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Modeling Risks: "A Sample Approach to Model Validation"

True or False Questions — Submit Answers Online

1. Risks associated with model input could be evaluated by understanding the financial theory of the model.

2. Reviewing models and associated risks should be considered when performing financial examinations.

3. Aggregation of risks at the holding company level is not a significant risk when reviewing modeling.

4. Review of models often requires a collaborative process involving many specialists, including actuaries, investment specialists, and IT examiners.

Using the Z-Score as a Tool to Analyze Health Entities Capital Risks under the Affordable Care Act

True or False Questions — Submit Answers Online

5. The NAIC utilizes the Z-Score as its primary tool for monitoring insurer solvency.

6. A company's Z-Score can easily be calculated from its Statutory Annual Statement without making any assumptions.

7. Companies with higher Z-Scores have stronger balance sheets and are better able to withstand financial risk events.

8. There are many uses for the Z-Score by both financial examiners and analysts.

Will Risk-Focused Exams Become More "Focused"?

True or False Questions — Submit Answers Online

9. The risk-focused examination approach became effective for examinations beginning after 12/31/09.

10. One of the outcomes of the Risk Focused Surveillance WG was to define "Critical Risk Categories".

11. The focus of Risk Focused Surveillance WG was to move risk assessment away from a "line item" perspective and more to a categorization of broader

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CRE READING PROGRAM QUESTIONS

(continued)

All quizzes MUST be taken online

risks related to a line item that may appear elsewhere in the financial statement.

12. In addition to numerous risks identified initially, the Risk Focused Surveillance WG received feedback that prompted them to add additional risk areas such as market risk, reputational risk, distribution system risk and compliance risk.

13. After the last working group meeting, it was decided that new risks would not be considered applicable to anything in the general purview of the Insurance Analyst general tasks.

How to Keep Anyone from Snooping Around Your Cloud

True or False Questions — Submit Answers Online

14. Encryption is a basic way to protect data prior to storing it in the cloud.

15. Under the U.S. Electronic Communications Privacy Act of 1986 and the 2001 Patriot Act, the federal government has the authority to request access to and search information stored in online repositories.

NAIC Spring 2013 Meeting Notes

True or False Questions — Submit Answers Online

16. One of the charges of the Principles-Based Reserving Implementation Task Force is to consider certain recommendations of the Captives and Special Purpose Vehicle Use Subgroup and to make further recommendations if necessary.

17. The Blanks Working Group voted to eliminate the requirement to file the Reinsurance Attestation Supplement.

18. The Financial Standards and Accreditation Committee voted to add the Own Risk and Solvency Assessment (ORSA) Model Act to the required accreditation standards.

19. As a result of discussions regarding the basis and method under which insurers will be required to submit newly required corporate governance information that is deemed sensitive, the Corporate Governance Working Group decided that a new stand-alone corporate governance model law should be developed.

20. According to an update given to the Reinsurance Task Force, all 50 states, plus the District of Columbia, have now adopted the revised credit for reinsurance models.

Modeling Risks: "A Sample Approach to Model Validation"

By Todd Sauer

As regulators enter into the era of ORSA reporting, it will become increasingly important to understand the risks associated with modeling.

Model validation touches many types of risks including but not limited to credit risk, operational risk, market risk, insurance risk and economic capital risk. Model effectiveness (or ineffectiveness) has a major impact on the ability of insurance companies to manage prospective risk embedded in their product offerings and investment strategy. Good corporate governance requires strong oversight of critical models and regulators need to better understand and assess this risk area. Understanding the model functionality is the first step in analyzing the associated risk and how one might test or validate such a model. The process of model validation commonly involves a defined scope of objectives that review the mathematical and theoretical soundness of functionality and use. Typically, the model validation team within an organization works with its various business units to establish policies that govern the development and associated documentation.

A closer look at model validation:

This requires an understanding of the model's use, limitations, policies, and procedures, which can be acquired through a review of model documentation and discussions with developers. Understanding the product (swaps, credit derivatives, fixed income bonds, etc.) is critical to a successful validation. Common elements of a model review typically would involve a 4 step process:

1) Review of Assumptions and Inputs

An organization must ensure that certain model assumptions are based on analysis that is reflective of current market conditions and activity. Determining the source of inputs and assumptions is critical. Do they include all major assumptions? (the AIG CDS model did not address collateral call risk). Do they come from a reliable source? Does the process of updating and vetting the assumptions occur within a controlled environment? Do the inputs come from an internal model or an external source? What are the controls surrounding this source? Inputs will vary by model. For example: A credit risk model will use financial ratios while a default model might use macroeconomic inputs.

Risks associated with assumptions and inputs can be evaluated by:

- Researching appropriate benchmarks applicable to the model assumptions,
- Creating a historical trend analysis of assumptions and inputs,

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Modeling Risks: "A Sample Approach to Model Validation"

(continued)

- Determining appropriate calibration of certain assumptions; have the inputs been properly calibrated to observable market data? and
- Determining the sensitivity of certain assumption changes. Which inputs create more variability? ORSA will require key assumptions be predicted based on normal and stressed assumptions. This is also prudent business management as key assumptions like market liquidity and consumer behavior will vary dramatically in stressed scenarios.

2) Theory — is the logic accepted and can it be supported?

The creation of the model is based upon the theory of a particular financial product. Does the developer of the financial model have the proper background? Risks associated with model logic can be evaluated by:

- Understanding the financial theory of related products.
- Verifying the theoretical soundness (as reflected in recent financial literature and evidence) of the pricing /risk relationship of various products.
- Assuring that all key risks are considered in the model.
- A comparison to historical experience, particularly performance during high stress periods.

3) Testing of the code — does the math work?

The testing of the code and mathematics behind the financial theory often requires detailed line-by line procedures. For many spreadsheet models this occurs by a replication of calculations and formulas given the same set of assumptions. Spreadsheet models should always be tested using a full replication of the workbook calculations due to the lack of security and key stroke errors which are often un-detected. Many debt-like features of certain bonds have detailed pay-down logic or waterfall rules which can be easily replicated within a spreadsheet environment.

Risks associated with model coding can be evaluated by:

- Independent recalculation of financial product amortization and expected cash flows including performance measurement statistics such as yield, duration and weighted average life.
- Testing option pricing models and applying Value at Risk assumptions.

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4) Reporting and model output

The analysis of model reporting is critical to the decisions made by senior management. Robust reporting functions allow users to back-test and benchmark more efficiently and accurately. The reports should also be used for clearly outlining the assumptions and associated results given a set of inputs. Many companies also use reporting to provide outside parties with a trail of evidence and support for audit related activities.

Risks associated with reporting and model output can be evaluated by:

- Thoroughly reviewing the reporting mechanism and associated accuracy of disclosed items,
- Back-testing the model and evaluating predicted outcomes vs. actual outcomes, and
- Generating scenarios which would potentially cause the reporting functionality to be stressed.

Reviewing models and the associated risks embedded in these models should be considered when performing risk focused exams. Ideally the corporate governance assessment and priority rating of the company will be impacted by the insurer's ability to effectively use models to mitigate prospective risk. New solvency tools like ORSA will be directly impacted by a company's ability to model key risk in a stressed environment. Inputs and assumptions vary based upon the type of model or system used to perform various tasks. The evolution of insurance products throughout the years has created a complex system of models. Each insurance company has specific models in place to predict financial markets, product pricing, consumer behavior and overall economic forecasts.

An area of risk often overlooked is the aggregation of risk at a holding company level. Recently we have seen that insurance companies are starting to pay more attention to modeling at the enterprise-wide level, ensuring that aggregations of risk are not created, and ensuring that consistent assumptions are used for models across the organization.

The impact of potential model errors can cause significant financial damage and create uncertainty in the operations of a company. Multiple risks identified within the exam process can be tied back to the use of models and the overall model design. Understanding what may cause a "break in the model" is critical when examining certain model related controls. Often times, specialists (IT, actuarial, investment and reinsurance) are needed for the deep understanding of specific products that may have unique assumptions or modeling approaches. For example: Certain models which are used by actuaries to predict optionality in products such as Equity Indexed Annuities may

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have significant investment assumptions embedded in the models. Both an Investment Specialist and an Actuary should collaborate on the model risk and the associated controls covering this activity.

In conclusion, risks associated with financial models could pose significant impact to many aspects of an insurance company. As regulators, understanding how to assess and review these models is critical to conducting effective and thorough examinations. The upcoming ORSA requirements facing many insurers will require significant expertise in model reviews for certain key activities.

About the Author

Todd Sauer is a Director at Risk & Regulatory Consulting LLC, where he works as an Investment Specialist. He has 13 years of experience in providing investment services. Todd performs investment and risk management consulting services for state insurance departments. Areas of expertise include the valuation of structured products, review of asset-liability risks and associated hedging programs, portfolio surveillance, assessment of financial models, cash flow modeling of structured transactions and various other corporate finance consulting assignments. Todd has assessed the reasonableness of assumptions and techniques used in the determination of security impairment, write-down and overall portfolio credit quality while participating on numerous risk focused exams. Prior to joining Risk & Regulatory Consulting, Todd worked in the financial risk and modeling practice of a "Big 4" accounting and consulting firm. Prior to that, Todd was in the consulting division of a Fortune 500 company. Todd holds a Masters of Business Administration from Loyola University in Maryland and graduated with Bachelor of Science degree in Economics from Mount Saint Mary's University. Todd can be contacted at todd.sauer@riskreg.com.

Using the Z-Score as a Tool to Analyze Health Entities Capital Risks under the Affordable Care Act

By Pat Tracy, Alex Quasnitschka, and Jan Moenck

An article authored by Pat Tracy and Margaret Spencer was published in the Fall 2003 Examiner explaining how the Z-Score could be utilized to analyze accident and health companies at the holding company level. This powerful tool could be very helpful to regulators as solvency risk may increase under the Affordable Care Act and the Z-Score focuses on liquidity risk which could be a problem before RBC action levels are triggered. This article serves to update the information from the 2003 article and provide insight into the use of the Z-Score to analyze both capital and liquidity strain under the Affordable Care Act (ACA).

The Z-Score is a way to measure and monitor financial performance by analyzing specific financial ratios for a given company. Developed as a bankruptcy prediction model in the 1960's, it is widely used by banks and consultants (like Risk & Regulatory Consulting) to evaluate companies and perform objective financial analysis.

Risk & Regulatory Consulting (RRC), and its predecessor firms, has been using this tool for over 30 years to analyze companies in many industries.

Working Capital is King

Working capital, current assets less current liabilities, is the key piece of information needed to use this tool. Currently the NAIC calculates working capital from the filed annual statement in order to calculate the Z-Score. This method of calculation makes assumptions that all investments are long term, and therefore does not (in most cases) accurately reflect the true working capital of the Company. By adjusting the NAIC Z-Score to include quality long term investments as current assets, the benchmarks we will discuss in this article can also be used at the individual statutory entity level.

Why so much discussion about working capital? Ed Altman, the developer of the Z-Score, studied 22 financial ratios and found that working capital is, in fact, one of the leading indicators of insolvency. The Z-Score is designed to predict insolvency before it becomes painfully obvious. When a company experiences financial difficulties, working capital will fall more quickly than total assets or capital and surplus. Working capital is the only source to pay policyholder obligations or any other bills. It is very possible for an insurance company to have significantly more capital and surplus than working capital.

The most successful companies manage their working capital positions very carefully. Even Life and P&C companies must manage working capital. Asset/liability matching tries to assure that companies without classified balance sheets can meet their obligations when they are due. The Z-Score provides a sophisticated method to focus in on this important liquidity measure for A&H companies.

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Using the Z-Score as a Tool to Analyze Health Entities Capital Risks under the Affordable Care Act

(continued)

In addition to working capital, the Z-Score also puts a heavy weight on the "earnings before interest and taxes" (EBIT)/total assets. This calculation is also commonly referred to as Return on Assets (ROA). This measures the basic profitability of the company in relation to its assets. Ed Altman's study proved that decreases in ROA are also highly correlated with insolvency. It is important to note that both working capital and ROA, the two most critical metrics in the Z-Score, do not currently receive much scrutiny by insurance regulators. This is why we believe the Z-Score can provide significant additional insight to the regulatory process.

The Z-Score has two additional components - retained equity/total assets and net worth/total liabilities. Both of these metrics are traditional balance sheet strength measures which we believe are similar to the RBC approach.

Z-Score Calculation and Benchmarks

The Z-Score model is as follows:

Z-Score Classification Model

	Description		Coefficient	
1)	Working Capital / Total Assets	x	6.56	=
2)	Retained Equity / Total Assets	x	3.26	=
3)	EBIT / Total assets	x	6.72	=
4)	Net Worth (Retained Equity) / Total Liabilities	x	1.05	=
				Z-Score

One of the great benefits to using this tool is the ability to relate the total score to the following benchmarks. The company can also quickly be compared to itself and a positive or negative trend can be noted.

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Z-Score Calculation and Benchmarks

(continued)

In RRC's opinion, appropriate benchmarks for the following industries are:

	Safe if greater than	**High Bankruptcy Risk if less than**
Distribution Companies	2.2	1.0
Auto Dealers	2.0	1.0
Service Organizations	2.6	1.1
Manufacturing	2.6	1.1
A&H Companies	2.6	1.1

The above benchmarks are based on Altman's original study (which focused on manufacturing companies) and the work done by RRC and its predecessor firms. In general, the more volatility an industry has in its earnings (ROA) the higher the safe range needs to be. The possibility of losing money quickly requires a stronger balance sheet. The ACA is a game changing event for the health industry, and strong balance sheets going into 2014 greatly mitigate solvency risk created by the uncertainty of what will happen to traditional books of business and the related cash flow.

The Z-Score in Action

We calculated the Z-Score for five major publicly traded health entities using publicly available information.

Working capital is disclosed in the SEC filings for these companies. GAAP recommends classified balance sheets wherever possible. In the case of health entities, the majority of their liabilities are current (will be paid within twelve months). Therefore, these companies report their GAAP results using classified balance sheets.

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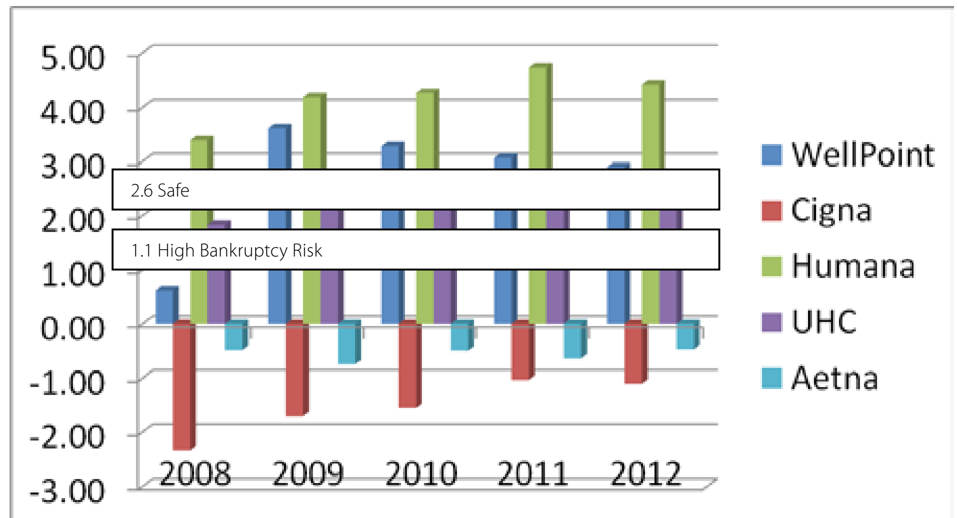
Z-Score Calculation and Benchmarks

(continued)

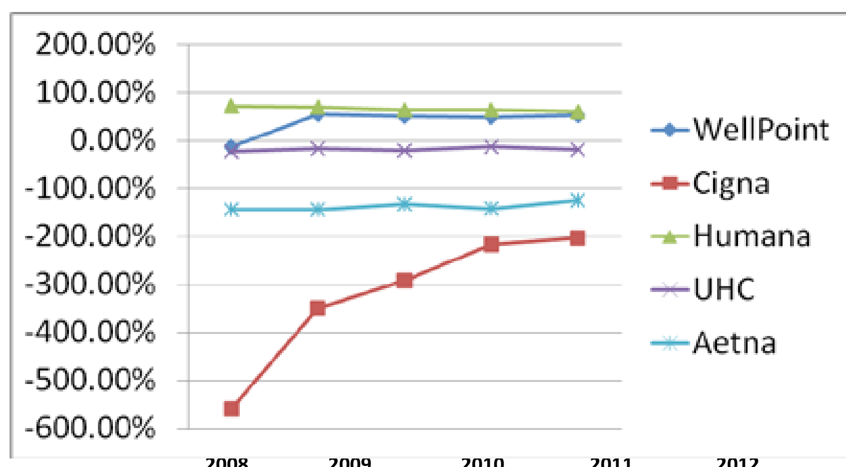
Using SEC filings for 2008 through 2012, as well as information from ycharts.com, we calculated the following Z-Scores:



It's important to note the safe benchmark of 2.6 and the high bankruptcy benchmark of 1.1 when reviewing this graph. It is also extremely important and productive to review the trend of each company. Note the ability of the Z-Score to relate these companies to one another.

Working Capital to Capital and Surplus Ratio as a Driver of the Z-Score

As seen in the chart below, working capital is a significant driver of the Z-Score. Companies with higher working capital to surplus ratios also are the Companies with higher Z-Scores. As you can see, the working capital of the most successful companies is carefully managed within a tight range to its capital and surplus.



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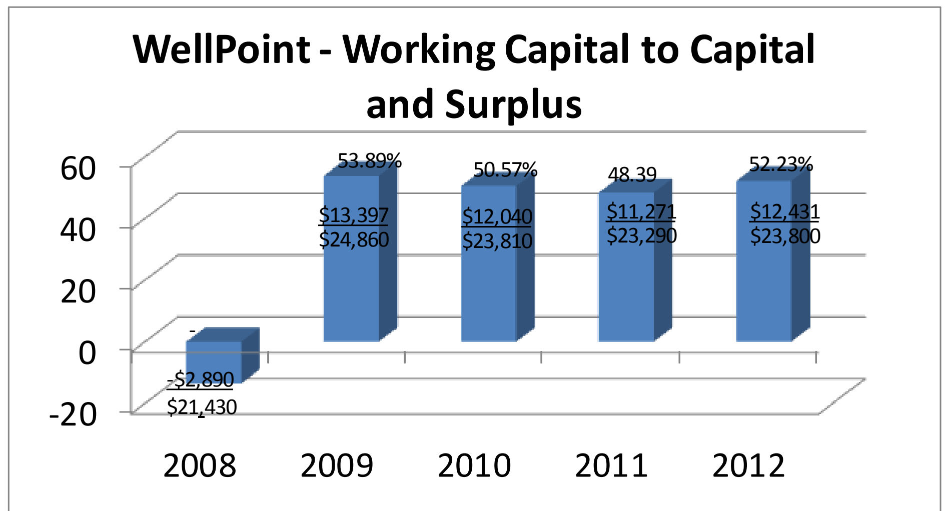
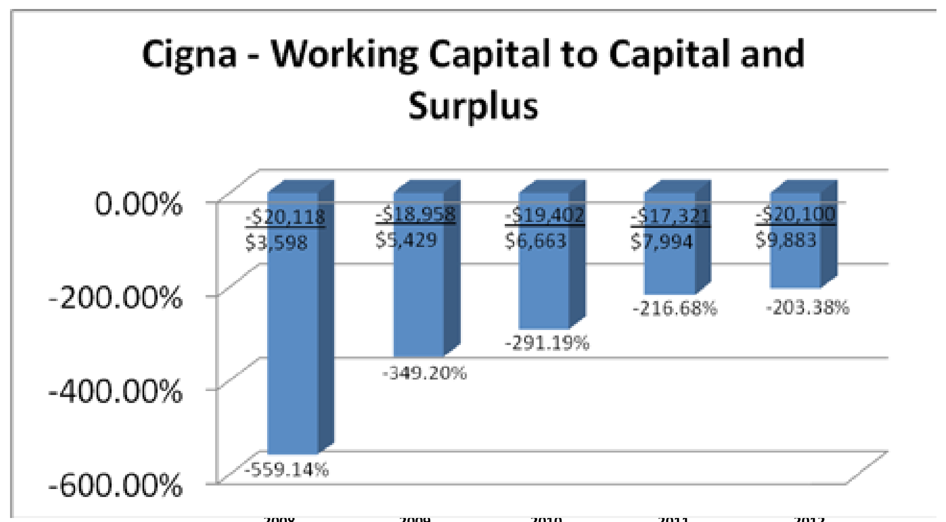
Z-Score Calculation and Benchmarks

(continued)

Note the relatively strong working capital positions of WellPoint and Humana get high credit using the Z-Score. The poor working capital positions of Cigna and Aetna result in much weaker Z-Scores. To further illustrate, see the individual charts below for WellPoint and Cigna.





The companies with less working capital will argue that they have predictable cash flow and access to the public markets if necessary. They are relying less on balance sheet strength and more on current cash flow from operations and liquidity options if necessary. But, working capital is a "law of nature" and operating with zero or negative working capital increases business risk, particularly with the uncertainty created by the ACA.

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Z-Score Calculation and Benchmarks

(continued)

Historical Trends

The Z-Score chart on page 14 shows that, for the most part, Z-Scores were lower for the companies studied in 2008 and have become stronger since then. The initial explanation for this may be the financial crisis led to a weakened working capital position. This is partially true. However, when we expanded the chart back to 2006, we saw that some of the companies seemed to be more impacted by the financial crisis than others. Additionally, some have had much stronger recoveries than others.

Humana

Humana's Z-Score is well over the safe benchmark of 2.6 for all five years, with an average of 4.20 over the period. Over the last 10 years, the only year it was below 3 was in 2006. Humana is very liquid, with working capital increasing each year, and manages its working capital to surplus in a very tight range. Humana's ROA has also been strong. It is evident that Humana places a premium on working capital.

WellPoint

WellPoint went from a Z-Score of 0.62 in 2008 to a Z-Score of 3.61 in 2009, and has been able to maintain a Z-Score in the safe range since then. It is interesting that in the 2003 article WellPoint had the strongest Z-Score and working capital of any of the companies studied; WellPoint took a significant hit to its Z-Score in the 2006 – 2008 period but has since recovered. With the exception of 2008, WellPoint's ratio of working capital to capital and surplus has been as strong as that of Humana. Researching the significant increase in WellPoint's working capital in 2009, we found the source of recovery to be that in the fourth quarter of 2009 WellPoint sold its prescription benefits manager to Express Scripts for $4.7 billion. Although WellPoint's Z-Score has decreased some since 2009, the Company appears to place a high degree of emphasis on its working capital and has been managing it above the safe benchmark.

United HealthCare

United HealthCare (UHC) has had a fairly steady Z-Score during this period, ranging from 1.83 to 2.11; just below the safe range. Its Z-Score was over the safe range pre-2008, and in 2008 decreased due to the overall market condition, but has re-bounded to a good position relative to its ability to generate positive earnings and access capital markets. UHC's working capital has also been very consistent throughout the period. Its working capital to capital and surplus ratio has been consistent, but slightly negative from 2008 through 2012, and its ROA has also increased incrementally during the

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period. Its high ROA is the main driver of its Z-Score. Since UHC's ratios are within a very tight range it is evident that a high degree of emphasis is placed on achieving safe levels of working capital.

Aetna

Aetna has had a slightly negative Z-Score, and a slightly negative level of working capital throughout the period. Both the Z-Score and working capital level have been very consistent, with the Z-Score ranging from only -0.47 to -0.75. Aetna's working capital situation became worse between 2009 and 2011, and began to slightly improve in 2012. Aetna also has a lower return on assets than its more robust competitors in this group. While Aetna's Z-Score was in the safe range pre-2006, Aetna has much less working capital today, and is dependent on cash flow from operations and access to the capital markets if liquidity becomes an issue.

Cigna

Cigna has had a negative Z-Score throughout the period; in fact, its Z-Score never reached above -1. For the last 10 years, Cigna's Z-Score has only been above +1 one year. It has improved however, from a low of -2.34 in 2008 to close to -1 in both 2011 and 2012. Its level of working capital, while negative as well, has also significantly improved, from -559% of surplus in 2008 to -203% of surplus in 2012. We believe that if Cigna continues its trend of working capital strengthening, its Z-Score will continue to improve as well. Cigna is relying on positive cash flow from operations and access to capital markets if a liquidity event occurs.

Not-For-Profit Healthcare Entities

We could not find publicly available data which could be utilized for the analysis of not-for-profit healthcare entities, and therefore could not calculate any Z-Scores for comparison to the public companies. We understand that many of the not-for-profit Blue Plans benchmark themselves against other Blue Plans; however, this information is not made available to the public. It is assumed that other not-for-profits benchmark this information as well. This is something that could be requested and reviewed by the analyst or examiner.

RRC feels that not-for-profit entities are particularly vulnerable to liquidity strain since they have limited access to capital markets. Additionally, many not-for-profit entities have significant investments in affiliated assets, including capital intensive assets such as hospitals, which are not readily converted into working capital. Uncertainties associated with the ACA such as adverse selection, utilization rates and pricing risk could put significant strain on the working capital of many not-for-profits. This is a significant prospective risk and should be taken into consideration in examinations and supervisory plans.

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Z-Score Calculation and Benchmarks

(continued)

Any State could monitor the working capital of a not-for-profit to assure the traditional focus on RBC is not creating and unrealistic sense of comfort. As 2014 and 2015 unfold we predict that liquidity issues will arise way before RBC trigger levels. This is particularly true for plans in the individual and small business markets as those books of business are hard to predict under the ACA.

Overall Conclusion

While the NAIC's primary tool for regulating companies is Risk-Based-Capital (RBC), for health entities the Z-Score can be used to effectively analyze holding companies and legal entities for liquidity risk. RRC predicts that with the implementation of ORSA, companies will be focusing on both liquidity and RBC and tools like the Z-Score. These tools are useful to both regulators and the industry.

Also liquidity usually becomes a problem way before RBC trigger levels are hit. The ACA makes it more difficult for a health insurance company to predict what its book of business and related cash flow will look like in 2014 and 2015.

The Z-Score could be applied in the following situations:

Financial Examinations

- M&A analysis –Z-Score is a great view of the liquidity impact of before and after major transactions
- Linkage to key risk evaluation-particularly ORSA type information which requires an analysis of liquidity and fungi ability of capital
- Evaluate parent/holding company
- Peer group analysis
- Prospective risk assessment
- Understanding of company strategy
  - Strategic plan, budgets and forecast
  - Evaluate management's solvency/liquidity monitoring controls
  - Evaluate liquidity risk mitigation options with objective balance sheet information

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Z-Score Calculation and Benchmarks

(continued)

Financial Analysis

- All of the above examiner uses
- Analysis of dividends- Z-Score before and after. Dividends reduce working capital which is why it's a helpful view in addition to RBC
- Objective analysis of working capital (liquidity) trends, particularly in 2014 and 2015 when winners and losers should emerge as a result of the ACA.
- Company risk profile
- CAMEL/CARRMEL
    - Liquidity
    - Capital and Surplus adequacy
- Asset liability matching (A&H, P&C)

The ACA creates a significant risk with unknowns associated with adverse selection, utilization rates, and pricing risk. Because of these risks, many large companies have chosen to limit participation in exchanges. These risks could have a significant impact on health companies, particularly not-for-profits, and should be monitored closely on a quarterly basis to promote long-term capital and surplus planning and mitigate short-term liquidity crises.

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Z-Score Calculation and Benchmarks

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Will Risk-Focused Examinations Become More "Focused?"

By James B. Morris CPA, CFE, CGMA, CICA

When the NAIC adopted the risk-focused examination approach beginning with examinations for years ending on and after December 31, 2010, one of the primary reasons given was to encourage financial examiners to concentrate their efforts on those areas having the potential to significantly impact an insurer's future solvency. A second objective was to make the examination process more efficient. Throughout the early years following implementation, examiners have learned to identify prospective risks that exist, or were likely to surface, as of the examination date and to evaluate and measure the potential impact they might have on an insurer's future solvency. However, the combined effects of the initial implementation learning curve, the risk-focused examination documentation requirements, and other guidance and requirements contained within the *Financial Condition Examiners Handbook* sometimes prevented the examiners from realizing the anticipated efficiency gains. Now, under proposals being considered by the NAIC's Risk-Focused Surveillance Working Group ("RFSWG" or "Working Group") and Financial Examiners Handbook Technical Group ("FEHTG" or "Technical Group"), it is possible that some of these impediments will be removed and replaced by additional guidance which could enhance the examiners' ability to perform more efficient examinations.

In 2012, the RFSWG was charged with analyzing responses received from the industry to a 2011 NAIC survey seeking feedback on the risk-focused examination approach. At its August 2012 meeting, the Working Group released a listing of "Sound Practices" for examiners to consider in addition to a proposal to adopt changes to the examination approach. At this meeting the Group agreed to expose the proposed changes for comment. The most significant changes proposed were the addition of "Critical Risk Categories" and the removal of the line item requirement; with the latter having been identified as one of the leading obstacles to performing efficient exams.

The line item requirement was established as an accreditation standard which, simply stated, required the examiners to perform at least a minimum level of examination procedures on the functional processes that contribute to any line item(s) on the subject insurer's Annual Statement that exceeded the tolerable error level established for the examination. Since this requirement was an accreditation standard, the examiners did not have the flexibility to forego testing regardless of their assessment of the effectiveness of the insurer's internal controls over financial reporting, corporate governance, enterprise risk management, internal and external audit functions, etc. As a result, examiners often got bogged down performing what could be argued to be unnecessary examination procedures. With the introduction of its "Critical Risk Categories," the Working Group is

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Will Risk-Focused Examinations Become More "Focused?"

(continued)

hopeful that the examiner's focus can be redirected from concentrating on the annual statement line items onto the most critical financial reporting and prospective risks as originally intended.

Through the introduction of the Critical Risk Categories, the Working Group's intention was to provide the examiners with a listing of the most common risks identified in past examinations which are capable of presenting significant challenges to an insurer's future solvency. The Group was careful to note that the Critical Risks are not intended to be an exhaustive listing but rather a minimum starting point for the examiners to consider. The Group also acknowledged that not all of the Critical Risks listed would apply to all insurers; especially small insurers, those that operate in a limited geographic area, only offer limited products, etc. In those instances, the accreditation standards will likely be modified to require the examiners to note those risks that do not apply in the examination workpapers and Planning Memo and offer an explanation as to why they do not. The initial listing of Critical Risks identified by the Working Group included:

- Valuation/Impairment of Significant, Complex Invested Assets
- Liquidity Considerations
- Appropriateness of Investment Portfolio and Strategy
- Appropriateness/Adequacy of the Reinsurance Program
- Reinsurance Reporting and Collectibility
- Underwriting and Pricing Strategy/Quality
- Reserve Data
- Reserve Adequacy
- Related Party/Holding Company Considerations
- Capital Management

The Working Group released an exposure draft of the proposal on November 16, 2012 and requested feedback from interested parties to be submitted by early January 2013. Specifically, the Working Group sought feedback on four areas:

- Are there additional categories of significant risk that commonly lead to solvency concerns that are not included?
- Are there categories unlikely to have a significant impact on solvency of most insurers which should be removed?

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- Are the definitions appropriate to clarify what is expected to be covered in each category?
- Given the shift in focus, does this signal a change that needs to be reflected in other areas of the handbook guidance such as the overall objective of the examination, the scope of the examination and/or the exam report?

Generally, the feedback received was in support of the concept and concurred that the risks included in the initial listing were appropriate. However, some respondents offered additional risk areas to be considered for inclusion, including but not limited to:

- External Market Risk
- Distribution System Risk
- Compliance/Regulatory Risk
- Reputational Risk

Further, the respondents indicated that it was likely that the guidance offered in several sections of the handbook would need to be revised in order to ensure the consistent application of the concepts throughout the entire examination.

The Working Group reviewed and discussed the feedback received at its meeting on January 24, 2013. During this discussion an additional potentially significant consideration was identified. Specifically, the Group identified the need to consider the potential impact of the change on other critical areas of the risk-surveillance process, namely the monitoring activities performed by the financial analysts. In recognition of the importance for collaboration between the analysts and the examiners, the Group agreed to solicit additional feedback regarding:

- How the proposed changes relate to the existing analysis process
- Whether a similar process should be undertaken for analysis
- If there are areas that should be revised
- If there are areas that should be leveraged
- Other concerns/considerations

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Will Risk-Focused Examinations Become More "Focused?"

(continued)

Responses to the follow-up request were considered by the Working Group which then drafted a sample of updates to the Examiners Handbook, including revisions to the narrative guidance relating to Phases 1 and 2 and the development of a new Exhibit DD which is designed to facilitate the documentation and communication of the exam team's consideration of the critical risk categories. During its March 28, 2013 conference call, the Working Group voted to refer the topic and its proposed revisions to the FEHTG. In its referral letter, the RFSWG requested the Technical Group to "consider the proposed guidance and critical risk categories for inclusion in the Handbook."

During its May 23 conference call, the FEHTG discussed the Working Group's recommended changes and voted to expose them for a period of 45 days, ending on July 8, 2013.The Technical Group will review and consider the responses received during the exposure period during its conference call scheduled for July 17. While it may be too soon to tell for sure, it does appear likely that the proposed critical risk categories will be adopted in some form or another. These changes serve as tangible evidence of the continuing evolution of the risk-focused examination approach into one that truly allows the examiners to focus their attention on those risks that have the potential to adversely impact an insurer's capital and surplus in a material fashion in the future.

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About the Author

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Hey! You! Get off of my Cloud!

How to Keep Anyone From Snooping around Your Cloud

By Scott Greene

In recent years government has increased its requests for access to Cloud data. Storage-As-A-Service providers such as Google Drive, Dropbox, iDrive, Microsoft Skydrive, Apple iCloud and others are receiving numerous requests to view what has been stored by various individuals and companies. In addition to the government, there are instances of the storage company's employees exposing or taking data for their own or others use. Data breaches have been experienced by companies such as DropBox and iCloud which has exposed data. This happens when storage company employees seize the opportunity to make a quick buck selling everything from company data to personal credit card information which has been stored in the Cloud.

The American Civil Liberties Union reported the U.S. Government claims the right to read personal online data without warrants. This trend is not unique to the U.S. Government. Many governments around the world make requests of these service providers as well.

According to statistics published by Google, it received over 16,000 requests for information affecting over 31,000 users in 2012. Google's same statistics stated they provided information in over 85% of the requests.

In 2012 Microsoft received over 70,000 requests affecting over 120,000 accounts. While this is a much higher number, Microsoft only produced information on these requests about 2% of the time. Almost 80% of the requests asked Microsoft to divulged subscriber and transactional information only.

Locking the thieves out:

Companies and individuals can take easy steps to prevent thieves, companies and the government from gaining access to online storage which contains private information.

Here are a few basic ways of protecting or encrypting the data to keep prying eyes from viewing confidential and/or personal information:

1. The data can be encrypted before it is stored in the Cloud. Products like TrueCrypt, Privacy Drive and MyInfoSafe allow for the user to encrypt their data. This type of encryption can be done for files as well as folders prior to storing it in the Cloud.
2. Use an "On The Fly" encryption product which encrypts data as it is stored by almost any online storage provider. Products like BoxCryptor, Cloudfogger, SafeMonk, and Viivo integrate with the Cloud Storage provider(s) of your choice encrypting data locally, but seamlessly before it is stored in the Cloud. These services provide encryption completely separate from the storage provider, ensuring even the storage provider employees can't access data stored in their company's Cloud.

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3. Choose a provider that encrypts the data as part of their service. Storage-As-A-Service companies like SpiderOak, iDrive and Comodo not only transfer your data via an encrypted protocol, these companies also store the data in an encrypted format preventing those who don't have an access key from easily viewing your data. It is unknown if there is a back door they are able to use to access data stored on their servers.

Businesses are acutely sensitive to government information requests due to their legal responsibilities under privacy laws, such as HIPAA and the Gramm-Leach-Bliley Act. Therefore, in highly regulated industries, such as financial services and healthcare, businesses must strike a balance between government oversight and consumer privacy.

The U.S. Electronic Communications Privacy Act of 1986 was enacted in the early days of the Internet. The act did not require government investigators to obtain a search warrant for requesting access to emails and messages stored in online repositories. In 2001, the PATRIOT Act further added to the authority of the federal government to search records under its "Library Records" provision, offering a wide range of personal material into which it could delve.

We are not suggesting people should try to skirt around the PATRIOT Act. But companies and individuals should do their best to comply with data privacy issues. It should be up to the organization or individual to establish a policy regarding exactly what, when and to whom they disclose information from their Cloud service provider.

About the Author

Scott Greene is CEO of Evidence Solutions, Inc. The White Hat Hackers: Collect, Correlate, Analyze, Report & Explain Complex Electronic Evidence in PLAIN English. Scott can be contacted at (866)795-7166 or Scott@EvidenceSolutions.com. Scott will be presenting at the 2013 SOFE CDS in Nevada this July.

NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2013 Spring National Meeting

The National Association of Insurance Commissioners held its Spring National Meeting in Houston April 4-9. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. This Newsletter also covers conference calls held subsequent to the Spring National Meeting. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

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Executive Summary

- The Executive Committee established two new high level task forces, the Principle-Based Reserving Implementation Task Force and the Financial Stability Task Force. (page 2)
- The Statutory Accounting Principles Working Group continued discussion of significant projects including accounting for the Affordable Care Act fee and proposed new 2013 disclosures for restricted/pledged assets. (page 3)
- The Emerging Accounting Issues Working Group finalized its consensus on a one-time extension of the 90 day rule for amounts due from agents and policyholders directly impacted by Hurricane/Superstorm Sandy. (page 6)
- On a special conference call April 30th, the Capital Adequacy Task Force unanimously adopted the Life RBC Working Group/ACLI commercial mortgage proposal for 2013 RBC reporting, after nearly five years of development and intensive review, and resolution of a last minute issue. At the Spring National Meeting, the task force adopted structural changes to all RBC formulas to allow treatment of Working Capital Finance Investments for 2013 RBC as Schedule BA assets, but deferred action on the factor charges for these investments. (page 6)
- The Investment RBC Working Group continues to consider the recalibration of invested asset factors; progress continues on the bond modeling project. The working group exposed for comment recommendations to update the Life RBC formula for derivatives and common stock. The SMI RBC Subgroup continued its discussions of operational risk. (page 9)
- The Catastrophe Risk Subgroup exposed a draft attestation regarding insurer catastrophe risk modeling and property exposure data validation and discussed exemption criteria for the new catastrophe risk RBC charge requirements. The Health RBC Working Group adopted a blanks proposal for additional data collection on health care receivables and an RBC blanks proposal for interrogatory questions regarding pandemic and bio risk. (page 11)
- The Valuation of Securities Task Force discussed recent trends in the RMBS and CMBS market and exposed proposed changes to the 2013 modeling process. (page 11)
- The Solvency Modernization Initiative Task Force adopted two model law development requests addressing annual reporting of corporate governance practices, and exposed an updated draft of its white paper "The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative." (page 13)
- The PBR Implementation Task Force discussed and exposed a draft PBR Implementation Plan and a draft PBR Legislative Information Package. (page 13)
- The Group Solvency Issues Working Group adopted its recommendations to the Financial Regulation Standards and Accreditation Committee for Part A accreditation standards and guidelines for the Risk Management and Own Risk and Solvency Assessment Model Act. The working group also re-exposed its document "Roles and Responsibilities of U.S. Lead State/U.S. Group Wide Supervisor Document." (page 15)
- The ORSA Subgroup discussed comments received on the draft ORSA Guidance Manual, and adopted the revised Guidance Manual. The subgroup also discussed its planned 2013 ORSA pilot exercise. (page 15)
- After nearly two years of work, the Corporate Governance Working Group completed and adopted its "Proposed Response to a Comparative Analysis of Existing U.S. Corporate Governance Requirements" and agreed to develop a new stand-alone Annual Reporting of Corporate Governance Practices of Insurers Model Act to collect sensitive corporate governance information. (page 16)
- The International Insurance Relations Committee discussed ComFrame, the EU-U.S. Dialogue Project, the Financial Stability Committee, and other activities of the IAIS. (page 18)
- The Financial Stability Task Force held its inaugural meeting in Houston and discussed its charges and heard updates on matters relating to financial stability and the Federal Reserve Board's proposals for enhanced prudential standards for foreign banking organizations and foreign nonbank financial companies. (page 21)

- The Reinsurance Task Force re-exposed for comment its draft "Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions," a document that includes an evaluation methodology to review jurisdictions that will approve Certified Reinsurers. (page 22)
- The Captives and Special Purpose Vehicles Subgroup continued work on its controversial white paper on the use and regulation of captives and SPVs, which may recommend significant changes to the current regime. The subgroup significantly revised the white paper based on comments received, and exposed the draft white paper until April 29. (page 23)
- The Blanks Working Group adopted ten blanks proposals as final and exposed nineteen new proposals for public comment. (page 24)
- The Life Actuarial Task Force continued its discussion of proposed revisions to VM-20, PBR for Life Products. The Joint Qualified Actuary Subgroup heard comments regarding the regulatory definition of Qualified Actuary and adequacy of the current disciplinary process, which will considered by the subgroup in developing its recommendations. (page 25)
- The Emerging Actuarial Issues Working Group continued its work on addressing implementation issues related to the recently adopted AG 38 revisions. (page 28)
- The Contingent Deferred Annuity Working Group adopted its recommendations regarding the regulation of CDAs, which includes suggestions for many additional projects related to this product. (page 29)
- The Separate Account Risk Working Group exposed for comment its draft Non-Variable, Insulated Product Characteristics/Proposed Recommendations document, which addresses insulation classifications. (page 30)
- The Annuity Disclosure Working Group finalized and adopted the Annuity Buyer's Guide for Deferred Annuities. (page 32)
- The Mortgage Guaranty Insurance Working Group met twice in 2013 and is focusing on possible fundamental changes in the solvency regulation of mortgage guaranty insurance. (page 33)
- The Title Insurance Task Force concluded that development of a title insurance guaranty fund model law will not pursued at this time. (page 35)

Executive Committee and Plenary

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

Adoption of New or Revised Models
During a conference call on March 1, the Executive Committee and Plenary adopted the following items:

- The Individual Market Health Insurance Coverage Model Act (#36), which incorporates the Patient Protection and Affordable Care Act (PPACA) 2014 market reform provisions, including its guaranteed availability and guaranteed renewability requirements and the prohibition on preexisting condition provisions
- The Small Group Market Health Insurance Coverage Model Act (#106), which incorporates the September 23, 2010 immediate reform and 2014 market reform requirements under PPACA that apply to the small group health insurance market.

At the Spring National Meeting, the Executive Committee and Plenary adopted the 2011 revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) for accreditation purposes. These revisions serve to reduce the reinsurance collateral requirements for non-U.S. licensed reinsurers that are licensed and domiciled in qualified jurisdictions, and are considered acceptable but not required for accreditation purposes.

Executive Committee

The Executive Committee met January 18, February 1, and in Houston. On February 1st, the Executive Committee established two new task forces:

- Principle-Based Reserving (PBR) Implementation Task Force (co-chaired by Rhode Island Superintendent Joseph Torti III and Tennessee Commissioner Julie Mix McPeak) to coordinate the work of NAIC technical groups addressing PBR issues and to

further assess the solvency implications of life insurer-owned captive insurers

- Financial Stability Task Force (chaired by Connecticut Commissioner Leonardi) to consider issues concerning domestic or global financial stability as they pertain to the role of state insurance regulators.

In Houston, the Executive Committee adopted a model law development request for amendments to the Creditor-Placed Insurance Model Act (#375).

New NAIC CEO

In January, the NAIC selected former Nebraska Senator Ben Nelson as its chief executive officer. Mr. Nelson has significant insurance experience, including service as executive vice president and chief of staff for the NAIC, director of the Nebraska Department of Insurance, and president/CEO of the Central National Insurance Group.

Statutory Accounting Principles Working Group

In January, the new chair of the SAP Working Group, Dale Bruggeman of Ohio, was appointed to replace Joe Fritsch of New York, who had retired at year-end. The working group held two conference calls in early 2013 and met in Houston to discuss the topics below. The most contentious issue has been the proposed accounting for the Affordable Care Act fee as discussed below.

Adoption of New Standards or Revisions to SSAPs

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

<u>Mandatory Convertible Securities (2013-01)</u>
During its January 15 conference call, the working group exposed proposed revisions to SSAP 26 to modify the accounting for mandatory convertible securities, at the recommendation of the VOS Task Force. Instead of following bond accounting, these securities will now be valued at the lower of cost or market and will not be assigned an NAIC Designation or Unit Price. At the Spring National Meeting, the working group adopted this amendment to SSAP 26.

<u>Preferred Stock Class of ETFs (2012-30)</u> – The working group adopted its proposal to add a preferred stock class of Exchange Traded Funds to the APP Manual, provided the SVO criteria are met. Under current statutory accounting, ETFs are classified either as common stock, or as bonds when specific criteria are met. These approved ETFs will now be accounted for as preferred stock.

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

<u>Inconsistency Regarding Tax Planning Strategies (2012-31)</u> – The working group adopted clarifications to SSAP 101, par. 14, to clarify that tax planning strategies are not required in the admittance calculation, but if used, "should not conflict" with the tax planning strategies used in computing the statutory valuation allowance if such strategies were used in the SVA determination.

<u>Other Revisions to SSAP 101 (2012-27)</u> – The working group voted to reject recent GAAP guidance in FSP FAS 109-2, FSP FIN 48-2 and FSP FIN 48-3. The working group adopted guidance from FSP FAS 109-1 related to the special deduction for qualified production activity.

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

Comments on exposed items are due to NAIC staff by May 31 unless otherwise noted. Subsequent to the Spring National Meeting, the working group scheduled an interim call May 15 to review comments on issues that have been expedited with an April 26 comment deadline.

<u>SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers (2011-38)</u> – After an especially contentious conference call December 18th discussing the accounting for the new health insurer fee mandated by the federal Patient Protection and Affordable Care Act, the working group held a conference call March 7 to finalize a proposal for official exposure for comment. The chair began the call by summarizing the three methods the working group had focused on for possible implementation.

- Method One – Companies would recognize both the 2014 payment and 2015 fee payable in the income statement in 2014.

- Method Two – Companies would recognize the 2014 payment in the income statement in 2014; this is consistent with the U.S. GAAP treatment except the deferred asset for GAAP would be non-admitted.

- Method Three – Companies would recognize the 2014 payment in the income statement in 2014. Similar to Method One, this method also recognizes the liability payable in the subsequent year (2015), at year-end for years 2014, but delays expense recognition for the 2015 payable until 2015.

After vigorous discussion, the working group voted to expose Method 3 for comment, with Pennsylvania objecting. At the Spring National Meeting, this issue dominated the working group's discussions. Five comment letters were submitted, including one from the North Carolina Department of Insurance, all objecting to the concept that the liability for the fee payable in 2015 should be accrued at year-end 2014.

Interested parties made a persuasive argument that the legal liability to pay the fee in 2015 does not exist as of December 31, 2014. However, Commissioner Joe Torti of Rhode Island responded that an assessment of the law "is not relevant to the issue" and has "no bearing whatsoever" on the working group's conclusion. He believes the fee meets the guidance in SSAP 5R (i.e. the liability is probable and estimable) and must, therefore, be accrued as of year-end 2014.

The working group held a conference call April 18 to continue discussion and review five additional comment letters. The call was nearly two hours long, but no consensus was reached. In addition to the compromises/alternatives suggested in the comment letters (e.g. establishing UPR for fees received in 2014 that relate to the 2015 fee), a new proposal suggested by industry would be to segregate surplus in 2014 for the fee to be paid in 2015 (similar to restricted surplus on P&C retroactive reinsurance transactions). No liability would be recorded in 2014 for the 2015 fee; segregated surplus would reduce unassigned funds and dividend paying ability but would not reduce total policyholder surplus. The chair of the SAP Working Group commented that this idea is "intriguing," but it was not exposed for comment.

The working group and interested parties are clearly at an impasse with no compromise solution receiving significant support from the regulators. Resolution of this issue is needed quickly as health companies are in the process of finalizing 2014 rates very soon.

The next conference call on this issue has now been scheduled for May 20th.

Restricted Asset Subgroup (2013-11) – The subgroup was formed in response to a request of the Financial Analysis Working Group that the regulators study certain guarantees and other financial activities that have pledge-like restrictions. The subgroup, composed of representatives from CA, DE, IA, NY, TX and WI, met March 6 for an introductory call and quickly prioritized topics for future discussion as follows:

- Transactions involving Home Loan Banks
- Qualified Financial Contracts
- Assets Held Under Reinsurance Trusts
- Repurchase/Reverse Repurchase Agreements
- Tri-party Repurchase Agreements

The subgroup also exposed for comment a proposal to amend SSAP 1 to capture more information on restricted assets in the notes to the financial statements (both annual and quarterly). The proposed revision to paragraph 17 of SSAP 1 is as follows (new wording is underscored):

> [Disclose] the amount and nature of any assets pledged to others as collateral or otherwise restricted (e.g., not under the exclusive control, assets subject to a put option contract, etc.) in the general and separate accounts by the reporting entity in comparison to total assets and total admitted assets.

The SAP Working Group also exposed this proposal for comment at its March 7 meeting in order for the new disclosure to be considered by the Blanks Working Group for the 2013 annual statement. The subgroup and working group believe capturing this data for 2013 is crucial to their efforts in considering "next steps" for regulation of restricted assets.

At its meeting in Houston, the working group briefly discussed the comments received from interested parties, who object to disclosing the detailed information on a quarterly basis and believe the definition of restricted and pledged assets needs to be clarified; the working group agreed to delete the requirement for quarterly disclosures and re-exposed the proposal for comment. The Restricted Asset Subgroup will discuss these comments and begin discussion of transactions with Federal Home Loan Banks on a conference call April 29.

Financial Guaranty/Mortgage Guaranty Insurers SSAP 101 DTA Calculation (2013-12) – The working group voted to expose for comment until April 26 proposed revisions to SSAP 101 to clarify the DTA admissibility test for financial and mortgage guaranty insurers. The clarifications are needed because the current wording of par. 11.b. does the reflect the original intent of the regulators and interested parties that the ratio of the Realization Limitation Threshold table be calculated as policyholders surplus plus contingency reserves divided by required minimum aggregate capital. The working group plans to hold a conference call in May 15 to adopt the changes so the interpretation can be used for the 2012 audited statutory financial statements due June 1.

Working Capital Finance Investments (2013-10) During its March 7 conference call, the working group exposed for comment an issue paper and SSAP to provide accounting guidance for this new proposed invested asset class. At the Spring National Meeting, the working group heard brief comments from the ACLI that the legal structure discussion in the guidance should be moved out of Issue Paper and SSAP and into the SVO Manual. The ACLI also suggested other revisions, which were not distributed at the meeting. The working group deferred action in Houston and will hold an interim conference call to discuss the exposure drafts.

Derivatives Reporting (2013-13) – Based on work performed by the Derivatives Investment Reporting Subgroup, which noted that additional guidance is needed as a result of Dodd Frank and to ensure consistent reporting, the working group exposed for comment "concept revisions" related to 1) accounting for collateral posted or received in accordance with derivative transactions, and 2) revisions to accounting guidance for futures and forwards with specialized daily-true-up features. Based on comments received on these concepts, the working group will determine next steps including a possible issue paper for discussion, and/or reconsideration of these recommendations.

Consideration of EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements (2013-02) – The working group proposed to adopt this guidance through amendments to SSAPs 21 and 92.

Policyholder Loyalty Program Obligations (2012-15) and Actuarial Calculation of DDR Reserve (2012-16) At the 2012 Summer National Meeting, the working group exposed for comment proposed amendments to SSAP 65, P&C Contracts, to address loyalty program benefits and additional guidance on reporting the death, disability and retirement reserve. Based on the significant number of comment letters received from interested parties and the Casualty Actuarial and Statistical Task Force, the working group asked staff to collect additional information and report back to the working group. At the Spring National Meeting, the working group noted that a proposed survey on the issues will be posted on the SAP Working Group's webpage for review and comment until April 26 before the survey is distributed.

Proposed Amendments to SSAPs 64, 86 and 103 (2013-07) – The working group exposed for comment proposed revisions to three SSAPs to require disclosure of gross and net amounts of recognized assets and liabilities for derivative, repurchase and reverse repurchase, and securities borrowing and securities lending assets and liabilities that are offset and reported net in accordance with SSAP 64(valid right of offset).

Seed Money Disclosures (2012-23) – At the Fall National Meeting, the working group exposed for comment a proposed new disclosure related to seed money and fees and expenses due to the general account, the intent of which is to identify the materiality of seed money in the separate account. At the Spring National Meeting, the working group discussed revisions proposed by interested parties and agreed to most of the revisions including a prospective building of the disclosure to "age" surplus in separate accounts. The proposal was re-exposed for comment until April 26.

Impact of Transfer on Provision of Reinsurance (2011-45) – This proposal from a large P&C insurer, which addresses transactions where collection risk for third party reinsurance has been transferred and secured by the counterparty in a loss portfolio transfer, but novation has not occurred, has been on the agenda since 2011 but has not yet been substantively discussed by the working group. At its meeting in Houston, the working group voted to re-expose the proposal for comment after narrowing its scope to apply to only "substantially duplicate coverage on asbestos and/or pollution exposures."

Property/Casualty Retroactive Reinsurance Exception (2013-14) – The working group discussed a proposal from a large P&C insurer to allow an exception for prospective reinsurance accounting (i.e. the recording of ceded premiums) for retroactive reinsurance agreements between affiliates which results in no gain in surplus to the parties at inception. The proposed accounting would be to account for such transactions as reinsurance run-off (i.e. paid loss) transactions. The Form A was exposed "for information gathering purposes" and "should

not imply positions supported by a majority of the working group."

Title Insurance Loss Reserves (2012-33) – At the Fall National Meeting, the working group exposed for comment proposed revisions to SSAP 57, Title Insurance, to clarify the reporting of loss reserves including known claims reserves, statutory premium reserves, supplemental reserves and the bulk reserve. The working group received significant comments from the Missouri Insurance Department, including an objection to the proposal to delete the requirement for bulk reserves in certain circumstances. The working group deferred action on this item and extended the comment period to April 26.

SSAP 100, Fair Value Measurements (2013-06)
The working group exposed for comment a proposal to reject ASU 2013-03, Financial Instruments: Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities, as the SSAP 100 disclosure requirements do not distinguish between public and non-public entities.

SSAP 104, Share-Based Payments (2013-03) – The working group requested comments related to the prevalence among insurance entities of share-based payments to non-employees. Based on responses received, the working group will either consider guidance for such transactions or propose rejecting EITF 00-18, Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees.

SVO Unit Prices –The working group reported that a new document, Relating SVO Unit Prices to the NAIC Fair Value Hierarchy to the Fair Value Hierarchy has been posted to the NAIC's website. The document assists companies in assigning appropriate fair value hierarchy levels to unit prices reported in the NAIC's Automated Valuation Service product. This document is explicit that it is not considered authoritative literature.

Emerging Accounting Issues Working Group

INT 13-01 Adoption
In January the working group reached a consensus, INT 13-01, for a one-time extension of the 90 day rule for uncollected premium balances, bills receivable for premiums and amounts due from agents and policyholders directly impacted by Hurricane/ Superstorm Sandy. The extension would apply to policies in effect as of October 29, 2012; insurers with policyholders in areas impacted would be granted 150 days, not to extend beyond March 28, 2013, before nonadmitting premiums receivable from those policyholders. The working group finalized this consensus on its January 15 conference call.

The working group also continues its review of INTs to determine which guidance can be moved from an INT directly into the related SSAP to further consolidate the Accounting Practices and Procedures Manual.

Capital Adequacy Task Force

The working group held conference calls February 26 and March 19, and met in Houston and discussed the following issues:

Commercial Mortgage Proposal
As discussed below in the Life RBC Working Group summary, the task force exposed for comment the ACLI's March 27 commercial mortgage proposal until April 22. The task force then held a special call April 30th to consider the proposal and, after lengthy discussion, adopted it unanimously for 2013 RBC reporting. The process to replace the mortgage experience adjustment factor took nearly five years.

Adoption was nearly derailed at the last minute when an issue arose with respect to the use of proprietary data from the National Council of Real Estate Investment Fiduciaries (NCREIF), which is used in the RBC formula to develop the market value of the underlying properties. The issue was resolved by an 11th hour "miracle" effort in which companies will obtain the NCREIF data from the ACLI, and regulators can obtain the data from the NAIC under a contract with NCREIF. Two additional outstanding issues related to confidentiality language and company reporting of data elements for each mortgage loan to the Capital Markets Bureau were also resolved on the April 30th call, to the relief of industry and regulators.

Working Capital Finance Investments
At the Fall National Meeting, the task force exposed for comment a referral from the Valuation of Securities Task Force which recommends that WCFIs must be preapproved by the SVO before an insurer can invest in them; the SVO has developed a methodology which would assign NAIC 1 or 2 designations based on the credit risk associated with the corporate obligor. At both the February and March conference calls, the task force had very lengthy discussions on consideration of WCFI as NAIC 1 or NAIC 2 for RBC purposes and whether a

higher RBC charge is appropriate. Representatives from Connecticut and Wisconsin expressed concerns about the low RBC charges if NAIC 1 and 2 RBC charges are used, commenting that the relatively high returns of WCFIs must signify higher risk than other NAIC 1s and 2s, and suggesting that a 10% and 12% charge, as used by the banks, might be appropriate. Interested parties responded that the higher yields on these instruments are a result of illiquidity risk, not credit risk.

At its meeting in Houston, the task force adopted the structural changes to the Life, Health, Fraternal and P/C formula pages to allow treatment of WCFI for 2013 RBC as Schedule BA assets. The working group did not vote on or expose a proposal for the factor charges for these investments. The new factors must be approved by June 30 to be effective for 2013 RBC. If the task force does not adopt specific factors for WCFI, they will default to the Schedule BA factors for 20% for health and P&C companies and 30% for life and fraternal companies, which would significantly reduce the attractiveness of these investments.

Securities/Broker Receivables

At the Fall National Meeting, the task force exposed for comment a letter from the ACLI regarding the sale of securities/broker receivables, which discussed the current "trade date" practice of assigning a 6.8% RBC charge as a proxy for investment risk to broker receivables. The ACLI believes this can lead to overly punitive or overly beneficial RBC treatment, depending on the risk level of unsettled assets. Adopting a "settlement date" approach for RBC calculations will result in a more accurate representation of investment risk and therefore, more accurate RBC. The task force discussed the proposal during its April 30th conference call and concluded they need additional information from the ACLI, and no action was taken. Therefore, no change will be effective for 2013 RBC reporting as some had hoped.

Life Risk-Based Capital Working Group

During the winter and early spring, the working group continued discussion of its all-consuming project to consider and reach consensus on the ACLI commercial mortgage proposal. At the Fall National Meeting, the regulators voted unanimously to adopt the structure of the ACLI commercial mortgage proposal for 2013 Life RBC while leaving debate on risk charges for specific risk categories for 2013. The working group met via conference call February 19 to review changes made to the proposal since

December. The ACLI noted that most of changes were edits for clarification, but several were in response to working group concerns: 1) the term “internal appraisals” was changed to “internal valuations” (companies can use internal valuations for the loan-to-value determinations if internal valuations use standards comparable to external appraisals), and 2) at the request of New York, the risk categories had been changed for certain loans with low loan-to-value and low debt service coverage. During the February 19th conference call another revision was agreed to: the ACLI’s AVR proposal was replaced with a “simplified AVR” proposal, which eliminates the Mortgage Experience Adjustment Factor used to adjust AVR factors for certain lines and “incorporates factors that represent the mid-range of the factors that will be used upon implementation.” The more robust ACLI methodology will be proposed for 2014 AVR. The working group then re-exposed the ACLI proposal (dated February 15) for comment.

During the comment period, an alternative proposal was received from two members of the working group, Connecticut and New York; the two regulators repeated their comment from 2012 that the ACLI proposed risk charges are too low. The alternative proposes increases to the first five of the seven risk categories for an average increase of 15%.

The working group met in Houston and again had an extended discussion of the commercial mortgage proposal. The ACLI responded to the Connecticut/New York Alternative noting that arbitrary increases in required capital for a single asset class give insurers an incentive to avoid that asset class which increases concentration risk. The chair of the Capital Adequacy Task Force raised an issue with respect to the confidentiality provisions for the insurer spreadsheets required by the proposal that are calculated outside the RBC Report. The chair asked that NAIC legal staff review the guidance and ensure it is consistent with the RBC Model Law. The Life RBC Working Group then voted on the commercial mortgage proposal (dated March 27) and adopted it with a 5-4 vote (with the chair breaking the tie). The CT/NY Alternative was not voted on.

At the subsequent meeting of the Capital Adequacy Task Force, the task force voted to expose the proposal until April 22nd to address issues raised in the Life RBC Working Group meeting, including the confidentiality issue discussed above; the task force unanimously adopted the proposal on April 30th.

Investment Risk-Based Capital Working Group

The Investment RBC Working Group, formerly known as the C-1 Factor Review Subgroup, continues to consider the recalibration of C-1 factors used in the life RBC calculation. The C-1 factors are intended to capture an asset's risk of default of principal and interest or fluctuation in fair value. While to date the focus has been on life RBC factors, ultimately the P/C and health factors will be considered as well since none of the investment risk factors have been updated since 1991. The subgroup generally meets bi-weekly, and much of the discussion continues to be focused on the bond modeling project being lead by the AAA. During 2012 the AAA developed a bond model which replicates the 1991 model, such that when using the 1991 scenarios and assumptions, the new model generates the either the same, or very similar, C-1 factors.

At the Spring National Meeting the AAA provided a comprehensive status update on its work, acknowledging that limited progress has been made since the Fall National Meeting as most of the actuarial resources supporting the effort have been busy with the year-end reserving process for their companies. The remaining critical path items include:

- Finalizing the total loss assumptions, including bond default and recovery assumptions. The AAA has tentatively determined that it will use Moody's cumulative bond default rate data based on experience over the last 10 years.
- Finalizing the tax assumptions – the AAA model will generate pre-tax factors. An explicit tax adjustment will need to be incorporated into the RBC calculation.
- Defining the representative bond portfolio – the modeled portfolio is expected to have characteristics similar to the average industry portfolio and contain between 400 – 600 securities.
- Defining the expected loss reflected in policy reserves (i.e. actuarial benefit reserves).

Construction of the representative corporate bond portfolio is expected to be completed by June 1st and all model logic and assumptions are targeted for finalization by July 1st. The current plan is for modeling of the corporate bond portfolio to begin in July.

The working group did receive summary reports and recommendations to update the life RBC formula for derivatives and common stock. For derivatives, the report makes only one recommendation: that the potential exposure formula included in the Schedule DB Part A instructions for written credit default swaps be changed to reflect recovery experience consistent with the RBC approach for bonds. For common stock, after thorough analysis, the report recommends that the base factor be maintained at 30%. The reports and recommendations were exposed for a comment period ending May 16th.

Progress continues the following additional invested asset classes: mortgages, real estate, and other invested assets. The working group plans to hold periodic conference calls over the next several months to continue its considerations. The working group continues to have the optimistic target of a 2013 completion date with the potential for implementing revised RBC factors for the 2014 RBC calculation. Once the working group has completed its work it will make a proposal to the Capital Adequacy and Valuation of Securities Task Forces.

SMI RBC Subgroup

The subgroup held four conference calls in January, February, and March and did not meet in Houston. During the conference calls, the subgroup continued its discussion of operational risk and its possible inclusion in the RBC formula, as well as its role in insolvencies and its interaction with other risk categories. Of the regulatory regimes that the subgroup reviewed, Bermuda is the only regime that does not simply apply a fixed factor for operational risk. Bermuda bases the factor on how an individual company responds to a predetermined questionnaire relating to the company's exposure on operational risk. The subgroup discussed a possible approach of incorporating an operational risk charge, i.e., to use a flat percentage factor (5%) initially and then adjusting after further analysis.

The subgroup received a summary report from NAIC staff on current RBC charges that might contain elements of operational risk. The report notes that operational risk is not specifically included in any life RBC risk charge. The property RBC page includes excess premium growth as a percentage of authorized control level, which might be an area where operational risk is included in that formula. However, the subgroup noted it would be inappropriate to conclude that the excessive growth

charge substitutes for operational risk, when operational risk would apply to all companies regardless of whether they experienced premium growth. The health RBC formula also has a premium growth charge. The task force asked the NAIC staff to provide a more detailed report of companies with premium growth charge.

The subgroup discussed the definition of operational risk used by Solvency II and Basel II: "the risk of loss arising from inadequate or failed internal processes, or from personnel and systems or from external events, including legal risks and excluding reputation risks, risks arising from strategic decisions, and risks otherwise covered in the standard formula." It was noted that the definition excluded reputational risks and risk arising from strategic decisions.

The subgroup heard a presentation from Canada's Office of the Superintendent of Financial Institutions, noting that Canada is currently conducting a quantitative impact study regarding operational risk as part of a broader revision of its regulatory capital requirements which Canada may implement in the next two years. The presentation covered the high-level principles underpinning Canada's proposed approach to determining the operational risk charge, which rests on the following factors: business volume, which includes premiums and account values, including ceded and assumed reinsurance; large increases in business volume, which includes lines of business and jurisdictions beyond a threshold of 20%, stressing that rapid growth creates additional pressure on people and systems; and the company's required capital, meaning that operational risk is often a by-product of other risk-taking activities.

The subgroup will continue to discuss and study different methodologies to capture operational risk. The subgroup has an explicit goal of making a recommendation to the SMI Task Force by the end of 2013.

Property/Casualty Risk-Based Capital Working Group

The working group met by conference call February 5 and March 7 and in Houston and discussed the following topics.

RRG Guidance
The working group discussed a referral letter from the Risk Retention Group Task Force relating to amending the P/C RBC Overview and Instructions to include additional guidance for risk retention groups. Following modifications to the original proposal, the working group exposed the proposed changes for comment; no comments were received. The working group subsequently adopted the additional guidance to be included in the 2013 RBC Instructions.

Calibration Research
During the conference calls, the working group heard lengthy presentations from the Casualty Actuarial Society on the examination of calibration and dependencies in the P/C RBC formula, including premium and reserve risk, risk dependency, risk calibration and other RBC issues. The CAS plans to first identify issues affecting calibration while considering prior research and then establish a baseline approach using the expanded data set, leading to development of a sensitivity test to determine the impact of variations in the baseline approach. It was noted that CAS is currently reviewing risk charge by type of company and combined ratio, Solvency II calibration approaches, regression analysis of risk factors, risk metrics, and dependency between lines of business. The working group was asked to provide thoughts and comments to CAS to help shape the direction of future research.

Reinsurance Reserve Credit Study
In Houston, the working group heard a presentation from the AAA on "Report on Reinsurance Credit Risk Charge in the NAIC Property/Casualty Risk-Based Capital." This report is part of the working group research as to whether the reinsurance risk credit of 10% is too high, as thought by many in industry. The report including the following topics:

- Components of the reinsurance credit risk charge and rationale for inclusion
- Ways in which each of the individual components of the charge can be quantified
- Extent to which the total risk can be seen as the sum of its individual components without any overlap or inter-correlation, or whether a lower amount would be more appropriate to reflect less than complete correlation
- Use of other exposure bases instead of or in addition to ceded balances for measuring reinsurance credit risk

Also in Houston, the working group received an update on calibration methodology for developing the "ex-cat" factors in the R5 components. The working group will continue to discuss this matter in future meetings.

Catastrophe Risk Subgroup

The subgroup met by conference call January 23 and February 14 and in Houston and discussed the following topics.

Attestation and Consistency of Models
The subgroup discussed implementation details of the overall catastrophe risk. A first priority is to work with the Financial Examiners Handbook Technical Group to develop procedures to validate that the insurer exposure data used in the modeling is accurate and complete, and that the insurer modeling, assumptions and data are the same in RBC calculations as those used in insurers' own catastrophe risk management processes. The subgroup will coordinate with the Handbook Technical Group to develop proper procedures which will be included in the 2014 Examiner's Handbook. The subgroup will discuss what information should be required in the expanded confidential RBC report. A comment was heard that the use of the model version should be clearly documented. However, it was noted that models may not be able to handle the complexity of some reinsurance arrangements, so insurers will often make certain adjustments outside of the models. The subgroup heard a suggestion allowing insurers to use the customized or proprietary models that are consistent with the insurer's own internal catastrophe risk-management process. The subgroup discussed a proposal that an attestation should be required whereby insurers disclose the models used and explain any differences from those used for internal purposes. In Houston, the subgroup exposed the draft attestation regarding insurer catastrophe risk modeling and property exposure data validation for a comment period ending June 4. It is expected that the attestation will be confidential similar to the RBC filing.

Catastrophe Risk Charge Exemptions
The subgroup also discussed a comment letter received from a trade organization relating to the criteria for exempting insurers from the new catastrophe risk RBC charge requirements. The comment letter requests an increase to the 15% threshold of the policyholder surplus exposure level and to provide exemption for those companies with property direct written premiums under $75 million. While the subgroup agrees with the desirability of avoiding imposition of unnecessary reporting burdens on small companies, it was agreed that the subject requires further analysis and no action was taken in Houston.

Non-U.S. Cat Event List
In February, the subgroup discussed the Worldwide Catastrophe Event List provided by Reinsurance Association of America. The list of non-U.S. catastrophe events was prepared based on information from Swiss Re Sigma and Munich Re Nat Cat Service. RAA considers the list as a starting point to assist the subgroup in developing a list of events going forward that could be placed on the NAIC website so filing companies will have access to it. RAA recommended that the subgroup consider raising the reporting threshold, as the current $25 million industry-wide threshold produces a long list of events, including many smaller events that might not be material to the determination of the R-5 factors. The subgroup chair agreed that a higher threshold based on the list of events is worth considering. In Houston, the subgroup discussed a proposed non-U.S. Cat Event List that was compiled by a subgroup member based on the RAA list. Following discussion, the subgroup adopted the proposed non-U.S. list for RBC data filing purposes.

Also in Houston, the subgroup adopted revised pages with minor technical corrections for 2013 catastrophe loss reporting.

Subsequent to its meeting in Houston, the subgroup held a conference call April 17 and discussed the following:

- U.S. Catastrophe Event List - The subgroup discussed the need for a U.S. Cat Event List, similar to the non-U.S. Cat Event List adopted in Houston, with the chair seeking assistance from the subgroup members. Florida and Illinois will draft a list of hurricanes and earthquakes using information from the National Weather Service and United States Geological Survey, respectively.

- Examination Procedures - The subgroup discussed a notification from the Financial Examiners Handbook Technical Group regarding exposure of newly proposed sections of Handbook guidance. Topics addressed in the exposed documents include new additions to examination repositories relating to the modeling of catastrophe risks. The chair expressed concern as to whether the proposed changes completely fulfill the subgroup's request for validating the accuracy and completeness of the insurer's exposure data used in the modeling, and to ensure that the insurer modeling, assumptions and data are the same in RBC calculations as those that are used in insurers' own catastrophe risk management process. The subgroup chair will draft a comment letter, circulate with the subgroup members and submit to the Financial Examiners Handbook Technical Group.

Health Risk-Based Capital Working Group

The working group met by conference call January 11, February 11, and March 4 and discussed the following topics.

Blanks Proposals
On January 11, the working group exposed a blanks proposal that would add a new section to the Underwriting and Investment Exhibit Part 2b for additional data collection on health care receivables that will allow further analysis of the health care receivable factors within the current heath RBC formula. On March 4, the working group adopted the revised blanks proposal and referred it to the Blanks Working Group.

On February 11, the working group exposed an RBC blanks proposal that would add a new page to the health RBC capital formula with three interrogatory questions regarding pandemic and bio risk. The new page would be for informational purposes only and allow for further discussion of the potential future inclusion of pandemic and bio risk within the heath formula. On March 4, the working group adopted the proposal for referral to the Blanks Working Group.

Impact of ACA on Health RBC
The working group discussed the work of AAA in reviewing the list of risks identified by the working group's Risk and Reinsurance Subgroup. These risks reflect the many unknowns, such as who will be covered and how effective the risk mitigation mechanisms in the Affordable Care Act will be. After reviewing the list of risks, AAA concluded that it is not anticipated that the effect of risk adjustment would be significant enough to warrant a change in the RBC formula. Adjusting the RBC formula would not be effective for the following reasons:

- Since it is retrospective, the RBC formula will not identify any negative result of these risks until the end of 2014, even if it could be changed by then.
- The risks are short term—only for two or three years. Making formula modifications for a short-term problem may not be feasible.

Rather, the AAA recommended that regulators consider the following:

1. Monitor carriers that have limited access to capital or that have low liquidity levels, and monitor carrier growth to identify those that may be growing faster than their capital would allow.
2. Monitor underwriting experience and loss ratios to identify carriers that may have difficulty covering claims and administrative expenses based on current premium levels.
3. Review quarterly estimates of health RBC based on quarterly financials to identify deteriorating RBC levels.
4. Monitor reinsurance and risk adjustment accruals to identify carriers that may not be adequately accruing liabilities, that may be over estimating receivables, or that may have a liquidity issue since payments will be delayed until final determinations can be made.

The working group plans to send a referral letter to the Financial Analysis Handbook Working Group regarding the recommendations received from the AAA.

The working group will continue to discuss the ACA impact of the health RBC formula.

Valuation of Securities Task Force

RMBS & CMBS Market Update
A consultant to the NAIC provided an update to the task force on recent trends and issues in the residential and commercial mortgage markets, who noted that the residential market seems to be rebounding with improving home prices and an increase in existing home sales. There has been a slight increase in new issues of RMBS, but still drastically below pre-2008 levels. The commercial markets are attracting new capital; more available credit should help marginal loans refinance. This should lessen the impact of the large loan maturity wave coming due in 2015.

Despite these market improvements, the consultant indicated that he is beginning to see signs of modestly deteriorating quality of RMBS and CMBS loans. Issuers of RMBS are beginning to limit certain representations and warranties with regard to the value of the property and confirmation of the borrower's income. For CMBS, loan underwriting is becoming less stringent and there is further concern that loans underwritten at current historically low interest rates presents significant future refinance risk in a rising interest rate environment. The task force will continue to monitor these trends because they are informative to the 2013 year-end macroeconomic assumptions used in the RMBS and CMBS modeling process.

2013 RMBS & CMBS Modeling Process
The task force exposed a proposal to consider the use of a risk-free discount rate and to consider all cash

flows of the security in the RMBS and CMBS modeling process this year, rather than the current methodology that uses the security's coupon rate and only considers principal cash flows. The task force also discussed plans to start developing the 2013 RMBS and CMBS modeling assumptions much earlier this year; industry representatives indicated that they are pleased with this approach. Previously, the industry and some task force members had expressed significant concerns with the 2012 timeline, where assumptions were not finalized until the end of October.

Quarterly RMBS & CMBS Reporting

The task force referred proposed quarterly reporting instructions of RMBS and CMBS to the SAP Working Group for incorporation into SSAP 43R, Loan-Backed and Structured Securities. NAIC staff developed the proposed instructions, at the direction of the task force, following the Fall National Meeting. The instructions indicate that insurance companies should report interim purchases of RMBS and CMBS that are subject to financial modeling as follows:

- If the prior year's modeling data, with respect to an RMBS or CMBS security purchased during an interim period, is available to the insurer, then the insurer may use that modeling data to determine the NAIC designation and book/adjusted carrying value;

- If the prior year's modeling data is not available to the insurer, or the insurer elects not to use that data to determine the NAIC designation and book/adjusted carrying value, the insurer should follow the modified filing-exempt process to determine the NAIC designation and book/adjusted carrying value.

Once SAP Working Group has considered the proposal and adopted updates to SSAP 43R, the task force plans to incorporate the instructions into the SVO Purposes and Procedures Manual.

Foreign Audit Project

At the Fall National Meeting the task force directed the SVO to work with ACLI representatives to evaluate whether there are informational resources that would permit the SVO to use financial information presented on a national GAAP or national IFRS basis to conduct credit analysis comparable to that performed using financial information presented on the basis of U.S. GAAP or IASB IFRS. This would allow an insurer to file audited financial statements expressed in national GAAP or national IFRS with the SVO when submitting securities from issuers that do not prepare GAAP or IFRS financial statements for SVO consideration. Currently a reconciliation to U.S. GAAP or IFRS is required to be included in the SVO submission.

In Houston, SVO staff provided an update on this joint project. The SVO has meet with the ACLI and other representatives, resulting in agreement on fundamental objectives of investment analysis, agreement of the purpose of the financial presentation as it relates to these investment analysis objectives and agreement on parameters for conducting an evaluation of the local accounting standards of a specific country. The ACLI and SVO are currently focused on Germany; an educational session on German accounting rules has been scheduled for SVO staff.

NAIC Designation Recalibration Project

The task force discussed comment letters received on the SVO-proposed definitions for NAIC designation categories under the recalibration project. As currently proposed, the NAIC would transition from the current single NAIC rating designation framework (1-6) to three separate frameworks: one each for corporate bonds, municipal bonds and asset-backed securities. The proposal would create new NAIC designation symbols and definitions. Additionally, RBC factors would be updated based on the work of the Investment RBC Working Group. The comment letters requested that consideration of the SVO-proposed definitions be deferred until the Investment RBC Working Group completes its charge. The task force adopted a directive for SVO staff to meet with AAA representatives performing the detailed modeling work for the working group to gain an understanding of the objectives of the project and the proposed methodology to identify ways for the two correlated projects to proceed in a synchronized way.

Mandatory Convertible Securities

In response to changes made by the SAP Working Group at the Spring National Meeting to SSAP 26, Bonds, the task force adopted changes to the SVO Purposes and Procedures Manual to conform the definition of mandatory convertible securities with the amendment to SSAP 26. The Purposes and Procedures Manual was also modified to exempt mandatory convertible securities from being assigned NAIC 6S under the new SVO classification procedures. The amendments are effective January 1, 2013.

New Credit Rating Provider
The task force received a letter from Egan-Jones requesting to be approved as an NAIC Credit Rating Provider. The task force directed the SVO staff to enter into negotiations to finalize an agreement recognizing Egan-Jones as a Credit Rating Provider and to include them in the appropriate listing in the SVO Purposes and Procedures Manual.

Solvency Modernization Initiatives Task Force

The task force met in Houston and exposed an updated draft of its white paper The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative; comments are due June 6. The revised draft contains minor changes to the first four sections of the paper, but now includes a draft of section five: Solvency Modernization Initiative - Future of U.S. Financial Insurance Regulation, which is intended to document policy decisions from the SMI, and therefore had not previously been completed. The new section contains background information on the SMI and its workstreams, as well as descriptions of the progress made to date and next steps for each area of focus.

The task force also discussed the creation of a dashboard to monitor the adoption by the states of the various SMI initiatives, of which it hopes to discuss a draft at the Summer National Meeting. The task force noted there has been significant progress on the adoption of the revised credit for reinsurance and holding company models by the states, but that less progress has yet been made on the adoption of PBR or the ORSA at state-level, given that the outputs of these workstreams were only more recently adopted by the NAIC.

Principles-Based Reserving Implementation Task Force

The PBR Implementation Task Force was established in January, replacing the PBR Working Group. The task force held its first meeting by conference call in April, met in-person in Houston, and then held a second conference call later in April.

The task force was established to coordinate with other NAIC technical groups involved in the PBR initiative, and also to assess the solvency implications posed by life insurer-owned captive insurers and alternative mechanisms. Specific charges of the task force include:

- To develop, maintain, and oversee components of the PBR implementation plan.
- To create a legislative information package regarding PBR to assist the states in their adoption efforts.
- To consider the Captives and Special Purpose Vehicle Use Subgroup's recommendations (when finalized) in the context of PBR, and to make further recommendations if necessary.

PBR Implementation Plan
A PBR Implementation Plan was exposed for comment by the PBR Working Group at the Fall National Meeting, and the task force discussed comments received from the AAA and the ACLI on its early-April conference call. Comments included the need to place greater emphasis on procedures to evaluate the overall effectiveness of the PBR methodology, and the need for the review to be flexible in approach, and carried out by appropriately expert resources as necessary. Comments were also received on roles, responsibilities, tools and resources relating to PBR, as well as confidentiality, training, and the potential benefits of the NAIC providing periodic reporting on the PBR review, and commentary on the methodology.

The task force also received comments from two state insurance departments, including California Department of Insurance, which noted the importance of reviewing insurers' PBR preparations and models over the run-up to implementation, and in the initial years of PBR.

The task force heard comments on the revised implementation plan from interested parties in Houston, with a particular focus on the update process for the Valuation Manual. The task force had discussed the update process on its earlier conference call, noting that the Life Actuarial Task Force is working on this issue, and that the process must provide sufficient opportunity for comment, whilst not becoming unnecessarily slow, onerous or inflexible. Interested parties at the Spring National Meeting suggested that the update process should be consistent with the process required to update regulations, given the importance of the Valuation Manual. Interested parties also asked for further guidance on expectations for supervisory review of PBR in examination and non-examination years, to encourage consistency and to help in the allocation of resources. The task force also discussed disclosure and accreditation requirements and re-exposed the implementation plan for comment for 30 days.

The task force intends to continue its discussions on the implementation plan by conference call following the comment period. A smaller group of regulators and NAIC staff is also expected to continue working concurrently to enhance and prioritize the tasks and decision points included in the plan.

PBR Legislative Information Package
The task force discussed an initial draft of its legislative packet document at the Spring National Meeting, having called for input on the document from states and interested parties on its earlier conference call. The packet provides background information on PBR, and key points on the implementation process for legislators and is meant to assist states in introducing the PBR legislation. The packet also provides answers to potential questions, including changes to the Standard Valuation Law and Standard Nonforfeiture Law, background information on the Valuation Manual and PBR, and on the need for and the implications of PBR.

The legislative packet was exposed for a 30 day comment period at the Spring National Meeting (with New York abstaining from the vote), and was later discussed by the task force by conference call on April 23rd. While at this point the comment period had not yet finished, the task force used the call to gather initial reactions from task force members and interested parties, which had not been possible in Houston. The packet was generally well received by interested parties and task force members, although there was discussion on additional information that could be included in the document, including how PBR will support uniformity, and the fact that PBR will apply only to new policies, so any transition to new reserve levels will be gradual. The AAA also proposed several additional questions to be addressed in the packet, focused on how PBR will affect consumers, companies and regulators, in addition to some additional explanatory information. The task force did not adopt any revisions on its conference call as the comment period had not yet finished, but was generally supportive of the changes proposed.

The task force also discussed the inclusion of quantitative information on the impact of PBR on reserves for different products, proposed by New York and also reflected in the AAA's proposed revisions. The task force heard that reserves would decrease by up to 50% for some products in studies carried out into the impact of PBR, although they also increased for some products and remained unchanged for many products. The task force agreed that this information would be useful for legislators considering the proposals, while recognizing that the studies carried out were not representative of the whole industry.

The task force also discussed whether the proposed legislative packet is currently too technically complex, and requested NAIC staff to produce a one page non-technical orientation document to support the packet. The task force also discussed providing material to legislators showing industry support for the proposals, and heard that the ACLI had testified in support of the PBR legislation in Rhode Island. The AAA has also agreed to provide a separate brief supporting the PBR legislation. However, the task force also heard that the National Alliance of Life Companies, which represents many smaller life insurers, does not support the new legislation. This was consistent with the findings of the Life Actuarial Task Force's survey of state resources (discussed further below), which found that some smaller companies are concerned with the level of complexity and cost in implementing PBR.

At its meeting in Houston, the task force heard that 9 states have either introduced or in the process of introducing PBR legislation, with Connecticut and Texas being the largest states acting thus far. Arizona has already adopted its proposed PBR legislation.

PBR Training and Resources
The task force discussed PBR training on its first April conference call, noting that several sessions at the NAIC Financial Summit in May 2013 will be on the topic of PBR. The task force also discussed resources in Houston, hearing an update from the Life Actuarial Task Force on its survey of state resources. The task force heard that 40 states had responded to the survey, which covered states' current resources and understanding of PBR and its implications. A need for an additional 45 actuaries across the states was identified, with 11 states reporting few actuarial resources. Overall, the task force heard that the survey results indicate that states do not expect resources to be a major issue for PBR implementation, with 29 states expecting that they have sufficient actuarial and accounting resources to implement PBR. However, the task force also discussed its expectation of a significant disconnect between states' expectations of their own resource needs and the task forces' expectations of the resources that the states will ultimately require. The survey also found that, overall, the need for training on PBR is recognized by the states.

Captives and SPVs
The task force received an update on captive and SPV activities at the Spring Meeting, which includes a re-exposure by the Captive and Special Purpose Vehicle Use Subgroup of its draft white paper. The task force discussed the potential implications of PBR for captives use, noting that it is expected that PBR should decrease the need for insurers to establish captives and SPVs, due to expected reductions in "redundant" reserves. However, the task force also recognized that this effect may not be that significant, particularly in the early years of implementation, as PBR still retains degrees of reserving conservatism. While the subgroup's white paper is not yet finalized, the task force plans to start working on its related charge concurrently, using the draft paper.

Group Solvency Issues Working Group

The working group met at the Spring National Meeting, and discussed and adopted its recommendations to the Financial Regulation Standards and Accreditation (F) Committee for Part A accreditation standards and guidelines for the Risk Management and Own Risk and Solvency Assessment (ORSA) Model Act (#505). The working group recommended that the following items should be considered significant elements for accreditation purposes:

- The definitions in the ORSA Guidance Manual
- The requirement to maintain a risk management framework
- The requirement to regularly conduct an ORSA consistent with the requirements of the ORSA Guidance Manual
- The ORSA Summary Report filing requirements.
- The exemptions to the model act
- The contents of the ORSA Summary Report
- Confidentiality provisions
- The effective date of the model act (January 1st, 2015).

F Committee also discussed the model act as a possible addition to the accreditation standards and agreed with the recommendation, as discussed on page 31 below.

The working group then discussed and exposed for a 45 day public comment period revisions to its financial analysis review team guidelines for holding company analysis. The guidelines were first proposed by the working group in 2010, and became required in 2012. Beginning in 2014, states are expected to be scored against the guidelines. The working group's proposed revisions are intended to reflect improvements to states' holding company analysis processes made over the last year, in addition to updates to the Financial Analysis Handbook, in particular concerning the respective roles of, responsibilities of and interactions between the lead state and other states. The revisions emphasize the role of the lead state in carrying out the analysis of the holding company system, and the responsibilities of non-lead states to carry out analysis of the impact of the holding company system on their domestic insurers, based on the analysis performed by the lead state. The revisions also address the responsibilities of the lead state where it chooses to rely on analysis work carried out by an international or other functional regulator.

The working group also agreed to expose for a 60 day comment period its document Roles and Responsibilities of U.S. Lead State/U.S. Group Wide Supervisor Document. The document is intended to form a new section for the Financial Analysis Handbook. The document is also intended to clarify the U.S. approach to group supervision to international regulators and other parties. The document contains a summary of the NAIC's approach to group supervision, applicable model laws and regulations, including the ORSA, the roles of financial analysis, financial examination and regulatory filings, and guidance for financial analysts. The document also summarizes the role of the lead state in the U.S. group supervisory system, and the U.S. approach to supervisory colleges. The working group heard that the roles and responsibilities summarized in the document are intended to align with ICP 23 (Group-Wide Supervision), which is in the process of being revised to make the ICP more outcomes-based.

ORSA Subgroup

The subgroup met by conference call in February and March, and the majority of its discussions were focused on revisions to the ORSA Guidance Manual. The subgroup had exposed an updated version of the Guidance Manual for comment in December. Changes were made to make the manual consistent with the recently adopted ORSA Model Law and to improve clarity and definitions, and to clarify the roles and responsibilities of supervisors, including with respect to interactions with overseas supervisors and the use of ORSA reports prepared under other jurisdictions' regulations. Wording was

also included to clarify that state law always supersedes the requirements of the Guidance Manual, which reflects the wording and requirements of the ORSA Model Act and therefore may not be reflective of individual state laws. The new wording notes that the laws adopted in the insurer's state of domicile are the final determinant of the risk management and ORSA requirements applicable to any individual insurer. The subgroup adopting the manual with further clarifying changes on its conference call in March.

The subgroup also discussed its planned 2013 ORSA pilot exercise. Any insurers wishing to participate were asked to volunteer by the end of May 2013, and to submit their ORSA Summary Reports by September 20th. In contrast to the 2012 pilot, all participating insurers are asked to provide a complete ORSA Summary Report with actual data. The 2013 pilot may also include one-on-one meetings with participating insurers before the ORSA Summary Reports are reviewed.

Similar to the 2012 pilot, the subgroup plans to provide high-level, non-group specific feedback from its review of the submitted reports. The subgroup also expects the review to help identify any necessary clarifications or amendments to the Guidance Manual, to help in the development of analysis and examination guidance, and to assist other NAIC committees address ERM and/or ORSA initiatives. The subgroup also intends to provide specific feedback to participating insurers.

The subgroup did not meet at the Spring National Meeting, but plans to meet with the North American CRO Council in June.

Corporate Governance Working Group

The working group held four conference calls in February and March and met at the Spring National Meeting, with the explicit goal of completing its final recommendations/document Proposed Response to a Comparative Analysis of Existing U.S. Corporate Governance Requirements. The working group had drafted the document, including proposed exhibits, to recommend enhancements to U.S. corporate governance regulation following its review of current U.S. requirements and comparison to IAIS Insurance Core Principles. At the Fall National Meeting the working group extended the comment period on the document and exhibits until January 18th.

Proposed Corporate Governance Reporting Requirements

Although the working group's explicit goal was to complete its proposed recommendations by the 2012 Fall National Meeting, this goal was not achieved due to continued opposition from interest parties with respect to certain proposals. As a result, the working group resumed discussions during its 2013 conference calls and agreed to the following changes from previous exposure drafts:

- Exhibit A, in which a company would summarize its corporate governance framework, processes and activities, was revised to require disclosure of the Board of Directors' role in overseeing a company's reinsurance strategy and risk management and compliance. These disclosures were previously proposed to be included in annual statement interrogatories; those proposals have been eliminated.

- Exhibit B, Supplemental Compensation Exhibit; The requirement to disclose aggregate compensation of all employees as part of the supplement was deleted.

- Exhibit C, Internal Audit Function Requirement; The proposed requirement for insurers exceeding the MAR premium threshold to maintain an "effective internal audit function" was revised to clarify the independence expectations of the internal audit department.

At the Spring National Meeting, after opening comments from the chair that the process took longer than "birthing an elephant," the working group voted unanimously to adopt the proposed corporate governance recommendations, which was also adopted by SMI Task Force. This adoption includes a recommendation to Executive Committee and Plenary of a Request for Model Law Development to amend the Model Audit Rule for the Exhibit C internal audit requirement discussed above. Upon adoption of the recommendations, a key member of the working group noted that adoption is "raising the bar for prospective supervision."

In addition to Exhibits A, B and C discussed above, this document also includes the following referrals to other NAIC working groups and task forces to consider developing guidance as discussed below.

- Exhibit D: Proposed Enhancements to Financial Analysis Handbook, to consider additional corporate governance principles and guidance in the Handbook.

- Exhibit E: Common Assessment Methodology; this controversial proposal recommends a long-term project to develop for examiners a common assessment methodology for corporate governance.

- Exhibit F: Enhancements to Examination of Corporate Governance; this referral asks the Financial Examiners Handbook Technical Group to review ICPs 5, 7 and 8 and consider adding guidance to the Handbook. This includes consideration of IAIS guidance on suitability (ICP 5).

- Exhibit G: Actuarial Reporting to the Board of Directors, which recommends that each life insurer's appointed actuary make an annual report to the Board.

- Exhibit H: Qualifications of the Appointed Actuary, which asks the Casualty Actuarial and Statistical Task Force to consider changes to the P&C actuarial process to allow the commissioner a level of authority to deem an appointed actuary unsuitable. (Commissioners currently have this authority for Life appointed actuaries.)

- Exhibit I and Exhibit J: Proposed Enhancements to Analysis of Corporate Governance; Exhibit I discusses the need to include consideration of a reinsurer's corporate governance as part of the process to review collateral reduction applications. Exhibit J asks the Accreditation Committee to include in the list of critical elements to be adopted from the Hazardous Financial Condition Model Section 4B(10) which allows the commissioner, upon a finding of hazardous operation, to issue an order requiring the insurer to correct corporate governance practice deficiencies.

- Exhibit K: Suitability Considerations in the UCAA Company Licensing Process

Corporate Governance Confidentiality

Last fall, the working group had asked interested parties to defer discussion of the method to collect sensitive corporate governance information (e.g. Exhibit A) until agreement had been reached on what information to require companies to submit. These discussions began in February and took up a significant portion of the working group's time this winter and spring. The group considered several existing mechanisms to gather information from companies including the model law on examinations, holding company requirements, the new ORSA model act, and the RBC model but ultimately decided, together with interested parties, that a new stand-alone Annual Reporting of Corporate Governance Practices of Insurers Model Act should be developed. A stand-alone model is considered necessary to have "clear legislative authority to collect and protect information" and "achieve greater consistency with international standards." One regulator pointed out that if they work quickly to develop the model, it could be adopted by states when they adopt the ORSA model law; otherwise it would likely be 2016 or 2017 before the information could be collected and analysed.

Before the working group is permitted to start work on a corporate governance model law, Executive Committee and Plenary must approve a Request for Model Law Development. That request was drafted by the working group and adopted at the Spring National Meeting by the working group and the SMI Task Force, together with the Model Audit Rule revision request on internal audit discussed above. Executive Committee and Plenary are expected to consider adoption of these two requests at an interim conference call in May or June.

Overlapping Corporate Governance Requirements

As part of its comments to the working group on the proposed corporate governance requirements, interested parties submitted a 36 page letter dated January 24th, signed by nine trade associations, documenting concerns regarding the duplication of effort that would result from the collection of information requirement by Exhibit A. The letter included a matrix which compares the proposed corporate governance regulation with current corporate governance requirements. Interested parties believe this matrix demonstrates how the proposal would duplicate many of the current corporate governance requirements. The working group responded by including the following in the Proposed Reponses paper: "As part of the model law development process, the Working Group would identify overlapping or redundant requests for corporate governance information that can be removed from other areas of the regulatory process."

Next Steps

The recommendations and referrals in the Proposed Response paper will now be considered by various other groups within the NAIC, and drafting of the Corporate Governance Practices of Insurers Model Act should begin this summer.

International Solvency and Accounting Standards Working Group

The working group met at the Spring National Meeting in Houston. The majority of its discussions were focused on ComFrame, and these, along with all discussions on ComFrame at the Spring National Meeting, are summarized under the International Insurance Relations Committee below.

At its meeting in Houston, the working group also discussed the IASB's March 2013 exposure draft, Financial Instruments: Expected Credit Losses, which is ultimately expected to be incorporated as a chapter into IFRS 9. The proposal requires credit losses to be recognized when expected on all financial instruments subject to impairment accounting, considering reasonable and supportable forecasts that affect the expected collectability of remaining contractual cash flows, as well as past events and current conditions. An entity should recognize an allowance, or impairment loss, on a financial instrument equal to 12-month expected credit losses, or if the credit risk of the financial instrument at the reporting date has increased significantly since initial recognition, then the entity should recognize its lifetime expected credit loss. The proposals are a departure from the various current IFRS impairment models, which require recognition of credit losses only when there is objective evidence of impairment or when a credit loss is incurred, considering only past events and current conditions, and which are therefore perceived to cause delays in the recognition of credit losses. The existence of multiple impairment models in the current requirements is also considered to cause excessive complexity.

The working group heard that the FASB also issued an exposure draft on the recognition of credit losses, Financial Instruments – Credit Losses, in December 2012. The FASB's exposure draft proposes a Current Expected Credit Loss Model, which shares common objectives, features and shared development with the IASB's proposals. A key difference is that the FASB would not require a threshold to be met before recording a lifetime expected credit loss. The IASB would require a significant increase in the credit risk associated with the asset before recording such a loss. The timing of the recognition of credit losses also differs between the IASB and FASB proposals.

The IASB's exposure draft is available for consultation until July 5th, 2013, and the FASB model's comment period has been extended to May 31st. The two boards plan to discuss the comments received jointly after the comment periods end.

The working group also discussed the IASB's progress on its planned replacement for IFRS 4 (Insurance Contracts), and heard that it is probable that a new targeted exposure draft will be issued as planned by the end of second quarter of this year. The exposure draft is expected to include the full text of the proposed standard, but will contain targeted questions on specific areas of presentation, measurement and the approach to transition. The IASB does not plan to re-open other aspects of the proposed standard.

International Regulatory Cooperation Working Group

The working group met in Houston, and heard an update on the activities of the IAIS. The working group heard that the Standards Observance Subcommittee has made progress on its Corporate and Risk Governance Self-Assessment and Peer Review, and that it has mapped out a timetable for 2013/2014 reviews on ICPs 6, 9, 10 and 11 (Supervisory Measures) and ICPs 18 and 19 (Market Conduct). The working group further heard that the Education Subcommittee has approved a survey on member educational needs, and that the Access to Insurance Initiative (A2ii) has launched a Self-Assessment and Peer Review on Regulation and Supervision Supporting Inclusive Insurance Markets in conjunction with the IAIS.
The working group also discussed and heard a presentation from Yoshihiro Kawai, Secretary General of the IAIS, on the strategic importance of the IAIS's Implementation Committee, and the link between standard-setting, assessing compliance, and supporting jurisdictions in implementing IAIS standards. The Secretary General noted the particular priority that the IAIS gives to supporting emerging markets through its partnerships with organizations like the A2ii, the Asian Development Bank and the World Bank, in addition to its regional initiatives.

The working group also discussed bilateral and regional developments, hearing that the NAIC had met with jurisdictions including China, India and Switzerland, and that the NAIC remains committed to working closely with other jurisdictions to reduce gaps in regulations, address systemic risk, and engage in comparative analysis. The working group heard that MoUs have been agreed with Nigeria and

are close to completion with India. The working group further heard that the NAIC's MoU and workplan with the China Insurance Regulatory Commission has been extended for a further two years, and that likely future topics for consideration include group supervision, market conduct and consumer protection.

International Insurance Relations Committee

The committee met at the Spring National Meeting, where its discussions were focused on ComFrame, the EU-U.S. Dialogue Project, the Financial Stability Committee, and other activities of the IAIS.

ComFrame

The Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) was discussed by several NAIC working groups at the Spring National Meeting. All discussions on ComFrame are summarized in this section.

Many of the discussions on ComFrame at the Spring National Meeting focused on ComFrame's current draft balance sheet valuation and capital assessment methodology. The current proposals are centered on a ComFrame Adjusted Pro-Forma Balance Sheet (CAPFBS), which is produced by making high level adjustments (including prudential adjustments) to an insurer's balance sheet prepared under any of U.S. GAAP, Japanese GAAP, IFRS or regulatory valuation bases. The adjustments are intended to bring the different valuation bases closer together, although the regulators heard that they are intended to be high level, and are not expected to achieve completely consistent and comparable valuation between groups. They further heard that, while U.S. SAP has not yet been explicitly endorsed by the IAIS Accounting and Auditing Issues Subcommittee (AAISC), there is general recognition at the AAISC that insurers preparing balance sheets under U.S. SAP should not be required to adjust to U.S. GAAP purely for ComFrame.

The regulators heard that the proposed approach is based on methodologies used by rating agencies to "normalize" insurer balance sheets prepared under different valuation regimes, and this is a change in approach from the AAISC's previous proposal to carry out a more detailed comparison of the valuation of insurance contracts under different regimes.

The International Solvency and Accounting Standards Working Group discussed a draft matrix detailing the valuations used in different regimes, and a draft of potential adjustments to be made to different balance sheet items, prepared by NAIC staff. The working group heard that different regulators are substantially aligned on the adjustments to be made for many balance sheet items, and the current draft suggested adjustments include, for example, a limit on goodwill, and the deduction of intangible assets. However, as expected, the treatment of financial instruments and loss reserves, and the adjustments to be made, are more controversial, in particular for life and long-term P&C reserves. The working group heard that current questions include the use of fair value and/or amortized cost valuation for financial instruments, the need for consistent treatment of discounting on short-term P&C contracts and the resulting deferred tax implications, and the discount rate used for reserves.

The draft adjustments discussed at the Spring Meeting propose that either amortized cost or fair value should be acceptable, with the difference disclosed, and interested parties in Houston voiced support for this approach. However, the working group also heard that there is likely to be significant support at the IAIS for a fair value approach. The draft adjustments further propose that any discount to P&C reserves should be added back, with the original discount disclosed. The discount rate used for life reserves, and how liabilities past the yield curve are treated, should also be disclosed. The working group also heard that the "group scope" that should be applied for ComFrame, and therefore for the proposed adjustments, has not yet been finalized. Interested parties commented that the treatment of risk transfer for reinsurance may be a potentially significant area that will require normalization, in addition to the level of consolidation, particularly for composite groups.

The normalized CAPFBS is expected to provide a basis for groups to carry out a partially-harmonized scenario-based capital assessment. However, the working group heard that many important questions, including the development of scenarios, whether the CAPFSB methodology should rely more on jurisdictional scenarios and local accounting, and the role of legal entity supervision, remain unanswered. The working group also discussed the possibility that the proposals may ultimately introduce a new formal group capital requirement, noting that the NAIC's preference for the capital assessment to remain informational for supervisors

rather than becoming a required level of capital has some support.

The potential for a global group capital requirement was also discussed at the International Insurance Relations Committee. The committee heard that the IAIS's discussions and research are informal at this stage, and are partially intended to consider the feasibility of creating a group capital framework that could be applied as needed in emerging markets as an alternative to the Solvency II framework. The committee further heard that the IAIS's discussions are being carried on outside of the ComFrame project, which is not intended to impose a global capital standard, and that the discussions have no fixed timescale. However, interested parties noted that, should any global group capital framework arising from the discussions be assessed by the Financial Sector Assessment Program, its use may become effectively mandatory in all jurisdictions. The committee noted that this would only take place should any framework be incorporated into the ICPs, which is not on the horizon at present.

The International Solvency and Accounting Standards Working Group also discussed the central role of allowable capital resources in ComFrame's capital assessment, hearing that the IAIS's Solvency Sub-Committee is working on a definition of allowable capital instruments, taking into account variations between jurisdictions. Interested parties agreed on the importance of the topic, and noted that any definition that does not allow for the use of debt for capital-raising by insurance groups may risk increasing capital costs for insurance groups.
The working group heard that, going forward, many of these questions will be considered at the IAIS in conjunction with the recently-created IAIS Field Testing Task Force, which was created to carry out and assess the results of impact studies into all elements of ComFrame. Field testing is scheduled to take place in 2014, and in some cases multiple different approaches are expected to be tested. This led some interested parties in Houston to express concern that many technical decisions are being pushed into field testing, rather than decisions being made by the relevant IAIS working groups. Interested parties noted that this may risk the field testing phase becoming unmanageably large, in particular if the CAPFBS approach is tested at legal entity-level, and therefore prohibitively expensive for groups to participate in.

The third comment period on ComFrame is scheduled for this year. The consultation was originally scheduled for July, but the IAIS now expects it to take place in Q3 to provide more time for the Field Testing Task Force to provide input into the draft.

EU-U.S. Dialogue Project

The committee discussed the ongoing EU-U.S. Dialogue Project, hearing that the project steering committee had met twice so far in 2013, and had agreed to a 5 year workplan, based on its December 2012 publication *The Way Forward, Objectives and Initiatives for the Future*.

The Way Forward set out common objectives and initiatives that will be pursued by EU and U.S. regulators, in seven areas:

1. Professional secrecy/confidentiality: removal of barriers to the free exchange of information between EU and U.S. supervisors.
2. Group supervision: establishment of robust group supervision, including a single group supervisor.
3. Solvency and capital requirements: developing a valuation approach that is sensitive to risk, and capital requirements that are fully risk-based and clearly and transparently calibrated.
4. Reinsurance and collateral requirements: consistency among jurisdictions
5. Supervisory reporting, data collection and analysis: greater consistency of reporting, improved coordination through analysis of reporting, and facilitated exchange of information.
6. Peer reviews, and
7. Independent third party review and supervisory on-site examinations:

The committee heard that the steering committee does not currently intend to make its workplan public, but that it does expect to issue a public report late in 2013 on its activities over this year.

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

The committee heard an update on the IAIS's Financial Stability Committee's (FSC) continuing work on the identification of global systemically important insurers (G-SIIs), and the policy measures to be applied to designated G-SIIs. The committee heard that the FSC's main recent policy measure-focus has been the application of Higher Loss Absorbance (HLA) requirements, and the definition of Non-Traditional and Non-Insurance (NTNI) activities. HLA requirements are now expected only to be applied to NTNI activities, although the treatment of variable annuities is still under

discussion. While the industry has argued strongly that the issuance of variable annuities is a traditional insurance activity, the committee heard that VA business may nonetheless be considered a potential source of systemic risk.

The committee also heard that the FSC is moving forward with its determination of which insurers (if any) should be designated G-SIIs, with interviews with affected supervisors and companies a likely next step. There was discussion in Houston regarding which companies in the FSC's current list of insurers should be designated G-SIIs, with interested parties comparing the level of systemic risk posed by banks with what it considers the much lower level of risk posed by insurers. The committee also heard that the FSC is analyzing insurers high on its list to see if they meet the FSB's agreed definition of Systemically Important Financial Institutions (SIFIs).

The committee heard that the FSC is expected to provide its package of policy measures to the Financial Stability Board in June, and that a consultation on HLA will be held in the second half of the year. An HLA impact assessment is also expected to take place.

Joint Forum
The committee received an update on the activities of the Joint Forum and its working group on Risk Assessment and Capital. The committee heard that the forum has reached draft conclusions in its report on longevity risk transfer, and discussed the Life RBC Working Group's project to develop a longevity risk charge for RBC.

The committee heard that the forum also plans to carry out a limited pilot test of its Principles for the Supervision of Financial Conglomerates, which were published in September 2012. A small number of jurisdictions will be selected to complete a self-assessment questionnaire using the principles. The findings of the pilot study are not expected to be made public.

Supervision of Branches
The committee also heard an update on the activities of other IAIS working groups, including the Insurance Groups and Cross-Sectoral Issues Subcommittee's Issues Paper on Supervision of Cross-Border Operations through Branches, which the committee heard is expected to release an exposure draft in May or June. The issues paper received substantial discussion in Houston, with both regulators and industry concerned that some aspects of the current paper present a negative and unbalanced view of the use of branches, although interested parties at the Group Solvency Issues Working Group commented that the current draft of the paper is an improvement on previous drafts. Regulators at the Group Solvency Issues Working Group discussed the paper, and generally agreed that a sound approach to regulation is more important than the structure of the group being regulated.

Financial Stability Task Force

The Financial Stability Task Force was recently established by the Executive Committee and Plenary and will report directly to the Executive Committee.

At its inaugural meeting in Houston, the task force discussed its mission to consider issues concerning domestic or global financial stability as they pertain to the role of state insurance regulators. The task force members discussed that the purpose of the new task force is not to duplicate the activities of other NAIC groups, but to coordinate and contribute to ensuring that the NAIC's approach to financial stability issues is holistic. Task force members expect policyholder protection to be a focus for the task force, in addition to working to reduce the risk of a two-tier system, where G-SIIs have a lower or higher cost of capital compared to non-G-SIIs. The task force members also expect to consider the implications of G-SII measures on the supervision of non-G-SIIs, including supervisory college practices and group supervision.

The task force's charges are as follows:

- To consider financial stability issues and to make recommendations to other concerned committees.
- To consider state insurance regulators' input to national and international discussions on macro-financial vulnerabilities impacting the insurance sector.
- To serve as a forum to coordinate state insurance regulators' perspectives on issues arising from the designation of U.S. insurance groups as "systemically important," both pre and post designation. This role should include: i) developing policy recommendations and/or guidance on the relevant roles, responsibilities and activities of state insurance regulators, ii) analyzing relevant proposed rules by federal

agencies, iii) analyzing proposed policy measures for G-SIIs, and iv) developing comment letters on the task force's analysis for further consideration by other relevant NAIC committees.

At its meeting in Houston, the task force discussed federal regulatory activities relating to financial stability issues. The task force heard that the Financial Stability Oversight Council (FSOC) is in the final stages of its initial selection of nonbank financial companies, and that the Federal Reserve Board (FRB) recently issued a final rule to determine when a company is "predominantly engaged in financial activities." The rule will be used by the FSOC in its determination of nonbank financial companies, which will be subject to consolidated supervision by the Federal Reserve, including enhanced prudential standards. The task force heard that insurance activities are considered to be financial activities for the purposes of the rule.

The task force further heard that the Federal Reserve Board has released for comment its proposals for enhanced prudential standards for foreign banking organizations and foreign nonbank financial companies, which include risk-based capital and leverage requirements, liquidity standards, risk management and risk committee requirements, single-counterparty credit limits, stress test requirements, and a debt-to equity limit applicable to companies that the FSOC determines pose a grave threat to financial stability. The consultation, on which the NAIC provided comments, also covered proposals for early remediation requirements, and additionally proposed that, in some cases, foreign banking organizations be required to form a U.S. intermediate holding company, generally to serve as the top-tier holding company for the group's U.S. subsidiaries. However, the task force heard that the consultation did not address capital surcharges for SIFIs.

The task force also discussed the FRB's proposals, issued in 2012 along with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, on replacement capital rules designed to implement the Basel III capital standards and certain aspects of the Dodd-Frank Act. The task force heard that the NAIC is primarily concerned that the proposals, which may apply to those insurers subject to consolidated supervision by the Federal Reserve, may take a bank-centric approach to consolidated supervision, which the NAIC believes is problematic when applied to the insurance business model. The NAIC is also wants to ensure that regulatory "walls" around legal entity insurers, intended to support policyholder protection, not be compromised. The task force also discussed similar concerns around the Dodd-Frank "source of strength" rules, which require applicable holding companies to serve as sources of financial strength for their subsidiary depository institutions, and which therefore have the potential to weaken the walls around insurance legal entities.

Reinsurance Task Force

The task force met in Houston and discussed the following topics.

Reinsurance Modernization Implementation
The task force heard an update on the adoption of the revised credit for reinsurance models by the states. The number of states which have adopted the revised models stands at eleven (representing 45% of U.S. direct premium). Twelve additional states have introduced legislation to adopt the new standards.

Qualified Jurisdictions
The task force also heard an update from its Qualified Jurisdictions Drafting Group, which met via conference call March 6 to discuss the November 28 discussion draft of the NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions. The proposed process is intended to be an outcomes-based comparison, which considers adherence to international guidelines, rather than a prescriptive comparison to the reinsurance models. The drafting group received ten comment letters on the draft which focused on proportionality, increased use of already available information, the requirement for the jurisdiction to do a self evaluation, the allocation of cost to participants, and support for an expedited review process for certain jurisdictions.

As a result of comments received, the drafting group agreed to include the following "procedure for the evaluation of non-U.S. jurisdictions" to recognize the countries already approved by New York and Florida.

> Expedited Review Procedure - Based upon the prior review and approval by Florida and New York of reinsurers domiciled in Bermuda, Germany, Switzerland and the United Kingdom, the NAIC has adopted an expedited review procedure with respect to these jurisdictions. This procedure is not intended to eliminate or reduce any element provided under Section IV: Evaluation Methodology, but is intended to

allow for a designation of Conditional Qualified Jurisdiction of these jurisdictions in order to facilitate the certification of reinsurers domiciled therein. Final qualification of each jurisdiction will be contingent upon completion of the full, outcomes-based evaluation procedure.

The regulators believe this revision represents a "major change in approach" for the evaluation process and could significantly accelerate the ability of other states to certify reinsurers and allow reduced collateral requirements. Other revisions include the elimination of a jurisdiction's self evaluation requirement.

At the Spring National Meeting, the task force heard additional comments and then voted to expose the March 29 draft "Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions" for a 30-day comment period.

Reinsurance FAWG

The task force also heard an update from its Reinsurance Financial Analysis Working Group, which purpose is to provide advisory support to states in the review of reinsurance collateral reduction applications and prevent "regulatory arbitrage," i.e. avoiding the situation where reinsurers flock to a state which has less stringent approval requirements than other states. (The working group itself cannot assign ratings or collateral requirements for individual reinsurers.) The working group has completed its Reinsurance Financial Analysis Working Group Procedures Manual, which was adopted by the Reinsurance Task Force on February 27th. Both the manual and the meetings of the working group are confidential and regulator-only; however, at the Spring National Meeting, the working group distributed a summary memo which documents the membership of the working group, its mission and charges, its procedures and ongoing monitoring process and how confidential information is handled.

Captive and Special Purpose Vehicle Use Subgroup

At the Fall National Meeting, the subgroup held a public hearing to discuss comments on the October 17th draft of its Captives and Special Purpose Vehicles White Paper; a revised exposure draft was expected shortly thereafter, but was not released until the subgroup met on March 14 by conference call. The chair noted that the subgroup had spent a great deal of time reviewing written and oral comments received and had significantly revised the paper. The subgroup member from Missouri noted that he agrees "wholeheartedly" with this revised paper; representatives from South Carolina, Vermont and New Jersey made similar comments. After these brief comments, the subgroup voted to expose the revised draft white paper until April 29; the subgroup did not meet in Houston. They do plan to meet via conference call sometime in May to discuss the comments received, and possibly vote to adopt the white paper to be considered by its parent group, Financial Condition Committee.

Significant revisions from the earlier draft include:

- An Executive Summary has been added to the paper which includes the following statements: "The current regulatory process should be enhanced to provide standardized tools and processes to be used by all regulators when reviewing such transactions. Commercial insurer owned captives and SPVs should not be used to avoid statutory accounting."

- As promised by the subgroup at the Fall National Meeting, the discussion of the captive industry as a "shadow banking system" was removed.

- With regard to the discussion on disclosures and transparency in the ceding company's financial statements, the white paper was revised from "there may be a need to disclose" to an explicit recommendation that enhanced disclosure in ceding company statements be added regarding the "impact of the transactions on the financial position of the ceding insurer. Development of a Note to the Financial Statements should be made to provide for disclosure of non-trade secret captive information and disclosure of the overall utilization of captives."

- The subgroup removed from the white paper its explicit support of the IAIS Guidance Paper on the Regulation and Supervision of Captive Insurers, which recommends that insurer- or reinsurer-owned or common-controlled captives or SPVs that are not otherwise self-insurance be subject to a similar regulatory framework as commercial insurers. This has been replaced with the recommendation to have the NAIC "closely monitor the on-going developments with respect to IAIS principles, standards and guidance, and consider where appropriate, enhancements to the U.S. captive and SPV regulatory framework in preparation for future FSAP reviews."

- At the Fall National Meeting, the subgroup discussed recommending the development of a database that includes an NAIC company code, name and domiciliary information for all captives and similar entities; this would allow state regulators to quickly respond to questions about its captives. (Some captive states already require some captives to obtain an NAIC company code or supply information to the NAIC sufficient to assign a code.) However, the subgroup could not reach consensus on a potential recommendation to develop such a database; therefore the white paper includes no proposed guidance on this topic.

There is still no consensus on confidentiality issues and the white paper includes a recommendation that the NAIC study the issue more closely. (The white paper notes that of the seven jurisdictions studied, only one (Iowa), makes captive financial information available to the public.) The white paper also continues to recommend further study of the effects of, and potential limits on, the variability in conditional LOCs, parental guarantees and other securities that "might not provide the intended protections provided within the Credit for Reinsurance Model Law."

Other parties in addition to the NAIC's subgroup are also closely studying captives. The Federal Insurance Office recently announced that its advisory committee on insurance (FACI) will be looking into the use of captives by insurers; the group is chaired by Washington, D.C. Commissioner William White. In addition, Superintendent Benjamin Lawsky of the New York Department of Financial Services recently reconfirmed that New York intends to continue its investigation of captives, which began last summer.

Blanks Working Group

The working group adopted the following ten blanks proposal effective for the 2013 annual statement, unless otherwise noted. These proposals, which were previously exposed during the Fall National Meeting, include the following:

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

- Add instructions to the Property and Casualty Line of Business Appendix to clarify that premiums from business placed by a lender ("force-placed or lender placed") should be reported on the line consistent with the underlying coverage (e.g. Fire, Automobile Physical Damage). (2012-33BWG)

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

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

- Add instructions and an illustration to Note 22, Events Subsequent, to disclose assessments the reporting entity may be subject to under the Affordable Care Act that are not being recognized in the statement. (2012-37BWG)

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

- Add information to Schedules F and S and related instructions to refine reporting for the certified reinsurer concept. This proposal is effective for the first quarter of 2014. (2012-40BWG)

The working group discussed three reinsurance related proposals which were exposed for public comment and also referred to the Reinsurance Task Force for their consideration. The three proposals would:

- Eliminate the requirement to file the Reinsurance Attestation Supplement. This supplement was added several years ago when finite reinsurance contracts were prevalent in the industry. One working group member commented that it is time to remove this requirement, as abusive finite reinsurance contracts have now been removed from the industry. (2013-03BWG)

- Modify various column headings of Schedule F for both P/C and Title blanks to provide more clarity of reporting. (2013-08BWG and 2013-09BWG)

Sixteen other new proposals were exposed for a public comment period which ends May 13. These

proposals will be considered for adoption on a conference call to be scheduled in June. The proposals include the following:

- Modify the instructions to reflect reporting of preferred stock Exchange Traded Funds as preferred stock. (2013-01BWG)
- Add two categories to Schedule BA for joint ventures, partnerships and limited liability companies with characteristics of mortgage loans (affiliated and unaffiliated). (2013-02BWG)
- Add illustrations to Note 23, Reinsurance for the certified reinsurer disclosure for those entities downgraded or subject to revocation of certified reinsurer status. (2013-04BWG)
- Modify instruction for 23F(1), to provide additional information with regard to retroactive reinsurance. (2013-07BWG)
- Add new lines to Schedules F and S to capture reinsurance data related to captive companies. Add a definition to the Schedule F and S General Instructions to define which companies will be reported on the new lines. (2013-11BWG)
- Add a new exhibit and related instructions to Health Annual Statement as Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued. (2013-12BWG)
- Add instructions and illustrations for a new disclosure to Note 5, Investments for Working Capital Finance Investments. (2013-13BWG)
- Modify the disclosures in Note 5, Investments to reflect the changes to SSAP 37, Mortgage Loans related to the credit quality disclosures of mortgage loans. (2013-14BWG)
- Modify the current Interrogatory Questions in the Separate Accounts Blank General Interrogatories regarding seed money; other fees and expenses; and other surplus. (2013-15BWG)
- Modify the instructions and illustrations for Note 21C to reflect additional disclosures for restricted assets. (2013-16BWG)
- Modify the instructions and illustration for Note 9 to clarify the disclosure regarding the impact of tax-planning strategies on adjusted gross deferred tax assets and net admitted DTAs. (2013-18BWG)
- Modify the instructions for the AVR to reflect elimination of the Mortgage Experience Adjustment Factor used to adjust factors for certain lines. The same lines on the blank will be modified to reflect the new specific factors. (2013-19BWG)

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

Life Actuarial Task Force

PBR Valuation Manual

Aggregate Margins

LATF received a report from the Aggregate Margin Subgroup in conjunction with the Academy's Aggregate Margin Task Force. The LATF subgroup was formed to consider an aggregate margin approach for quantifying uncertainty versus the current granular level of assessing margin in VM-20. The Academy Task Force has considered current and evolving approaches for risk evaluation in a reserve framework, focusing on goals of developing an aggregate margin approach that provides adequate policyholder protection, covers all material policy risks, is practical to implement, auditable and reasonably transparent. Three approaches currently under consideration include a percentage add-on, confidence interval and cost of capital alternatives. Next steps include quantitative evaluation of each approach and further consideration of the pros and cons of each approach as well as the goal of leveraging what companies are already doing with regard to risk considerations.

Blanks and Valuation Manual Updating Process

LATF continued discussion of refinements to the process for updating the Valuation Manual and changes needed to the annual statement to address PBR. Planned refinements include increased specificity around how changes to the Valuation Manual are made, including priority categorization of changes and corresponding minimum exposure periods commensurate with the length of the draft and complexities of the issues. Several items in the annual statement have been identified as requiring changes to reflect PBR. LATF voted at this meeting to form the PBR Review Subgroup to support PBR implementation generally, study and propose changes to reporting blanks and also to consider changes needed in regulatory annual review and examination procedures. This subgroup will operate under the PBR Implementation Task Force.

Standard Nonforfeiture Law and Low Interest Environment Considerations
LATF discussed a proposed amendment to floor the maximum nonforfeiture interest rate at 4%, the rate used to demonstrate that a life insurance contract meets the requirements of IRC Section 7702 to qualify as life insurance for federal tax purposes. Currently, the maximum nonforfeiture rate, as with the valuation interest rate for reserves, is a dynamic formula based on the Moody's Corporate Average Yields. Without such a floor the potential exists for the state nonforfeiture interest rates to drop below 4%, whereby traditional life insurance contracts would fail to comply with IRS requirements for favorable tax treatment. Changes are required in both the Valuation Manual and the Standard Nonforfeiture Law for Life Insurance (#808). LATF voted to request that Executive Committee and Plenary approve a model law development to revise the model law for this issue.

Starting Assets
LATF continued discussion from the Fall National Meeting on starting assets and the potential for modeled net yields on non-investment grade assets to exceed those on investment grade assets and result in lower reserves. Amendments proposed by the ACLI and the state of New York were discussed and considered, but no vote was taken.

Policy Loans and Deterministic Reserve
LATF discussed amendments to the Valuation Manual clarifying the treatment of policy loans and other amendments proposing an alternative method for calculating the minimum deterministic reserve and a change in the way the pre-tax investment maintenance reserve is reflected in the deterministic reserve. The proposed changes simplify the calculations and produce results equivalent to those prescribed in the current draft of the Valuation Manual. LATF voted to expose the proposed changes for 45 days.

Actuarial Guideline XXXIII (AG 33)
Reserves for Participating Income Annuities
Discussion continued on a proposal from Northwest Mutual Life (NWM) to increase the reserve requirements for a new product design for participating income annuities with low minimum guarantees but with a significant portion of future benefits expected to come from non-guaranteed dividends on the contracts. The proposed revision to AG33 was discussed at the Fall National Meeting and exposed for comment. NWM's proposal, driven by a tax reserve issue, proposes a change in AG 33 for participating policies only that would increase the statutory reserve requirements (and would lead to higher tax reserves). Support for the proposal recognizes the value of the product to policyholders, while opponents feel is it not appropriate to have reserve requirements based on the participating status of a contract. A conference call will be scheduled to discuss this matter further.

C-3 Phase 2/AG 43 (E/A) Subgroup
This subgroup is charged with developing more consistency between RBC's C-3 Phase 2 and AG 43 reserves. The subgroup held interim conference calls to discuss short term action items which include the definition of "in the money," issue year discount rates and standard scenario lapse rates relative to guaranteed benefits, and updates to the AG43 scenario calibration criteria and standard scenario assumptions. Work is underway on proposed updates and the subgroup plans to make recommendations to LATF in time for 2013 implementation.

VM-22 Fixed Annuity PBR
LATF received reports from both the VM-22 Subgroup and the Academy Annuity Reserve Work Group on activity related to development of a PBR methodology for non-variable annuities. The VM-22 Subgroup is charged with developing the proposal, and preliminary discussions have focused on approaches that preserve a cash value floor and reflect a "best estimate" reserve plus aggregate margin, with adequacy evaluated using Asset Adequacy Analysis. The Academy Work Group is considering these ideas and has also developed a tentative stochastic exclusion test, with the end result being a modified AG33 reserve with prescribed utilization rates applicable to specific benefits such as guaranteed living benefits. Work on this initiative will continue.

Valuation Mortality Tables
LATF received a report from the Society of Actuaries & AAA Joint Project Oversight Group on the status of work related to development of a 2014 Valuation Basic Table (VBT) and Preneed/Guaranteed Issue/Simplified Issue mortality tables. The exposure period covers experience in 2002-2009 and reflects significantly more experience than that supporting the 2008 VBT, including more non-tobacco, older age and female risks. There is significant improvement in mortality relative to the last study (2002-2004), with overall mortality ratios at 93% for experience through 2009 versus 101% for experience through 2004. The group expects to develop three sets of tables: Experience, Valuation Basic (VBT) and Commissioners Standard Ordinary (CSO, with margins) with aggregate and preferred structure tables. Select periods are expected to vary

by issue age and gender, based on observable data. The group will need guidance from LATF on the margins to include in the CSO table, but in the meantime will continue work to develop the aggregate, select and ultimate VBT tables. Work on the Preneed and other tables is behind schedule. The group expects to present more substantive information at the Summer National Meeting.

Nonforfeiture Modernization

LATF received an update from the Academy's Nonforfeiture Modernization Working Group. It was noted that, at 25 years old, this work group is the longest running workgroup in the history of the Academy. At the Fall National Meeting, the work group provided information regarding the proposed methodology for determining the Guaranteed Nonforfeiture Basis used to calculate the Required Policy Nonforfeiture Account. Current efforts are focused on identifying regulatory and consumer information requirements to support the new methodology, including information provided to regulators upon product filing, to a statistical agent to support a feedback loop, to consumers prior to completion of sale and via inclusion in the policy, and to inforce policyholders. The information provided would include factors and other assumptions underlying the nonforfeiture values and availability of cash surrender values and other benefits. The current proposal also suggests that information regarding potential future values be available to policyholders "on demand." The work group continues to focus on UL and ULSG products but is also considering annuities with guaranteed living benefits.

Synthetic GIC Reserves

At the Fall National Meeting, LATF received a recommendation from the Academy to modify the reserve requirements for synthetic GICs to address a mismatch between asset and liability valuations for these products which creates unnecessary volatility in statutory financial results. The Academy subsequently provided proposed revisions to the current Synthetic Guaranteed Investment Contracts Model Law (# 695), which change the valuation discount rate to a 50/50 blend of Treasury spot rates and a corporate bond index, and eliminate the AVR factor-based deduction in the reserve in cases where the default risk is borne by the policyholder. The changes were discussed during in interim conference call during which LATF raised questions about derivatives use with respect to replication for pooled funds. The Academy presented findings suggesting that use of derivatives for pooled fund replication is minimal and that pooled fund prevalence and use of synthetic GICs has remained stable. LATF asked the Academy to incorporate suggestions for tightening reserve practices around pooled funds. Discussion of this topic will continue via conference call.

Experience Reporting

LATF discussed comments on proposed changes to simplify the policyholder behavior format for experience data gathering. Proponents of the changes emphasize the need to collect those fields considered most important in understanding policyholder behavior, while opponents to the changes, primarily the Life Insurance Marketing Research Association (LIMRA) express concern that limiting the data collected will compromise the value of experience reports and that the data collected may not reflect what is needed in a PBR environment to fully understand experience. Proposed changes which significantly reduce the number of data items collected for level term insurance will be exposed.

Actuarial Opinion and Memorandum Regulation Communication Group

LATF heard a report from the Academy's Actuarial Opinion and Memorandum (AOM) Regulation Communication Group. This discussion group is focused on opening lines of communication between regulatory actuaries and appointed actuaries in order to improve practice. Current ideas being piloted are consolidation and standardization of AOMs, improved communication of assumptions, an enhanced Regulatory Asset Adequacy Issues Summary, and inclusion of links in a Word or PDF document to other sections within the AOMs for discussion of key issues. Discussion forums on this topic were held at the September Valuation Actuary Symposium and were very well received. The discussion group is currently designing sessions for the 2013 Symposium.

IIPRC Report

The Interstate Insurance Product Regulation Commission provided LATF with an update on recent activities including release of several group term product standards exposed for comment and issuance of two filing information notices relative to long term care product filings. One of these notices addresses concerns raised at the Fall National Meeting about "Mix and Match" usage of filings approved by the IIPRC and other filings approved by individual states. The filing notice provides specific requirements for mix and match submissions.

Joint Qualified Actuary Subgroup

At the Fall National Meeting LATF (and subsequently HATF and the Casualty Actuarial and Statistical Task Force) agreed to form a Joint

Qualified Actuary Subgroup (A/B/C) to develop recommendations on (1) a uniform definition of "qualified actuary" for life, health and P&C Appointed Actuaries signing prescribed Statements of Actuarial Opinion, identifying any differences that should remain between lines of business and a uniform definition of "qualified actuary" for other regulatory areas (e.g. rate filings, hearings), and (2) a definition of inappropriate or unprofessional actuarial work and a process for regulatory and/or professional organizations' actions. The subgroup held an open conference call on February 13 to discuss the charges and held a session at this meeting to discuss written comments received on specific questions posed subsequent to the open call.

Comments were received from the U.S. credentialing organizations (SOA, CAS, AAA), industry (ACLI), the Center for Economic Justice and consumer representatives. During this spirited discussion commenters summarized their views, particularly around the question of whether the regulatory definition of Qualified Actuary should include reference to specific professional organizations (current regulations typically require AAA membership for signing NAIC actuarial opinions), and the adequacy of the current disciplinary process.

Most groups support reference to specific professional organizations in the definition, and generally agree the ABCD process could be strengthened and made more transparent. The subgroup will hold a regulator only conference call later in April to digest the comments and will discuss the potential for another open call to be held on May 1st. The subgroup plans to provide a report to the three parent task forces (LATF, HATF and CASTF) at the Summer National Meeting.

Emerging Actuarial Issues Working Group

The Emerging Actuarial Issues Working Group was formed by the NAIC to address implementation issues resulting from the revisions to AG 38 for universal life products with secondary guarantees. Following the first in-person meeting of the working group at the Fall National Meeting, the working group held three conference calls to discuss interpretations of the revised guidance in response to questions submitted by practitioners. Interpretations adopted during these interim calls included guidance on (1) starting assets for the deterministic reserve calculation in section 8D, (2) the treatment of reinsurance in section 8D, and (3) exemption under section 8E for certain products with relatively short secondary guarantees. During this brief meeting, the working group adopted previously exposed interpretations and voted to expose responses to pending questions. To date, the working group has issued and finalized 25 interpretations, which have also been adopted by the Financial Condition Committee.

The working group will continue to hold conference calls to discuss interpretations of questions still under consideration. Submitted questions, exposed responses and adopted interpretations are available on the NAIC website.

Health Actuarial Task Force

Long Term Care

The LTC Actuarial Working Group of HATF received a report from the AAA/SOA Long-Term Care Valuation Work Group on analysis of data collected for purposes of developing a new valuation table. The Medical Information Bureau provided the work group with policy and claim data from 13 companies. Based on the limited number of companies represented, significant variations in data quality and insufficient information to identify benefit coverages, the Valuation Work Group concluded that the data was not adequate to develop a valuation table. Frustration on the part of the LTC work group over the difficulty in making progress on this important project led to lengthy discussion of a mandatory data call and appropriate positioning for effective response. The work group is investigating the possibility of a mandatory data call.

The LTC Working Group then briefly discussed potential amendments to the Long-Term Care Insurance Model Regulation (#641). Recent discussions indicate there will be an annual rate certification of sorts using a bifurcated approach for new and existing filings. Specific criteria for rate increase requests are still under discussion and these matters will continue to be discussed in biweekly conference calls. Initial steps regarding amendments to the Long-term Care Reserving Standards in the Health Insurance Reserves Model Regulation (#10) were also discussed. In addition, in response to a HATF request at the Fall National Meeting, the AAA formed a Long-Term Care Terminations Work Group to study termination experience specifically, with the hope that such experience may be useful to valuation actuaries in the absence of a new valuation table. Scoping discussions regarding data collection are underway and the goal is to submit the data to HATF before the 2013 Fall National Meeting.

The Long-Term Care Pricing Subgroup reported on progress made during several interim calls to discuss the charge from the Senior Issues Task Force to make recommendations concerning long- term care premium stabilization issues. The subgroup rejected the concept of imposing annual rate caps in the LTC Model Regulation, and is discussing the concepts of gender rating and geographic rating.

Cancer Claim Cost Table
The task force received a report from the joint AAA/SOA Cancer Claim Cost Table Work Group on the development of a new cancer morbidity table. The work group reported problems with the data submissions from 12 of the 17 companies that responded to the data call. The work group held discussions with the data aggregator to devise solutions and some companies will have to completely resubmit their data. The aggregator plans to have usable data to the work group by June 2013. In the meantime the workgroup is ironing out issues with the calculations that will be applied to synthesize the data. The working group is targeting May 2014 for presentation of a proposed table.

Individual Disability Experience
The task force received a report from the joint AAA/SOA's Individual Disability Table Work Group (IDTWG) formed in February 2013 in response to the HATF request to the Academy to develop an individual disability income valuation table to replace the 1985 CIDA and CIDC tables. The valuation table will build on the work of the SOA Individual Disability Experience Committee (IDEC) and the experience tables currently exposed (until May 31, 2013). The IDTWG structure is similar to that of the Group Long Term Disability Work Group that recently completed similar work. The scope will include termination rates for disabled life reserves as well as incidence rates for active life reserves. Distinct subgroups have been formed to work on valuation tables, margins, credibility methodology for incorporating company experience, and implementation logistics. Preliminary expectations are that the new valuation table will be more complex than CIDA, reflecting some of the additional variables included in the IDEC tables such as medical occupation class and more elimination periods, and will lead to more robust statutory reserve calculation. The work group plans to deliver recommendations at the Fall National Meeting and suggested January 2015 as a possible effective date.

Contingent Deferred Annuity Working Group

The working group met by conference call on February 25 and in Houston to continue its discussion of the contentious issues surrounding contingent deferred annuities (CDAs). In drafting its memorandum and recommendations to the Life Insurance and Annuities Committee on how CDAs should be regulated, the working group had previously gathered information from industry, interested parties, SEC staff, FINRA, and consumer representatives. In Houston, the working group adopted its memorandum and recommendations after a lengthy discussion, acknowledging that issues raised will need additional work after consideration by its parent Life Insurance and Annuities "A" Committee.

Key conclusions from the recommendations include the following:

- A CDA is defined as "an annuity contract that establishes a life insurer's obligation to make periodic payments for the annuitant's lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually-defined amount due to contractually-permitted withdrawals, market performance, fees and/or other charges." As suggested in the definition, a CDA is neither a fixed or variable annuity, but shares the qualities of both a fixed and variable annuity. As such, the working group recommends that CDAs be classified as a separate category of annuity.

- The adequacy of existing laws and regulations applicable to the solvency of annuities, as such laws are applied to CDAs, should be referred by the A Committee to the existing working groups with the appropriate subject matter expertise. The working group recommends a review of issues relating to reserving, RBC, and financial reporting requirements, including possible changes to the annual statement blank.

- Capital and reserving requirements as set forth in Actuarial Guideline 43 and RBC C3 Phase II (C3P2) are applicable and appropriate for CDAs. However, the working group notes that AG43 and C3P2 are principle-based guidelines that are subject to credits for a "clearly defined hedging strategy" and therefore, evaluation of the capital and reserving requirements for CDAs should be

ongoing at the NAIC level, and states will need to monitor the actuarial assumptions, hedge effectiveness, and the adequacy of risk management techniques used by insurers issuing CDAs.

- The working group recommended that A Committee direct an appropriate working group to perform the following:

  - review the definition of CDA, as proposed by the working group, and determine whether amendments to the Life and Health Insurance Guaranty Association Model Act (#520) are necessary.

  - develop a template/checklist of questions states could use to facilitate review of a company's risk management program at the time of policy form filing. Requested information could include a description of a company's hedging programs, risk appetite, goals for hedge effectiveness, copies of any third party contracts in place, investment parameters, and other product options designed to control risks.

  - develop a whitepaper that can serve as a reference for states interested in modifying their annuity laws to clarify their applicability to CDAs.

The working group also concluded that, like other guaranteed benefits, including guarantees offered in connection with variable annuities, reserves for CDAs should be reported in the general account statement.

The Life Insurance and Annuities Committee adopted the working group's memorandum and recommendations, noting that a conference call will be held to discuss which working groups the recommendations will be referred to.

Separate Account Risk Working Group

The working group held a conference call January 9 to resume its discussion on insulation classifications for separate account products, which was its first public meeting since April of 2012. The purpose of the call was to discuss the working group's draft Non-Variable, Insulated Product Characteristics/ Proposed Recommendations document, which summarizes information regarding product attributes and characteristics for non-variable, insulated products. The paper was developed in response to a February 2011 request from the Financial Analysis Working Group asking the Financial Condition Committee to study risks associated with non-unit linked products being included in separate accounts.

The chair reiterated comments from previous conference calls that the goal of their work is to "establish an expert view without considering the existing requirements of models or state laws and regulations." The working group voted to expose the document for a comment period ending February 25. In exposing the document specific information and detail was requested with respect to the following key areas: (a) product groupings and attributes, (b) assessments, (c) proposed recommendations including whether respondents agree or disagreement with the recommendations, and (d) specific questions regarding stable value protection contracts and the market impact of insulation.

The draft paper segregates the products into five groups and recommends for three of the groups, Grouping A (Market Value Adjusted Annuities and Modified Guaranteed Annuities), Grouping B (Flexible Premium Deferred Annuities, Deferred Annuities, Fixed Annuities, Fixed Income and Fixed Credited Interest Rate) and Grouping E (Single Premium Annuities, Experience Rated Contracts and Non-Experience Rated Contracts), that these products (and products with different names, but similar characteristics) should not be insulated from general account claims. The paper does note that many of these products are not currently insulated, but some do have regulatory approval as insulated. For Grouping C (BOLI and COLI) and Grouping D (Guaranteed Investment Contracts, Guaranteed Interest Funding Agreements, Group Annuities, Group Annuity Contracts, Guaranteed Group Annuities and Group Annuity-Funding Agreements), the working group believes further analysis and discussion is needed.

At the subsequent request of the ACLI and the Committee of Annuity Insurers, the comment period was extended to March 25. The working group did not meet at the Spring National Meeting but anticipates a conference call later this spring to discuss comments received.

Financial Regulation Standards and Accreditation Committee

The committee met in Houston and took the following actions:

Revisions to Documents Required for Accreditation
Revisions made during 2012 to publications that are required for accreditation purposes (e.g., the Annual Statement Blanks and Instructions; Life and P/C RBC Formulas; the SVO Purposes and Procedures Manual; the APP Manual; and the Financial Condition Examiners Handbook) but are deemed to be insignificant for exposure purposes were adopted by the committee at the Spring National Meeting as revised accreditation standards. Three significant revisions made to the Financial Condition Examiners Handbook relating to prospective risk assessment, issue/risk tracking template, and IT reviews of small companies were exposed for a 30-day comment period.

Revisions to the Business Transacted with Producer Controlled Property/Casualty Insurer Act (#325)
The committee discussed revisions to this model, noting that the revisions remove the exemption of risk retention groups chartered as captives from the definition of licensed insurer. The proposal was exposed for a 30-day comment period.

Own Risk Solvency Assessment Model Act (#505)
The committee discussed the ORSA Model Act as a possible addition to the accreditation standards, and the proposal was exposed for a 30-day comment period. (See further discussion on page 15.)

Standard Valuation Law (#820)
The committee discussed comments received related to the 2009 revisions to the Standard Valuation Law, which authorizes life insurer principles-based reserving. Other than two comment letters suggesting an extended comment period, no other comments were received. The working group agreed to delay voting on whether the 2009 revisions to the Standard Valuation Law should be an accreditation standard until the 2014 Spring National Meeting while the committee monitors the implementation process. The committee also made a referral to the Life Actuarial Task Force to consider whether the Standard Non-Forfeiture Law for Life Insurance (#808) should be added to the accreditation standards.

Insurance Holding Company System Regulatory Act and Model Regulation (#440, #450)
The committee discussed one comment letter received from a trade organization in connection with the 2010 revisions to the Insurance Holding Company System Regulatory Act and the Insurance Holding Company System Model Regulation. The comment letter seeks a revision to exempt small insurers from complying with the Enterprise Risk Report requirement. The comment letter states that the cost of compliance for small companies is potentially significant and that there was no consideration of the cost of compliance or regulatory enforcement during the model law development process. The comment letter further states its belief that the lack of a size threshold was an oversight. The committee heard that certain states have enacted an exemption amendment and the comment letter requested for the exemption to be incorporated into the model act.

A lively discussion ensued with a regulator stating that it was a very conscious effort by the Group Solvency Issues Working Group not to make a size exemption and it is inappropriate now to request a change to the accreditation standards. As a result no proposal to exempt small insurers was considered by the committee. A suggestion was made to have the committee send notices to the states that have enacted laws exempting small insurers to inform that there may be a deficiency in the regulatory framework that should be addressed, but no formal action was taken.

Revisions to Part A Preamble
At the Fall National Meeting, the committee discussed and exposed proposed revisions to the Part A Preamble to clarify that certain accreditation standards are applicable to health organizations. The amendments are the result of the committee adopting the Risk-Based Capital for Health Organizations Model Act as an accreditation standard at the 2012 Summer National Meeting. No comments were received. In Houston, the committee adopted the proposal.

CPA Audit Standards
At the Fall National Meeting, the committee discussed and exposed proposed revisions to the Part A CPA Audits accreditation standard to clarify that state statute or regulation should contain a requirement for annual audits of domestic insurance companies "that is substantially similar to" the Annual Financial Model Regulation. No comments were received. In Houston, the committee adopted the proposal.

Viatical Settlements Working Group

The working group met via conference call December 18 and discussed comments received on the proposed guideline revisions to the Viatical Settlements Model Regulation (#698), including Appendix A – Viatical Informational Brochure. The working group agreed to several changes to the model and brochure and then unanimously adopted both documents. At the Spring National Meeting, the Life Insurance and Annuities Committee also adopted the revised model and brochure.

Annuity Disclosure Working Group

Since the Fall National Meeting, the working group has held four interim conference calls to discuss in detail comments received on drafts of the exposed Annuity Buyer's Guide for Deferred Annuities. In Houston, the working group adopted the Buyer's Guide with nonsubstantive technical revisions. This is the first revision to the Buyer's Guide in over a decade with the last revision released in the late 1990s when indexed annuities were introduced. Work on the Buyer's Guide started five years ago at a time when national attention began to intensify on having clarity, simplicity, transparency, and disclosure in financial and insurance products. The Buyer's Guide is required to be distributed to consumers under the Annuity Disclosure Model Regulation (#245) and is intended to allow consumers to make a more informed purchase. Following adoption by the working group, the Life Insurance and Annuities Committee also adopted the Buyer's Guide and reappointed the working group to continue its work on creation of an electronic version of the guide.

Casualty Actuarial and Statistical Task Force

The task force held conference calls February 12 and March 12, and met in Houston. During the February 12 conference call, the task force discussed implications of the blanks proposal #2012-33BWG, which proposes that business placed by a lender ("force-placed" or "lender-placed") be recorded as a "write-in" on line 34 in the financial statement. The task force submitted a comment letter to the Blanks Working Group on March 6, stating concerns about the proposal. As a result the Blanks Working Group has decided not to move forward with that proposal. Instead, the proposal has been modified to address the issue of non-uniformity in reporting. The revised proposal calls for premiums of all force-placed or lender-placed business to be reported on the line consistent with the underlying coverage (e.g., fire, allied lines, automobile physical damage, etc.) and adds a definition of force-placed or lender-placed business.

In Houston, the task force approved a request to move the start date of work for the Property and Casualty Actuarial Opinion Model Law (#745) to coincide with the completion of work of the Joint Qualified Actuary Subgroup. The task force heard a presentation from the Society of Actuaries regarding their General Insurance Education Track and heard reports from the American Academy of Actuaries Committee on Property and Liability Financial Reporting and Council on Professionalism.

Risk-Focused Surveillance Working Group

The working group met by conference call January 24, March 7, and March 28. During these calls, the working group discussed its efforts on increasing the focus of examinations toward prospective risks and eliminating unnecessary financial statement verification. A decision was made in August 2012 to recommend elimination of the tolerable error requirement as the standard for risk identification and establish a framework to provide guidance that will help ensure appropriate identification of critical risks. The proposed critical risk categories and related guidance for the Financial Condition Examiners Handbook should be viewed as a starting point in refining the risk-focused examination process. Other issues impacting risk-focused surveillance, such as group solvency and the ORSA, will need to be addressed in the future by examiners and analysts. The proposed handbook changes are designed to eliminate the requirement to identify a risk for every line item exceeding tolerable error and walk those risks through the seven-phase exam process or otherwise explain why the items should not be examined in the planning memorandum. In conjunction with that recommendation, the use of tolerable error is proposed to be replaced with 10 critical risk categories developed to serve as the minimum requirement when identifying risks during an examination.

Following the exposure of two documents, "Proposed Critical Risk Categories for Review in Financial Examinations" and "Sound Practices for

Risk-Focused Exams Generated by Industry Feedback" in November 2012, the working group received significant comments from industry which were discussed during the January 24 and March 28 conference calls. Various comments were received on the proposed risk categories recommending categories that may need to be added, deleted or clarified. The chair reminded that it is important to note the goal associated with creating these categories. In many exams, significant risks have been left unaddressed by examiners because they are bogged down by standard financial reporting risks that may not be significant to the ultimate solvency of the insurer. The hope is to give examiners freedom to focus on what they deem most significant to an insurer's solvency and not spend time on unnecessary financial verification. While the working group would like to be flexible, a minimum must still be required to ensure that those risks most commonly impacting insurer solvency are addressed. The critical risk categories are designed to focus on the industry as a whole. They are not intended to include short-term issues or those that are specific to one line of business, which are expected to be identified by the examiner on a company-by-company basis as necessary.

Industry support was noted for the elimination of the tolerable error requirement should significantly reduce unnecessary testing and move the examination closer to being truly risk-based. Comment letters received confirmed that there is a disconnect between analysis and examinations in risk-focused surveillance. The risk categories proposed for examinations appear to be the right step forward from an examination perspective, but the same categories are not necessarily applicable for analysis. In particular, consideration should be given to the fact that analysis might currently be overly focused on financial reporting rather than prospective risk and other strategic risks.

During its January 24 conference call, the working group agreed to proceed with the proposed critical risk categories as revised by the comments received. A request was made to NAIC staff to begin considering how to incorporate the proposed critical risk categories into existing Financial Condition Examiners Handbook guidance for consideration by the Working Group. On March 7, the working group agreed to refer the proposed guidance to the Financial Examiners Handbook Technical Group.

Climate Change and Global Warming Working Group

The working group heard a presentation from Ceres summarizing its findings and recommendations based on its review of the 2012 Insurance Climate Risk Disclosure Survey administered by California, Washington and New York. Key findings included:

- A growing concern among insurers who completed the survey, with more than half seeing climate change as a potential future loss driver.

- Inconsistent industry response - while 23 respondents articulated a comprehensive climate change strategy, many companies are still in the early stages of the learning curve. Some respondents viewed climate change as an environmental issue rather than a business issue; this was especially true for life and health insurers, but also noted among some P&C insurers as well.

The working group discussed its 2013 work plan which includes receiving presentations from interested parties and experts on the impact of climate change on investments, compiling data to analyze building codes by the states, and evaluating the need for a guidance document or revision of questions on the Insurer Climate Risk Disclosure Survey. The Impact of Climate Disclosure Survey Subgroup will be doing this evaluation over the spring and summer.

Mortgage Guaranty Insurance Working Group

Since its inception in Fall 2012, the working group held an open conference call on February 28 and met in Houston. The working group discussed its charge, which is to determine and make recommendations to the Financial Condition Committee regarding what changes are deemed necessary, if any, to the solvency regulation of mortgage guaranty insurers, including possible changes to the Mortgage Guaranty Insurers Model Act (#630), which has not been amended in 30 years.

During the conference call, the working group exposed the Concepts List of Potential Regulatory Changes for a 30-day comment period. The Concepts List sets forth problems identified by the working group concerning the current regulation of mortgage guaranty insurance that suggest the need to reform Model Act #630. In the Concepts List, the working group identified three problems:

1. Overconcentration of mortgage origination in a too few banks places competitive pressure on insurers to either take all the business from a given bank or receive no business from that bank.

2. Mortgage guaranty insurance, which is a form of economic catastrophe insurance in which long periods of great profitability are punctuated by periods of varying duration of catastrophic loss, is thought to lead to excessive corporate income taxes and stockholder dividends in relation to actual profits over the life of a company in this line of business.

3. Profitability of mortgage guaranty insurance during long periods of great profitability is thought to create a disincentive to underwrite the business attentively.

In response to these issues, the Concepts List sets forth potential regulatory changes, most of which could be very significant:

- Requiring minimum underwriting standards
- Considering changes to minimum capital requirements and limiting dividends
- Updating and modifying contingency reserve requirements
- Revising reinsurance requirements to concentrate resources and cut unnecessary overhead expenses
- Prohibiting captive reinsurance arrangements with originating banks
- Creating a mutual reinsurance company that all insurers would be required to use to house additional reserves for bad times
- Creating an FDIC-like government entity as a backstop where premiums are paid in over an entire business cycle
- Modifying investment limitations
- Establishing rights and responsibilities for mortgage guaranty insurers concerning rescissions of insurance policies and certificates.

In Houston, the working group discussed comments received from interested regulators, industry and consumer representatives, who all recognize that the model law likely needs updating given the events of the past few years. Comments were focused on the following areas:

- The need for a more risk-based approach to minimum capital requirements which includes ladders of different levels of intervention, but does not eliminate the use of leverage ratios

- The need for new reporting requirements that segregates the mortgage insurers' exposures into different levels of risk, which may be used as partial input into the minimum capital requirements

- The need to preclude mortgage insurers from investing in mortgage-backed securities but not prohibit other asset-backed securities that are not correlated to the liabilities of the mortgage insurer

- The need to prohibit captive reinsurance agreements between mortgage insurers and originating banks

The working group will continue its discussion on its Concepts List in a conference call.

Title Insurance Task Force

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

<u>Title Insurance Risk-Based Capital</u>
The Title RBC Subgroup has not met since the Fall National Meeting. The subgroup will be issuing a survey soon regarding title insolvency risks and remedies to select states and interested parties. The results of this survey will assist the subgroup in determining its next steps.

<u>Title Insurance Escrow Theft White Paper</u>
On March 21, the Escrow Theft White Paper Subgroup distributed a new draft of its white paper. Industry and regulators were asked to review the paper and provide input. A conference call is scheduled for May 9th to discuss the paper and comments.

<u>Title Guaranty Fund</u>
The Title Insurance Guaranty Fund Working Group met by conference call February 14 to continue discussing whether a title insurance guaranty fund model law or guideline should be developed. The

goal was to determine how these insolvencies played out and what the financial impact was on consumers. The working group noted that there has been major consolidation of title insurance companies and research indicates that many of these companies have instituted stronger internal controls including demanding audited financial statements from their title agents, tougher pre-licensing requirements, higher bond limits, and malpractice insurance.

While none of these requirements would entirely eliminate the risk of a title company insolvency, they should have a positive effect on agent defalcations which caused some of the losses identified in the research. The working group's report found that establishment of a model law is not supported at this time; however, the working group did decide to move forward with a model guideline so that states considering a guaranty fund for title insurance would have a resource document. Comments were heard for the working group to consider resolution techniques to deal with impaired companies short of a guaranty fund and for the working group to coordinate with the Title RBC Subgroup.

Risk Retention Group Task Force

The task force held an interim conference call in March to discuss the results of a survey of states regarding the circumstances in which regulators may have provided captive RRGs with exemptions from an annual audit requirement. Concern was initially raised at the Fall National Meeting that the exemptions may have been provided based on the RRGs premium dollar amount or the number of policyholders. Such exemptions are permitted for traditional insurers in accordance with the Annual Financial Reporting Model Regulation (#205); however, under the federal Liability Risk Retention Act of 1986 these exemption criteria are not applicable to RRGs. After some discussion, the task force reached a consensus that regulators are not utilizing the premium thresholds established by the model regulation, but are using other state authority to exempt RRGs that are recently formed or have little or no premium.

In Houston the task force continued discussion of whether the model regulation requires captive RRGs, which prepare GAAP financial statements for regulatory purposes, to have the GAAP to statutory reconciliation audited. Most captive RRGs do not maintain separate statutory financial records and significant effort would be required for the CPA firm to audit the GAAP to statutory reconciliation. Following significant discussion, the task force voted to recommend to the Financial Regulation Standards and Accreditation Committee that it remove the requirement in the Part A accreditation standards for captive RRGs that the reconciliation of surplus from other bases of accounting (e.g., GAAP) to statutory accounting principles be an audited component of the audited financial report. The reconciliation will, however, still need to be included in the annual statement filing.

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The next National Meeting of the NAIC will be held in Indianapolis August 24-27. We welcome your comments regarding issues raised in this newsletter. Please provide your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor at jean.connolly@us.pwc.com.

Disclaimer

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

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

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July 27–30
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Loews Philadelphia Hotel

2015

July 19–22
San Diego, CA

Town and Country Resort Hotel

2016

July 24–27
Marco Island, Florida

Marco Island Marriott Resort and Spa

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