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The questions are on the following page. Good luck!



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Please see the details on the previous page.

“Issue Brief: An Economic Analysis of Corporate Demand for Terrorism Insurance in the U.S.”

True or False Questions — [Submit Answers Online](#)

1. The U.S. Terrorism Risk Insurance Act (TRIA) was established in 2002 as a public-private partnership to make terrorism insurance widely available to corporate America.
2. Renewed in 2005 and 2007, TRIA will expire at the end of 2020 unless extended again by Congress and the President.
3. Larger firms tend to purchase proportionally more coverage than smaller firms; they are more diversified and can better self-insure some risk.
4. Demand for property insurance is twice as sensitive to price as the demand for terrorism insurance.

“Financial Reporting Risks Taking a Back Seat”

True or False Questions — [Submit Answers Online](#)

5. The financial examination process has not changed significantly since 2008 when the risk focused examination approach was implemented.
6. Financial reporting risks may no longer be required for financial examinations with an increased reliance on the work performed by the CPAs.
7. C-level interviews will no longer be conducted as a key component of risk focused financial examinations.
8. Mobile technology applications could enhance and change the examination workflow processes with increased smartphone and tablet implementation to document examination procedures.



CRE READING PROGRAM QUESTIONS

All quizzes **MUST** be taken online

(continued)

“Information Security Essentials for a Financial Examiner”

True or False Questions — [Submit Answers Online](#)

9. Merger/Acquisition is a type of data that we may come in contact with during an examination
10. Medical information describing a condition you had as a baby is considered ePHI information
11. Using a cable lock, locking your laptop into a desk, or locking your laptop into a cabinet offers the same level of physical security for the laptop
12. USB flash drives, CD, and DVR are all examples of portable media devices

“Building Effective Regulatory Relations”

True or False Questions — [Submit Answers Online](#)

13. It is never a good business decision for insurance company managers and executives to develop an effective relationship with insurance regulators.
14. An insurance company can build an effective relationship with regulators by understanding the regulatory landscape, getting to know its regulators, educating its regulators on the insurer’s operations, acting in the way regulators needs and expects, and becoming part of regulatory solutions.
15. Regulators can promote and facilitate effective regulatory relationships by providing insurance company managers and executives with an understanding of how the department is organized, the responsibilities of its various units, and the key people charged with carrying out those responsibilities.
16. Insurance companies can demonstrate commitment to effective regulatory relationships by being transparent, communicating issues thoroughly, and implementing a “no surprises” rule.



CRE READING PROGRAM QUESTIONS

All quizzes **MUST** be taken online

(continued)

NAIC Spring 2014 Meeting Notes

True or False Questions — [Submit Answers Online](#)

17. Proposed Revisions to the Purposes and Procedures Manual of the NAIC Securities Valuation Office include renaming the manual to the Purposes and Procedures Manual of the NAIC Investment Analysis Office.
18. Based on the requirements for PBR to become effective, a status report presented to the Principles-Based Reserving Implementation Task Force indicated PBR will likely become effective by the end of 2015.
19. The February 17, 2014 Rector captive report recommends significant revisions to the regulation of captives assuming business from life insurers.
20. Under the proposed Corporate Governance Disclosure Model Act, all insurance entities, regardless of size, would be required to file corporate governance filings under the model provisions.

INFORMED DECISIONS ON CATASTROPHE RISK

An Economic Analysis of Corporate Demand for Terrorism Insurance in the U.S.

The terrorist attacks of September 11, 2001 triggered \$40 billion in insured losses (2014 prices), then the costliest disaster in the recent history of insurance.

The U.S. Terrorism Risk Insurance Act (TRIA) was established in 2002 as a public-private partnership to make terrorism insurance widely available to corporate America, and has succeeded in doing so.

Renewed in 2005 and 2007, TRIA will expire at the end of 2014 unless extended again by Congress and the President.

If TRIA is extended, the federal government might require insurers to assume more risk, as was the case when TRIA was renewed in 2005 and 2007.

To manage their exposure and growing concerns from rating agencies, insurers are likely to respond to increases in their risk by limiting availability of coverage and/or significantly increasing premiums.

We find that under current market conditions, firms' demand for terrorism insurance is not very sensitive to gradual price changes.

- Before the September 11, 2001 terrorist attacks (9/11), commercial insurance contracts typically included terrorism as an unnamed peril.
- Following 9/11, reinsurers and insurers excluded terrorism from most property coverage contracts.
- The federal government established a dedicated partnership with insurers—TRIA—that provides up to \$100 billion in coverage to corporations doing business in the U.S.
- Firms have the option to purchase terrorism insurance coverage as an endorsement to their property insurance contract.
- It is thus possible to evaluate whether American corporations differ in their demand for property and terrorism insurance, and if so in what ways.
- Using a unique dataset of corporate clients and insurance providers from Marsh & McLennan, we performed the first empirical analysis of demand for terrorism coverage by over 1,800 large firms.
- About 6 out of 10 firms in the sample have some terrorism insurance coverage.
- Larger firms tend to purchase proportionally *less* coverage than smaller firms; they are more diversified and can better self-insure some risk.
- Corporate demand for terrorism insurance is strong as demonstrated by a low price elasticity: a 10% increase in terrorism premium leads to only a 1.3% decrease in terrorism coverage.

Context

Since the 9/11 attacks the Wharton Risk Center has taken a leadership role in providing policymakers and business leaders with evidence-based analysis of the U.S. and foreign terrorism insurance markets, releasing more than 20 studies on the topic to date.

The 2002 Terrorism Risk Insurance Act (TRIA) established a partnership between the federal government and the insurance industry. Insured losses above \$100 million are shared as follows:

- First, insurers assume a deductible, defined as the percentage of their direct earned premiums for all TRIA insurance lines of the previous year. That deductible has increased significantly since the passage of TRIA: it was 1% in 2002, 7% in 2003, 10% in 2004, 15% in 2005, 17.5% in 2006, and 20% since 2007.
- Above the deductible there is an 85%-15% co-pay between the federal government and insurers (increased for insurers from 90%-10% in 2007).
- Any federal compensation paid from the loss sharing above the deductible is to be recouped via a mandatory policyholder surcharge to the extent that aggregate insured losses do not exceed \$27.5 billion, referred to as the insurance marketplace aggregate retention amount. (133% of that federal payment will be collected.) This retention level was \$10 billion in 2002, \$15 billion in 2005; \$25 billion in 2006, and has remained at \$27.5 billion since 2007 – an increase of 175% since 2002.

Unlike basic coverage against natural disasters (e.g., earthquakes, floods, hurricanes) which is provided as part of standard commercial property insurance, firms operating in the U.S. that want terrorism coverage for property, related business interruption and liability loss, need to purchase a dedicated endorsement. (The only exception is workers' compensation insurance where terrorism is automatically included as part of the coverage.) One can thus measure corporate demand for terrorism insurance specifically and compare it with the demand for property coverage, which has been extensively studied.

Hypothesis

Because past terrorist attacks have been very costly and highly publicized events, risk-averse managers are likely to perceive a large-scale terrorist attack as potentially more harmful to their company and to their reputation than other losses covered by property insurance. In addition, the Sarbanes-Oxley Act of 2002 increased the liability of corporate directors, who in turn may urge firms to purchase terrorism insurance. We thus hypothesized that corporate demand for terrorism insurance will be less sensitive to price changes than demand for property coverage.

Data and Methodology

To test this hypothesis empirically, the Wharton Risk Center obtained data from **Marsh & McLennan** on **insurance purchases by 1,808 large U.S. corporations** headquartered across the country (average total insured value of \$1.7 billion; U.S. operations only) and representing 20 industry sectors. The data contain information about the quantity of insurance purchased for the firms' U.S. operations and the premiums paid for two lines of risk – property and terrorism – for 2007. We performed a series of econometric analyses to capture the demand/supply dynamic of the market. Key results, described here and in more detail in the published peer-reviewed study referenced at the end of this Issue Brief, are robust to several specifications.

Findings

1. What proportion of firms have terrorism insurance?

The majority of firms in our sample – 59% – purchased terrorism insurance. Still, more than **4 out of 10 of firms in the sample had no terrorism insurance.** These percentages have remained constant over the period 2006-2013. What will happen to the uninsured firms following a terrorist attack is unclear. If the past is an indication of the future, federal disaster relief will be forthcoming if the attack is large.

2. Does insurance coverage vary with firm size?

We found that **larger firms are more likely to purchase terrorism insurance, but that they purchase proportionally less coverage than smaller firms.** Larger firms are typically more diversified so the likelihood of suffering simultaneous losses on multiple facilities is fairly low. Aside from this study and the recent report of the President's Working Group on Financial Markets published in April this year, little is known about insurance penetration for small businesses, even though they represent a significant portion of the U.S. GDP and private sector employment, and are arguably more vulnerable to shocks.

3. How price sensitive is the demand for terrorism insurance?

We found that demand is not very sensitive to changes in terrorism insurance costs if the price changes are gradual. **A 10% increase in terrorism premium leads to only a 1.3% decrease in terrorism coverage purchased.**

4. How does demand by firms for terrorism insurance compare with the demand for property coverage?

We found that the **demand for property insurance is twice as sensitive to price as the demand for terrorism insurance.** Firms that purchase terrorism insurance really want this type of coverage. This might reflect a strong risk aversion of the firms' managers' vis-à-vis terrorism threat and/or specific requirements imposed on these firms.

Congress and the White House need to consider the demand side of the market when discussing the future of terrorism insurance post-2014. At the same time, they also need to consider how the supply side of the market will be affected by changes in TRIA. The Wharton Risk Center is completing a companion study on how alternative designs of TRIA will affect the current exposure of insurers compared to their surplus, a concern of both insurers and rating agencies. In this study we also analyze how losses would be spread across uninsured firms, insurers, policyholders and the federal government under scenarios of conventional and NBCR attacks in four large cities (Chicago, Houston, Los Angeles and New York).

Sources: Michel-Kerjan, E., Raschky, P. & Kunreuther, H. (2014). Corporate Demand for Insurance: New Evidence from the U.S. Terrorism and Property Markets. *Journal of Risk and Insurance*. Online (March 2014): <http://onlinelibrary.wiley.com/doi/10.1111/j.1539-6975.2010.01380.x/pdf>. Michel-Kerjan, E. (2013). Testimony before the US Senate. "*Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market.*" September 23. Partial financial support for this research was provided by Wharton's Managing and Financing Extreme Events project, DHS's Center of Excellence CREATE at the University of Southern California and Monash University.

Issue Brief: An Economic Analysis of Corporate Demand for Terrorism Insurance in the U.S.

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About the Wharton Risk Center

Established in 1984, the **Wharton Risk Management and Decision Processes Center** develops and promotes effective corporate and public policies for dealing with catastrophic events including natural disasters, technological hazards, terrorism, pandemics and other crises. The Risk Center research team – over 70 faculty, fellows and doctoral students – investigate how individuals and organizations make choices under conditions of risk and uncertainty under various regulatory and market conditions, and the effectiveness of strategies such as alternative risk financing, incentive systems, insurance, regulation, and public-private collaborations at a national and international scale. The Center actively engages multiple viewpoints, including top representatives from industry, government, international organizations, interest groups and academia. More information is available at <http://www.wharton.upenn.edu/riskcenter>.

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Financial Reporting Risks Taking a Back Seat: Examinations in 2020

By **John Romano, CFE, CPA**
ParenteBeard

At the upcoming SOFE Career Development Seminar in Philadelphia, PA I am excited to present a collaborative session where attendees can actively discuss the risk focused examinations trend and the growing focus on non-financial reporting and prospective risks. We will walk through a hypothetical and thought-provoking view of what examinations will look like in 2020. Here is a preview of what is to come, happy reading and I look forward to seeing you there!

As I rewind to 2009, I can remember consultants and state examiners alike during a risk focused examination saying: Where is the repository? Let's make sure we include as many risks as possible. Which risks should I include on the prospective risk matrix? Can we incorporate the CPA substantive testing in Phase 3? Should there be a corporate governance risk matrix? There were many other questions as most experienced examiners were still in the process of letting go of the SRA approach and applying the risk focused examination approach. Most examiners would agree that 2008 and 2009 examinations were "modified risk focused examinations" transitioning in the guidance and process of the Financial Condition Examiners Handbook.

Fast forward to present day. Plain and simple, most examiners understand the process. You have it down, you know how to conduct a C-level interview, you understand the difference between financial reporting and non-financial risks and can avoid needing to confirm the petty cash onsite at the company (at least most of you can). The planning process is more streamlined; the information technology review is customized and has moved towards adapting the most recent framework of COBIT 5. Exams are not as "check the box" or so focused on "beating up the balance sheet." State insurance departments consistently meeting accreditation requirements are also key indicators and reflective of understanding the process. Most importantly, most companies are seeing benefit from the process, especially those going through their second risk focused examination. However, what is the current trend in industry and regulation and how will that affect the examination process? What will the examination process look like five years from now, considering how far we have come in the past five?

The trends in the industry and in regulatory compliance are clearly putting more emphasis on enterprise risk management and corporate governance. From a technology perspective, mobile computing, big data and data analytics dominate the insurance industry market moving from "the next big thing" then to "if you aren't there yet you are behind" now. Considering these trends, I believe we may see transitions with the risk focused examination approach. The following are some areas to provoke insight and discussion during the SOFE presentation:



Financial Reporting Risks Taking a Back Seat: Examinations in 2020

(continued)

- Financial reporting risks – we may no longer need to have financial reporting risks and instead will spend more time and effort completing the Exhibit E – CPA review and indicating where material balance line items were addressed. An overall assessment on level of work on financial reporting risks can be made based on review of the work from the CPAs. The assessment would drive the need to include certain financial reporting risks on the risk matrix.
- Enterprise risk management – the examination approach may revolve more around an insurer’s enterprise risk management framework. Consideration of critical risk categories would no longer be an exhibit but rather integrated into the examination process.
- C-level interviews – interviews could be conducted with a group of executives and individually. Group interviews would gauge the extent of dominance of the CEO or other executives based on their responses. In addition, the examiners could ascertain validity of responses based on the non-verbal cues from other members of management in the room. Group interviews may also lead to efficiencies and reduce the redundant questions.
- Risk matrix presentation and workflow– the risk matrix may no longer have the separation of non-financial reporting and financial reporting risks. Rather, the risk considerations could be aligned by branded risk to better align the focus of the examination team. The risk matrix and possibly key activities would also align how insurers model their ERM framework, i.e., consideration of strategic, insurance, operational risk, etc.
- Mobile technologies – examination teams will be using applications on smart phones. CCH TeamMate and Citrix may further advance technologies to make mobile and tablet use considered the norm. Risks identified within interviews or walkthroughs could immediately be documented and synced with the examination project.
- Data analytics – the use of data analytics may drive the assessment of inherent risk by incorporating competitor, industry data and forecasting. Moreover, performing independent assessments of an insurer’s economic capital modeling through re-performance of modeling assumptions and/ or conducting separate analysis could arise. The use of ACL and other analytical software would also become increasingly important in the areas of fraud detection.

The SOFE presentation will expand and elaborate on these ideas and provide thought-provoking examples. There were be nodding heads and disagreement but ultimately there will be thoughts on improvement and efficiency which will benefit regulation in the long run--and hopefully result in an enjoyable presentation.



Financial Reporting Risks Taking a Back Seat: Examinations in 2020

(continued)

About the Author



John Romano, CFE, CPA, is a Director at ParenteBeard in its business advisory practice where he provides internal audit, internal control assessment, Enterprise Risk Management, Sarbanes-Oxley (SOX) 404 compliance, and corporate governance and risk management solutions to the insurance, life sciences, higher education, financial institutions and healthcare industries. In addition, Mr. Romano leads ParenteBeard's insurance industry advisory practice and he has served as the Examiner-In-Charge (EIC) on numerous National Association of Insurance Commissioners (NAIC) examinations for various state departments. He has served as the lead EIC on coordinated examinations of large multinational insurers for various states. Prior to joining ParenteBeard, Mr. Romano held accounting and audit positions with two Fortune 500 financial institutions and a major healthcare provider.

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Information Security Essentials for a Financial Examiner

By **Scott Bryson, CISA, CISSP**
Risk and Regulatory Consulting, LLC

An estimated 267 million data records were exposed in 2012¹. As financial examiners, we gain access to many varieties of sensitive company data throughout our exams. By incorporating good security habits into our daily lives, we can strive to keep safe the data we utilize and obtain.

I would like to start by reviewing the types of data that we may come in contact with through the course of an exam.

- Personal data ePHI/PHI/PII (see note A below)
- Financials
- Payroll
- Merger / Acquisition
- Board Materials
- Strategic Planning Documents

Note A: You may be familiar with many of the above data types, but for those not familiar with the acronyms for personal data, here they are defined:

Personally Identifiable Information (PII) - "any information about an individual maintained by an agency, including, but not limited to, education, financial transactions, medical history, and criminal or employment history and information which can be used to distinguish or trace an individual's identity, such as their name, social security number, date and place of birth, mother's maiden name, biometric records, etc., including any other personal information which is linked or linkable to an individual."²

Electronic Protected Health Information (ePHI) - Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA) Privacy Rule, protected health information (PHI) refers to individually identifiable health information. Individually identifiable health information is that which can be linked to a particular person. Specifically, this information can relate to:

- The individual's past, present or future physical or mental health or condition,
- The provision of health care to the individual, or,
- The past, present, or future payment for the provision of health care to the individual.

Common identifiers of health information include names, social security number, addresses and birth dates.³



Information Security Essentials for a Financial Examiner

(continued)

You may be thinking, “Who would really be interested in trying to gain access to data that I have out on all the millions of computers and devices out there?” My response to you is to consider the actual dollar value of the data. The below table contains the value associated with different data types on the black market.

Type of Data	Value per Item ⁴
Magnetic-stripe from a “secure” premium level credit card	\$80
Your Mother’s Maiden Name	\$6
Name and Password for your online bank account	\$1,000
Your Social Security Number	\$3
Medical Record	\$50
Date Of Birth	\$3

Some of the dollar values may not seem high individually, but consider for example a client data file that includes 10,000 medical records valued at \$50 per record. That data is worth an estimated \$500,000 dollars on the black market, which is plenty of incentive for a hacker to target an individual computer!

Hopefully, it is now evident to you that the data we possess and see each day is pretty valuable. The fact is we are all vulnerable to data loss, primarily through physical loss or theft and cyber attacks. You may now be wondering how we can reduce our exposure and what controls are available and in place for protection of this data.

Let’s start with physical loss. One of the easiest ways to prevent the loss of a laptop is to secure it to a heavy object. This can be accomplished through the use of a cable lock securely attached to a desk. Though I recognize these locks can be a pain to cart around, they are a great deterrent to the theft of your laptop at a client site or hotel room.

Unfortunately, I can speak to personal experience with respect to the importance of properly securing one’s laptop. I began work as a consultant and was excited to start my first client service engagement away from home. Coincidentally, the firm just kicked off a big “Save the Trees” campaign that reinforced performing work electronically. In my quest to save the environment, I chose to take all my notes from the walkthroughs with the client on my computer instead of using the traditional pad of paper. At the end of the second day of the three day trip, I arrived back at my hotel room, set my laptop bag down on the bed and stepped out to grab some dinner. As you can probably guess when I arrived back only 30 minutes later, my laptop and all of the notes that I had meticulously taken and saved on my laptop



Information Security Essentials for a Financial Examiner

(continued)

the prior two days were history. Boy, do I wish I had used my cable lock that day. Though it would have been possible for the thief to cut through my cable lock with the right tools, it may have been enough of a hindrance to persuade the thief to move on to the next room. In addition to losing all my notes, having to explain to my boss and IT support group what happened is an experience I never want to repeat.

The option of locking your laptop into a desk or cabinet at the client or company work site is less ideal than using a cable lock, as one can't be sure who else has access to the keys.

In addition to data on our laptops, some companies continue to provide sensitive data on portable media such as CD, DVD or USB flash drive. In these cases, it is of the utmost importance to securely maintain and eventually discard this data while it's in your care. In some cases, with these portable media types, the data may not be encrypted making it particularly vulnerable if it falls into the wrong hands.

I recall a very public and embarrassing event earlier in my career at a consulting firm where an associate left an unencrypted disc with client data on an airplane. Ironically, the client was well known information security software vendor McAfee⁵. Word of the loss traveled quickly throughout the organization from firm leadership down to the interns. The firm responded by prohibiting the use of CD's or DVD's for transfer of client data and requiring that all future correspondence with clients, that couldn't be handled electronically through secure email or secure file transfer mechanism, would be done utilizing firm supplied encrypted USB flash drives. These handy devices are an inexpensive way to keep client data safe during transport. If the use of an encrypted flash drive is not possible and the client requires the use of CD or DVD, you should request that the data is encrypted prior to saving it to the disk. Whenever possible, you should avoid transfer of client data through unsecured CD or DVD.

Just as critical as physically securing your device is electronically securing your device. Here are some simple tips that will go a long way in keeping client data on your laptop safe and secure:

- Always lock your screen when away from your computer (CTRL + ALT + DELETE and then click on "lock this computer")
- Only request and obtain data that you actually need; if you are requesting a file record, only request those fields necessary for testing and have the company leave off any fields (unless necessary) containing PII
- If you are obtaining scanned documents, request that the company block out any PII before scanning the document
- Don't install unauthorized software to your laptop
- Don't access your personal email on your work-issued laptop



Information Security Essentials for a Financial Examiner

(continued)

- Utilize a “strong” password (i.e., combination of upper and lower case alpha, numbers, symbols and/or other characters) and do not share it with anyone else—ever
- If you must document your passwords do so in a secure manner; consider using a tool specifically designed to keep your passwords safe in one place where you only need to remember one password to access your password list
- Use separate passwords for different accounts; don’t use the same password for everything (and don’t use the same passwords for your personal and professional accounts)
- Use care when browsing the web or accessing unknown emails messages
- Look for the secure icon for online transactions (the yellow padlock in the lower right side of your screen) and https:\\ in your browser
- Do not copy work related information to personal computers
- Do not use unencrypted USB flash drives to store or transfer data

To summarize, it is important for all of us to use common sense with respect to keeping our client data secure. Simple things like using a cable lock and locking your screen when stepping away go a long way in reducing the likelihood of client data loss. Second, always think before you click. The World Wide Web is a great resource to an examiner but also has the ability cause some real damage. What may look like a legitimate website may not be and without your knowledge install something on your computer that exposes client data. If ever in doubt, reach out to your local security expert.

ENDNOTES

- 1 - <http://www.riskbasedsecurity.com/reports/2012-DataBreachQuickView.pdf>
- 2 - Executive Office of the President, Memo for Chief Information Officers, M-06-19
- 3 - <http://www.hrsa.gov/healthit/toolbox/HealthITAdoptiontoolbox/PrivacyandSecurity/underhipaa.html>
- 4 - http://www.ncix.gov/issues/cyber/identity_theft.php
- 5 - http://www.computerworld.com/s/article/109003/Auditor_loses_data_on_thousands_of_McAfee_employees

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Building Effective Regulatory Relationships

By **Neil Miller CFE, CPA**
*Alvarez & Marsal Insurance
and Risk Advisory Services, LLC*

One of the most beneficial actions insurance company managers and executives can take to improve their operations is to build effective relationships with their regulators. Like most relationships, the benefits realized from even modest efforts can be substantial. For example, an insurer that has educated its regulators about its operations has a head start in explaining a complex transaction needing regulatory approval. Also, an insurer that learns regulator expectations can reduce its risk of encountering market conduct issues. And, of course, it is much easier for managers and executives to work through complicated problems, issues and crises if they have already made a sincere effort to get to know and work with their regulators.

While I was working for the Maryland Insurance Administration, the president of a small county mutual insurer taught me the value of having a good working relationship and how to go about creating one. This man started his working life as a Southern Maryland tobacco farmer. Later in life he was asked to take over as president of the insurer. This company had been in operation since the 1800s and insured many area homeowners and farmers.

I met the president during a financial examination of his company. Beginning with our first meeting he fostered a sound working relationship with me. He started by getting to know me personally and telling me about his background. We each learned how the other approached our jobs and what concerned us most. I learned that the biggest risk his company faced was losses from a major storm. He feared that a hurricane coming up the Chesapeake Bay could cause losses his company could not withstand, and explained how the company largely mitigated this risk through reinsurance. He also explained how the company would operate after a catastrophe, including how it would process claims while maintaining adequate liquidity.

The hurricane he feared never came. Instead, his company suffered severe losses from a tornado that virtually destroyed the town of La Plata, Maryland. When we talked a few days after the storm he told me his greatest concern was for his community and its losses. On the subject of his company, he was unsure how it would ultimately fare. However, he reminded me of his company's reinsurance program and plans for operating in just this type of situation. Because of his investment in our relationship, I understood and trusted both the president and his plan, and let the company work through the crisis without interfering. In the end the company recovered and successfully merged with a larger company.

Since the fortunes of insurers and their regulators are closely connected – both benefit when the insurers thrive while working to satisfying policyholder obligations and meeting regulatory requirements – both should see the benefit of working together. And yet we all know companies that underutilize or entirely ignore regulatory relationships.



Building Effective Regulatory Relationships

By Neil Miller CFE, CPA
Alvarez & Marsal Insurance
and Risk Advisory Services, LLC

So how can you help a company utilize this tool better? By following the common-sense example of our tobacco farmer friend, you can help an insurer to build effective regulatory relationships by:

- Understanding the regulatory landscape;
- Getting to know its regulators;
- Educating its regulators on the insurer's operations;
- Acting in the way its regulator needs and expects; and
- Becoming part of regulatory solutions.

Understanding the Regulatory Landscape

Just as it's important to understand the rules before playing a game, it's important to understand the regulatory landscape in order to effectively plan for building regulatory relationships. Begin with the concept that state insurance regulators primarily exist to make sure insurers have the financial strength to meet their policyholder obligations; meet those obligations in a fair and equitable manner; and operate in accordance with public policy.

Viewed in this light, many insurance laws and regulations, such as the holding company act, investment limitation laws, and the standard valuation law, are designed to address causes of insurer financial trouble. Other insurance laws and regulations (e.g., laws governing policy forms and rates) can be seen as addressing causes of policyholder mistreatment. Still others like anti-fraud and prompt payment laws address public policy matters.

Of course, insurance departments are organized and staffed to enable them to enforce insurance laws and otherwise meet their regulatory responsibilities. For example, the financial regulation section will generally include financial examiners who assess insurer risk management, verify financial reporting accuracy, and assess compliance with solvency laws and regulations; financial analysts who review financial filings to monitor ongoing solvency; and analysts who ensure compliance with holding company laws. Providing managers and executives an understanding of how the department is organized, the responsibilities of its various units, and the key people charged with carrying out those responsibilities allows them to identify the key relationships they need to develop and who in their company will best own those relationships.

I recommend that insurance company executives research current and emerging issues of interest to the regulators. Issues that are important to the commissioner and key departmental staff should also be important to the insurer, and this background can help facilitate discussion. Great sources of information include department web sites (http://www.naic.org/state_web_map.htm), press releases and news stories. Discussions with persons



Building Effective Regulatory Relationships

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knowledgeable about the department can yield additional valuable insight. The NAIC web site (<http://naic.org/>) includes information such as the working groups on which the Commissioner and staff participate, and minutes of those working groups where positions on key issues are often documented.

Getting to Know its Regulators

Insurance company managers and executives often begin building relationships by meeting their domiciliary commissioner. While a great relationship to have, they should not stop there. Deeper longer term relationships are often found with career regulators. These are relationships with the people who make day-to-day decisions affecting the insurer, and/or advise the commissioner on those decisions.

The insurer's understanding of the regulatory landscape will assist in finding the right regulators to engage. These should include the leaders and key staff in the sections at key points where the company and the regulator interact, including:

Financial examination	Company licensing
Financial analysis	Actuarial
Market conduct	Fraud
Complaints	Premium tax
Rates and forms	Legal

Equally important is who in the company should meet the various regulators. Start with the premise that the regulator's section leaders and key staff will want to meet with leaders of the insurer. In some cases the CEO, CFO, CCO or CRO is the right leader, especially in areas like financial regulation, while in other cases other leaders are more appropriate. The regulators will also want to meet with their counterparts at the insurer (for example, the complaint section at the state insurance department should be matched with the complaint staff at the insurer). Both sides should work to introduce the next generation of leaders. The result should be mutual trust that facilitates long-term communication and problem solving.

Insurance company managers and executives are often concerned with maintaining control over the information being requested by regulators as well as what and how it is being provided. Common-sense solutions to this concern include designating someone who can facilitate communication without undue delay to act as a main point of contact with the regulators.



Building Effective Regulatory Relationships

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The long-term goal of these efforts should be to develop trust and understanding, thus creating an effective working relationship. The next two sections provide examples of how managers and executives can demonstrate to regulators their company functions in a trustworthy manner, and help them to better understand the company's operations. In return, managers and executives can learn how to better operate in their regulated environment and to best facilitate regulatory objectives. They can also work to help the regulators to understand the challenges and obstacles their company faces, and in exchange find solutions within the regulatory framework. The company can help the regulators understand their positions on proposed changes to the regulatory framework.

Educating its regulators on the insurer's operations

As noted above, insurance regulators primarily exist to make sure insurers have the financial strength to meet their policyholder obligations, meet those obligations in a fair and equitable manner, and otherwise operate in accordance with public policy. In practice, all of an insurer's interactions with its regulators serve to educate them on how the insurer acts in relation to these objectives. Managers and executives should seize these opportunities in a proactive way to demonstrate compliance and a dedication to improvement when problems arise. For example, an insurer can demonstrate its commitment to fair claims settlement practices by understanding regulator expectations and by working closely with the regulator to promptly and fairly address policyholder complaints.

Financial regulators are increasingly asking managers and executives to explain their view of the insurer's operations and prospects. What before might have been limited to providing projections and a business plan has evolved into expectations of transparent demonstrations that the company is actively and effectively addressing key business risks and has sufficient capital and liquidity for stress situations. Regulators want to know managers and executives are on top of the situation, much like our tobacco farmer friend demonstrated his sound management to me.

Companies can embrace this opportunity by providing periodic presentations like those made to ratings agencies to their regulators, and actively participating in, and even driving, supervisory colleges. Supervisory college participation is particularly beneficial in that multiple regulators can be educated at the same time and their concerns addressed in a holistic manner.



Building Effective Regulatory Relationships

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Acting in the way its regulator needs and expects

No greater tool exists for demonstrating commitment to the regulatory relationships an insurer is trying to develop than by doing what is expected. Some great tips include being transparent to the regulator, following the “no surprise” rule (i.e., tell the regulator about problems and proposed solutions as soon as appropriate and practical), and communicating all sides of the story.

A few examples serve to clarify this point.

Regulators created the holding company act in 1969 to address some of the most common causes in insurer failure. These causes include having inappropriate owners and managers and entering into unfair and unreasonable transactions with affiliates. As a regulator nothing concerned me more about an insurer’s future than its consistent failure to adhere to the requirements of the act.

Years ago I regulated an insurer that continually complained about the time it took to approve intercompany agreements. This company routinely filed intercompany agreements with explanations that supported approval, but did not always discuss all of the facts or address risks from the transactions. Having learned there was usually more to the story; our analysts scrutinized this company’s filings and asked questions until they fully understood them. In some cases the additional facts the analysts found led to changes to or denials of transactions.

After some education, the quality of this company’s proposed transactions and the related filings improved and our relationship improved. The company learned to consider the act’s “fair and reasonable” standard in structuring transactions and clearly explained in its filings how the standard was met. Just as important, transactions were walked through as they were being conceived to discuss potential issues and solutions.

A more current example is the opportunity for companies to improve their operations with the tools developed through the solvency modernization initiative. These include guidance on effective corporate governance, risk management and capital adequacy assessment. Regulators worked with Industry to create these tools to assist managers and executives in helping to ensure financial stability. Companies that embrace these tools can demonstrate to regulators a commitment to trustworthy operations.



Building Effective Regulatory Relationships

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Becoming part of regulatory solutions

An insurer's research into current and emerging issues of interest to its regulators helps identify areas where it can assist its regulators in finding and implementing effective solutions. Involved companies benefit through developing better relationships, having their opinions considered, and helping to frame solutions implemented in a way that allows the companies to minimize cost or maximize value.

A great example of this involved a state attempting to improve regulator and insurer reaction to, and reduce losses from, catastrophes. The state's multi-faceted approach included viewing this as an economic development and safety issue, as well as an availability and affordability issue. The commissioner of that state involved many insurers in this effort by having them provide data, complete surveys, and participate in discussions. This resulted in the commissioner obtaining a clear picture of how the insurers reacted in prior catastrophes and receiving their suggestions for improving responses to future events. In addition, insurers had the opportunity to contribute to the commissioner's efforts to improve the economics of doing business in that state.

In summary, not every company will face a life-threatening crisis in which it will need to work effectively with its regulators, but every company can realize substantial benefits from growing and maintaining effective relationships with its regulators. You can help them in this by following the common-sense approach of our tobacco farmer friend.

About the Author

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TeamMate Beyond EWP

By **Francois Houde CPA, CA, CFE,
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In addition to having experience in the use of TeamMate in the examination process for several years, I had the privilege to lead the TeamMate implementation team for a large state agency for the last two years. As such, I attended more than forty hours of training facilitated by TeamMate implementation specialists and had the opportunity to develop training sessions for all the users of the agency. Our initial plan was to use the EWP module in a similar fashion as we have in the past few years on NAIC regulatory insurance examinations. We developed a matrix system inspired by the COSO framework and NAIC's template. Although this system suited our needs, we wanted to make a better use of the technology. Following our discussion with TeamMate representatives, we knew there was more to TeamMate than EWP, but we had never explored the entire suite and never took the time to learn the different functionalities and benefits of this truly integrated project management application suite.

The first thing we needed to consider was the cost associated with expanding our use of TeamMate. TeamMate does not license its modules individually. The licenses your organization already owns include all the modules of the TeamMate application suite. This was great news for us, as our client was cost conscientious, and it would have been difficult to justify additional licensing fees to try the different TeamMate modules. Little did we know, we were about to embark on a steep learning curve of geeky greatness. Human resources were available and our budget allowed us sufficient time for training on the system without impacting our commitment to the client.

The TeamMate application suite comprises of 7 modules: TeamAdmin, TeamCentral, TeamRisk, TeamSchedule, TeamStore, TeamTEC and of course EWP. I will convey, in the following pages, our experience and the use we made of the different modules through this journey while demonstrating how this could be adapted to performing regulatory insurance examinations.

TeamMate can be installed in a distributed environment or on a central database. In a distributed environment, the application is installed on every workstation and a network drive or shared folder is designated to store EWP projects. Although easy to manage, this setup does not allow using TeamAdmin, TeamCentral, TeamRisk, TeamSchedule and TeamTEC, as these modules require the connection to a database. We quickly rejected this option. We opted for the central database model, which raised another series of options: can we manage the database server ourselves or should we outsource it, do we want the database server to also host the application or will we install the application on every workstation? Wolters Kluwer, the company behind TeamMate, offers hosting packages for the database only, as well as for the database and application. A monthly rate is assessed by user and varies depending on the option selected. This allows the client to be up and running relatively quickly and delegates the burden of maintaining the database



TeamMate Beyond EWP

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and updating the application to the hosting company. Wolters Kluwer provided us with a SSAE-16/SOC-1 report and after reviewing it we were confident that appropriate controls were in place to ensure the security and confidentiality of our data. We decided to outsource the hosting of our database and application for the first year, with regard to our large state agency client. We opted not to renew our hosting contract at its expiration; we have been managing our own database server since November 2013 and believe that the system better suits our needs than it was last year. We have always managed our own Citrix server for all of our department of insurance (“DOI”) clients (if needed by the DOI). We are still hosting both the database and the application on the server, for our large state agency client, but we are no longer relying on a third party to do so. Our users do not need to install TeamMate on their computers and they can connect to our server and launch TeamMate from practically any computer, tablet or smartphone. Prior to deciding on hosting your own server, make sure your information technology department has the appropriate experience and resources to do so. The server should be adequately secured, be backed up regularly, monitored for unauthorized access and there should be adequate physical and logical security to protect your data. You should consider testing your installation environment using the *Financial Condition Examiners Handbook’s Exhibit C*; most of the objectives stated in this exhibit should be applicable to your TeamMate environment.

TeamAdmin



Once setup, it was time for to get serious. There are so many options in TeamAdmin that it would have been difficult to navigate through them all without the guidance of the experienced professional from TeamMate. The first thing we did was to turn on Windows authentication; this is one of TeamMate’s best-kept secrets. TeamAdmin has the ability to integrate to Active Directory; access to TeamMate is then granted without the need for users to enter an application specific password. Access is managed centrally by your network administrator, which ensures that your organization’s password requirements also apply to TeamMate access. The only drawback of turning on Windows authentication is that the basic authentication mechanism is not fully deactivated. The basic authentication mode is weaker, from a security perspective. We are not going to discuss its weaknesses in further detail, but keep in mind that Windows authentication should be considered.

The global organization hierarchy is another one of those concepts, which does not mean much to those not properly introduced to the suite’s functionalities. The hierarchy is an organized list of the targeted auditable areas. Every last branch of the tree corresponds to an audit. This list of auditable areas will



TeamMate Beyond EWP

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be used to generate the audit plan and perform the risk assessment later on. Be as granular as you can, it will be possible to combine auditable areas when developing the actual audit/examination plan. The state agency for which we performed the implementation had nine regional offices and their hierarchy had close to one thousand auditable areas, most of which were repeated at each location. For a DOI, the first level could be the domiciled companies, as the second level of the hierarchy could be the key activities (premiums, claims, reinsurance, etc.).

The audit plan will be derived from the hierarchy. Although it is labeled “audit plan” in TeamAdmin, this does not exactly correspond to the audit plan your audit committee, board of directors or DOI examination division is expecting, it is rather a list of auditable areas that will be reviewed over a certain period of time, without prioritization at this point; it will be reviewed as part of a periodic risk assessment. To ease the management process of the system, we opted to break out the audit plan by location. Each location would have its own audit plan and therefore a risk assessment with cumulative risk scores would be prepared for each location. This model also allows for better security whereas each user can only be granted access to the audit plan and risk assessment for their location. The audit plan for a DOI could be, assuming the hierarchy was built as suggested above, a list of the companies to be examined in the current year, with their key activities.

TeamRisk



The generation of the traditional audit plan derived from a systematic approach is performed through TeamRisk. This module is used to score and manage risk assessments. The application permits the creation of complex measurement metrics based on criteria determined by the user. In our example agency, it was established that five main factors would influence the risk level and should be measured: 1) quality & stability of the control environment, 2) business exposure, 3) public and political sensitivity, 4) compliance requirements and 5) information technology & management reporting. Scoring levels were developed individually for each of these criteria. Examples of these scores could be low/moderate/high or less than \$500,000/greater than \$500,000, etc. Each criterion can have the same or different possible scores. Once the criteria and possible scores are defined some thought needs to be spent to ensure each criterion is given the proper weight in the equation. A formula must be established that will translate the scoring of each criterion into a numeric value. Our formula changed multiple times over the implementation period. The relative importance that we theoretically wanted to give to one criterion did not translate into the score we were expecting; areas



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we expected to be high risk were given risks that were too low and vice versa. Fine tuning our formula over time allowed us to have a risk assessment scoring methodology that reflected our expectation and mirrored the risk levels observed in prior audits. Separate formulas can be defined for the inherent and residual risk. We added a criterion to take into consideration the control effectiveness when calculating the residual risks, in our example. The matrix used throughout NAIC risk-focused examinations could easily be integrated into TeamRisk, without changing any of the criteria used to evaluate the inherent and residual risks.

With the scoring methodology defined, let the rating begin. When opening the “worksheet” of the risk assessment associated with the audit plan, the audit plan outlined in TeamAdmin will be presented with all its branches. The process is unfortunately not as simple as scoring each area on each of the criteria defined. Although such a high level scoring methodology may be useful, we will be expanding our use of the module to benefit from the integration of the suite. We imported all the risks and controls documented in our TeamStore and associated with each auditable areas, for every location, in a global risk assessment. We had more than 10,000 risks and over 30,000 controls to rate on each of our five criteria. What seemed to be a great idea at first when developing a comprehensive list of potential risks for each area turned out to be challenging when it was time to rate each of these over our criterion. The mere volume of risk and control in our risk assessment not only was overwhelming for us, but also largely exceeded the capacities of the system. Our system would constantly freeze and there was a delay after rating each criterion. We decided to break this risk assessment by location, which also forced us to rearrange our hierarchy and break our audit plan by location. Rating for the inherent risk our 10,000+ risks took four experienced auditors a few months to accomplish.

The rating of all the identified risks allowed evaluating the auditable areas against each other's. We then determined which score represented a high, moderate and low inherent risk and exported all our auditable areas to a spreadsheet to better analyze our results. Some areas were combined into joint audits. Although we thought it would be convenient to combine auditable areas into fewer audits, it turned out to be logistically more complicated than we expected and we slowly adjusted our audit plan and separated them into individual audits. Building the audit plan was a breeze, once our auditable areas were classified by risk priority. Using TeamRisk, we created the projects, defined the estimated start date, hours budget and resources needed and released them to TeamSchedule.



TeamMate Beyond EWP

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TeamSchedule



TeamSchedule is a great tool to manage resources, and visually illustrate the progression toward the completion of the audit plan. Although we tried using it, we did not find it fitting for our purposes and essentially released projects from TeamSchedule to EWP without using most of the functionalities of TeamSchedule. If you plan on using this module, ensure you are properly trained on it. We did not find this module to be as user friendly as the other modules.

TeamMate EWP



TeamMate EWP should not need any introduction. Examiners have been using it for many years, but many DOIs are mostly using it as a document repository and are therefore missing out on the benefits of its integration to the rest of the suite. In addition to being a document repository, functionalities such as the Risk & Control viewer of EWP allows the rating of controls and linkage of controls to the procedures in which they are tested. The NAIC risk matrix is essentially already built-in TeamMate. If only that was all!

If the agency or the DOI has developed standard procedures, work papers or even findings, they can easily be saved in the TeamStore and retrieved in EWP projects upon their creation. Procedures can be associated with specific risks and controls and be automatically inserted in an EWP project without user intervention, upon the creation of the project. Although EWP is also widely used to document issues or findings, there is somewhat of a disconnect when it comes to the preparation of the report. This process is very manual for most DOIs. The use of TeamMate's 360-Reports allows the generation of a custom report to the exact specification of a DOI by pulling information already documented in EWP to automatically produce a report. We have deployed 360-Reports at our client and gained great efficiency in the report preparation process. Our reports are literally prepared in a few clicks, although they still need to be reviewed for page breaks. Finally the 360-Reports also allows management to type their response to findings directly in the report and enable the examiner to import their response directly to each finding, with minimal effort, without retyping or copy/pasting.



TeamMate Beyond EWP

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TeamCentral



TeamCentral is a web-based interface that connects to the TeamMate database. It allows the production of many statistics related to the progression of projects, but mostly it is a useful tool to track the implementation of findings. Every finding created in an EWP project can be sent to TeamCentral for tracking. This allows the examiner during the next examination cycle to easily retrieve the findings from the prior examination and document in an organized matter whether management's action plans have been adequately implemented.

TeamTEC

Although we didn't discuss the use of TeamTEC, this module is a timekeeping system that integrates to EWP and allows users to post time spent, by category, on each project. Rates per hour can be associated with each user, facilitating the billing of examination fees to the companies.



The examination process could gain substantial efficiencies should a DOI decide implementing all the modules of the TeamMate suite. Adequate planning, open communication, user training, system testing and providing support to the users are keys to ensure a successful system implementation. Finally, you should ensure the project manager in charge of deploying the various modules has been adequately trained and is experienced with TeamMate to avoid roadblocks that would increase your implementation cost and delay the deployment of the entire suite.

About the Author

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NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2014 Spring National Meeting

The National Association of Insurance Commissioners held its Spring National Meeting in Orlando March 27-April 1. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.



Executive Summary

- The Executive and Plenary Committee adopted revisions to the statutory accounting guidance for the Affordable Care Act fee which brings closure to this contentious topic.
- The Executive Committee approved model law development requests for various models to address contingent deferred annuities.
- The Financial Condition Committee committed to considering the FIO's report on modernizing insurance regulation in 2014.
- The Governance Review Task Force began its discussion of recommendations related to the NAIC's organizational and committee structures, and internal and external decision making policies and procedures.
- The Statutory Accounting Principles Working Group and Emerging Accounting Issues Working Group adopted accounting for and disclosures related to the ACA's risk sharing provisions effective for the first quarter of 2014.
- The Capital Adequacy Task Force adopted the ACA Fee Sensitivity Test for 2014 reporting for the Health and Life formulas. The task force has scheduled a call for April 30 to consider adoption of other significant changes to the 2014 formulas.
- The Life RBC Working Group exposed a proposal to update the C-3 Phase I's interest rate generator, re-exposed a proposal on the "conflicting use" of AVR and discussed New York's unauthorized reinsurance proposal. The Stress Testing Subgroup discussed possible bases for exempting companies from a total asset requirement adequacy test.
- The Investment RBC Working Group received a presentation from the AAA, which revised its findings of the corporate bond modeling. The working group adopted a previously exposed addendum to the life RBC derivatives report and began addressing whether the 30% common stock factor in the Life formula should be applied to the other RBC formulas.
- The Operational Risk Subgroup exposed a revised structural proposal for operational risk RBC that would be on an informational-only basis for 2014.
- The Property/Casualty RBC Working Group adopted the insurance subsidiaries' RBC charge proposal and exposed a revised RAA proposal on the reinsurance credit risk charge.
- The Catastrophe Risk Subgroup reviewed findings from the 2013 catastrophe risk filings, noting that only 14 companies out of 2,500 triggered an action level event by applying the new charge. Most companies experienced no or negligible change in total RBC.
- The Health RBC Working Group adopted three sensitivity tests for 2014 filings related to assessing the effect of the Affordable Care Act on total adjusted capital.
- The Valuation of Securities Task Force exposed a proposal to move administrative oversight of the SVO from the task force to the NAIC CEO. The task force also adopted guidance on structured notes. The Securitization Data Quality Working Group was formed to develop data quality and documentation standards for RMBS and CMBS modeling.
- The PBR Implementation Task Force exposed significant recommendations in its Rector Report on captives and heard comments from regulators and strong objections from interested parties related to the proposed effective dates, which would be as early as July 1, 2014 to evaluate new XXX and AXXX captive transactions.
- The Corporate Governance Working Group exposed its draft *Corporate Governance Annual Filing Model Regulation*, which would replace the controversial proposed Corporate Governance Guidance Manual. The working group also adopted a proposal to require an internal audit function at large insurers.
- The ORSA Subgroup exposed revisions to the ORSA Guidance Manual and invited companies to participate in the 2014 ORSA pilot.
- The Private Equity Issues Working Group voted to proceed with developing best practices for regulators to consider in their review of potential acquisitions of life insurers by private equity companies and hedge fund managers.

- The ComFrame Development and Analysis Working Group held its first meeting and will coordinate participation of U.S. regulators in the IAIS's field testing of ComFrame.
- The Reinsurance Task Force exposed for comment the Uniform Application Checklist for Certified Reinsurers for states to use to ensure initial applications are complete and are based on the requirements of the Credit for Reinsurance Model Law and Model Regulation.
- The Blanks Working Group adopted a revised Supplemental Compensation Exhibit.
- The Unclaimed Life Insurance Benefits Working Group held its first meeting and discussed "asymmetric use" of the Social Security Death Master File.
- The Life Actuarial Task Force exposed proposed Valuation Manual amendments regarding small company exemptions, proposed changes to Actuarial Guideline 33, and proposed guidance regarding Indexed Universal Life policy illustrations.
- The Emerging Actuarial Issues Working Group exposed an implementation issue related to the AG38 revisions which is an interpretation confirming the basis for calculating the gross deterministic reserve and reinsurance reserve credit.
- The Financial Regulation Standards and Accreditation Committee exposed for comment a controversial proposal to apply accreditation standards to many captive insurers on a prospective basis.
- The Mortgage Guaranty Insurance Working Group discussed comments on its proposed *Mortgage Guaranty Insurance Model Regulation*.

Executive Committee and Plenary

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

ACA Fee Accounting

The NAIC held a special conference call on February 19 to consider adoption of the controversial guidance on accounting for the Affordable Care Act fee. In a 35-17 vote of the commissioners, the NAIC gave final approval to the proposed revisions to SSAP 35R. The adopted guidance requires accrual of the fee on January 1 of the year the fee is paid ("fee year"), not the year preceding ("data year"). Beginning January 1, 2014, in addition to accruing the full 2014 fee, an insurer is required to "reclassify from unassigned surplus to special surplus an amount equal to its estimated subsequent fee year assessment. This segregation in special surplus is accrued monthly throughout the data year. The reclassification from unassigned surplus to special surplus does not reduce total surplus." Additional disclosures are also required for the period ending December 31, 2014 and thereafter.

In Orlando, the Executive Committee and Plenary unanimously adopted the following items which were the subject of public hearings and debate as they were considered by various groups of the NAIC:

- Amendments to the *Health Insurance Reserves Model Regulation (#10)* and Actuarial Guideline, The Application of Company Experience in the Calculation of Claim Reserves under the 2012 Group Long-Term Disability Valuation Table
- Title Escrow Theft and Title Insurance Fraud White Paper
- Health Reform-Related Codes and Definitions for the NAIC's Complaint Database System

The Executive Committee and Plenary also adopted previously exposed revisions to the NAIC Policy Statement on Open Meetings. These revisions reemphasize the NAIC's commitment to conducting its activities openly and clarifies when it is appropriate for regulator-only sessions to occur.

Executive Committee

In Orlando, the Executive Committee approved model law development requests for amendments to the following:

- *Annuity Disclosure Model Regulation (#245)*
- *Suitability in Annuity Transactions Model Regulation (#275)*
- *Advertisements of Life Insurance and Annuities Model Regulation (#570)*
- *Life Insurance and Annuities Replacement Model Regulation (#613)*
- *Insurance Holding Company System Regulatory Act (#440)*, and
- *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450)*.

The first four model revisions were requested by the CDA Working Group related to its charges.

Financial Condition Committee

Consideration of Recommendations from the Federal Insurance Office Report

In a letter dated March 30, 2014 from the NAIC Officers to the NAIC Committee Chairs and Vice Chairs, the officers asked the chairs to consider recommendations included in the Federal Insurance Office's December 2013 report on modernizing insurance regulation. Although the Financial Condition Committee did not discuss the recommendations during the meeting, they committed to considering them in the upcoming year and/or assigning them to other groups. The following lists the recommendations and the proposed committees that could be assigned to each (keeping in mind that some of the recommendations of the FIO are already currently being worked on by various NAIC working groups):

1 - For material solvency oversight decisions of a discretionary nature, states should develop and implement a process that obligates the appropriate state regulator to first obtain the consent of regulators from other states in which the subject insurer operates. (Financial Condition Committee)

2 - State-based solvency oversight and capital adequacy regimes should converge toward best practices and uniform standards. (Financial Condition Committee and International Insurance Relations Committee)

3- States should develop corporate governance principles that impose character and fitness expectations on directors and officers appropriate to

the size and complexity of the insurer. (Corporate Governance Working Group)

4 - In the absence of direct federal authority over an insurance group holding company, states should continue to develop approaches to group supervision and address the shortcomings of solo entity supervision. (Group Solvency Issues Working Group)

5 - State regulators should build toward effective group supervision by continued attention to supervisory colleges. (Group Solvency Issues Working Group and International Insurance Relations Committee)

6 - States should: (1) adopt a uniform approach to address the closing out and netting of qualified contracts with counterparties; and (2) develop requirements for transparent financial reporting regarding the administration of a receivership estate, and 7 - States should adopt and implement uniform policyholder recovery rules so that policyholders, irrespective of where they reside, receive the same maximum benefits from guaranty funds. (Receivership and Insolvency Task Force)

8 - Federal standards and oversight for mortgage insurers should be developed and implemented. (Mortgage Guaranty Insurance Working Group)

9 - To afford nationally uniform treatment of reinsurers, FIO recommends that Treasury and the U.S. Trade Representative pursue a covered agreement for reinsurance collateral requirements based on the NAIC Credit for Reinsurance Model Law and Regulation. (Reinsurance Task Force)

10 - FIO should engage in supervisory colleges to monitor financial stability and identify issues or gaps in the regulation of large national and internationally active insurers. (Group Solvency Issues Working Group)

Governance Review Task Force

This was the first public meeting of this task force, which was established in response to discussions at the Fall National Meeting requesting that a consultant be engaged to make recommendations to the NAIC with regard to its corporate governance. Previously, an ad hoc governance review committee had been established to discuss these issues, but those meetings were closed to the public.

Commissioner Huff of Missouri, the task force chair, reviewed the charges of the task force, which are to review the NAIC's governing documents, practices

and procedures and potentially make recommendations to the Executive Committee on revisions to the NAIC's organizational structure, committee structure, and internal and external decision making policies and procedures. The task force will also consider making a recommendation to the Executive Committee regarding whether to engage an outside consultant to assist in the review. The chair expressed his hope that the task force can reach a conclusion on the consultant recommendation before the Summer National Meeting.

Commissioner Leonardi of Connecticut commented on the "elephant in the room," referencing his controversial letter to state regulators last December, which was widely distributed (see our PwC NAIC Fall 2013 Newsletter for additional discussion). He believes this task force and its charges aim to address the issues raised in that letter. He cautioned that the "world is watching" and the need to improve the NAIC's governance is an issue well known both internally and internationally.

Other commissioners echoed these thoughts that the NAIC should take an honest look at itself. One cautioned that the commissioners must ensure that they control the NAIC and protect the general interests of the NAIC, rather than it being at the direction of a few commissioners and past presidents.

Interested parties were generally supportive of the desired move toward transparency. Some concerns were raised by consumer group representatives regarding the changes to the NAIC's Policy Statement on Open Meetings which give the NAIC the ability to close sessions with a majority vote of regulators. The chair noted that the exception was meant to be limited. The party's request to require a two-thirds majority vote to conduct a closed meeting will be considered by the task force.

The task force recommended posting notice of all meetings, including regulator-to-regulator sessions, to the NAIC's meetings page, which was subsequently adopted at the Executive and Plenary session.

Statutory Accounting Principles Working Group

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

Insurer Accounting for the Affordable Care Act

The SAP Working Group held two conference calls with the Emerging Accounting Issues Working Group to discuss INT 13-04: Accounting for the Risk Sharing Provisions of the Affordable Care Act; this Newsletter summarizes those meetings along with the discussion held by both working groups at the Spring National Meeting.

SSAP 35R - ASU 2011-06, Fees Paid to the Federal Government by Health Insurers (2011-38) – As discussed in the Executive Committee and Plenary summary, the NAIC adopted final guidance on accounting for the ACA fee during an interim conference call February 19th.

ACA Guidance in a Separate SSAP (2014-01) – The SAP Working Group voted to expose for comment SSAP 10X—Affordable Care Act Assessments, which moves the guidance on the ACA fee from SSAP 35R to a standalone SSAP. It is expected that the new SSAP will be revised to include the guidance on risk sharing provisions currently included in INT 13-04.

Accounting for the Risk Sharing Provisions of the Affordable Care Act (INT 13-04) – During a joint meeting of the two groups on February 12 to discuss the INT 13-04 guidance exposed at the Fall National Meeting, the regulators agreed to a proposed revision from interested parties to exclude receivables related to the risk corridor program from the 90 day non-admission test since funding of that program is mandated by law. Other changes agreed to from the December exposure draft are the addition of footnotes to paragraphs 12 and 56 detailing some of the differences between the Medicare and ACA risk adjustment programs, and additional text in paragraphs 15 and 58 on the difficulty in calculating reasonable estimates for the risk adjustment and risk corridor programs.

The INT was then re-exposed for comment, and a second conference call was held March 19 to hear any final comments. However, at that meeting, the EAIWG representative from Virginia proposed amendments to the INT which would require non-admission of risk corridor and risk adjustment receivables programs given the "uncertainty and complexities" in the programs and the subsequent effect on insurers' ability to make estimates given these uncertainties. There was lengthy debate on this proposal, and the EAIWG ultimately voted 8-3 in favor of the concept to nonadmit receivables from these programs with subsequent review after second quarter filings in the event uncertainties had been resolved.

At the Spring National Meeting, the EAIWG reviewed both the proposed March 19 revisions to the INT to reflect the non-admission concept discussed above, and the February 12 draft. Immediately after review of the two drafts, the representative from Pennsylvania moved to adopt the February 12 exposure, stating that industry needs guidance for the first quarter of 2014 and that the issues raised by Virginia should be debated by the SAP Working Group after adoption of the INT. Virginia responded saying that the risk corridor and risk adjustment receivables are so uncertain, that it doesn't make sense to allow entities to admit them. Interested parties commented that if an insurer is not able to reasonably estimate receivables due to these uncertainties, then no amounts will be recorded. However, some companies may be able to make reasonable estimates based on their specific fact patterns, and therefore, the guidance should be available. After another lengthy discussion, the EAIWG voted 8 to 4 to adopt the February 12 version of the INT, and to refer the issues raised by Virginia to the SAP Working Group, which agreed to consider these concerns as soon as possible.

Risk Sharing Disclosures of the Affordable Care Act – Disclosures (2013-28)

At the Spring National Meeting, the SAP Working Group adopted disclosures related to the risk sharing provisions of the ACA, effective for the first quarter of 2014. The financial statements will include detailed disclosures of the assets, liabilities and revenue elements of each of the three programs; material re-estimations and impairments for the reporting period should also be disclosed. The working group also exposed for comment a proposed rollforward of the ACA risk sharing balances for both quarterly and annual financial statements beginning with the year-end 2014 financial statements. The rollforward includes disclosure of explanation for adjustments to balances, e.g. adjusted due to federal audit, revised participant count or due to experience in the pool. The disclosure will also be forwarded to the Blanks Working Group with the proposal that the footnote be data captured in the annual statement.

Adoption of New Standards or Revisions to SSAPs

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

regarding use of different interest rates for similar transactions.

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

Clarification of Merger Footnote (2013-29) – The NAIC adopted revisions to SSAP 68 to clarify that the exemption for a merger of a shell company into an insurer still requires the effect of the merger to be accounted for on January 1 of the year of the merger.

ASU 2011-09, Disclosures about an Employer's Participation in a Multiemployer Plan (2013-37) The working group adopted revisions to SSAP 92, OPEB, and SSAP 102, Pensions, to incorporate limited disclosures from ASU 2011-09. In the interested parties' comment letter, they noted insurance entity participation in such plans is not common, since typically these plans are associated with union organizations.

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

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

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

Insurance Contracts – The outcome of the FASB's February meeting was discussed, whereby the Board made three decisions regarding the future of the project: make targeted improvements to existing GAAP for long duration contracts, enhance disclosure for short duration contracts, and limit the scope to insurance entities. The FASB met on April 16 and selected a list of targeted improvements for future deliberation; read PwC's Insurance Alert [Link](#) for details of the discussion.

Investment Classification Review (2013-36) – At the Fall National Meeting, the working group agreed to a new comprehensive project to review the investment

SSAPs and clarify definitions, scope, accounting methods and reporting guidance. The working group exposed for comment the overall proposal. In their comment letter, interested parties responded that “significant caution and restraint needs to be exercised when undertaking a project of this magnitude.” They also expressed the belief that the “SSAPs, in their current state, are not broken in their entirety and hence a comprehensive rework of them is unnecessary and undesirable to the industry.”

Interested parties at the meeting reiterated the points in their comment letters, asking for targeted improvements to the SSAPs rather than wholesale changes, similar to the move of the FASB with respect to the Classification and Measurement project. They offered to assist in developing a listing of targeted improvements to current SSAPs. The chair commented that it was not the intent of this review to re-write all investment SSAPs. NAIC staff is expected to begin work on an issue paper shortly.

On April 18, the SAP Working Group exposed for comment until June 7 an investment matrix which identifies various investments within the SSAPs and related reporting information. The working group is looking to gather information from regulators and interested parties on the issues that should be discussed.

Disclosure for Structured Notes (2014-02) – The working group approved incorporating a new disclosure in SSAP 26 for structured notes for 2014 year-end financial statements, which will provide regulators with information regarding the volume of activity in these notes. This information will assist the Invested Assets Working Group in determining if additional accounting or reporting revisions (including valuation and RBC) are necessary. The working group also proposed an amendment to paragraph 48 of SSAP 43R to replace “structured note securities” with “structured securities.” See the Valuation of Securities Task Force summary for additional discussion on the structured note issue.

Definition of a Public Business Entity (2014-03) – The working group rejected implementation of ASU 2013-12, *Definition of a Public Business Entity*, as statutory guidance does not differentiate between public and non-public entities, and as such, this is not applicable to SSAP.

Inconsistent Audit Requirement in SSAP 16R (2014-04) – Currently the disclosure requirements of SSAP 16R, Electronic Data Processing Equipment and Accounting for Software, are restricted to the annual audited financial statements only, whereas disclosure requirements of SSAP 87 - Capitalization Policy, does not include this restriction. The working

group approved revision to remove the restriction to annual audited financial statements only from SSAP 16R.

Service Concession Arrangements (2014-05) – ASU 2014-05, *Service Concession Arrangements*, provides guidance that an operating entity should not account for a service concession arrangement as a lease. The working group exposed for comment a proposal to adopt with modification ASU 2014-05 and clarify that service concession arrangements are not within the scope of SSAP 22. The working group also proposed revisions to SSAP 19 to clarify that these arrangements should not be recognized as property, plant or equipment. The working group also asked for comment whether these arrangements are prevalent before considering the need to revise the SSAPs.

SSAP 57 -Title Insurance Premium Classifications (2014-06) – The working group exposed amendments to the disclosure requirements of SSAP 57 to delete the categories for Gross All Inclusive Premiums and Gross Risk Rate Premiums and replace them with five Activity Codes: Risk Rate, Search, Exam, Closing and Escrow. The proposed changes would make the SSAP 57 consistent with recent Title annual statement changes.

SSAP 11—Clarification of Adopted GAAP (2014-07) – The working group exposed for comment proposed revisions to SSAP 11 to incorporate paragraphs 6A and 7 of APB 12 that were not carried over from SSAP 14 when it was superceded by SSAP 92. The working also noted that the disclosure guidance in SSAP 11 was incorporated from the pension and other postretirement benefit GAAP guidance, but these disclosures are not generally completed under GAAP for postemployment benefits or compensated absences. The working asked for comments as to whether these disclosures requirements should be modified.

ASU 2014-03, *Derivatives and Hedging—Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach* (2014-08) – The working group rejected the FASB Private Company Council’s ASU, which provided a practical expedient to apply cash flow hedge accounting for certain types of swaps, as it specifically scoped out financial institutions including insurance entities. There is another FASB project to simplify practice issues relating to hedge accounting, and the working group agreed to consider revisions to SSAP 86 at the time FASB issues an updated GAAP standard; however this is unlikely to occur in 2014.

ASU 2010-28, Intangibles—Goodwill and Other (2011-12) – The working group disposed of this item, as new GAAP has been issued since ASU 2010-28, including most recently ASU 2014-02, *Intangibles—Accounting for Goodwill*; ASU 2014-02 will be considered in future meetings by the working group.

Restricted Asset Subgroup and Proposed FHLB Disclosures (2013-27) – The subgroup is waiting to receive information from the first quarter filings before continuing discussions on FHLBs. NAIC staff is gathering information for their next topic, repurchase and reverse repurchase transactions, to begin discussions.

Accounting for bottom-tier residual interests – The Valuation of Securities Task Force referred the accounting for bottom-tier residual interests to this working group and requested consideration of revision to SSAP 43R to distinguish the most junior and contingent economic interests, and to specifically define bottom-tier residuals within SSAP 43R and/or the SVO P&P Manual. Additionally, the working group will review whether: 1) bottom-tier-beneficial interests conform to the definitions of loan-backed and structured securities in SSAP 43R; 2) the statement value of bottom-tier residuals should be limited to fair value; and 3) bottom-tier beneficial interests meet the definition of an asset. The working group also directed NAIC staff to work with the task force to understand these investments.

Impact of Additional Reinsurance on Provision of Reinsurance (2011-45) – The working group had a spirited discussion of whether Blanks proposal 2014-15BWG accurately reflects the intent of the accounting guidance adopted by the working group in 2012. Members of the working group agreed to work with the Blanks Working Group to ensure the guidance will apply to both paid and unpaid reinsurance recoverables.

PBR “Accounting Smoothing” Proposals – The SAP Working Group is being asked to coordinate with the Life Actuarial Task Force on a “smoothing mechanism” to reduce the volatility in the income statement of reserving using PBR after its adoption. No documents related to this project were distributed at the SAP WG meeting.

Emerging Accounting Issues Working Group

All of the working group’s activities since the Fall National Meeting relate to insurers’ accounting for the Affordable Care Act and are summarized in the SAP Working Group summary above.

Capital Adequacy Task Force

The task force met March 10th and in Orlando and discussed the following issues.

ACA Fee Sensitivity Test

The task force adopted the ACA Fee Sensitivity Test for the Life and Health RBC formulas for 2014 reporting. See additional discussion in the RBC Working Group summaries below.

FHLB Proposal

The task force adopted changes to all RBC formulas and instructions to reflect the additional categories added for restricted assets in the general interrogatories in 2013, including FHLB capital stock, collateral pledged to the FHLB and assets on deposit with other regulatory bodies. The RBC factors for the new categories remain consistent with other restricted assets: 1.3% for Life RBC and 1.0% for P/C and Health RBC.

Single Asset/Single LLC Real Estate Proposal

The task force was asked by the SAP Working Group to consider a proposal from interested parties to account for real estate held by certain LLCs in accordance with SSAP 40 (primarily valued at cost) as opposed to SSAP 48 (valued using an equity method and with a higher RBC charge) when certain criteria are met. The task force exposed the proposal for comment and received a response only from interested parties, who continue to support the change in classification and RBC treatment. The task force stated it would work with NAIC staff to draft a response to the referral for the SAP Working Group, but did not indicate any preliminary conclusions.

April 30 Conference Call

The task force has scheduled a conference call for April 30 (10 CDT) to consider adoption of the various proposals for 2014 RBC discussed in this Newsletter.

Life Risk-Based Capital Working Group

The working group held conference calls February 26 and March 14 and met in Orlando and discussed the following issues.

Sensitivity Test for the Affordable Care Act Assessment

The working group voted to add the ACA Sensitivity Test developed by the Health RBC Working Group to the Life RBC formula for 2014 reporting. The sensitivity test does not change an insurer’s reported

RBC ratio. See the Health RBC Working Group summary for additional discussion.

Possible C-3 Phase I Modifications

During 2013, the working group discussed at length potential alternatives to update C-3 Phase I for the current interest rate environment and to address inconsistency of economic scenario generators among different uses. During its February 26 conference call, the working group exposed for comment a proposal to add a schedule to show C-3 RBC cash flow testing results calculated using modifications to the methodology with respect to the number of scenarios and the scenario generator to be used. Indexed annuities would be included in the C-3 Phase I calculations. (There are separate revisions related to the consistent treatment of AVR for C-3 Phase I and II, but no details have been provided on that issue.)

These alternative results would be presented on an informational-only basis for 2014 and would be required for companies with statutory admitted assets in excess of \$10 billion as of year-end 2014. (Per the NAIC, there are 89 companies that meet this threshold.) Companies would also disclose the proprietary generator used, the calibration criteria and the number of scenarios used. In 2015, the working group is proposing that for companies with admitted assets in excess of \$10 billion, the schedule would be mandatory for the 2015 RBC filing; companies which did not file in 2014 would make the informational filing. In 2016, it is anticipated the calculation would be required for all companies.

At its meeting in Orlando, the working group reviewed a comment letter from the ACLI, which supports the proposal but has concerns that the proposed timeline “seems very aggressive and may be unrealistic.” In light of these comments and similar remarks from some regulators, the working group decided to continue developing the proposal and hopes to have a conference call the week of April 21 to finalize the proposal. The working group still hopes to have an informational-only filing effective for 2014.

Contingent Deferred Annuities

The working group is continuing its consideration of how CDAs should be treated in RBC. During its March 14 meeting, the working group voted to ask the Operational Risk Subgroup to consider CDAs in its deliberations. In Orlando, the working group reviewed the AAA’s March 21 letter responding to the working group’s detailed questions on reserving for CDAs. The working group also voted to expose the ACLI’s C-3 Phase II proposal entitled, “Guidance for Contracts in Which the Insurer Does Not Own

the Investments Which Form the Basis for the Guarantee.” The comment deadline is May 19.

“Conflicting Use” of AVR

After discussion at the 2013 Summer and Fall National Meetings, the working group re-exposed for comment a proposal that the amount of AVR that can be included in Total Adjusted Capital for RBC purposes would be limited to the amount not used in asset adequacy testing; the comment deadline ended April 14. If adopted by June 30, the change would be effective for 2014 RBC filings.

NY Unauthorized Reinsurance Proposal

During its March 14 conference call, the working group discussed the proposal from New York to require collateral from unauthorized reinsurers for RBC purposes, which would be in addition to collateral required for credit for reinsurance purposes. The proposal has the support of some members of the working group members, but is strongly opposed by the ACLI, the AAA and international trade associations. The chair acknowledged that the proposal is “politically sensitive” and that he has requested guidance from the Capital Adequacy Task Force on this issue since it has implications beyond the technical aspects of the life formula, especially in light of adoption of the certified reinsurer concept. The regulators are looking for alternative ways to address the concerns raised by New York.

At the Orlando meeting, the chair of the working group reported that there has been recent “fruitful” dialogue with NAIC leadership over “possible alternatives” to the New York proposal which he expects to report at the next meeting.

Stress Testing Subgroup

This subgroup was formed to “evaluate RBC in light of PBR and consider changes to RBC as needed because of the changes in reserve values, contemplating “right sizing” of reserves, margins in the reserves, any expected increase in reserve volatility, and the overall desired level of solvency measurement.” The subgroup is to consider a total balance sheet approach, i.e. focus on the total asset requirement (TAR) and once comfortable with the level of TAR, subtract PBR reserves to determine the RBC portion of TAR and then apply stress scenarios.

The first phase of the subgroup’s work is educational, and the subgroup held two interim conference calls to review materials on stress testing. In particular, the subgroup reviewed the International Actuarial Association’s July 2013

Stress Testing and Scenario Analysis report, which states that the purpose of stress testing is to “assess the financial effect of the events or sequence of events that lead to specific scenarios in adequate detail so that their causes can be identified and their effects on the firm understood.”

Considering the concepts and testing approaches in this report, the subgroup discussed an initial stress testing proposal wherein the following issues were identified as needing to be addressed:

- Coordination of reserve and required capital levels in a PBR environment;
- Regulatory lag with respect to emerging risks and product innovation;
- Limitations of RBC formulas to adapt to different risk profiles;
- RBC Action Level thresholds may be too low;
- Total Asset Requirement (equal to statutory reserves plus company action level RBC) is considered by at least one subgroup member to be a critical element of solvency oversight, yet there is no current test of TAR adequacy in statutory reporting.

The subgroup discussed possible bases for exempting companies from a TAR adequacy test, such as compliance with ORSA requirements or satisfying a minimum company action level RBC requirement. The proposal suggested this threshold be set at 300%, which would exempt approximately 93% of all companies. With regard to using ORSAs as a basis for exemption from TAR adequacy testing, the subgroup discussed potential challenges in using ORSAs performed at a group level instead of a company level. The subgroup also discussed, testing time horizons, possible stress test scenarios and criteria for passing stress tests. The initial proposal suggested two-stage implementation, with the first stage introducing informational reporting only, and the second stage incorporating TAR adequacy testing results in calculations of RBC action levels and ratios. Discussion will continue in future conference calls.

C-3 Phase 2/AG 43 Subgroup

This subgroup of the A and E Committees held three open conference calls during the interim period. With the appointment of a new subgroup chair, initial discussions focused on developing a workplan consistent with the subgroup’s charge, which is to

“evaluate the overall effectiveness of the C-3 Phase II and AG 43 methodologies used to evaluate the market risk component of RBC by conducting an in-depth analysis of the models, modeling assumptions, processes, supporting documentation and results of a sample of companies writing variable annuities with guarantees, and to make recommendations to the Capital Adequacy Task Force or Life Actuarial Task Force on any changes to the methodologies to improve their overall effectiveness.”

The subgroup discussed at length the meaning of the term “effectiveness” and agreed that reserve and capital methodologies are effective if they produce reserve and capital levels that are consistent with the product’s risk profile and move in an intuitive direction when the outside environment changes and in response to sound risk management actions (e.g. hedging). It was noted that AG43 results are more volatile compared to other statutory reserves and it has been suggested that some of this volatility is attributable to the impact of hedging and differences between reserves, RBC requirements and hedge targets.

This and other related observations emerged from the AG43 field test following implementation of AG43, and the subgroup plans to review the issues identified in that report through case study analysis. The case studies will include a range of product types and benefit guarantees with risks along a continuum from low risk to high risk and evaluated under a range of “moneyness” levels. Both reserves and capital would be valued for sample contracts and analysis would be performed, both including and excluding risk management (e.g. hedging). Representatives from the AAA and ACLI will discuss with their members the potential for getting sample results to use for this analysis.

Investment Risk-Based Capital Working Group

The Investment RBC Working Group continues to consider the recalibration of C-1 (asset) factors used in the life RBC calculation. The working group generally meets bi-weekly.

Corporate Bond Factors

During 2013, the AAA deliberated on the relevant modeling assumptions for corporate bonds and the construction of the representative corporate bond portfolios to be used in the current bond modeling project. The purpose of the representative portfolios is to create generic life insurer portfolio structures, as it is impractical to model every insurer’s portfolio.

At the Spring National Meeting, the AAA presented updated outputs from the bond model. Preliminary outputs had been presented at the Fall National Meeting; however, the AAA has now further analyzed the output and revised the discount rate assumption. The discount rate used in the December 2013 model was a 6% after-tax rate. Since that time, AAA has decided to base the discount rate on the historical 10-year swap rate over the last 20 years; this approach yields a 5% discount rate before-tax or 3.25% after-tax. The March 2014 model reflects this revised discount rate assumption, which, all else equal, results in higher C-1 factors as compared to the December 2013 model.

While the AAA continues to validate the model outputs, the AAA representative described the quality of C-1 factors produced by the March 2014 model as “pretty good,” noting that factors may still be revised by +/- 10%. These revised factors continue to indicate that current C-1 factors are generally too low for investment grade securities; however, the prior indication that current C-1 factors for below investment grade securities were too high no longer appears to be the case as a result of the discount rate adjustment. The results continue to highlight the need to move beyond the current NAIC designation (1-6) framework to an expanded vector rating approach (based on rating agency credit ratings) or to a matrix approach (based on both credit ratings and level of subordination). For example, the current C-1 factor for an NAIC-1 designated corporate bond is 0.40%, while the March 2014 model indicates an expected C-1 factor of 0.67% for a Moody’s Aa2 rated senior secured bond and 1.80% for an A3 rated junior subordinated bond. The current C-1 factor for an NAIC-5 designated corporate bond is 23.0%, while the model indicates an expected C-1 after-tax factor of 20.17% for a Caa1 senior secured bond and 51.31% for a Caa3 junior subordinated bond.

A key decision for the working group in 2014 will be whether to recommend a vector or matrix based approach and to what extent the 19 credit rating classifications used in the bond model should be compressed. Under the vector approach, the current NAIC designations would likely be retained but a “+” and “-” would be added to expand the number of designations (e.g., 1+, 1, 1-). NAIC-6 designated bonds, and potentially NAIC-5 designated bonds, would not have a +/- indication, resulting in 14 or 16 designation categories. The AAA appears to be in favor of the matrix approach which would utilize the expanded vector approach and further apply 3-5 levels of subordination categories, to enable even

more granular C-1 factors; the AAA acknowledges that such approach would create more complex implementation issues.

The AAA is also expecting to perform a sensitivity analysis on material assumptions and will further review the outputs for inconsistencies and anomalies. As the bond modeling has focused on the corporate bond life C-1 factors, the working group will also need to determine how C-1 factors for non-modeled fixed income classes (municipal bonds, private placements, preferred stock, and other invested assets) should be developed. Additionally, the working group will need to determine to what degree consistency is desired between the life, health and P/C investment RBC formulas. The working group has previously discussed that the time horizon should be shorter and the composition of the representative portfolios should be different for health and P/C companies.

Municipal Bond Factors

The working group reviewed a 2012 analysis prepared by NAIC staff that compared the investment portfolios of the five different insurer types. It was observed that there is a significant differential in municipal bond investments made by life and P/C companies: municipal bonds represent 37.0% of P/C insurers’ bond portfolios and 5.9% of life insurers’ total bond investments. The chair of the working group noted that it may be necessary to model the municipal bond portfolio to update the RBC factors given its significance to P/C investment portfolios. The AAA representative noted that this topic has been discussed and they are trying to identify resources that could perform such modeling. If the municipal bonds cannot be modeled separately, the corporate bond factors might be used as a starting point and adjusted, if needed, based on differences in historical default rates. The AAA representative pointed out that one of the issues with modeling municipal bonds is determining how representative the historical default data is of the future and finding recovery statistics.

Common Stock Factors

Prior to the 2013 Summer National Meeting, the working group finalized its consideration of the unaffiliated common stock RBC factors for life insurers, keeping the base factor unchanged at 30%. The working group has not yet determined whether any revisions will be made to the common stock RBC factors (currently 20%) for P/C and health insurers. On its January 23 conference call, the working group discussed an analysis of the historic common stock turnover by insurers performed by the NAIC Capital Markets Bureau. The turnover analysis showed that,

for 2012, the common stock holding period for life, P/C (excluding the two largest common stock holders) and health insurers was 1.25 years, 2.33 years and 2.75 years, respectively. A similar analysis for 1992 indicated a holding period for life and P/C insurers was 0.35 years and 0.63 years, respectively. (The 1992 analysis did not include health insurers.)

In general, the working group members noted that a longer holding period, or time horizon, would indicate the need for a higher RBC factor. NAIC staff noted that the current P/C RBC factor for common stock reflects a shorter, rather than longer, holding period than that life insurers. An industry representative pointed out that the holding period for common stocks will vary significantly depending on whether the stock market is rising or falling, and is also dependent on the insurer's capital position.

On its March 14 conference call, the chair of the working group indicated that he is in favor of applying the same common stock factor that was recommended in the Life RBC (30%) to non-AVR companies unless there is valid reason to have a different factor. This would represent a significant increase from the current factor (20%). The chair indicated that this topic will be discussed on subsequent conference calls. The common stock exposure constitutes approximately 8% of P/C assets, excluding the 2 largest stockholders. This total exposure is more significant as compared to life insurers, whose common stock exposure is less than 1% of total assets; thus the impact of any change in the P/C unaffiliated common stock RBC factor will have a greater impact on RBC.

Real Estate Factors

No comments were received during the exposure on the proposed recommendations for changes to the real estate C-1 factors. However, in February the AAA indicated that they have questions on the proposal and indicated they were still finalizing a draft response letter. The working group agreed to defer action on the proposal, pending comments from the AAA. A summary of the proposal is included in the PwC NAIC Fall 2013 Newsletter. The most significant change is a proposed base factor of 8%, compared to the current base factor of 15% which has been in effect since 2000.

Derivatives

On its February 13 conference call, the working group adopted a previously exposed addendum to the approved recommendations for derivative factors contained in the Life Insurer RBC Derivative Report dated March 29, 2013. No comments were received

on the exposed addendum, which was prepared by industry representatives with oversight provided by working group members to further consider the treatment of replications and derivative collateral for over-the-counter centrally cleared derivatives. The addendum concludes that the risks inherent in replications, particularly the RBC treatment of the C-1 charge applied to the cash instrument component, are already sufficiently addressed by the initial report and are addressed by current RBC instructions. With respect to collateral for OTC centrally cleared derivatives, the addendum recommends changes to both the RBC and AVR calculations to align them with the associated risk and transactional changes resulting from Dodd-Frank.

Timeline

The timeline for implementing any new life RBC C-1 factors remains uncertain given the magnitude of work that remains to be completed. The 2015 life RBC calculation appears to be the earliest any changes could be implemented. The working group has not developed a formal work plan with specific target completion dates or deadlines to finalize its considerations.

Operational Risk Subgroup

The subgroup met by conference call on February 25 and March 20. During the earlier call, the subgroup revised its name from Solvency Modernization Initiative RBC Subgroup to Operational Risk Subgroup.

The subgroup heard comments on its December 2013 exposure of an operational risk structure to be effective for the 2014 Life, P/C and Health RBC formulas. Nine comment letters were received; responses included the following:

- Operational risk is already imbedded in the Life, P/C and Health RBC formulas and this proposal would create double-counting.
- It is important to define operational risk and to understand that there might be different dimensions of operational risk across all three business types.
- The factor charge provided as an example in the proposal is too high.
- The subgroup should consider testing the operational risk charge for two years, similar to the catastrophe risk charge.

- The subgroup should consider defining “gross and net premium” as direct plus assumed less ceded to avoid double-counting.
- A closer look should be given to the risk-focused examination as an alternative to creating an additional charge to the RBC. Other analytical NAIC initiatives, such as the ORSA and corporate governance guidance, could also address this risk.

All respondents called for more time for a thorough review and participation by regulators and interested parties to work on this charge in a more measured way.

In response to the comments, the subgroup presented a working definition of operational risk as “the risk of financial loss resulting from operational events such as inadequacy or failure of internal systems, personnel, procedures or controls, as well as external events.” The subgroup also presented a chart of examples of operational risk types with initial thoughts on whether the risk was implicit in current RBC formulas. The subgroup discussed a revised methodology and structural proposal that would be added to the RBC formulas on an informational-only basis for 2014.

The revised proposal uses direct premiums and reserves instead of gross, removes defined factors in the formulas (to be reinserted later when agreed upon), and provides two versions of the life formula, with one version combining life and health and another version splitting the life and health components. Following the discussion, the subgroup exposed the revised structural proposal and operational risk examples until April 14. The proposal would need to be adopted by the subgroup and the Capital Adequacy Task Force by April 30 in order to become part of the 2014 RBC formulas. Modifications to the instructions and risk factors can be adopted as late as June 30.

Property/Casualty Risk-Based Capital Working Group

The working group met by conference call on January 13, held an e-vote on March 5 and 12, and met in Orlando to discuss the following:

Reinsurance Credit Risk Charge

In Orlando, the working group heard updates to a previously exposed Reinsurance Association of America proposal with respect to the R3 charge. Currently, the R3 charge includes a reinsurance credit risk charge of 10% applied to all ceded balances except for recoverables from U.S. affiliates

and mandatory pools. This charge is 4 to 7 times higher than the credit risk factors used by S&P for an A-rated reinsurer, which are based on historical default rates for reinsurance recoverables. The RAA’s proposal outlines a framework for determining the R3 charge consistent with the NAIC’s use of credit ratings and treatment of collateral in the revised credit for reinsurance model. Based on comments received from the AAA and others, the RAA revised its previously exposed methodology to make the framework more risk-based and easier to implement

Under the revised RAA framework, the R3 charge for uncollateralized recoverables is proposed as: 3.6%, 4.1%, 4.8%, 5.3%, 7.1% and 18% for Secure 1 to Vulnerable 6 reinsurer, respectively. The primary effect of the revised proposal is to make the R3 charge risk-based and to allow the charge to be further reduced for collateral while maintaining a minimum charge that consists of an other than credit charge of 3% plus an additional margin for credit risk and a margin for performance of collateral. Following the discussion, the working group exposed the revised RAA proposal until May 13.

ACA Fee Sensitivity Test Proposal

The working group voted to adopt on April 21 the ACA Fee Sensitivity Test for the 2014 P/C formula for those health entities that file a P/C annual statement and are subject to the ACA fee. See further discussion in the Health RBC Working Group summary below.

Underwriting Risk Charge

During the conference call, the working group heard a presentation by the Casualty Actuarial Society RBC Dependency and Calibration Working Party. The presentation highlighted findings regarding calibration of underwriting (premium and reserve) risk in the P/C RBC formula. The CAS discussed the use of various techniques, including more years of data, minor lines filter, size, and pooling adjustment. In Orlando, the AAA informed the task force that it is reviewing the CAS research and will continue to work on its development of a proposal for consideration by the working group to improve the methodology used to estimate underwriting risk.

Catastrophe Risk Subgroup

The subgroup met by conference call on January 23 and March 7, held an e-vote on March 12, and met in Orlando and discussed the following:

2013 Industry RBC Results

In Orlando, the subgroup discussed the 2013 catastrophe risk charge results. The results are based

on submissions from approximately 2,500 companies. The average RBC ratio with and without catastrophe risk charge is 8,241% and 8,374%, respectively. Fourteen companies triggered an action level event as a result of the catastrophe risk charge, either moving from one action level to a more significant level or triggering an ACL for the first time. Other significant findings are that 1,218 companies had zero change in the RBC ratio while 697 companies had negligible change (+/-5%). More companies experienced an increase in the RBC ratio with 696 companies increasing and 547 companies decreasing. The subgroup requested feedback on ways to analyze the data. The RAA suggested taking a weighted average instead of a straight average. One suggestion was to remove companies with no catastrophe exposure from the analysis. Another suggestion was to assess the data by company size. The subgroup intends to continue discussion on this matter based on feedback received.

PRO25 Instructions

During the January 23 conference call, the subgroup discussed comments received on the draft PRO25 instructions for calculating R6 (earthquake) and R7 (hurricane) risk for 2014. The subgroup heard recommendations to modify the wording and definitions used in the instructions for consistency with the attestation and PRO25 footnote, to which the subgroup agreed. The Reinsurance Association of America suggested that the instructions specify any requirements related to model vintage and document the subgroup's determination not to allow adjustments for tax and reinstatement premium. Following the discussion, NAIC staff was asked to revise the instructions. In Orlando, the subgroup exposed a revised draft of PRO25 until April 11.

Catastrophe Event Lists

The subgroup discussed adding 2013 events to the Catastrophe Event Lists and noted that the only event in 2013 to be included is Typhoon Haiyan which struck the Philippines in November 2013. NAIC staff was asked to add this event to the non-U.S. catastrophe event list.

Attestation for Catastrophe Modeling

The task force heard that state insurance departments are still in the process of contacting specific companies which reported R6 and R7 charges for 2013 and requesting completion of the catastrophe modeling attestation. This approach only applies for 2013. In 2014, the attestation will be included in the RBC package. The chair made a request for companies to be as thorough as possible in completing the attestation as the information will be helpful in evaluating the model.

PRO17A Underwriting Risk Factors

During the January 23 conference call, the subgroup discussed the new R6 and R7 charges which are explicit charges intended to replace the prior implicit charge. The RAA commented that it is appropriate for companies that do not have R6 and R7 losses to use the ex-cat, hard-coded line 1 and 4 factors. To avoid confusion, a subgroup member recommended not maintaining both cat and ex-cat sets of factors while another member suggested creating flags for companies that reported no catastrophe experience to enable regulators to check on the accuracy of reporting. The subgroup will discuss this matter again after the factors are re-run in April.

2014-04CR Insurance Subsidiary RBC Charge for Catastrophe Risk Proposal

In a regulator-to-regulator conference call on March 7, the subgroup discussed the timeframe needed for submitting the insurance subsidiaries' RBC charge proposal to the Capital Adequacy Task Force for inclusion in the 2014 P/C RBC formula. The proposal addresses the issue that the RO component in the current P/C RBC formula was not updated to reflect the insurance subsidiary RBC charge including catastrophe risk. The subgroup and the P/C RBC Working Group adopted the proposal in Orlando, which was subsequently adopted by the Capital Adequacy Task Force.

Health Risk-Based Capital Working Group

Since the Fall National Meeting, the working group met by conference call on January 27, March 10 and April 8 to discuss the following:

ACA Fee Sensitivity Test Proposal

During the January 27 conference call, the working group discussed a proposal for the 2014 instructions for the completion of the ACA fee sensitivity test. The test provides a "what-if" scenario for regulators to analyze the impact of the ACA fee on the overall RBC ratio. The test does not change the insurer's RBC ratio. The structure of the sensitivity test had been adopted by the working group on October 23, but final adoption had been deferred until the accounting for the ACA fee had been finalized. Following the discussion, the working group exposed the proposal for comment until February 24. No comments were received and the working group adopted the proposal on March 10.

ACA Risk Sharing Provisions

The working group discussed the treatment of the ACA reinsurance, risk corridor and risk adjustment programs in the health RBC formula. As it relates to the reinsurance program, the working group

reviewed a draft proposal that breaks out the paid and unpaid reinsurance recoverables for non-affiliates and ACA in separate line items, which would allow regulators to identify the ACA-related reinsurance recoverables.

With respect to the risk corridor and risk adjustment programs, the working group discussed a proposal for adding a sensitivity test to identify the impact of the risk adjustment and risk corridor receivables and payables from ACA on total adjusted capital and the impact of misestimation on TAC. On March 10, the working group exposed both proposals, which were adopted on its April 8 conference call. All three proposals were adopted by the Capital Adequacy Task Force and will be effective for 2014 RBC filings.

Underwriting Risk – Experience Fluctuation Risk

During the January 27 conference call, the working group discussed an update to page XR012. The working group had, on September 17, adopted for 2014 a previously exposed proposal to page XR012 - Underwriting Risk - Experience Fluctuation Risk that would break out premiums, incurred claims and underwriting risk claims ratio by individual, small group and large group for informational purposes. This segregation will allow for future analysis of the impact of the ACA on the underwriting risk within the current health RBC formula. The analysis is for informational use only and will not impact the actual RBC and the RBC risk requirement will remain based on total premiums reported on the Analysis of Operations in the annual statement filing.

Based on comments received on the original proposal, the revised proposal introduces a new page XR012-A for reporting the more granular data, as adopted under the original proposal. The reason for incorporating these changes into a new page was to better identify that it is for informational purposes only. A footnote was added to provide leeway for companies if it was overly burdensome to break out the data. A second footnote was added for companies to explain how they define small group.

The working group was asked whether it would be acceptable for companies that cannot match amounts reported on page XR012 to the amounts reported on the Supplemental Health Care Exhibit to allocate the amounts on page XR012-A based on the allocation of the individual, small group and large group plans as reported in the Supplemental Health Care Exhibit and if this should be explained in the footnote. The chair responded that the intent is not to make amounts balance to the penny but to come as close as possible and explain how companies derived data reported in page XR012-A. The working group exposed the revised proposal and received one comment letter. On March 10, after hearing

comments and a discussion of the revisions which were deemed non-substantive, the working group adopted the proposal.

Excessive Growth Charge

On the April 8 conference call, the working group discussed the excessive growth charge and the chair asked for feedback on how states have dealt with start-up companies. There was consensus by working group members not to change the charge but to add clarifying instructions for companies in the first two years of start-up. The working group heard that the Operational Risk Subgroup is studying how to incorporate operational risk into the RBC formulas and excessive growth charge may be a component of operational risk. A working group member stated that a drafting note regarding excessive growth charge had been included in the instructions at the time RBC was created which may be helpful. NAIC staff was asked to review archived documents to locate the drafting note. The working group will continue discussion of this issue in future meetings.

Valuation of Securities Task Force

Structured Notes

At the 2013 Summer National Meeting, the task force charged its Invested Asset Working Group to consider the accounting and reporting treatment for structured notes; the working group held three interim conference calls to address these charges. Structured notes are currently classified as issuer bonds under SSAP 26; however, a subset of structured notes, known as mortgage-referenced securities, are subject to the credit risk of pool of mortgages rather than the credit risk of the bond issuer. At the Fall National Meeting, the task force adopted a proposal from the Invested Asset Working Group to require that mortgage-referenced securities be filed with the SVO.

The working group held three interim conference calls following the Fall National Meeting to further consider the reporting and valuation of mortgage-referenced securities and structured notes in general. Some working group members believe that mortgage-referenced securities would be more appropriately classified as RMBS under SSAP 43R; however, the working group agreed that before considering changes to accounting of valuation, it should first assess the significance of the industry's exposure to structured securities.

On its February 25 conference call, the task force adopted a recommendation from the working group

to request that SAP Working Group and Blanks Working Group revise the disclosure requirements of SSAP 26 to include issue level information with regard to holdings of structured securities within the annual statement blank (Blanks Working Group proposal 2014-06BWG). In Orlando, the task force received a report from the SSG staff regarding research efforts to identify the population of structured notes held by insurance companies. The staff noted that it was difficult to parse through the data, but the preliminary indication is that there are roughly 400 CUSIPs with a value of approximately \$1 billion. The task force noted that difficulty getting accurate information further highlighted the need to gather this information through annual statement disclosures. The SAP Working Group exposed for comment a proposed disclosure for 2014 reporting.

Comprehensive Revisions to the P&P Manual

The task force exposed a proposal which would make substantial revisions to the Purposes and Procedures Manual for a 45-day comment period. The proposed revisions include renaming the Purposes and Procedures Manual of the NAIC Securities Valuation Office to the Purposes and Procedures Manual of the NAIC Investment Analysis Office, to reflect the 2013 formation of the Structured Securities Group as a separate and distinct unit from the SVO. The proposed changes would also add references to SSG and the SSG process throughout the manual as applicable and change the administrative oversight of the SSG and SVO from the Valuation of Securities Task Force to the NAIC Chief Executive Officer. The task force member representing New York, as well as interested parties, raised concerns regarding the proposed change in administrative oversight, foreshadowing what could be lively debate following the exposure period. The task force would continue to approve substantive changes to the P&P Manual. A separate proposal to add a new Part Seven to the P&P Manual detailing the policies and procedures of the SSG was also exposed for a 45-day comment period.

Technical Amendments to the P&P Manual

On its February 25 conference call, the task force discussed and exposed for comment four technical amendments to the SVO P&P Manual. Three of the proposed amendments were intended to resolve conflicts between the P&P Manual and the classification methodology that became effective January 1, 2013. Under this new methodology, the SVO no longer has the authority to reclassify investment securities to reflect additional risk, but instead is only permitted to adjust (or notch) the NAIC designation to reflect the additional risk. Statutory accounting principles dictate the

appropriate classification of investments. The proposed technical amendments include:

Removing the instructions for short-dated non-principal protected notes - The current P&P Manual instructions on short-dated non-principal protected notes require the SVO to treat as equity any instrument where repayment of principal is uncertain. This violates the revised policy and therefore the SVO recommended that it be deleted.

Amending the instructions for catastrophe bonds - The current instructions require the SVO to direct an insurer to report catastrophe bonds as equity if the NAIC Credit Rating Provider methodology is not consistent with the one specified by the NAIC. The SVO recommended that catastrophe bonds be subject to filing exemption on the basis that they are rated by a credit rating provider.

Adding instructions to clarify the process for unrated hybrids securities - Current reporting guidance requires that hybrids be reported as bonds without analytical intervention by the SVO. Most hybrids are subject to the filing exempt rule and therefore few are presented to the SVO; however, a small population is not rated and must be filed with the SVO. The proposal recommends clarifying that unrated hybrid securities shall be reported as bonds, pursuant to NAIC policy, but with an SVO-assigned NAIC designation.

Removing the "expedited review" paragraph in the RTAS instructions - A fourth technical amendment proposed removing the "expedited review" process from the existing Regulatory Treatment Analysis Service (RTAS) instructions. This process, which was intended to provide a shorter turn-around time and a reduced fee for RTAS applications involving the issuance of a security identical to one previously reviewed by the SVO, has created significant confusion. The term has been misunderstood and some have tried to bargain with the SVO for a reduced fee or get a quicker turnaround on other instruments. The SVO does not encounter a lot of issuance of the same type of security in multiple batches; thus, it believes that the provision is no longer necessary.

The exposure period ended March 26 and the proposed technical amendments were adopted as final at the Spring National Meeting. A proposed technical amendment describing the SVO methodology for Principal Protected Notes was deferred based on concerns raised by an interested party with the description of the weighted average

methodology. The SVO will consider whether any changes to the proposal are necessary.

2013 RMBS & CMBS Modeling Observations

SSG staff reported on the 2013 year-end RMBS and CMBS modeling results, indicating that there were no surprises in 2013. SSG observed favorable trends across all RMBS vintages, both from an intrinsic price and expected loss perspective. For CMBS, the typical post-2008 vintages indicated no expected losses; however, the financial modeling for pre-2008 vintages was mixed, with higher-tier tranches improving or remaining unchanged, while lower-tier tranches indicated slightly more expected losses in stress conditions. SSG noted that it is developing new analytical tools which are expected to be available for 2014; additional communication regarding this is expected at the Summer National Meeting.

Securitization Data Quality Working Group

The task force discussed an issue raised by New York regarding the 2013 year-end RMBS modeling whereby the NAIC's SSG concluded that certain RMBS could not be modeled due to a lack of sufficient information. While the SSG provided an explanation for the 2013 modeling, New York noted that questions still remained regarding the process and standards used by SSG to assess data quality. The task force formed the Securitization Data Quality Working Group to consider this issue and develop data quality and documentation standards for RMBS and CMBS modeling. The working group expects to complete its charge, including recommended amendments to the P&P manual, by June 15.

The first meeting of the working group has been scheduled for May 6; the stated purpose of call is to "present information about characteristics of securitizations (and of RMBS and CMBS) that are relevant to fashioning an NAIC data quality standard for the year-end process and for new transactions."

Non-U.S. GAAP Considerations

The SVO informed the task force that it is working with ACLI representatives to study a new set of accounting standards in Canada for private companies. Canadian GAAP ceased to exist in 2011, when the adoption of IFRS became mandatory for public companies; private companies were given the option to adopt IFRS or the new Accounting Standards for Private Enterprises. The SVO will also study the national GAAP of France and the Netherlands. The objective is to determine whether those accounting bases can be used by the SVO to

conduct credit analysis comparable to that performed using financial information presented on the basis of U.S. GAAP or IFRS. This would allow an insurer to file audited financial statements prepared on the relevant national GAAP basis with the SVO when it submitted securities from issuers that do not prepare GAAP or IFRS financial statements for SVO consideration.

NAIC Designation Recalibration Project

The NAIC continues to consider the impact that changes to NAIC designations and designation categories would have on NAIC operations and procedures and state insurance investment-related laws, given the lack of uniformity in the terminology contained within these laws. Although the SVO staff did not elaborate, they observed that 10 states would likely need to modify their existing state laws if the NAIC designations are revised. The NAIC is collaborating with the state attorneys roundtable to further address the potential impacts. The Investment RBC Working Group is currently considering whether to recommend that NAIC designations be expanded for RBC and AVR purposes.

Principles-Based Reserving Implementation Task Force

The task force held conference calls February 6 and March 12, met in-person at the Spring National Meeting and held a conference call April 14 to finish discussion of comment letters received on the Rector captive report. During these meetings, the task force discussed the following issues below.

PBR Implementation

The working group heard a report on the status of states adopting principles-based reserving requirements. As of the Spring National Meeting, the following 9 states have adopted PBR: Arizona, Indiana, Louisiana, Maine, Mississippi, New Hampshire, New Mexico, Rhode Island, and Tennessee; Iowa, Nebraska, Virginia and West Virginia's adoptions are awaiting governors' signatures. Texas has adopted the Revised Standard Nonforfeiture Law, but still needs to adopt the Revised Standard Valuation Law. Sixteen more states plan to introduce legislation in 2014 or 2015, which would represent more than 60% of U.S. direct written premiums. In order for PBR to become effective, the two revised model laws must be adopted by at least 42 jurisdictions representing at least 75% of the U.S. premium. Based on this information, it appears highly unlikely that PBR will be effective prior to 2017.

February 17th Rector Report on Captives

The task force released for comment on February 17 a revised 68 page report from Rector & Associates that provides specific recommendations building on the earlier report released last September. The task force held a conference call March 12 to summarize the report and held a public hearing at the Spring National Meeting to hear comments. At the March 12 call, Mr. Rector summarized the primary recommendations as follows: unless the transaction is exempt (as defined in the report), the direct ceding company would need to hold “hard assets” (i.e. “primary assets”) approximately equal to the PBR-level reserves, hold assets or securities approved by the primary regulator in support of the remainder of the statutory reserves, disclose the assets and securities used to support the reserves, and hold an RBC cushion as required for other business. Mr. Rector said the proposal focuses on the direct (i.e. ceding) insurer and does not recommend revised regulation of captives since new restrictions on those captives would probably move the transactions off-shore.

The report proposes the following effective dates for the new requirements:

- 7/1/14 for newly created financing structures
- 12/31/14 for the new “Disclosure Requirements”
- 1/1/15 for new business ceded to existing financing structures
- 12/31/15 for the new RBC rules

At the March 12 conference call, the New York representative asked about the goal of the task force to eliminate permitted practices with respect to these transactions during the interim period before any revised requirements are effective. Mr. Rector acknowledged that the states do not have to adopt the revised models (until they would become accreditation standards) but that the new disclosure requirements will be part of the annual statement and will therefore be required for all companies. In addition, there may be pressure from rating agencies, regulators and the market to comply.

The task force received 70 pages of comment letters from 18 trade associations, life insurers, insurance departments and one consumer organization on the revised Rector report; the consensus from companies and at least some regulators is that the proposed timeline is too aggressive given the complexity and the level of work that still needs to be done on the proposal. The co-chair of the task force, Superintendent Torti of Rhode Island, responded that the timeline is “not unrealistic” and no changes were made to the proposed effective dates at the Spring National Meeting. There was no discussion of

the proposed effective dates during the April 14 conference call.

Comments from regulators took up most of the remaining meeting time in Orlando, and these remarks fell into three distinct camps. Arizona, Connecticut, Iowa, Kansas, Nebraska, Ohio and Vermont support, to varying degrees, the recommendations in the Rector report with some substantive changes and noting additional work is needed. New York and California support a moratorium on new transactions until new requirements can be developed and implemented. Delaware continues to assert that “economic obligations are being sufficiently reserved for” and that there is no need for new model law.

Other significant issues highlighted in both verbal and written comments in Orlando and on the April 14 call included the following:

- Four comment letters (ACLI, Affordable Life Insurance Alliance, Iowa and Nebraska) objected to the “presumption of hazardous financial condition” in the draft *XXX and AXXX Reinsurance Model Regulation*. Section 7 of the draft states that any ceding insurer that reduces its net retention of reserves for life insurance within the scope of regulation through a reinsurance ceding arrangement “shall be presumed to be in a hazardous financial condition” pursuant to the NAIC Model Regulation to Define Standards and Commissioner’s Authority for Companies Deemed to be in Hazardous Financial Condition unless the specific criteria of the draft regulation are met. The ACLI suggested that the Actuarial Opinion and Model Regulation should be amended to require the appointed actuary to opine on XXX/AXXX captive transactions. There was a lengthy discussion of the use of the AOMR as an alternative during the April 14 call, after which the task force representative from Kansas stated that he endorses this alternative. It was not clear on the call the extent of other regulators’ support for ACLI’s proposal.
- Concerns were expressed about the use of a modified VM-20 basis for reserves. Both the ACLI and the AAA commented that the net premium reserve requirement should be eliminated entirely for the Primary Asset Requirement. The ACLI, AAA and ALIA all indicated that the mortality assumptions and the interest rate scenario generator will need to be modified. The Kansas and Nebraska letters commented that they do not support the use of a modified VM-20 reserve basis; however, letters from Connecticut, Northwestern Mutual Life,

New York Life and USAA are in support of VM-20 as the foundation. At the April 14 conference call, the task force representative from Texas (and chair of LATF) voiced his support for use of VM-20, stating it is “usable in the short-term.”

- Other issues raised by the comment letters related to the scope of the proposed regulation and whether it is too broad, the complexity of developing the related proposed RBC requirement, which assets should qualify as “primary assets” to support PBR reserves, what specific disclosures would be required by ceding companies and whether there should also be new disclosures for the captive companies.

The task force is also considering an interim in-person meeting with all groups which have PBR-related charges, e.g. Life Actuarial Task Force, Life RBC Working Group, and the Reinsurance Task Force. The task force has requested that interested parties submit agenda items by April 21 for a potential interim meeting. No dates or locations have been suggested for this meeting.

FAWG Recommendations

The task force meeting materials included a memo from the Financial Analysis Working Group on recommendations to domiciliary regulators to address company specific concerns regarding the solvency regulatory system related to XXX and AXXX captive transactions. The proposed recommendations are for the review of current and near-term transactions, i.e. prior to the adoption of any new model regulation, and include the following:

- A department life actuary or consulting actuary should determine the reasonableness of the economic reserve calculations, including consideration of the actual experience of the company, stress testing of various assumptions and determining the credibility of experience studies.
- The domiciliary department should ascertain that economic reserves are supported by high quality assets in accordance with state investment laws.
- Five year pro forma financial statements and modeling information of gross statutory reserves, economic reserves and XXX/AXXX reserves should be required and reviewed by the department.
- The domiciliary regulator should consider captive dividend limitations, minimum capital

requirements and available capital within the holding company group.

- Each ceding insurer with a prior transaction should be reviewed by the domiciliary regulator at least annually to verify the initial assumptions used in the initial projections remain reasonable.

This report was also discussed at the Financial Condition Committee but was not exposed for comment.

Small Company Exemption

During its February 6 conference call, the task force discussed a proposal from the ACLI to consider a “small company exemption” to PBR. The “near-complete” proposal looks to reduce PBR implementation effort for a substantial number of companies. The task force co-chairs responded that they are open to the idea and asked the Life Actuarial Task Force to evaluate the idea and make a recommendation to the task force. See the LATF summary for additional discussion of the small company exemption proposals.

PBR Statistical Agent Framework

At its meeting in Orlando, the task force heard a detailed presentation on a proposed Framework to collect life insurance experience data as prescribed by the PBR Valuation Manual, while considering confidentiality, uniformity and efficiency. The proposed framework recommends the establishment of a Life Statistical Agent Working Group to recommend a statistical agent or agents and to oversee the process. The Framework also recommends that 3-5 states be designated to collect data on behalf of all states. The proposed Framework was exposed for comment until May 15.

PBR Review Working Group

The working group was established to coordinate financial analysis, examination, and actuarial review procedures as outlined in the PBR Implementation Plan. The working group established two subgroups to focus on specific areas: the PBR Review Procedures Subgroup will focus on developing review procedures, recommending tools for obtaining and testing data, and identifying other data and reporting needs and the PBR Blanks Reporting Subgroup will focus on potential changes to the annual statement blanks as a result of PBR implementation. During its meeting in Orlando, the working group provided an update on its progress.

Emphasis has been on development of recommended changes to the annual statement

blanks; the working group received a report from the PBR Blanks Reporting Subgroup, including a mock-up of the potential changes. These changes will be formally exposed once instructions are developed to accompany the changes. The proposed changes include additional lines in Exhibit 5, the Analysis of Increase in Reserves (including in the Interest Sensitive Life Insurance Products Report supplement), the Five Year Historical Data section, and introduction of a new supplement currently referred to as the PBR VM-20 Supplement. This supplement has five parts, and includes reporting of reserves and related information by product and specific reserve basis within VM-20 (i.e. Net Premium Reserve, Deterministic Reserve, or Stochastic Reserve), exemption information, smoothing information and PBR interrogatories. Similar changes would also be incorporated into the Life Separate Accounts blank. Another open call will be scheduled to continue discussion of the proposed changes.

Work within the PBR Review Procedures Subgroup had stalled while focus was directed to changes in the annual statement blanks, but this subgroup will now focus on finalizing for exposure proposed changes in examination materials and on developing tools for analysis and exam analysis procedures. Considering that examination procedures go into greater depth but are performed less often, regulators have noted that exam procedures may need to be performed at the initial implementation of PBR.

In Orlando the working group also heard from a member of the PBR Implementation Task Force about activities related to company outreach. Task force members are working with the SOA on a company survey to ascertain companies' preparedness for PBR and to give them ideas of what they should be thinking about. The survey will be split into two phases: 1) a higher-level survey targeted for release in May with results distributed before the Fall National Meeting, and 2) a more technical survey to be conducted in 2015. Other activity is focused on identifying company training needs and modes for education. Also under discussion is a pilot study, similar to the VM-20 and ORSA field studies, to help identify unanticipated issues and communicate resolution of issues.

Corporate Governance Working Group

Corporate Governance Annual Filing Model Regulation

The working group held a conference call March 6 to continue discussion of the draft corporate governance model act, which focused on the ongoing disagreement with respect to the corporate governance guidance manual. Industry continues to object strongly to the concept of a guidance manual because use of a manual would allow changes to be made to the corporate governance filing requirements outside the legislative process that is required for a model law; this position was reiterated in a January 31st comment letter signed by seven major trade associations.

The chair announced that the working group would no longer pursue a standalone guidance manual, but would instead include instructions for filing in a newly developed *Corporate Governance Annual Filing Model Regulation*. New York submitted additions to the model regulation drafted by NAIC staff "to provide more certainty to regulators in receiving information on corporate governance." The additions appear to require much more extensive disclosure of Board of Directors' policies and practices, including describing the following:

- The qualifications, expertise and experience of each board member including integrity, accountability, informed judgment, financial literacy, and high performance standards.
- How the board as a whole possesses all of the following core competencies: 1) accounting or finance, 2) business judgment, 3) industry knowledge, 4) management, 5) leadership, and 6) vision and strategy.
- A clear articulation of director responsibilities including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.
- How the board oversees the conduct of the corporation's business to evaluate whether the business is being properly managed; reviews and, where appropriate, and approves the corporation's financial objectives and major corporate plans and actions. (Five other board level tasks are also proposed which are not excerpted here.)
- Whether the insurer has established, and reviews at least annually, corporate governance principles that address, at a minimum: board

leadership, qualifications for directors, director independence, director responsibilities, the structure and functioning of board committees and, where appropriate, charters for those committees, board access to management and advisers, director compensation, director orientation and continuing education, and management succession.

A trade association representative commented that the new proposal contains prescriptive filing instructions and appears to require insurers to conduct corporate governance in specific ways; the explicit intent of the working group at the outset was not to require this. Other regulators expressed support for New York's proposed additions, and the working group voted to expose the draft model regulation for comment until April 21.

Corporate Governance Annual Disclosure Model Act

At the Spring National Meeting, the working group discussed an updated draft of the model which has been renamed the "annual disclosure model" from the "annual filing model." Proposed amendments were received from interested parties, New York and Pennsylvania, and the working group agreed to nearly all of the changes. The working group did not agree to any size exemption; therefore all insurance entities will be required to file once the models are adopted. An interested party asked whether the corporate governance filings will be required by captives insurers; NAIC staff will research the question and respond at a future meeting. The working group then voted to expose the revised model act for comment until April 21. The chair reiterated her commitment to finish this project in 2014.

Concerns related to "redundant filings" were also discussed in Orlando, i.e. whether the NAIC will eliminate other filings or portions of filings that will be redundant once the corporate governance filings must be made. One regulator responded that provisions related to redundant filings don't belong in this model act and need to be addressed by a separate model. At the meeting of the Governance Review Working Group, the trade association PCI asked that the working group consider an initiative to eliminate redundancy in solvency regulation guidance; the vice chair asked that PCI provide them a listing of redundancies for consideration.

Internal Audit Requirement

At the Fall National Meeting, the working group re-exposed for comment proposed changes to the Model Audit Rule which would require large insurers (greater than \$500 million in annual premium) to maintain an effective internal audit function, with a proposed effective date of January 1, 2016. At the

Spring National Meeting, the working group reviewed changes proposed by Pennsylvania, which were intended for additional clarification. The working group then voted to adopt the revisions; these changes to the *Annual Financial Reporting Model Regulation* were also adopted by the Financial Condition Committee at its subsequent meeting.

ORSA Subgroup

The subgroup held a conference call on January 30 to discuss draft revisions to the ORSA Guidance Manual resulting from the 2013 ORSA Feedback Pilot Project (summarized in PwC's Fall 2013 NAIC Meeting Notes). Proposed revisions include clarification that the foundation of the ORSA Summary Report should be tied to the insurer's reporting to the Board of Directors, clarification for filings of U.S.-only ORSAs by international groups, and clarification for the prospective solvency assessment to include a discussion of prospective risks impacting the capital projections, including a discussion of whether risk exposures are expected to increase or decrease in the future and steps the insurer plans to take that may change its risk exposures. The proposed revisions note that the term "prospective" should pertain to both existing risks likely to intensify and emerging risks with the potential to impact the insurer in the future.

Following the discussion, the subgroup exposed the proposed revisions until March 17. The subgroup has scheduled a conference call for May 2 to consider adoption of proposed revisions to the Guidance Manual.

The subgroup discussed the 2014 ORSA pilot and following the conference call, an invitation was posted to the subgroup's webpage seeking companies' participation in the third ORSA pilot. The deadline for email notification to the insurer's lead or domiciled state is May 1, with submission of the ORSA Summary Report by July 1.

Group Solvency Issues Working Group

The working group met by conference call on March 17 and discussed its 2014 projects:

- Review the *Insurance Holding Company System Regulatory Act (#440)* and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450)* and consider amendments to address issues that have arisen subsequent to the adoption of the

2010 amendments to the model act and regulation.

- Consider potential changes to existing regulatory guidance regarding supervisory colleges including development of required procedures for state regulators to use when leading and participating in supervisory colleges.

Private Equity Issues Working Group

FAWG Possible Best Practices

At the Fall National Meeting, the working group heard a presentation from a private equity firm, Athene Holding Ltd., and discussed Athene's comment letter response on proposed best practices for regulators to consider in their review of potential acquisitions of life insurers by private equity companies and hedge fund managers. The suggested best practices document had been developed by the Financial Analysis Working Group, and was re-exposed by the working group in December as only one comment letter had been received.

At the Spring National Meeting, the chair reported that no comment letters were received during the second comment period and that the working group did outreach efforts to private equity companies and got no volunteers to speak in Orlando. Therefore, the working group has concluded it needs to "move forward and develop best practices" without additional input from private equity firms. However, any proposed guidance wouldn't just apply to private equity firms since the NAIC wants a level playing field. The working group then directed NAIC staff to develop a new section to the NAIC Financial Analysis Handbook for the review of Form A change in control applications, which will be discussed at a future meeting.

Industry Analysis

The chair asked NAIC staff to perform an analysis on private equity-owned insurers compared to the insurance industry as a whole. He suggested that this should be a risk-based approach, rather than narrowed to private equity firms alone and that the intent of this analysis is not to frustrate private equity and discourage investment, but to focus on the potential risks that insurers may be exposed to by such an investment. The working group adopted a motion to pursue this analysis.

Next Steps

The chair expressed his goal that the group's work be completed by year-end 2014.

International Insurance Relations Committee

Activities of the International Association of Insurance Supervisors

The committee met by conference call in January and March, and discussed the NAIC comments on the IAIS proposal for the development of the basic capital requirement (BCR) for globally systemically important insurers (G-SIIs). The proposed NAIC comments were approved and submitted to the IAIS. See the ComFrame Working Group summary below for a discussion of the IAIS' ComFrame project.

Group Supervision

During the March call, the chair reported that the Executive Committee discussed the growing prominence of international group supervision. The Committee discussed the need to consider enhancements to the *Model Holding Company Act* to include more direct authority to act as the lead supervisor for a group, looking at issues at the holding company level and considering a consolidated reporting requirement for internationally active groups. Based on these discussions, a new group was formed, the ComFrame Development and Analysis Working Group to review and provide input to the IAIS Common Framework for the Supervision of IAIGs as well as international group capital developments. See below for a summary of that meeting in Orlando.

ComFrame Development and Analysis Working Group

The working group held its inaugural meeting in Orlando to discuss the development of the International Association of Insurance Supervisors Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). A charge of the working group is to facilitate the input and participation of U.S. insurance regulators in the IAIS field testing processes. In connection with this, the working group heard a presentation by representatives from the IAIS.

The IAIS representatives provided an overview of the development phase of ComFrame and the ComFrame modules which began in 2010 and is near completion as the IAIS completes review of the more than 400 pages of comments received. The IAIS established a Field Testing Task Force in 2013; field testing for Module 1 (which comprises identifying internationally active insurance groups, scope of supervision, and identifying group-wide

supervisor) was launched in October 2013 with the analysis to be completed by June 2014.

Quantitative field testing which covers Basic Capital Requirements (BCR) began recently. Field testing will explore three basic balance sheet valuation methods, including those used in the IAIG's own economic capital model on a consolidated group-wide basis, on an insurance legal entity basis, as well as a total balance sheet approach, using GAAP along with components of the balance sheet prepared on an adjusted basis and submitted separately. In that last approach, invested assets would use fair value measurement. Field testing will involve enough stress in order to test the sensitivity of balance sheets to risk. The stress test is not intended to be specific to particular insurers or jurisdictions. Its only purpose is to assess comparability and risk sensitivity of different valuation approaches.

The IAIS representatives summarized the timeline for ComFrame and informed the working group that the IAIS released its first consultation paper on BCR in December 2013. Development of Higher Loss Absorbency requirements, which is derived from the results of BCR, will occur in 2015, followed by development of Global Insurance Capital Standard in 2016 and adoption of ComFrame in 2018. With the first quantitative field testing under way, subsequent iterations of field testing will be conducted in the second quarter of 2015 through 2018. Qualitative field testing is expected to commence in October 2014, after the IAIS Technical Committee approves the revised draft of ComFrame. Future exposures will involve a consultation for ICS at the end of 2014 and comprehensive ComFrame consultations in 2015 and 2017, scheduled to be implemented in 2019.

Financial Stability Task Force

The chair opened the meeting by discussing how this task force was created less than a year ago, and is a forum to consider issues relating to the impact of the SIFI designation on state regulators. He also discussed the IAIS' work on the development of capital standards (summarized in the ComFrame Working Group above.) He noted that it is unclear how the global insurance capital standard will interact with BCR. He suggested that this task force monitor the progress of the development of these global capital requirements, and how they might interact with the RBC requirements.

Non-bank, Non-insurer (NBNI) Designation Process
The task force discussed a consultative document by the Financial Stability Board, "Assessment Methodologies for Identifying Non-bank Non-

Insurer Global Systemically Important Financial Institutions (G-SIFI)" dated January 8, 2014. One question is whether NBNI subsidiaries of insurers could be designated as G-SIFI independent of the Basel Committee on Banking Supervision's designation. Comments were due on April 7.

Group Capital Proposal

A representative of the North American CRO Council discussed concerns over the IAIS group capital proposal. The CRO Council's main concern is the lack of clarity in the proposal of whether the capital standard is aimed at a minimum capital requirement, or an amount in excess of a minimum, targeting an operating capital level. Additional concerns were raised as to whether jurisdictional capital requirements would be preserved, and the risk that group capital assessment may pull capital from one legal entity to another, potentially leaving individual entities weaker.

International Regulatory Cooperation Working Group

Among its charges, the working group promotes the use of U.S. regulatory practices around the world. In addition to discussing various international training programs being held in 2014, the working group learned that the NAIC and the Financial Services Agency of Japan issued a joint statement regarding their alliance, which commits both parties to work together in the future.

Subsequent to this meeting, the United Arab Emirates requested that the NAIC join a collaborative effort with their country, which was unanimously approved. The chair mentioned that many insurers consider this a priority market. The NAIC also hopes to negotiate a Memorandum of Understanding with the United Arab Emirates Insurance Authority.

Receivership Reinsurance Recoverables Working Group

The working group discussed comments received on its previously exposed Model Guideline for Payment of Interest on Overdue Reinsurance Recoverables. The guideline is intended to be used by states that want to permit a receiver to collect interest on overdue reinsurance recoverables on valid claims. It would add a financial cost for reinsurers that elect to "slowpay" without a valid business reason. The working group plans to draft additional language for the drafting note within the guideline to more clearly explain the intent. Following an additional exposure

period, the working group is expected to adopt the guideline at the Summer National Meeting.

Reinsurance Task Force

The task force discussed the following topics in Orlando.

2014 Priorities

The chair began the meeting by summarizing the task force's top priorities for 2014: 1) on-going work to implement collateral reductions through modernization efforts, 2) re-examination of collateral requirements, 3) development of Part B accreditation standards related to certified reinsurers; and 4) recommendations regarding captives. Including the discussions at this meeting, the task force has made progress on all these projects except the last item. The chair noted that the task force needs to continue monitoring developments of the PBR Implementation Task Force before making any recommendations.

The chair briefly referred to the FIO recommendation on covered agreements with foreign authorities for reinsurance collateral requirements. He noted that there many questions that need to be addressed with respect to this recommendation, but that the NAIC and the states "do not see the necessity of a covered agreement at this time."

Reinsurance Modernization Implementation

The task force received an update on the adoption of the revised credit for reinsurance models by the states, noting that one new state adopted the models since December, bringing the total to 19 states, which represents more than 50% of U.S. direct premium. Nine additional states have confirmed that they plan to adopt the models in 2014 or 2015, which would bring the total to 80% of U.S. premiums.

With respect to the certification of reinsurers, NAIC staff reported that 30 reinsurers have now been certified by eight states to hold reduced collateral, and additional reinsurers are being currently reviewed. An interested party suggested that the NAIC provide a list of certified reinsurers in each state; the chair replied that the credit for reinsurance statutes require each state to publish a list of its certified reinsurers along with notice of any applications received.

Report of Qualified Jurisdiction Working Group

The working group held a regulator-only meeting March 11 and reported in Orlando that they are beginning the full reviews of the four supervisory authorities (Bermuda, Germany, Switzerland and the

UK) approved as conditionally qualified jurisdictions at the end of 2013. The chair reported that the French insurance regulatory authority (ACPR) has accepted an invitation to participate in the NAIC review process.

Report of Reinsurance FAWG

The Reinsurance Financial Analysis Working Group met twice in March to develop a Uniform Application Checklist for Certified Reinsurers for states to use to ensure that a reinsurer's initial application is complete and is based on the requirements of the Credit for Reinsurance Model Law and Model Regulation. The checklist is also intended to provide "clarity and consistency with respect to the "passporting" application process" for those reinsurers that have already been certified in an NAIC-accredited state. The task force voted to expose the 7-page checklist for comment for 30 days.

Part B Accreditation Standards

The task force discussed developing Part B standards for states' processes for certifying reinsurers and approving qualified jurisdictions, and then directed staff to coordinate with the Qualified Jurisdiction and Reinsurance Financial Analysis Working Groups to develop initial recommendations for the task force to consider.

Re-examination of Collateral Amounts

As part of the NAIC's commitment to re-examine the collateral amounts required by the Credit for Reinsurance Model Law and Model Regulation, the task force is considering a survey to regulators and interested parties to gather thoughts on the collateral amounts and other aspects of the models revised in 2011. The chair directed staff to develop a brief survey which he hopes to discuss at the Summer National Meeting.

Blanks Working Group

At the Spring National Meeting, the working group adopted four blanks proposals as final; all adopted proposals are effective for 2014 annual statement reporting. The adopted proposals include:

- Modifying the Supplemental Compensation Exhibit and adding instructions to facilitate the collection of additional detail on the nature of compensation paid to top executives and directors (2013-20BWG). This proposal was deferred in 2013 to allow input from the Corporate Governance Working Group, but was adopted without modification. The disclosure will be based on paid amounts versus accrued amounts.

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

The working group deferred a blanks proposal to add additional lines for commercial mortgage loans to the AVR Default Component and Equity and Other Invested Assets Component blanks pages and modify the related instructions. This proposal would implement the AVR treatment for commercial mortgages that is consistent with the methodology used for life RBC (2013-27BWG). The proposal was deferred as numerous changes are needed to line item references, which will be updated and considered for adoption on the working group's June conference call.

Fifteen blanks proposals were exposed for a public comment period which ends May 8. These proposals will be considered during the working group's June conference call. The proposals include the following and would:

- Amend the Schedule P instructions to clarify when restatement of historical data is needed as a result of a change in pooling percentage (2014-01BWG).
- Add a column and instructions to Schedule S, Part 3 for Type of Business Ceded and update column references in the instructions for Schedule S, Parts 4, 5 and 6 for the column additions in Schedule S, Part 3. A question would also be added to the General Interrogatories, Part 2 to capture information about captive affiliates reported as authorized reinsurers (2014-03BWG).
- Add a new disclosure to Note 5, Investments for Structured Notes in accordance with changes to SSAP 26. The illustration for the new note will be data captured (2014-06BWG).
- Modify/add instructions and illustrations for disclosures related to the Affordable Care Act (2014-07BWG) and (2014-12BWG).
- Modify the definition of contingent deferred annuities in the instructions for the Exhibit 5 Interrogatories (2014-09BWG).
- Modify the instructions and illustration for Note 12 to reflect new SSAP 102 disclosures related to multiemployer plans (2014-10BWG).

- Amend the Actuarial Opinion annual statement blanks instructions for the Life and Fraternal annual statements. These changes result in requirements for appointed actuary reporting that is similar to that currently in the Health and P/C Actuarial Opinion instructions, which stipulate that the appointed actuary report to the board of directors or audit committee (2014-13BWG).
- Add a new supplement with details of reinsurers aggregated on Schedule F and make conforming modifications to the existing instructions. A disclosure Note 23J would also be added (2014-15BWG). This proposed change reflects a compromise adopted by the SAP Working Group that will allow companies to aggregate asbestos and pollution reinsurers on Schedule F, Part 3 if certain criteria identified in SSAP 62R are met, while still allowing regulators access to the underlying detail through the addition of a new supplement.

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

The working group also received a memorandum from the SAP Working Group directing the Blanks Working Group to post 2014 quarterly guidance to its webpage for the newly adopted disclosures related to the risk sharing provisions of the Affordable Care Act (2014-12BWG). This provides guidance for the quarterly disclosure adopted during the Spring National Meeting by the SAP Working Group.

Investment Reporting Subgroup

The subgroup has held four conference calls this spring to consider ten investment reporting issues, which may result in formal blanks proposals, including possible changes to Schedule BA and the derivatives schedules. The subgroup plans to hold additional conference calls over the next several months.

Unclaimed Life Insurance Benefits Working Group

In December 2013, the Life Insurance and Annuities Committee adopted, after some contentious debate, the following charge for 2014: "the Committee should undertake a study to determine if recommendations should be made to address unclaimed death benefits." During a conference call

in March, the committee formed the Unclaimed Life Insurance Benefits Working Group. The working group is chaired by Tennessee and vice-chaired by Iowa. Eight of the nine states on the Investigations of Life Insurance and Annuity Claims Settlement Practices Task Force are members of the working group along with five other states (MN, NE, RI, TN, and WI).

The working group first heard a summary of the work by the Investigations Task Force which noted that six lead states have settled multi-state market conduct examinations of the 40 largest life insurers, which represent 60% of the industry. The focus of the examinations was “asymmetric use” of the U.S. Social Security Death Master File whereby insurers used the DMF for discontinuing annuity payments to deceased policyholders and for fraud prevention, but not to identify deceased life insurance policyholders to pay death benefits. Through the work of the insurance regulators and state controllers, more than \$1 billion has been paid to beneficiaries and \$1.3 billion to the states, which will continue to search for beneficiaries.

There was a lengthy discussion of the exact definition of “asymmetric use” of the DMF, whether the working group should develop a uniform standard to address this practice, and whether all companies should be required to use the DMF to search for beneficiaries even if they have not used the DMF at all in the past. Discussion of this issue is sure to continue at future meetings.

The working group then heard testimony from various interested parties; their comments included the following:

- The ACLI and the Center for Insurance Research suggested that the working group review and consider using the National Conference of Insurance Legislators’ (NCOIL) Model Unclaimed Life Insurance Benefits as a starting point for developing a uniform standard. Nine states have adopted legislation based on the NCOIL model.
- Several parties referred to state “lost life insurance policy service programs,” which help consumers find lost policies. The ACLI suggested that the working group consider development of a uniform national lost program.
- Two trade associations (National Alliance of Life Companies and Life Insurers Council) stated that they would object to any retroactive requirement to use the DMF to search for beneficiaries, especially if a life insurer had not used the DMF in the past. An Iowa regulator

responded that the working group could consider requiring insurers to certify that they do not use the DMF in the normal course of business; the working group should also consider developing a process to require insurers to make a reasonable effort to locate beneficiaries.

Next Steps

The co-chair stated his belief that the working group needs more information before making any recommendations, including a better understanding of the use of the DMF by small insurers. The co-chair suggested that an interim meeting before the Summer National Meeting might be helpful. The chair noted that the working group’s recommendation to the Life Insurance and Annuities Committee could be one of the following: 1) a determination that current state laws and practices are sufficient to address unclaimed benefits, 2) a new NAIC model law, regulation or guidance should be developed or 3) something in between the first two conclusions.

Life Actuarial Task Force

During the day and a half dedicated to the meeting, task force representatives focused on issues related to the Principle-Based Reserve Valuation Manual (VM). In addition, the task force received reports and updates from other NAIC subgroups, industry groups or task force members on a variety of other topics. Highlights of these sessions are summarized below.

PBR Valuation Manual and Related Issues Valuation Manual Amendments

During interim conference calls, LATF adopted the updated Valuation Manual investment spread tables that had been exposed for comment at the Fall National Meeting. Interim discussions also addressed proposed clarifications to the amendment to exempt industrial life business from PBR requirements and for a direct iteration method for calculating the deterministic reserve. The direct iteration method is an option that defines the deterministic reserve as the amount of starting assets that are sufficient to provide for future cash flow projections and result in a zero balance at the end of the projection period. These proposed amendments were exposed during the interim period and were adopted in Orlando into the “working” copy of the Valuation Manual that LATF expects the full NAIC to adopt sometime prior to the effective date of PBR.

Amendment proposals previously exposed and still under discussion include clarifications regarding

treatment of due premiums in expected future cash flows when calculating deterministic and stochastic reserves and a change in the way the pre-tax interest maintenance reserve is reflected in the deterministic reserve. Discussion of these proposals will continue during interim conference calls.

A significant portion of the discussion on Valuation Manual amendments focused on three ACLI amendment proposals related to small company considerations. These proposed amendments include a definition of a small company as measured by ordinary life premium volume, RBC ratio and the absence of universal life products with secondary guarantees that do not meet the definition of a “non-material” secondary guarantee. This concept is intended to minimize the need to calculate deterministic reserves for products expected to operate primarily on the base guarantee.

Another proposed amendment clarifies that asset adequacy models may be used for the stochastic exclusion ratio test (SERT) and raises the SERT threshold to 6%. The third proposal clarifies that the net premium reserve is applicable to basic reserves and not deficiency reserves. LATF voted to expose these proposed amendments for a period of 45 days.

Actuarial Certification/Education for PBR

The PBR Implementation Plan includes a specific charge for LATF to “determine whether specific continuing education requirements should be established for PBR actuaries and whether those should be regulatory requirements or actuarial professional requirements.” The American Academy of Actuaries Committee on Qualifications (COQ) was asked to assist LATF in addressing this item, and the committee chair provided an update on this topic.

After considering the issue the COQ concluded that the skills required for PBR are the same as those currently performed for cash flow testing and RBC work, and that there are multiple certification and qualification requirements already in place that will automatically cover PBR such that no additional certification requirements are recommended. The COQ will prepare a discussion paper to address the application of professionalism and qualification requirements in a PBR framework and will recommend a list of topics that actuaries working on PBR should include in their experience and education requirements. The AAA also noted the need for professional organizations such as the AAA and SOA to train regulators in the review of PBR materials, to ensure reviewers have a sufficient level of understanding. LATF members appeared to support the COQ conclusions and proposed next steps and requested that the COQ provide status

updates at future meetings and a formal recommendation by the end of 2014.

Actuarial Opinion Instructions

In response to a referral from the Corporate Governance Working Group to incorporate a requirement for life insurers’ appointed actuaries to present the full actuarial report to the board of directors on an annual basis, consistent with the requirements for appointed actuaries of health and property/casualty entities, LATF approved proposed edits to the actuarial opinion instructions in the life blank and referred the proposed edits to the Blanks Working Group for adoption. The proposed edits require the appointed actuary to annually report to the board of directors or audit committee on items within the scope of the actuarial opinion, but does not prescribe the form of the report.

Actuarial Guideline XXXIII (AG 33)

LATF heard a presentation from the AAA’s AG33 Non-Elective Task Force on proposed changes to AG33 to address potential reserve issues related to treatment of non-elective non-mortality benefits that can be more valuable than the contract’s accumulation value. An example of such benefits is waiver of surrender charges for specified contingent events such as confinement to a nursing home, disability, or diagnosis of a terminal illness. The issue is that reserves may be understated when incidence rates are applied after the surrender charge period or after the account value is depleted but elective benefits (i.e. Guaranteed Lifetime Income Benefits) are still available. The proposed changes effectively limit the application of incidence rates after the surrender charge period or when the cash value drops to zero. LATF voted to expose the proposed changes for a period of 45 days.

VM-22 Fixed Annuity PBR

LATF received a report from the VM-22 Subgroup on the Kansas Insurance Department Field Test of the PBR methodology for non-variable annuities proposed by the Academy Annuity Reserve Work Group (ARWG). The proposed methodology sets the reserve equal to the greater of a “Floor Reserve” and a “Modeled Reserve,” where the floor reserve is expected to generate results comparable to current CARVM requirements while the modeled reserve is scenario-based. The floor reserve introduces the concept of “Listed Benefits” for purposes of qualifying additional benefits (e.g. GLIBs, annuitizations) for consideration in the valuation. Floor reserves would be defined as the greater of the cash value, reserves excluding listed benefits (alpha) and reserves including listed benefits (beta). The modeled reserve reflects the risks inherent in

different product designs and includes a best estimate reserve plus an aggregate margin.

The objectives of the Kansas field test are to help establish parameters for and simplify the Beta calculations, compare the resulting reserves with account values, CARVM and AG43 Standard Scenario reserves, test the practicality of the modeled reserve and ultimately provide sufficient information to support consensus on the appropriate level of “right-sized” reserves for non-variable annuities.

Initial test results indicate that the VM-22 floor reserve is approximately 97% of the CARVM reserve currently. Sensitivity testing indicates beta calculations adjust to relative plan richness, reserves for qualified policies are greater than those for non-qualified, and that joint life benefits tend to be richer than single life benefits. Next steps include examination of the shift in CARVM, Alpha and Beta reserve paths over time, more sensitivity testing and testing of the modeled reserve calculations. Updates will be provided in future conference calls.

Valuation Mortality Tables

LATF received a report from the Society of Actuaries & Academy Joint Project Oversight Group on the status of work related to development of a 2014 Valuation Basic Table, a 2014 Commissioners Standard Ordinary table and considerations relative to margins in Prudent Estimate Mortality under VM-20 (PBR margins). The 2014 VBT gender distinct and smoker status tables have been developed and final adjustments to older-age select rates and for post-level term experience are targeted for completion by the end of April. Adjustments for changes in the mix of business since the underlying experience data was submitted and mortality improvement from the experience dates to 2014 will be determined in the next several months, along with the development of the relative risk tables targeted for completion in August.

Considerations for the CSO table include margins to be used for purposes of developing net premium reserves, tax reserves, nonforfeiture values, IRS values and caps for universal life cost of insurance charges. The group is also considering whether margins can be lower in a PBR environment since (1) mortality assumptions will be regularly updated, (2) the volume of experience is greater now than in prior studies, (3) the lack of future mortality improvement in the reserves is an implicit margin, and, (4) the minimum reserve floor provides another layer of

conservatism due to the additional deterministic and stochastic reserve requirements.

With regard to PBR margin development, evaluation of margins appropriate for gross premium or principles-based reserves is pending a decision regarding aggregate or individual margins on assumptions in VM-20. If individual margins are required, then the margins currently within VM-20 need to be updated based on the 2014 VBT table and credibility considerations related to the underlying company data. LATF will schedule a conference call in April to continue the discussion of PBR margins.

Nonforfeiture Modernization

LATF received a brief update from the Academy Nonforfeiture Modernization Working Group (NFMWG), which is currently focused on nonforfeiture considerations for guaranteed lifetime withdrawal benefits for fixed (non-variable) deferred annuities. At the Fall National Meeting, the NFMWG presented a proposed approach to establishing nonforfeiture benefits for GLWBs that would essentially provide a reduced paid-up deferred life annuity benefit. Three approaches were suggested for quantifying this benefit as equal to the present value of future GLWB benefits, the present value of future GLWB fees, or the accumulated value of GLWB fees. The working group developed a worksheet to illustrate the determination of the GLWB nonforfeiture benefit under the proposed approaches and discussed the approaches with LATF members during an interim conference call. Next steps for the working group include defining the approach for variable deferred annuities and contingent deferred annuities, and providing guidance relative to the Guaranteed Nonforfeiture Basis factors for interest accumulation, discount rates and mortality that would be applied under the proposed approaches.

Experience Reporting

The recent focus of this subgroup has been on collection of expense data. At the Fall National Meeting, LATF exposed for comment an expense data collection report proposed by the Medical Information Bureau, which recommended that ten additional policyholder behavior data items (e.g., premium payment behaviors) be collected to calculate the Total Expense Units to facilitate unit expense comparisons.

In Orlando, the ACLI presented points outlined in its comment letter opposing mandatory expense reporting, citing lack of homogeneity in expenses between companies, relevant data at the company

level on which to base expense assumptions, absence of a need for prescribed expense assumptions since companies exercise direct control and influence over expenses, and evidence suggesting that expenses do not materially impact PBR results. The ACLI recommended a review of current annual statement reporting (Exhibit 2) to determine if more relevant information can be provided through that process, as well as review of the actuarial memorandum, VM-31 documentation and other guidance to determine if enhancements are needed for validation of modeled expenses.

The subgroup of regulators asserted that collection of expense data will help in their review of cash flow testing results currently and eventually PBR results, and could provide benchmark unit expenses for popular products. One LATF member concurred with the ACLI position and questioned whether the subgroup was appropriately focused on expenses and requested that the subgroup collaborate with all stakeholders (e.g. MIB, ACLI, SOA, NAIC) to develop a plan for future experience studies considering possible PBR implementation in 2017. The subgroup will schedule a conference call to discuss the matter at greater length.

Actuarial Opinion and Memorandum Regulation Communication Group

LATF heard a report from the AAA Actuarial Opinion and Memorandum Regulation Communication Group. This discussion group is focused on improving communication between regulatory actuaries and appointed actuaries of key issues covered in the actuarial memorandum. Three distinct subgroups including both regulatory and company actuaries were formed to discuss consolidation and standardization of AOMs, communication of assumptions and enhanced Regulatory Asset Adequacy Issues Summary, and addition of links in the AOMs for key issues. The AAA group released its report "Improving the Communication of Issues within the Appointed Actuary's Memorandum" in March, and in this session presented it to the NAIC for further discussion and perhaps additional action in regulating formats to facilitate rapid retrieval of important information.

Indexed UL Illustration Guidance

A representative of the ACLI presented a draft actuarial guideline for application of the Life Insurance Illustrations Model Regulation to indexed universal life (IUL) contract illustrations. During an interim conference call, the ACLI noted that there is a wide range of practices in the area of policy

illustrations, particularly for indexed universal life contracts, and this guideline is intended to provide more uniform and consistent interpretation of the regulation as it applies to IUL products.

The draft guideline establishes a cap on the illustrated crediting rate based on the average index performance over a twenty-five year look-back period, asserting that this length of time is necessary to demonstrate a full economic cycle. The guideline also proposes that the illustration include a table or chart showing the rate that would be credited in each of the past twenty years based on that index. The proposed effective date is July 1, 2015. Discussion noted that the guidance currently does not reflect participation rates, caps and floors, and does not require any demonstration of results under alternative indexing strategies. LATF members and the ACLI recognized that the draft is a work in progress, and the ACLI will modify the draft guideline to reflect LATF members' comments. LATF voted to expose the draft for a period of 45 days in the meantime, noting that proposed revisions based on initial LATF feedback will be forthcoming.

Indexed-Linked Variable Annuity Subgroup

This subgroup is charged with providing recommendations to LATF regarding the applicability of the NAIC variable annuity regulatory framework to separate account index-linked products filed as variable annuities. During the interim period, the subgroup held one closed call and three open calls to discuss this matter. The subgroup released a summary document in January describing the product and regulatory concerns, and identified five specific discussion points for the subgroup and interested parties. Both the ACLI and Committee of Annuity Insurers have provided input to the discussions, which are focused on the applicability of the *Variable Annuity Model Regulation*, the *Modified Guaranteed Annuity Model Regulation* or a hybrid of these regulations. Interested parties appear to favor application of the VA Model Regulation, while some subgroup members favor a modified VA approach. Responses to the discussion points in the summary document will be discussed on future conference calls, and interested parties are asked to address these discussion points when providing comments.

Contingent Deferred Annuity Subgroup

See the summary of CDA Working Group for discussion of the subgroup's deliberations on CDAs.

Joint Qualified Actuary Subgroup

This subgroup has been working for some time on developing recommendations on (1) a uniform definition of “qualified actuary” for life, health and P/C Appointed Actuaries signing prescribed Statements of Actuarial Opinion, identifying any differences that should remain between lines of business and a uniform definition of “qualified actuary” for other regulatory areas (e.g. rate filings, hearings), and (2) a definition of inappropriate or unprofessional actuarial work and a process for regulatory and/or professional organizations’ actions.

During its February meeting the subgroup adopted a uniform definition of “qualified actuary” which requires membership in the Society of Actuaries (for life and health actuaries) or the Casualty Actuarial Society (for property/casualty actuaries) or that the signing actuary be a member of the AAA who has been approved as qualified for signing statutory opinions relating to reserves and any other actuarial items by the AAA. The subgroup delivered to LATF, HATF and the CASTF a report containing the specific definitions applicable to each practice area, which was received by each task force at the Spring National Meeting. Receipt of the report does not signify adoption of the proposed definition, and the task forces will coordinate together to discuss the proposed definitions.

A key element of the proposed uniform definitions is a requirement that qualified actuaries who are not members of the SOA or CAS be members of the AAA and approved [certified] by the AAA as “qualified.” Discussions among the three task forces and the AAA are underway to address this item. Topics of discussion include potential aspects of an AAA “validation and verification” process, the timing of such process, regulator expectations for qualification requirements and the extent of documentation required by either the AAA or regulators. The AAA confirmed its commitment to provide the necessary approval should the definition be adopted, and the matter will be discussed on an interim conference call.

Emerging Actuarial Issues Working Group

The working group was formed by the NAIC to address implementation issues resulting from the revision to AG 38 for universal life products with secondary guarantees. At the Spring National Meeting, the working group discussed comments on

previously exposed interpretations and voted to expose the interpretation for one question. Issues discussed included the basis for determining the pre-funding ratio and the appropriate interest rate credited to the shadow account, and the basis for establishing the starting asset portfolio rate for purposes of calculating the gross premium reserve. No conclusions were reached and discussion of the matters will be continued on a future conference call. The working group voted to expose for 45 days an interpretation confirming the basis for calculating the gross deterministic reserve established pursuant to AG38 Section 8D and the corresponding reinsurance reserve credit. Submitted questions, exposed responses and adopted interpretations are available on the working group’s webpage.

Health Actuarial Task Force

Long-Term Care

The Long-Term Care Pricing Subgroup reported progress on its charges to the LTC Model Act and LTC Model Regulation for appropriate long-term care insurance rates, rating practices and rate changes. Following the Fall National Meeting, the subgroup held several conference calls to address matters related to benefit reductions in lieu of rate increases, loss ratios and margins. The subgroup recommended further revisions to the LTC Model Regulation to address these issues, which were adopted by both the LTC Actuarial Working Group and HATF and will now be considered by the Senior Issues Task Force.

The Long-Term Care Valuation Subgroup of the LTC Actuarial Working Group reported on continued discussion of LTC valuation issues pertaining to contract reserves, claim reserves and premium deficiency reserves. The subgroup held an interim conference call to discuss ACLI comments on the subgroup’s proposed new premium deficiency reserve definition and at this session discussed the potential need to revise tabular reserve standards to reflect lower mortality and lapse experience since the model regulation was established. The subgroup will continue to discuss these matters on future conference calls.

The LTC Actuarial Working Group received a status report from the Academy’s State LTC Principle-Based Work Group. The work group is developing and testing a model to examine the impact of stochastic analysis under a principles-based approach to LTC reserve valuation. Key assumptions to be considered in a PBR framework are morbidity,

mortality, lapse, expenses and interest, but experience studies are needed to establish the basis for assumptions and work has been stalled due to lack of Academy resources. In addition, it was noted that with fewer companies in the LTC marketplace currently there may be less value in a PBR methodology that is only applicable to future business. Initial work indicates that deterministic and stochastic reserve levels are similar, providing some comfort on the adequacy of current reserves. Work on this matter will continue as resources allow.

The Academy Long-Term Care Terminations Work Group reported on its work to provide analysis of LTC termination, voluntary lapse and mortality experience. The work group is evaluating SOA LTC experience study data from 2004-2006 and has identified challenges in separating terminations from lapse versus mortality, resulting from underreported deaths (i.e. deaths are not reported for active lives). The work group anticipates setting mortality based on a current annuity mortality table and backing into the lapse component. A report is expected by the end of 2014.

Contingent Deferred Annuity Working Group

The CDA Working Group met via conference call in March and at the Spring National Meeting to continue its consideration of several projects with respect to the regulation of contingent deferred annuities.

As discussed in the Executive Committee and Plenary summary, the NAIC approved the working group's request to consider revisions to the *Annuity Disclosure Model Regulation*, the *Suitability in Annuity Transactions Model Regulation*, the *Advertisements of Life Insurance and Annuities Model Regulation*, and the *Life Insurance and Annuities Replacement Model Regulation* to specifically address the applicability to CDAs. In Orlando, the working group discussed draft revisions to these model regulations and exposed them for a three-week comment period. The working group expects to vote on the proposed revisions to the NAIC model regulations applicable to CDAs at the Summer National Meeting, with adoption by the Life and Annuities Committee planned for Fall National Meeting.

The CDA Working Group also serves as the coordinating body for the NAIC technical groups with projects related to CDAs. The working group

received updates on the progress of other NAIC groups with regard to their work on CDAs; each NAIC group expects to complete these charges by the Summer National Meeting.

Life Actuarial Task Force – The task force formed a CDA Subgroup, which is evaluating Actuarial Guideline 43 to determine whether the reserve guidance as it applies for variable annuity guarantees is deficient or inappropriate when applied to CDAs. On its February 19 conference call, the subgroup exposed proposed revisions to the *Standard Nonforfeiture Law for Individual Deferred Annuities* to specifically exclude CDAs from the scope of the model. The proposal also included a suggested definition of CDAs (previously adopted by the Life Insurance Committee) for inclusion in SSAP 50, Definition of Insurance Contracts, since the Nonforfeiture Model does not include a definition.

A consumer representative expressed concern that removing CDAs from the Standard Nonforfeiture Law, without a creating a new nonforfeiture law applicable to CDAs, removes a significant consumer protection. The subgroup indicated that that consideration was beyond its charge. However, at the subsequent meeting of the Life Insurance Committee, its chair agreed that the decision to exclude CDAs will be discussed again.

The subgroup also drafted a proposed supplement to AG43 to clarify the applicability of AG43 to CDAs. The supplement provides guidance on reflecting CDAs in modeling both stochastic and deterministic calculations. LATF voted to expose the proposed guidance for a period of 45 days.

Financial Condition Committee – The committee is considering the development of a template or checklist of questions that state insurance departments could use to facilitate the review of an insurer's risk management program at the time of a policy form filing related to a CDA.

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

Receivership and Insolvency Task Force – The task force is reviewing the proposed revised definition of CDA and considering whether amendments to the *Life and Health Insurance Guaranty Association Model Act* are needed and warranted in light of the revised definition.

GAO Report

On its March 7 conference call the CDA Working Group received a presentation from the U.S. General Accounting Office representatives on the GAO's December 2012 report "Annuities with Guaranteed Lifetime Withdrawals Have Both Benefits and Risks, but Regulation Varies across States." The GAO representatives noted that the SEC has regulatory authority over variable annuities; however, it is less clear whether this authority extends to CDAs. Despite this uncertainty, the GAO noted that CDAs are being registered with the SEC, although the SEC does not have a process in place for detecting if some CDAs are not being registered. It was noted that the SEC could take action if it determines that products that are required to be registered are not. The GAO report indicated that there are varying opinions among experts as to whether existing state insurance regulation and actuarial guidance adequately address risks to insurers offering CDAs to consumers.

Separate Account Risk Working Group

The working group held two conference calls in March to continue discussion of its Proposed Recommendations documents, which had been revised and re-exposed for comment. On March 6, the working group received an educational session focused on bank-owned life insurance (BOLI) with limited specific information on company-owned life insurance (COLI) presented by the ACLI. After the session, the subgroup noted that a subsequent conference call will be scheduled to discuss additional COLI information and determine whether BOLI and COLI products fit within the existing regulatory frameworks and how the working group should address these products.

The working group's March 24th call focused on separate accounts and insulation, which is being referred to as "Document #1" of the two exposed Proposed Recommendations documents. (The BOLI/COLI issues discussed above are included in Document #2.)

Document #1 includes three recommendations: 1) incorporate of ACLI's suggested principles (as revised) for insulating separate account assets for non-variable products, 2) review and consider updating SSAP 56, Separate Accounts, and the *Modified Guaranty Annuity Model Regulation* related to the transfer of assets from the separate account to the general account as non-insulated assets, 3) review and consider updating revisions to *Separate Accounts Funding: Guaranteed Minimum*

Benefits for Group Contracts Model Regulation.

Based on the comments received, the working group expects limited revisions to the suggested principles. However, decisions on whether modified guaranteed annuities are insulated products and whether it is appropriate to have insulated/book value products with both group and individual contracts are pending. The working group will schedule a conference call to consider these modifications and to continue discussion on other recommendations.

SEC Consideration Subgroup

The subgroup met by conference call on April 14 to continue discussion of its charge to study and develop regulatory guidance regarding handling of separate accounts with SEC registered products in a receivership for the Receivers' Handbook for Insurance Company Insolvencies. The Receivership Separate Accounts Working Group had requested the subgroup to consider a hypothetical receivership that involved SEC registered products and to review issues that arise in this hypothetical scenario. Input provided by industry and two trade organizations has been instrumental in development of the draft Receivers' Guidance and accompanying checklist. Following the discussion, the subgroup exposed the guidance and checklist until May 29.

Financial Regulation Standards and Accreditation Committee

The committee met in Orlando and took the following actions:

Revisions to Documents Required for Accreditation

Revisions made during 2013 to publications that are required for accreditation purposes (e.g., the Annual Statement Blanks and Instructions, Life and P/C RBC Formulas, the SVO P&P Manual, and the APP Manual) that are deemed to be insignificant for exposure purposes were adopted by the committee in Orlando as revised accreditation standards. Two significant revisions made to the Financial Condition Examiners Handbook relating to the concept of critical risk categories and IT general controls review were exposed until May 2.

Model Risk Retention Act (#705)

The committee discussed the Risk Retention Model Act as a possible accreditation standard for risk retention groups. One comment letter was received from the California Department of Insurance in support of accreditation during the one-year exposure period. The committee will consider

adoption effective January 1, 2015 at the Summer National Meeting.

Revisions to Risk-Based Capital for Insurers Model Act (#312)

The committee discussed the 2011 revisions to the RBC Model Act related to the trend test for life insurers. No comment letters were received during the one-year exposure period. The committee will consider adoption effective January 1, 2017 at the Summer National Meeting.

Revisions to Standard Valuation Law (#820)

The committee received an update on the 2009 revisions to the Standard Valuation Law. Given the in-progress status of the implementation of PBR, the committee is deferring action until the 2015 Spring National Meeting.

State of Entry Model Law (#665)

The committee heard an update on proposed revisions related to port-of-entry insurers (i.e., U.S. branches of non-U.S. insurers). It was noted that the *State of Entry Model Law*, written in 1993, may relate to the issue. NAIC staff conducted an informal survey and responses with 19 states indicating they have laws that allow U.S. branches of non-U.S. insurers to enter the U.S. market through their state. Of the 19 states, 9 states have companies utilizing those laws to enter the U.S. market. It has been 21 years since the model law was revised. The committee discussed reviewing the model law for applicability and consideration for accreditation. Following the discussion, the committee approved a referral for the Financial Condition Committee to review the model law to determine if any updates should be made related to port-of-entry insurers.

Referral on Part A Corrective Action Standard

The committee discussed a revised referral from the Corporate Governance Working Group for Section 4B(10) of the *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in a Hazardous Financial Condition*, to be added to the list of critical elements required to be adopted as part of the NAIC Accreditation Standard for Corrective Action. The working group is recommending that the standard be amended to clearly identify a state's authority to correct corporate governance practice deficiencies, noting the need for some flexibility in meeting the standard. As a result, the Corporate Governance Working Group proposed revisions to Accreditation Standard #4 to incorporate authority for the Commissioner to order the insurer to correct corporate governance practice deficiencies or at a minimum demonstrate with examples that the Commissioner's statutory and/or regulatory authority extends to corporate governance practice

deficiencies. Following the discussion, the committee exposed the updated referral until May 2.

Definition of Multi-State Insurer

As a follow-up to its meeting in the fall, the committee continued discussion on the controversial definition of multi-state insurer for accreditation purposes. The committee discussed proposed revisions to Part A and Part B Preambles which would subject certain captive insurers to the Part A and Part B Accreditation Standards. The proposal was greeted with mixed reaction by the regulators, some concerned that this would push captives offshore.

The committee heard that the proposed revisions were meant to be broader than to address only XXX and AXXX reserves that are ceded to life captives. The revisions would recognize that multi-state reinsurers that assume business in any state other than its state of domicile would be a multi-state business subject to accreditation standards. However, captive insurers owned by non-insurance entities for the management of their own risk will continue to be exempted. All other captive insurers, special purpose vehicles and other entities assuming business in states other than their state of domicile will be subject to the accreditation standards. The committee heard that care was taken so as not to interfere with traditional captive insurance companies.

The revised definition is intended to have prospective effect only, so that insurance entities reinsuring multi-state business will only be subject to the accreditation standards if they enter into reinsurance transactions on multi-state business on or after July 1, 2014, or with respect to reinsurance agreements entered into prior to this date on direct business written on or after January 1, 2015. It was acknowledged that the NAIC continues to consider other financial solvency mechanisms with respect to reinsurance assumed for XXX and AXXX reserves, and therefore, future revisions to the accreditation standards to recognize the adoption of these mechanisms by the NAIC may be necessary.

Several state insurance commissioners weighed in on the proposal. Connecticut Commissioner Leonardi noted that while the issue needed to be addressed, he did not believe changes can be made overnight as is being proposed. North Carolina echoed Commissioner Leonardi's comment noting that this would drive transactions offshore. New York Commissioner Lawsby and Rhode Island Superintendent Torti both expressed a need to move with relative haste on the issue, with Superintendent Lawsby stated that he is against moving at the standard 3-year accreditation pace and asked for

months instead of years to address this issue as the stakes are as high as they get, not only for the industry but for the NAIC. Utah Commissioner Kiser stated that discussions with the industry in his state showed that 70% of those doing business as captives are prepared to abandon Utah for sites offshore. ACLI commented that it strongly disagreed with the proposal, claiming that this would put a moratorium on new captive transactions. Following the heated discussion, the committee exposed the proposal until May 19.

Casualty Actuarial and Statistical Task Force

The task force met by conference call in February and March, and at the Spring National Meeting and discussed the following issues.

Schedule P Referral

At the Fall National Meeting, the task force received a referral from the NAIC/AICPA Working Group to consider removing the Schedule P Testing Requirement from the audited financial statement procedures. The task force discussed this matter and its draft response at length during the conference calls and in Orlando. In addition to the Schedule P testing requirement, the instructions currently include a requirement for the auditor to subject “significant data elements” used by the appointed actuary in the reserve analysis to audit procedures. This specific requirement addresses the accuracy of data elements and provides a basis for removal of the Schedule P testing requirement, which can be extensive and time-consuming and often not represent the “significant data elements” used in the actuary’s reserve calculations. Additionally, audit procedures to reconcile the “significant data elements” to Schedule P Part 1 totals provide assurance over completeness. The AICPA considers the Schedule P testing to be duplicative which leads to higher audit fees without increasing the level of assurance obtained by auditors as to the completeness and accuracy of the underlying data used by the appointed actuary.

During the March 4 conference call, the task force heard a presentation by AICPA representatives describing auditing requirements and processes related to the appointed actuary’s work and Schedule P. They made the point that regulators cannot assume that the source data used by an insurer to compile Schedule P has been subjected to audit because data used to test Schedule P may not be from the same file that was used to create Schedule P. The representatives commented that auditors have not been discovering errors when performing this Schedule P testing (which have been in effect for

20 years) and that Schedule P restatements are extremely rare.

Comments from task force members indicated varying thoughts, with some supportive of removal while others cautioning that validation over Schedule P is needed as well as consideration that Schedule P is essential for other uses. Following discussion in Orlando, the task force adopted its response to the referral, indicating their view that Schedule P Part 1 does need to be audited annually. The response also indicates that the task force is open to considering options that save time and lessen the burden of conducting the audit, such as limiting testing to particular columns of Schedule P Part 1.

Report of the Joint Qualified Actuary Subgroup

See the Life Actuarial Task Force summary for an update on the development of a uniform definition of a “qualified actuary.”

Actuarial Education for P/C Appointed Actuaries

The task force discussed its charge to make a recommendation by July 1, 2015 regarding the ability of the Society of Actuaries’ fellows in general insurance to sign P/C Statements of Actuarial Opinion. During the March 4 conference call, a regulator suggested that the task force study the Casualty Practice Council’s guidelines for analyzing qualifications since there is currently a process in place for SOA actuaries to sign the Statements of Actuarial Opinion through the CPC. The chair commented that regulators “own the issue” and have a responsibility to prescribe the required qualifications, and asked for task force members to submit objective criteria for measuring an educational track.

In Orlando, the task force reviewed a compilation of comments received with regard to how the task force might proceed and complete its charge. The task force heard comments from the AAA, SOA, Casualty Actuarial Society and interested parties. A task force member emphatically noted that current processes through the AAA seem appropriate until the SOA has proven that its new educational track works well. The chair emphasized that the task force needs to thoroughly vet this matter and requested a survey be sent to task force members seeking feedback on important elements that the task force should be considering.

Blanks Proposal for Changes to the Actuarial Opinion Instructions for P/C and Title and Actuarial Opinion Summary Instructions for P/C

The task force heard an update on proposed changes to the Actuarial Opinion Instructions and Actuarial Opinion Summary Instructions. The changes

incorporated responses to comments made by the AAA Committee on Property and Liability Financial Reporting over the year as well as expanded instructions for pooled company opinions. The proposed changes were exposed until February 21 and no comments were received. The task force subsequently adopted the proposal, which was exposed by the Blanks Working Group in Orlando.

Loss Adjustment Expense Survey

The task force heard an update on the loss adjustment expense (LAE) survey that was sent to chief financial regulators and P/C regulatory actuaries on January 30. A majority of respondents noted that companies are reporting their LAE data accurately with classification into the two categories of adjusting and other expenses and defense and cost containment expenses; these classifications are being used for loss reserve projections and/or for comparisons between companies and lines of business. Schedule P's use as an actuarial tool is not negatively impacted by the current LAE definitions; and most preferred to leave the definitions as they are. After discussion, the task force concluded that there does not appear to be sufficient concern by regulators to continue to address this issue at this time and agreed to defer this item to a later date.

Actuarial IRIS 11-13 Subgroup

This subgroup was created at the Fall National Meeting to verify that the formulas for IRIS ratios 11, 12 and 13 on loss reserve development are accurate and efficient calculations in light of proposed revisions to the ratios by the Financial Analysis Research and Development Working Group. The subgroup will also work to ensure that there is a consistency between the IRIS ratio 11-13 formulas and related NAIC documents, including the annual financial statement blanks, Schedule P, and other documents; the subgroup will also establish a range for usual/unusual values for each IRIS ratio.

The subgroup met by conference call in February, March and April and discussed whether to add Adjusting and Other Expenses (A&O) to the IRIS 11-13 ratios, exploring the reason why A&O is currently not included in the formula. After hearing support to adding A&O to the IRIS ratios, the subgroup worked on evaluating the impact of the change on small companies or companies in run-off. Texas shared a regulator-only study using an alternative IRIS formula which uses the income statement, net of tabular and non-tabular discounts. The current IRIS formula uses Schedule P Part II which is gross of discounting. NAIC staff was asked to run a study similar to Texas' but using the formulas in the IRIS proposal.

After much discussion at several meetings, the subgroup voted in favor of adding A&O to the IRIS ratios. The next steps involve figuring out which formula to use (NAIC or Texas), addressing consistency issues on how the change impacts other NAIC ratios/information, and considering whether to change the range of the IRIS ratios.

Risk-Focused Surveillance Working Group

The working group met via conference call on March 18 and discussed the following issues.

ORSA Guidance for Exams and Analysis

The working group exposed for comment proposed new ORSA implementation guidance for use by both examiners and analysts; it includes key considerations regulators should think about when reviewing their insurers' ORSA Summary Reports. The working group hopes to include this significant new guidance in the 2014 Financial Examination Handbook and 2014 Financial Analysis Handbook. The exposure period is through May 2.

Referral from the Corporate Governance Working Group

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

Climate Change and Global Warming Working Group

The working group heard a presentation from the American Insurance Association on challenges of insuring for floods and the steps state insurance regulators could take to encourage the purchase of flood insurance. AIA stated that several studies have reinforced the need for the National Flood Insurance Program even if a private flood market exists. AIA urged the NFIP to move toward actuarially sound rates and away from premium subsidies noting that affordability is best addressed through social programs rather than rate suppression. The National Institute of Building Science has concluded that for

every \$1 spent on mitigation, \$4 is saved in future damage costs. Thus, AIA urged for a focus on resiliency efforts, such as mitigation, land use planning, modeling and mapping, to encourage development of private flood insurance.

The working group also heard a presentation from the California Department of Insurance detailing the NAIC Climate Risk Disclosure Survey filing process and the use of related querying tools to aggregate survey response data. The survey, developed in 2009 and 2010, is comprised of eight questions that assess an insurer's strategy and preparedness in the following areas: investment, mitigation, financial solvency/risk management, emissions/carbon footprint, and engaging consumers. Survey results provide insight on trending, vulnerabilities and best practices.

Survey responses have grown from 90 insurers in 2010 to 1,067 insurers in 2013, representing 77% of the U.S. insurance market. The California Department of Insurance serves as the central location for insurers, regulators, and industry to access survey information. All parties are encouraged to visit the site to access results which can be sorted, filtered and downloaded for analysis and is available to the public.

Mortgage Guaranty Insurance Working Group

The working group held a conference call webinar March 5th that was devoted entirely to the presentation from a mortgage guaranty industry coalition on the development of and progress on its proposed capital framework. Five mortgage guaranty insurers are working together to “develop a sources-and-uses model that determines the long-term claims-paying ability of a mortgage insurer in a stress scenario.” The goal is to have the model demonstrate claims-paying ability in an environment similar to the recent economic crisis. The four principles of the capital framework are “risk sensitivity, forwarding looking, comprehensive and adaptable.” The coalition noted they have made considerable progress in developing a risk-sensitive model and work is continuing; no timetable for completion of a draft model was discussed.

The industry presenters then discussed in detail the inputs into the model and that the output “considers the full projections over the 10-year period, in addition to a simplified factor-based approach for loan-level capital requirement.” The regulators and a representative of the Center for Economic Justice asked detailed questions about the inputs and assumptions. The webinar finished with the chair

stating that several regulator-to-regulator sessions might be necessary for further deliberations, along with a closed session with the mortgage insurers. There was no discussion of the capital framework at the working group's meeting in Orlando.

At the Spring National Meeting, the working group spent most of the meeting reviewing industry's comments on the working group's comprehensively revised *Mortgage Guaranty Insurance Model Act* draft. The comment letter noted that their remarks are such a “thorough and specific revision to the conceptual draft that a marked copy would be of limited use.” As a result, the private mortgage guaranty companies did not provide a red-lined version of the model. The chair commented that industry's proposal deleted most of the working group's original proposals for “flexibility at the expense of the original intent.” A representative for the industry responded that the working group's version of the model is too prescriptive to get adopted uniformly across all states.

Two specific issues were highlighted during this meeting: underwriting standards and the contingency reserve. The working group wants to include underwriting standards in a mortgage guaranty model act especially since the current model has no underwriting standards; industry believes this would introduce too detailed and prescriptive of requirements into legislation. Steve Johnson of Pennsylvania then took exception to the industry proposal not addressing issues with the contingency reserve, which he noted “disappeared during the financial crisis along with most of the industry's capital.” He added that industry will have to demonstrate how any proposal related to contingency reserves would have survived the recent financial crisis.

The chair suggested a series of conference calls to look at industry's comments in more detail and to reconcile the working group's version of the model to industry's version. He commented that the NAIC has to keep this process moving forward especially in light of comments made in the FIO report regarding the federal regulation of insurance and a draft bill in Congress that could have a material impact on the entire mortgage industry.

Terrorism Insurance Implementation Working Group

In Orlando, the working group discussed the status of federal efforts to extend the Terrorism Risk Insurance Act (TRIA); while the Senate and House of Representatives are working on bills, the working group was informed by NAIC legal staff that there

does not appear to be an urgency to renew TRIA before it is set to expire on December 31, 2014. The working group received presentations from the American Bankers Association and the Property Casualty Insurers Association of America regarding the impacts to lenders and insurers as a result of the uncertainty with respect to TRIA. The Reinsurance Association of America also demonstrated a software tool that the organization has developed to analyze the impact on the insurance industry of potential changes to TRIA.

Title Insurance Task Force

In Orlando, the task force received an update on the development of a consumer guide by the Title Consumer Shopping Tools Working Group. The working group, appointed at the 2013 Summer National Meeting, held four conference calls. During the conference calls, the working group discussed a survey prepared by NAIC staff that was distributed to working group members, interested regulators and interested parties. The survey asked respondents to classify elements that should be included in a title consumer's guide into three categories – critical, nice to have, or not needed. NAIC staff proceeded to draft the guide using elements deemed critical by 32 survey respondents. The draft was discussed during the February 5 conference call and exposed for comment. During the February 26 conference call, the working group discussed comments received, including a separate draft created by the co-chair using information from a real estate purchasing buyer's guide. The working group elected to use the co-chair's draft going forward and acknowledged that more work is needed, including considerations related to state law differences, seller protection, consumer testing of the guide, and ways to distribute the guide to consumers. The working group will continue its discussion of the guide in its next conference call scheduled for May 22.

The next National Meeting of the NAIC will be held in Louisville August 16-19. 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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The Publications Committee is looking for members to write articles for the quarterly Examiner magazine. Authors will receive six Continuing Regulatory Credits (CRE) for each technical article selected for publication.

Interested authors should contact the Publications Committee Chair, **Colette Hogan Sawyer or Co-chair Joseph Evans**, via sofe@sofe.org.

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