25 call, the drafting group presented a revised proposal to the working group which includes revisions to the 2015 annual and audited financial statement footnote and a revised Interrogatory 9.2. Significant changes from the prior drafts include an addition to SSAP 61R to require disclosure of permitted practices that apply to VA captives, along with example disclosures. Interrogatory 9.2 would be significantly revised to provide more meaningful benefit details about VAs with guarantees, and separately show reinsurance credits for captive and non-captive amounts. The drafting group noted that the amount of information proposed for the revised 9.2 creates formatting issues, so the Interrogatory may need to be moved to a supplemental exhibit. The proposed Interrogatory 9.2 requires disclosure of the following:

> For variable annuities with guaranteed benefits disclose the type(s) of guaranteed benefit(s), the number of contracts or certificates with those benefits, the amount of the benefit base related to each type of benefit, the net amount at risk for death benefits and the guaranteed annual payout for income and withdrawal benefits, the gross amount of the reserve for the guaranteed benefit(s), the portion of the contract/certificate account value related to contract/certificate funds in the General Account or the Separate Account and the percent of the guaranteed benefit reinsured.

The revised disclosures are exposed for comment until May 25.

The drafting group chair noted that they expect to recommend new standardized disclosure items to the AG 43 Memorandum by the end of June. The drafting group has not yet developed a disclosure for fixed annuities for a more uniform disclosure of all guaranteed living benefit features and asked for feedback as to whether a separate group should be established for that task and for similar CDA disclosures.

Quantitative Impact Study
The working group engaged Oliver Wyman to assist in the study of variable annuity issues. Fifteen VA writers are participating, which includes companies that have VA captives and those who do not. The QIS started in February and will continue through July. The final report is due in September but a progress report is expected at the Summer National Meeting.

Blanks Working Group

The working group held two e-votes in December to complete open items for 2015 and also met in New Orleans to work on 2016 revisions to the annual statements.

Schedule D, Part 1 Guidance
The working group held e-votes in December to expose and then adopt for 2015 reporting the Schedule D, Part 1 Guidance document for posting to the working group's webpage. The document was developed by the Investment Reporting Subgroup and is intended to provide voluntary reporting guidance for the description column, issue column and capital structure code column for Part 1 of Schedule D. In 2016, this informal guidance was converted into BWG agenda item 2016-02 for authoritative use for 2016 annual statements.

Adoption and Exposure of Proposals
At its Spring National Meeting, the working group adopted two new proposals which included final adoption of the long debated Schedule F proposal (2016-26BWG). The revision adds a new supplement with details of reinsurers on Schedule F, Part 3 and conforming modification to the existing instructions on Schedule F, Parts 3 and 5. Additionally, the new proposal adds changes to Schedule F Part 3 for asbestos and pollution contracts. A disclosure Note 23J is also being added.

The working group also adopted clarifying instructions to the Schedule D, part 1A, section 1 footnote. The purpose of this proposal is to remove references to "non-rated" and clarify what is to be reported for Cash and Cash Equivalents in the footnote for Schedule D, Part 1A, Section 1 of the annual filing and Schedule D, Part 1B of the quarterly filing. (2016-25BWG)

Twenty-two blanks proposals were exposed for a public comment period which ends May 16. These proposals will be considered for adoption on a conference call to be scheduled in June. The more significant proposals, which would be effective for 2016 annual statements, include the following and would:

- Add a column to schedule Y, Part 1A to identify SCAs where an initial or annual NAIC filing is required. It would also add an electronic-only column for legal entity identify. It would also add a column to schedule D, Part 6, Section 1 to identify non-admitted amounts. (2016-01BWG)

- Modify the definition of XXX Life on Schedule S Part 3, Section 1, so the wording is similar to the instructions for the Supplemental XXX/AXXX Reinsurance Exhibit. (2016-05BWG)

- Reduce the number of codes from 12 to four for the foreign code column on Schedule D. It would also remove the foreign code matrix. (2016-06BWG)

- Modify the Annual Statement Instructions for Schedule D, Part 1 to provide clarification on the Bond Characteristic Column. (2016-07BWG)

- Clarify regulatory requirements to insurers and appointed actuaries and add instructions in the P/C Statement of Actuarial Opinion and the Actuarial Opinion Summary regarding error discovery and consistency between actuarial documents. (2016-09BWG)

- Add a definition of "SVO-designated securities" to the Investment Schedules General Instructions. (2016-18BWG)

- Add illustrations to Note 23G, Reinsurance, for insurers ceding XXX/AXXX business to captive reinsurers and related RBC disclosures. (2016-19BWG)

Many of the other blanks proposals not separately discussed above are proposed revisions to the Notes to the Financial Statements to reflect recent adoptions by the SAP Working Group (and which are summarized in that section on the Newsletter.)

Investment Reporting Subgroup
The subgroup met via conference call in February and March 21 and adopted the 2016-02BWG, 2016-06BWG, and 2016-07BWG proposals discussed above. The subgroup also discussed a proposal to update Investment General Interrogatory 28 to provide additional information about the use of investment managers by insurance companies. The subgroup noted that responses to this interrogatory in the past have been very inconsistent. Based on comments received, the subgroup agreed to change the "assets under management" column to a yes/no question based on the percentage exceeding 10% of invested assets for individual external asset managers and 50% of the aggregate external asset

managers. This revision was made as a result of concerns voiced by interested parties that the interrogatory is public and the subgroup's original proposal included confidential and/or competitive information.

Finally, the subgroup began discussions on the current collateral type codes for Schedule D, Part 1. The subgroup plans to review the current 21 codes and consider reducing the number of codes for annual 2017 reporting.

Governance Review Task Force

At the Spring National Meeting, the Governance Review Task Force discussed possible improvements to Letter Committee, Task Force and Working Group selections, regarding structure and composition. Commissioner Jones (CA) proposed that state market share information be provided each year for the representatives that are being selected for a given committee, consistent with the information Director Huff provided during this past year's committee selection process. He added that there shouldn't be a requirement to meet certain thresholds, but rather it is helpful information in assessing a committee composition. It was also suggested that the number of years on a committee may also be useful in deciphering the more tenured representatives on each committee. The chair, Commissioner Ridling (AL) suggested that the candidate's skillsets should be incorporated into the committee selection questionnaire.

During the "any other matters" section of the agenda, Commissioner Donelon (LA) made a recommendation to adopt a motion that would require a 2-year "cooling off" period before a former state regulator could be hired by the NAIC. He noted that many states require this at the congressional level, and this measure would diffuse perception that the NAIC is a fraternal organization, rather than a public policy organization, particularly since the NAIC is currently seeking a new CEO.

Commissioners Jones, Donegan (VT), Nickel (WI) and others voiced their disagreement with motion. They collectively thought this requirement would be unnecessary, and could prevent the NAIC from considering the best candidates. Support was voiced by one commissioner who is not a task force member. Ultimately no other task force member seconded the motion, and as such, it failed to reach a vote.

Life Insurance and Annuities Committee

The committee met at the Spring National Meeting and discussed the following topics.

DOL's fiduciary/conflict of interest rule making

The committee heard an update from NAIC staff on the U.S. Department of Labor's proposed regulation to broaden the definition of "fiduciary" under the federal Employee Retirement Income Security Act and the Internal Revenue Code. The DOL released the final rulemaking on April 6. Under the new rule, investment advice given to an employee of a benefit plan or individual retirement account is considered fiduciary advice and therefore must be in the best interest of the investor. The rule is comprehensive and complex, and greatly expands the definition of who is considered an ERISA fiduciary to include many insurance agents, insurance brokers and insurance companies. The final rule extends the implementation timeline. The new fiduciary standard for investment advice is effective April 10, 2017 and firms will need to comply with several conditions by this deadline to utilize the best interest contract exemption. Full compliance with the new standard was delayed until January 1, 2018.

During the meeting, NAIC legal staff noted that the NAIC "has reiterated the importance of not limiting insurers' ability to sell proprietary products and encouraged the DOL to consider clarifications to affirm that proprietary product sales are consistent with the standards proposed in its rule." Since the final rule was released two days after the committee met in New Orleans, it is not known what response, if any, the committee or the NAIC will have on the final rule.

Pricing of Certain Separate Account Products

The committee discussed a recommendation from the Financial Condition Committee on the issue of sufficiency of pricing of non-variable life insurance products in separate accounts. The proposal would require a qualified actuary to provide an opinion on the sufficiency of pricing for new filings and an annual update on sufficiency. If pricing was deemed insufficient the company would need to discontinue sales of the contract until the pricing is adequate and the filing has an updated opinion from a qualified actuary. The recommendation was a result of the Financial Condition Committee's study in 2014 of separate account products and whether the general account was receiving adequate compensation to cover the risk borne by the general account

The committee voted to refer the issue to the Life Actuarial Task Force, which will review the

recommendation to require a new filing for non-variable life insurance products.

Contingent Deferred Annuity Working Group
The committee disbanded the working group at the Spring National Meeting, noting that the working group had completed the majority of its charges since creation. The committee will now oversee the resolution of the three outstanding CDA related issues, which are the adoption of CDA related revisions to the *Standard Nonforfeiture Model Act (#805)*, a checklist for state insurance regulators to use in reviewing the risk management program of insurers proposing to offer CDAs, and the possible creation of a CDAs Buyer Guide.

Life Insurance Policy Locator Service
The committee heard an update on feasibility of the NAIC developing a life insurance policy locator service. The staff have outlined a process whereby consumers could submit a request on the NAIC's website and have outlined additional steps for the NAIC to consider should the committee decide to pursue the policy locator service, which includes putting together a formal proposal.

Life Insurance Illustrations Issues Working Group

The 2016 charge of working group is to explore how the narrative summary required by Section 7B of the *Life Insurance Illustrations Model Regulation* (#582) and the policy summary required by Section 5A(2) of the *Life Insurance Disclosure Model Regulation* (#580) can be enhanced to promote consumer readability and understandability of these life insurance policy summaries, including how they are designed, formatted and accessed by consumers. The working group intends to present a report to the Life Insurance and Annuities Committee, with preliminary recommendations on enhancements to the narrative and policy summaries by the Summer National Meeting.

During the Spring National Meeting, the working group heard presentations from the ACLI and Birny Birnbaum (Center for Economic Justice) on issues and ideas on how the working group can fulfill its charge. Mr. Birnbaum believes the current illustrations lack clear and itemized disclosures of fees, charges and potential charges in the future, clear disclosure of the risk associated with different products and investments within the different products, and a lack of comparison to alternative investments. The ACLI will provide the working group with examples of policies summaries and narratives currently in use via a conference call prior to the Summer National Meeting.

Life Actuarial Task Force

During the day and a half dedicated to the LATF meeting, the majority of the discussions related to Valuation Manual amendments, including adoption of some proposals and exposure of others. This topic and other highlights from the Spring National Meeting (and interim meetings since the Fall National Meeting) are summarized below.

PBR Valuation Manual and Related Matters
Valuation Manual Amendment Proposals
During the interim period, LATF discussed, exposed and adopted several clarifying amendments to VM-20 including removal of references to the "seriatim" reserve, and clarifications to the definition of the term "modeled reserve," and also adopted a re-ordered and consolidated version of VM-31 on reporting and documentation requirements. Several additional amendment proposals were discussed at this meeting.

The Spring National Meeting began with discussion of a proposed amendment regarding aggregation of reserves for calculating minimum reserve requirements. The proposed amendment addresses regulator concern that under the current allocation method PBR amounts in excess of the NPR may be allocated to a product that did not generate it, and would bar aggregation of term and ULSG for the calculation of the NPR and for purposes of the stochastic exclusion test.

This conversation led to a broader discussion around assumptions for term products. Several regulators expressed concerns that the assumptions were not as conservative as desired, offering a relatively low guardrail. Specific items mentioned were the expense allowance of $2.50 per $1,000 and the 2017 CSO mortality table. One regulator in particular felt it was arbitrary to maintain assumptions adopted when the 2001 CSO mortality table was the operative table, and not review assumptions wholesale with the adoption of the 2017 CSO table.

The ACLI then proposed an amendment to VM-20 whereby the deterministic exclusion test would be suspended for term products. Furthermore, the regulation would still require companies to calculate the NPR for informational purposes. LATF could then review the results and make changes as they deem appropriate (including retroactive changes). The goal of this amendment is to collect information on NPR while maintaining the goal of having the deterministic reserve be the consistently dominant reserve. Several members of LATF were concerned that the NPR is too low to serve as an effective guardrail and mentioned that perhaps PBR should

be delayed until this issue is cleared up. Silence descended upon the room momentarily.

At this point, representatives from New York Life gave a presentation on NPR noting their concern that this guardrail minimum reserve is lower than LATF anticipated. In particular, they noted that when the NPR methodology was developed, two modeling permissions were included: 1) $2.50 per $1,000 expense allowance, and 2) inclusion of post level term profits.

These inclusions were offered as a way to align the NPR using the 2001 CSO mortality table with the deterministic reserves. With the adoption of the 2017 CSO mortality table, the NPR reserve has consequently fallen. New York Life representatives presented what happens to term reserves for a representative sample of policies as well as the impact for "millennial" policies based on current methodology. In particular, for millennial policies, reserves were near, zero driven by the expense allowance and the post level term profits. New York Life proposed modifying the NPR to eliminate the expense allowance and not include post-level term profits, and instead move to a model whereby the reserve would be X% * (PV Benefits – PV Net Premiums). It was noted that at this time, there is no recommendation for an appropriate level of X. Due to the substantial nature of the change, this proposed amendment was exposed until April 25.

A final proposed amendment regarding aggregation was presented which allows aggregation of term and ULSG only for purposes of calculating the deterministic and stochastic reserves. All other products may be aggregated together but neither term nor ULSG may be combined with other product groups. Additional amendment proposals were made related to the application of the deterministic reserve exclusion test and NPR requirements for term lapse rates. The proposed amendments are exposed through April 25.

It is anticipated that Valuation Manual amendments adopted in 2016 will be included in the version of the Manual that may be adopted by companies as of January 1, 2017.

VM-G Amendments (Corporate Governance)
Both the ACLI and AAA presented amendments to VM-G. These amendments were materially similar and the two groups agreed to coordinate and present a combined amendment form for VM-G.

VM-22 Fixed Annuity PBR
LATF received a report from the VM-22 Subgroup on work related to development of PBR methodology for non-variable annuities. During the interim period, the subgroup focused on work performed by the Academy SVL Modernization Working Group to evaluate the SVL interest rate methodology for non-variable annuities, particularly single premium immediate annuities and structured settlements.

There is general agreement among regulators and industry that the current methodology based on a 12-month corporate bond yield index is outdated and flawed, especially in a low interest rate environment. The Academy working group recommends an approach based on U.S. Treasury rates plus a spread pegged to an average insurer bond portfolio, reset at least quarterly, and daily for contracts greater than or equal to $100 million. The subgroup exposed the report for public comment until April 20, and is considering alternative bases for setting the spread as well as caps to the spread. The subgroup established a drafting group to develop the required content for the Valuation Manual, and plans to make a recommendation to LATF by June 30.

The subgroup also reported that the Academy's Annuity Reserve Working Group re-focused its PBR work on developing a PBR method for non-variable annuities that would be consistent with the future VACARVM. The working group doesn't want to establish a methodology that favors one product over another. A floor reserve (as previously developed by the working group) would be combined with an exclusion test specific to non-variable annuities to determine whether a modeled reserve is required. The proposed framework also includes a simplified valuation of guaranteed living income benefits.

SVL "Significant Elements"
Because the revised *Standard Valuation Law* is an accreditation standard, the Financial Standards and Accreditation Committee has requested that LATF and HATF members review the revised proposed significant elements and provide recommendations prior to the Summary National Meeting. The goal is for the committee to approve the PBR significant elements by the end of this year.

Indexed UL Illustration Subgroup
The IUL Illustration Subgroup was established to consider post-adoption enhancements to Actuarial Guideline 49, *The Application of the Life Illustrations Model Regulation to Policies with Index-Based Interest,* adopted by the NAIC in June 2015. For the past nine months the subgroup has worked on revisions to the guideline to address policies with dual accounts. The issue is that for these policies, each having its own set of charges, the guideline as written allows different rates to be illustrated based on whether charges are implicit or explicit, when in reality the illustrated rates should be the same. During the interim period, the

subgroup re-exposed revisions to AG 49 to address this issue. The revisions reflect comments received during the first exposure period. Following the comment period, the subgroup forwarded the proposed revisions to LATF for consideration, and LATF discussed the revisions at the meeting in New Orleans.

The proposed revisions provide guidance where there are multiple account options within one policy. Specifically, the proposed revisions modify the credited rate to be used to illustrate each Index Account, as well as the account charges and credits applicable to the Benchmark Index Account. The proposed revisions also prevent gaming the illustrations by requiring that each set of Index Accounts corresponding to a Benchmark Account Index independently pass the self-support and lapse-support tests under Model #582. LATF adopted the proposed revisions and will forward them on to the Life Insurance and Annuities Committee for approval.

One issue raised during the discussions was applicability of the guidance to new policies (i.e. as currently prescribed based on issue dates set forth in the guideline) or to new illustrations on in-force policies. The current language may result in different illustrations provided after the effective date for two policies that are identical other than the date of sale. This issue has been raised by interested parties previously and was supported by the Center for Economic Justice at this meeting. LATF members noted that this is a broader illustration question, not a technical matter, and will advise the Life Insurance and Annuities Committee of the issue.

Actuarial Guideline 48 Update
The Reinsurance Task Force recently exposed a new model regulation, *Model Regulation on Credit for Reinsurance of Life Insurance Policies Containing Nonlevel Gross Premiums, Nonlevel Gross Benefits and Universal Life with Secondary Guarantees* that prescribes uniform standards governing reinsurance credits, consistent with Actuarial Guideline 48. At the meeting in New Orleans, LATF members discussed proposed comments on this draft to recommend that the adjustment to the Required Level of Primary Security for an exempt YRT reinsurance arrangement to an assuming reinsurer be the same for policies issued before and after the operative date of the Valuation Manual. LATF members voted to send the comment letter to the Reinsurance Task Force for consideration.

Academy Council on Professionalism
The task force received an update from the American Academy of Actuaries Council on Professionalism and activities within the Actuarial Standards Board and the Actuarial Board for Counseling and Discipline (ABCD). Proposed revisions to Actuarial Standards of Practice 21 Responding to or Assisting Auditors or Examiners in Connection with Financial Audits, Financial Reviews, and Financial Examinations and 23 Data Quality are expected to go before the ASB in June; exposure drafts for both standards are available on the ASB webpage.

The ABCD representative noted a record high number of requests for guidance (a core function of the ABCD) in 2015, and there's been an increase in the number of regulators reaching out for guidance and wanting to understand the discipline process.

Work continues on a third exposure of the Modeling Actuarial Standard of Practice, which has received substantial feedback from actuaries. The ASB is also looking into developing a new standard specific to assumption setting.

During this session, the Academy representatives provided an update on usage of the attestation form released earlier this year, noting that over 1,300 people used the form and that just under 500 people completed the attestation. The form is a web-based application that allows actuaries submitting statements of actuarial opinion to document their qualifications under the U.S. Qualification Standards.

Nonforfeiture Modernization
LATF members heard a brief update from the Academy Nonforfeiture Modernization Work Group. At this point the work group has a model, but doesn't have "guardrail" factors that would be intended to reflect the funded portion of the risks assumed by the company under the policies. Current efforts are focused on deriving these factors and better defining what they stand for.

PBR Review Working Group

The working group met in New Orleans and received updates from its subgroups.

PBR Blanks Reporting Subgroup
The subgroup met March 8 to discuss proposed changes to the exposed revisions to the new VM-20 Supplement. Comments from the ACLI were reviewed and adopted for consideration by the PBR Blanks Working Group.

PBR Review Procedures Subgroup
The PBR Review Working Group adopted in New Orleans the subgroup's proposed revisions to the Financial Analysis Handbook to incorporate principle-based valuation guidance developed by

NAIC staff. The subgroup will now work with staff to develop guidance for the Financial Examiners Handbook prior to the Summer National Meeting.

2016 PBR Pilot Project
The goal of the PBR Pilot Project is to “test out and evaluate the PBR regulatory processes as defined in the *Standard Valuation Law* and Valuation Manual to determine if any changes need to be made to the regulatory processes, requirements defined in the Valuation Manual and reporting requirements as defined in the VM-20 Supplement to the annual statement blanks and the VM-31 reporting requirements.” As of the Spring National Meeting, twelve companies residing in nine states have volunteered for the pilot project. An internal webcast for the NAIC and the participating companies was held to discuss questions and for the NAIC to present the pilot project requirements. The list of companies participating is confidential and the companies participating do not know who the other participants are.

Companies participating in the pilot project will test three aspects of PBR: 1) PBR calculations, 2) VM-20 reserve supplement and 3) VM-31 Actuarial Report. NAIC staff are planning for the work to occur April through August with the hopes of presenting conclusions at the Fall National Meeting. The focus from an NAIC perspective will be on processes and not on numerical precision of the calculations.

NAIC Support for PBR
The working group heard an update on NAIC actuarial staff and modeling software selection. The NAIC currently has two FSAs on staff and one ASA and plans to hire two more FSAs in 2016 to support the states in analysis and examination of PBR valuations. The NAIC actuaries will also work with the Valuation Analysis Working Group to ensure that states consistently evaluate application of the PBR requirements. NAIC staff also reported that they have selected GGY Axis as the modeling software for NAIC work. The models built by the NAIC actuarial staff will be used by the states to aid examinations.

Health Actuarial Task Force

Long-Term Care
At the Spring National Meeting, the LTC Actuarial Working Group heard a presentation from Claude Thau, of Thau Inc., on LTC policy lapse study done by the Center for Retirement Research at Boston College (BC CRR). This was a continuation of a discussion held at the Fall National Meeting. The BC CRR study measured cumulative policy lifetime lapses and concluded that even low annual voluntary lapse rates could accumulate to a significant number of voluntary terminations over time, and that policyholders with cognitive impairment were more likely to lapse. Mr. Thau is critical of the BC CRR’s methods and pointed out limitations of the data and questionable conclusions, citing a risk that readers of the BC CRR report may impute too much credibility on the report’s conclusions.

The LTC Actuarial Working Group also heard a presentation from Dale Hall of the SOA, and Vince Bodnar and Matt Morton from LTCG. The presentation covered feedback received on the most recent SOA Intercompany Experience Study performed by LTCG, which covered claims incidence, claims termination and benefit utilization. The feedback received on the experience study consisted primarily of questions to the authors from actuaries who plan on using the tables seeking additional guidance and technical clarifications to ensure proper use of the study results. A formal Response Report will be drafted to address questions that have been received; however, a timeline for the report was not provided.

The LTC Actuarial Working Group heard two presentations by Warren Jones from PwC representing the American Academy of Actuaries. The first presentation was on Principles-Based Reserving for LTC. At the request of the LTC Actuarial Working Group, the Academy’s LTC PBR Work Group developed a demonstration model for LTC reserves under PBR. The model platform is Excel allowing calculations to be transparent, and the model is generally useable by all actuaries. The report of the AAA LTC Principle-Based Reserves Work Group was published on the Academy website on January 21; see this link.

The second presentation covered the LTC Credibility Monograph being developed by the Academy; see this link. Work to date on the Monograph includes the drafting, informal and formal peer reviews, and formal review by the Academy. The LTC Credibility Monograph Work Group chair is in the process of reviewing the responses to the Academy’s comments. No representation was made as to when the Monograph would be published.

The LTC Valuation Subgroup held several conference calls during the interim period to discuss LTC insurance reserving standards, in connection with the development of a PBR approach for LTC reserves. The discussions focused on current mortality and termination rate requirements as compared to recent experience study results. In particular, discussion has focused on a potential move to the 2012 Individual Annuitant Mortality table from the 1994 Group Annuity Mortality table which is the current standard. These calls included

continued discussion of the joint SOA/LIMRA LTC policy termination experience study, for which results were first presented at the 2015 Summer National Meeting. The results of this study are available on the SOA website. The subgroup will draft requests to the SOA to develop a valuation table based on the study results, and for tabular representation of the experience lapse assumptions.

Individual Disability
The Health Actuarial Task Force heard an update from the Individual Disability Valuation Table Implementation Subgroup regarding adoption of the 2013 Individual Disability Income (IDI) Valuation Table and related updates to Model #10, *Minimum Reserve Standards for Individual and Group Health Insurance*, and VM-25. HATF adopted the 2013 IDI valuation table and associated report via conference call on December 11, 2015. During a conference call on February 12, the subgroup exposed related changes to Model #10 and VM-25. The proposed changes prescribe new minimum standards for claim reserves and clarify that while new requirements provided through the Valuation Manual apply only to policies issued after the effective date of the changes in the Valuation Manual, the requirements for claim reserves are applicable based on the claim incurral date irrespective of the policy issue date, i.e. consistent with historical practice. The comment period closed March 15.

Financial Regulation Standards and Accreditation Committee

Certified Reinsurer Provisions
During many prior meetings, the committee discussed both the optionality of states to adopt the certified reinsurer provisions as part of the Credit for Reinsurance Model language necessary for accreditation and the request from interested parties to make this guidance mandatory since uniformity across the states is critical. At the Spring National Meeting, the committee adopted this proposal effective January 1, 2019.

Definition of Multi-State Insurer
The committee adopted the proposed revisions exposed at the Fall National Meeting to the Part A Preamble related to RRGs and the Part B Preamble. The revisions ensure the description of what constitutes multi-state business is consistent among the Preambles and will apply to RRGs organized as captives. At the Spring National Meeting, the revisions were accepted with an effective date of January 1, 2017. This effective date doesn't apply to variable annuity and long-term care captives, which will be considered after progress has been made on those projects (discussed in other sections of this Newsletter).

Revisions to Modernize the Accreditation Guidance
The committee discussed proposed revisions to the Review Team Guidelines and the Accreditation Review Process and Procedures to help enhance and modernize the accreditation program to provide more valuable feedback both to the states and the Accreditation Committee. Included in the recommendations are those related to the processes for on-site review, such as the elimination of numerical scores for each state as the sole basis for the review team's recommendation, and instead focusing on an overall recommendation by the review team regarding the state's accreditation status. The proposed amendment was exposed for public comment until June 4.

Casualty Actuarial and Statistical Task Force

The task force met by conference call on February 9, March 8, and April 20 and met in New Orleans to discuss the following matters.

P/C Statement of Actuarial Opinion and Actuarial Opinion Summary Proposal
The task force received an update from the Actuarial Opinion Working Group that it had adopted a blanks proposal to update the instructions for the 2016 Statement of Actuarial Opinion and the Actuarial Opinion Summary. Substantive changes proposed include:

- definitions for "appointed actuary" and "board of directors" were added,
- clarifying language was added regarding the need to inform the domestic commissioner only upon initial appointment of the appointed actuary,
- clarification about reliance on another's work product, and
- a requirement to provide an explanation for any material differences between Schedule P and the data used by appointed actuary, and changes in the actuary's estimate on both a net and gross basis.

The working group clarified that "reliance on another person" should not be interpreted that an actuary may rely on a non-actuary for reserve analysis, but could rely on a non-actuary for an activity such as modeling. The working group further clarified that the actuarial analysis for a material portion of the reserves should be performed by an

actuary. Additionally, reliance should be placed on an individual who is credentialed.

Actuarial Standards Board Exposure
The task force discussed comments on the Actuarial Standards Board's second exposure draft of the proposed Actuarial Standard of Practice (ASOP), Property/Casualty Ratemaking, and reviewed a draft comment letter. The task force's discussions focused primarily on the role of the actuary in ratemaking. The chair expressed disagreement with the ASOP's proposal to separately define rate from price, noting that ASOPs 29 and 30 and the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Insurance Ratemaking each define "rate" consistent with one another, whereas the draft ASOP provides a different definition. Additionally, the draft ASOP defines "rate" separately from "premium," noting that the ASOP is not intended to apply to "the price charged after taking into account other considerations, such as marketing goals, competition, and legal restrictions."

The chair commented that the CAS Statement of Principles states that the ratemaking process involves a number of considerations including marketing goals and competition but then adds "to the extent that they affect the estimation of future costs associated with the transfer of risk." In contrast, the draft ASOP seems to imply that these considerations need not be associated with the transfer of risk. Considerable discussion was held by the task force on these issues and when it finally came to a vote on April 20, the draft comment letter failed to pass. Subsequently, NAIC staff was asked to update the draft comment letter to include the task force's different views including the reasons. The task force discussed the revised comment letter on April 28 and after making a few editorial changes, adopted the comment letter for submission to the ASB.

Risk-Focused Surveillance Working Group

The working group met by conference call in February and at the Spring National Meeting to discuss the following topics.

Financial Analysis Handbook
At the Fall National Meeting, the working group discussed a framework and project plan to add risk-focused enhancements to the Financial Analysis Handbook to "encourage more flexibility, promote more incorporation of prospective risks and align more closely to the new Insurer Profile Summary (IPS) format that utilizes the nine branded risk classifications." During its February 22 meeting, the working group exposed its Enhanced Risk-Focused Analysis Process, including a timeline, for comment.

At the Spring National Meeting, discussion focused on comments received from interested parties regarding the proposed framework. Interested parties commented on the lack of specifics in the project timeline, the importance of consistency between the Financial Analysis Handbook and the Financial Condition Examiner's Handbook, accreditation standards, the desire for a strong peer review program, the potential for risk-focused financial analysis training, and the expansion of the peer review process to single state domestic insurers.

After listening to the interested parties, the working group voted to refer the framework to the Financial Analysis Working Group for that group to begin the effort to revise and reorganize the Handbook. Comments received from Texas and Connecticut were not addressed by the working group but were sent to the Financial Analysis Working Group for its consideration. The two working groups expect the project will be completed by year-end 2017 which includes reprogramming and testing automated tools.

Training Schedule
The working group discussed a draft training schedule for 2016 and 2017 for the revised risk-focused financial analysis process discussed above. Overall, the trainings will give analysts an update on the new risk-focused approach and how to implement changes into their monitoring process.

Financial Planning Analysis Guidance
The working group exposed draft financial analysis planning guidance on "Understanding the Company in Risk-Focused Financial Analysis" until June 3. The guidance outlines steps for obtaining information necessary to understand the company and suggests sources of information.

Single State Domestic Insurers
The working group discussed comments received on examinations of single state domestic insurers that are part of a group where the examination is not performed on a risk-focused basis or in accordance with the Financial Condition Examiner Handbook. Interested parties have concerns that in some states, single-state domestic insurers are not subject to a risk-focused surveillance approach. Interested parties suggested an expansion of the peer review project to address the potential issue. The working group referred the comments to the Financial Examiners Coordination Working Group for its consideration.

Mortgage Guaranty Insurance Working Group

The working group met in New Orleans to discuss its projects.

Model Act and Standards Manual
Discussion of the proposed Mortgage Guaranty Insurance Model Act began with the chair remarking that the November 2015 draft is still the most current "official" draft because the working group has spent most of its time since the Fall National Meeting working on the capital model. Industry representatives submitted a track-changes version dated February 2016, and the working group discussed the proposed changes in New Orleans. Industry comments continue to focus on the proposed prohibition of paying any dividends from amounts released from the contingency reserve, and reinsurance issues including the distinction between affiliated versus non-affiliated reinsurers. The representative from California noted that the working group wants to maintain this distinction, and interested parties suggested a compromise of requiring affiliated reinsurers to assume all contingency reserves.

The meeting materials also included version five of the draft Mortgage Guaranty Insurance Standards Manual, which is referenced in the model act, but the manual was not discussed in New Orleans. The comment deadline for the draft model law and the standards manual is August 25.

Capital Model
The working group heard an update on the capital model and that it is nearly ready for public release and will be posted to the working group's webpage. The regulators then plan to hold public hearings "as soon as possible" after that time. As of the date of publication of this Newsletter, the capital model had not been released for comment.

Timeline to Completion
Earlier this year, the working group received approval from Executive Committee for an extension to the 2016 Fall National Meeting to complete its three projects.

Federal Developments
NAIC legal staff gave an update on activities in Washington on housing finance and mortgage guaranty matters; it now appears very unlikely that mortgage industry legislation will be adopted before the presidential election. However, staff believes that such legislation will be one of the first things addressed by the new administration, including a possible merger of FNMA and FHFA as discussed in "A More Promising Road to GSE Reform."

Climate Change and Global Warming Working Group

In New Orleans, the working group heard presentations on rising sea levels and Florida's New Climate Resiliency Adaptation Action Areas.

Rising Sea Levels along Northern Gulf Coast
Researchers continue to study and model climate change and the impacts climate change has on coastal areas. Modeled climate change scenarios have a wide range of potential outcomes. In some scenarios, the sea level rise in the northern gulf coast by the year 2100 exceeds one meter. A sea level rise of this magnitude would have a significant impact on coastal areas and the insurance industry.

Climate Resiliency Adaptation Action Areas
The working group then heard a presentation about Adaptation Action Areas (AAA), which focused on actions that Florida has taken to help combat rising sea levels. The AAA helps prioritize funding for infrastructure and adaptation planning. Municipalities along the coast will face different issues and need potentially different solutions to address coastal flooding as a result of rising sea levels. The AAA aims to limit potential effects of coastal flooding through coordinated efforts and planning, which could ultimately benefit both the municipalities and the insurance industry.

2016 Tentative Work Plan
The working group provided a tentative working plan for 2016 as part of Spring National Meeting agenda. Areas of focus include the following:

- Identify insurer invested asset risks and invite insurers, institutions (such as pensions), reinsurers and consultants to present how they measure and track climate change risks to help determine best practices for insurers to use.
- Review financial examination guidance/ practices and how an insurer's climate actions might impact their exams.
- Review ORSA guidance and discuss what level an insurer should be expected to disclose climate-related issues within its ORSA.
- Identify insurance industry best practices for encouraging climate mitigation and investment practices, such as offering discounts for taking steps to mitigate climate-related losses.

The meeting concluded with discussion focused on the coal industry. California is working with insurers domiciled in the state and encouraging them to divest from coal-based companies. Indiana and Oklahoma do not plan on delivering a similar message in their states where the coal industry and other industries that rely on coal are very important.

Terrorism Insurance Implementation Working Group

The working group heard reports from recent Federal Insurance Office meetings related to collecting terrorism data. The data call will be issued in two parts by the 11 participating states to collect countrywide data on terrorism risk insurance. The first part is to collect workers' compensation data beginning in April and the second will collect commercial lines data in the fall. The NAIC staff discussed that each insurer is to provide one submission, and the NAIC and FIO will coordinate their requests in the future to reduce duplication of data and cost on the industry.

The NAIC staff provided a report on federal activities, including a Federal Register notice requesting feedback on the effectiveness of the Terrorism Risk Insurance Program (TRIP) to assist the FIO in preparing its report to Congress, such as any aspects of the program that impede insurers from providing coverage for terrorism, and the impact on workers' compensation, and availability and affordability. NAIC staff also noted that the Treasury Department has proposed rulemaking to implement changes to TRIP as required by the 2015 reauthorization law and to propose some other changes; comments are due May 31.

The U.S. Treasury Department is set to issue a supplemental data request and may propose to allow small insurers to be exempted from the request. Small insurers are defined as those with less than $500 million in annual premium, which one regulator thought was "unreasonably high" to be considered a small insurer.

Sharing Economy Working Group

Sharing Economy Product Updates

The working group heard an update from the Insurance Services Office regarding approval of its TNC products in 42 states and development of home-sharing products which cover theft, vandalism, liability coverage and personal injury. The working group then heard a presentation from Airbnb regarding insurance coverages it provides to hosts, guests and landlords for rental properties listed on its website and mobile application including property damage, liability and third party bodily injury.

After the presentations, the chair suggested that the working group discuss insurance requirements of proposed legislation for short-term rental or home-sharing companies to consider developing and promoting a uniform approach to insurance legislation.

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The next National Meeting of the NAIC will be held in San Diego August 26-29. We welcome your comments regarding issues raised in this newsletter. Please provide your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor at jean.connolly@pwc.com.

Disclaimer

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

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

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AUTHORS WANTED

The Publications Committee is looking for members to write articles for the quarterly Examiner magazine. Authors will receive six Continuing Regulatory Credits (CRE) for each technical article selected for publication.

Interested authors should contact the Publications Committee Chair, **Tian Xiao**, via **sofe@sofe.org**.

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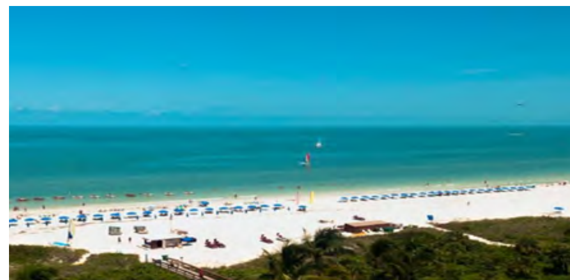
2016

July 31–August 3
Indianapolis, IN

Indianapolis Downtown Marriott



2017

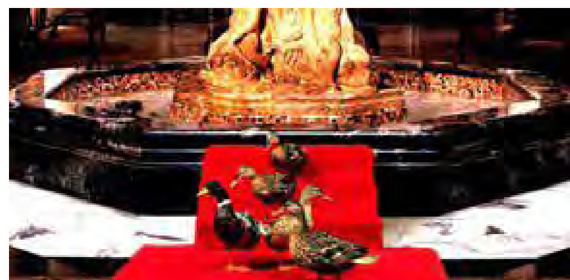
July 23–26
Marco Island, FL

JW Marriott Marco Island

2018

July 15–18
Indian Wells, CA

Hyatt Regency Indian Wells Resort & Spa



2019

July 21–24
Memphis, Tennessee

The Peabody Memphis

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