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CRE READING PROGRAM QUESTIONS

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"Implementing ORSA: Aligning ORSA Reporting with Existing Frameworks"

True or False Questions — Submit Answers Online

1. For some insurance companies, ORSA can be just a one-off exercise; for others, ORSA is a continuously evolving component of the insurer's enterprise risk management (ERM) framework.
2. The risk management function of an organization is to ensure the Risk Identification and Prioritization process is appropriate and functioning properly at all levels.
3. One of the six principles relating to risk governance and culture is that the organization establishes governance and operating structures in the pursuit of strategy and business objectives.
4. Options for risk treatment may include avoiding the risk, changing the likelihood, removing the risk source, and avoiding the risk, etc.

"The Role of NAIC Designations in Financial Solvency Monitoring in State Insurance Regulation"

True or False Questions — Submit Answers Online

1. At the time when the NAIC Valuation of Securities Office was established in the mid of 1940s, the credit ratings was used as in independent confirmation that a security was not in default, a test of eligibility for amortized valuation.
2. In the 1985 NAIC Valuation Procedures and Instructions for Bonds and Stocks (the "Procedures"), the NAIC security quality rating was expressed in four quality classifications for bonds and preferred stocks.
3. The Valuation of Securities Office produces NAIC 1-6 Designations by translating credit ratings of Moody and Standard & Poor' into its quality categories.
4. NAIC Designations are directly or indirectly incorporated into states laws through adopting the financial regulation standards in the NAIC Financial Regulation Standards and Accreditation program.

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CRE READING PROGRAM QUESTIONS

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“Post-Election Analysis 2016”

True or False Questions — Submit Answers Online

1. It is clear whether there would be a substantial shift in position on the covered agreement from the Obama Administration to the Trump Administration.
2. In June 2016, the Federal Reserve developed capital standards for insurers who have been designated as a systemically important financial institution (SIFI).
3. It is unclear whether the Trump Administration will take a similar interest in monitoring the growth of the cyber insurance market.
4. The author of this article anticipates numerous proposals to drastically change the National Flood Insurance Program (NFIP).

The Role of NAIC Designations in Financial Solvency Monitoring in State Insurance Regulation

*By **Bob Carcano, Senior Counsel, NAIC Investment Analysis Office***

This article is intended to help insurance regulators understand the valuation of securities function performed by the Valuation of Securities (E) Task Force and the SVO; why the function was developed, how it has evolved and how it translates into regulatory treatment at the state level today.

1. The Development of NAIC Designations

NAIC rules and procedures related to the valuation of securities are concerned with what a security is worth if it had to be sold (value) and whether or not it can be expected to pay in accordance with its terms (quality). These issues differ from those related to what an insurer can or cannot invest in and the investment making process the insurer must follow which are addressed in state insurance codes. Valuation procedures were developed and are maintained to assist state insurance regulators in monitoring financial solvency of insurers.[1]

To function properly, a national financial solvency process requires a uniform approach to determining the value of insurer owned securities. This was brought home to US insurance regulators in the aftermath of the collapse of the New York stock market in 1907 which led the New York insurance department and the NAIC Committee on Assets to investigate insurer valuation practices and the discovery that insurers reported widely different prices for the same security. Concerned with erosion of public confidence, the states acted through the NAIC to create the Committee on the Valuation of Securities (the Committee) which was charged with developing and maintaining a national uniform valuation procedure.[2]

The Committee decided that it would fulfill its core function by becoming the sole source of the values reported by insurers. The Committee would hire experts to help it produce the values. It would compile the official values into a list or book which it would distribute to the state insurance departments. The state insurance departments would instruct their insurers to report the securities they owned using the values in the list.

A problem with valuations is that they fluctuate, often for reasons not related to the financial condition of the issuer. The Committee managed fluctuations by adjusting the method to generate values of securities to be reported by insurers.3 However, it recognized that fluctuations in asset value made an assessment of financial solvency more difficult. Accordingly, it sought for objective benchmarks of investment "quality" that could justify stabilized value reporting and cumulatively help to clarify the financial condition of the insurer. A 1909 New York law offered the first objective benchmark. The law provided that a security not in default was amply secured and could be amortized while securities not amply secured would be marked to market. While it was not clear that it was possible to determine ample security4, the law linked an objective benchmark to a specific regulatory treatment – i.e., amortization.[5] By 1932, the

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(continued)

Committee's mission could be described as creating procedures to identify amply secured bonds eligible for amortization. In this same time frame, the Committee also begins to acknowledge the need for an internal technical staff[6] to make amortization determinations and to produce uniform market values for securities not eligible for amortization for it.[7]

Committee valuation procedures were specified in a resolution which the NAIC would adopt at year-end. Credit ratings are first used as a test of amortization eligibility in the 1941 year-end resolution. Bonds certified by the insurer as not in default and rated in any of the first five grades by at least two of Moody's Investors Service, Standard & Poor's Corporation and Fitch Investors Service were of a sufficient quality to be deemed amply secured and be amortized.[8] All other bonds would be valued at the market values shown in the Book on Valuations of Securities.[9] Over the next several years, credit ratings in the specified grades become an accepted indicator of quality and one of the components of a three-part test used to identify an amply-secured bond that could be amortized.[10] Importantly, credit ratings did not determine regulatory treatment – they served as an ancillary indicator and perhaps as an independent confirmation of the certification required by the insurer that the security was not in default.

Since 1909, the Committee hired an external consultant to produce the values. In 1943, it hired its own staff to produce valuations and amortization determinations[11], and in 1945, it established the Valuation of Securities Office.[12] By 1949, the SVO Committee procedures for producing valuations varied. Listed stocks and bonds were assigned market values. Unlisted, publicly-traded securities were valued using methodologies developed by the Committee. Unlisted, privately-purchased, not traded, common and preferred stock consistently paying dividends were valued by reference to the issuer's balance sheet, earnings statements and factors that could affect marketability. The issuer's balance sheets, earnings statements, indentures and other data were examined to determine if a bond had speculative elements. If a bond was not predominantly speculative, had not defaulted and the company's financial position indicated the company could make debt service payments per the agreements, it was eligible for amortization. Market prices were developed for bonds which did not qualify for amortization.[13] Under the procedures, a bond or preferred stock was either amortizable or not and the symbol used to convey the determination was a "Yes" or a "No."[14]

However, by 1949, the population of untraded, privately-purchased bonds was too large to permit the Committee to produce individual amortization determinations. The Committee tasked the SVO to develop standards and criteria for this population.[15] SVO proposed quality standards in 1951. In discussions, the Committee summarized its valuation procedures. The Committee would derive quality classifications from: 1) credit ratings of three rating agencies, 2) market quotations and 3) an SVO unique methodology for direct placements. The Committee's goal was to classify the quality of publicly-traded and rated securities just as it was doing for direct placements. The Committee also noted that the quality classification quantified the probability of principal and interest being paid.[16] The 1951 procedure envisioned five quality classifications comparable to the first four rating agency grades with one grade capturing all lower ratings. Once quality was established, a price could be determined based on a traded security of similar quality and industry.[17] The Committee expressed concern with "... reliance on rating agencies [because their] approach and objectives differ from those of the NAIC and its staff ..." In the following year, the SVO proposals for classifying the quality of private placements was merged with a project to develop a Mandatory Security Valuation Reserve (MSVR) for life companies.[18]

Under the procedure for private placements, SVO would conduct two industry specific tests. A security that passed the first test could be amortized by all insurers. A security that failed the first test but passed the second test could only be amortized by companies subject to MSVR (i.e., life companies). P&C companies would carry these securities at market values. All other securities would be reported at the values determined by the SVO per Committee procedures.[19] Prior to 1953, NAIC quality classifications were YES and NO. In 1953 the quality classification "No*" is added and linked to 20% MSVR maximum. In 1965 a fourth quality classification NO** is for bonds that failed Test 1 and Test 2.[20] These procedures and symbols were in use until 1988-1989 when their application to speculative grade securities (so-called junk bonds) and other complex securities undermined confidence in them.

The 1985 Valuation Procedures and Instructions for Bonds and Stocks (the "Procedures") said the function of the SVO was to produce an "Association Value"[21] which consisted of a numerical notation (the value) and a statement of eligibility for amortization (the quality classification). The statement of eligibility for "amortization" for bonds (and "Good Standing" in the case of preferred stock) was called an NAIC quality rating[22] expressed in four quality classifications for bonds and three quality categories for preferred stocks.[23] Credit ratings continued to be one of the amortization tests used by the NAIC. When a rating was not available, SVO conducted the aforementioned test based on financial analysis.[24] Increasingly the phrase designation comes into use as a reference to the Yes, NO, NO* and NO** symbols.[25]

The current approach to valuation and quality assessment was adopted in 1988. Although the Task Force's procedure changed, its mission remained the same. The 1989 Procedures continue to define Association Value as an actual or estimated market price and an NAIC Designation for quality assigned to determine eligibility for stabilized value accounting.[26] The Task Force then replaces the Yes, No*, No**, No symbols with the 1 – 6 grades in 1990. SVO would produce NAIC Designations by translating credit ratings of Moody and

Standard & Poor's directly into the new quality categories[27] and when these were not available, it would produce an NAIC Designation on its own. In 2004 the Task Force adopted an exemption from filing with the SVO for securities rated by any NRSRO.[28] Insurers would translate the credit rating into and report the NAIC Designation for the security.

2. Producing NAIC Designations Today

The Task Force no longer functions through an annual resolution in which it identifies the procedures to be used to produce Association Values for insurer owned securities. Instead, the P&P Manual collects the cumulative decisions and instructions of the Task Force. A comparison of the historical background to the current regulatory framework demonstrates a remarkable degree of resiliency in the overarching framework developed by the Committee. The Task Force produces, through the SVO valuations and designations of investment quality for use by regulators in financial solvency monitoring. Although developments in statutory accounting have significantly modified the Task Force's valuation role, the SVO continues to produce values for private insurer owned securities. NAIC Designations trigger the valuations rules insurers use through the Accounting Practices and Procedures Manual. NAIC Designations provide a statement of quality under a six-classification framework only slightly altered from what was adopted in 1953. Designations continue to be assigned only to investment securities and only on a post-purchase basis. The Task Force still develops a list of insurer owned securities in which it publishes a uniform value and quality opinion for each insurer owned security.[29] However, the nature of procedures used by the SVO have changed, and their number has increased[30] while the regulatory tools that use values and quality opinions to trigger regulatory treatment have increased and become more interrelated.

In the first instance, SVO valuations and NAIC designations for quality acquire regulatory significance through state laws that require insurance companies to obtain and report them to the state insurance departments as part of their financial statement reporting obligation.[31] Beginning in the early 1990s, valuation and NAIC Designations acquired a more comprehensive regulatory significance as a result of the accreditation program administered by the NAIC Financial Regulation Standards and Accreditation (F) Committee. The accreditation program establishes and maintains standards that promote financial solvency regulation. The program is built around the NAIC Policy Statement on Financial Regulation Standards which is reflected in an Accreditation Program Manual.

Four areas for standard setting are identified. Part A identifies laws and regulations necessary to financial solvency regulation.[32] Part B identifies regulatory practices and procedures that supplement and support enforcement of the financial solvency laws and regulations in Part A.[33] Part C contains three standards related to an insurance department's organizational and personnel policies. Part D is concerned with organization, licensing and change of control of domestic insurers. As of August 2016, there are a total of 52 jurisdictions that are accredited: i.e., all fifty states, the District of Columbia and Puerto Rico.[34]

NAIC Designations are directly or indirectly incorporated into states laws through accreditation program standards in Part A of the Policy. Standard 5 requires that insurer owned securities be valued in accordance with the standards promulgated by the NAIC Investment Analysis Office.[35] Standard 2, the Risk-Based Capital (RBC) for Insurers Model Act (#312)[36] assigns RBC factors for securities based on their credit risk as measured by NAIC Designations. Standard 3, the Accounting Practices and Procedures Manual[37] uses NAIC Designations produced by the SVO and or Price Grids produced by the SSG to identify valuation rules applicable to an investment and the reserved capital amount the insurer must report. Standard 8, pertaining to state-investment regulations, often incorporate NAIC mechanisms that relate asset allocations by reference to credit risk expressed in the form of NAIC Designations.[38] Standard 10, the Credit for Reinsurance Model Act (#785),[39] identifies securities compiled by the SVO, and letters of credits issued by the banks on the NAIC Bank List administered by the SVO, as eligible for use as collateral in reinsurance transactions.

The standards, processes, procedures, rules and methodology adopted by the Task Force and published in the P&P Manual and the use of NAIC Designations are directly incorporated by reference into state law if the laws or regulations of an accredited state refer to or incorporate Standard 5 on valuation. The use of NAIC Designations would be indirectly incorporated by reference if the law or regulations of a state refer to, or incorporates, a Standard that uses NAIC Designations, for example, Standard 2 in the case of RBC and/or Standard 3 in the case of statutory accounting. For example, paragraph 8 of Statement of Statutory Accounting Principles (SSAP) No 26, Bonds says that Bonds shall be valued and reported in accordance with this statement and the (P&P Manual). Insurance companies that maintain an asset valuation reserve (AVR) report bonds at amortized cost, except bonds designated to be of NAIC 6 quality, which are reported at the lower of amortized cost or fair value. Insurance companies that do not maintain an AVR can report NAIC 1 and 2 bonds at amortized cost but report NAIC 3 through NAIC 6 bonds at the lower of amortized cost or fair value. Similarly, the rules for classification of preferred stock as perpetual or redeemable, for determining balance sheet amounts and values for them are outlined in paragraphs 15 through 22 of SSAP No. 32 Preferred Stock. While most of the paragraphs refer to the designation some, for example, paragraph 17, refers to and require consistency with the rules specified in the P&P Manual.

The Role of NAIC Designations in Financial Solvency Monitoring in State Insurance Regulation

(continued)

End Notes

1. The long-term nature of the insurance contract led to the conclusion, developed over time, that financial solvency of an insurer required an ability to maintain solvency until all of the insurer's obligations had been paid. See the discussion in NAIC Proceedings, 1940 pages 155-163.
2. Proceedings of the Forty-Seventh Session of the National Convention of Insurance Commissioners, September 21-24, 1915, page 11). "... It is obviously desirable that there should be uniformity among the companies in reporting values of their securities ... (But absent) ... cooperation ... a divergence between values fixed by various states for the same securities (would exist). The (NAIC"s) ... permanent Committee on Valuation of Securities grew out of these various discussions ... NAIC Proceedings, 1940 pages 155- 163.
3. "The list or book on the valuation of securities has not always corresponded with stock exchange quotations ... (because) ... The commissioners want real values, not fictitiously depressed nor fictitiously inflated values, ... the Committee ... has felt that ... it would be a disaster to policyholders if ... valuations ... would perhaps compel liquidation ... (with policyholders absorbing loss from) the disposal of securities which in all likelihood are intrinsically good. So, ... ascertaining the general condition of a company ... (requires that) ... we ... permit a valuation fairly ascertained, to be used in the auditing of the annual statements that would not compel a needless loss upon the "great mass of people throughout the United States." NAIC Proceedings, 1940 pages 155-163.
4. "... One is inclined to be certain that all Government bonds, whether Federal, State, City or Village, School District, etc., are certain to have the interest paid regularly and the face amount paid on the date of maturity. The fact is, however, ... many railroad bonds ... for years ... regarded as amply secured have not been paid at maturity, ... The ... real value ... of a bond or stock at any particular time is ... interesting ... (but it is) doubtful, whether ... a proper method for determining the real or asset value of securities (could be identified)." Proceedings of the Forty-Ninth Session of the National Convention of Insurance Commissioners, September 10-13, 1918, page 89).
5. "...Since fluctuation in the value of bond holdings may vary the rate of interest earnings over a certain period, ... (and) ... affect ... surplus ... amortization ... assures that the yield of any of the bonds will remain uniformly level at the figure which, they were bought to yield, the premium or discount being absorbed as the bonds mature. In 1932, the Convention adopted a resolution drawn up by its Committee on Valuations ... (endors)ing and recommending (that) the principle of the amortization of amply secured bonds ... (be adopted) and recommend(ing) legislation which would permit such amortization for all types of insurance companies ..." NAIC Proceedings, 1940 pages 155-163.
6. "Should we form a Statistical Bureau? – i.e., an internal staff to appraise, value and analyze the portfolios of insurance companies transacting business in the United States ... very few Departments ... have the money, the staff, or ... the facilities for getting the information that we all ought to have and which would be furnished by this bureau. Proceedings of the Sixty-Fifth Annual Session of the National Convention of Insurance Commissioners, December 5 - 6, 1934. page 8, and pages 21-37.
7. Proceedings of the Sixty-Seventh Annual Session of the National Association of Insurance Commissioners, December 3 - 4, 1936, page 149. Also, Proceedings of the Seventy-First Annual Session of the National Association of Insurance Commissioners, December 7 - 9, 1939, page 156.

8. In both cases, it was a condition to the use of this process that the security had actual sales or bid prices that reached 60 percent or higher during each of the months of September, October and November 1941. "RESOLVED, ... Bonds not in default as to principal or interest, ... certified by the insurer ... to be amply secured, (and that) meet any one of the following tests shall be carried at the amortized values .... (b) Bonds, ... rated in any of the first five grades by at least two of the recognized rating services .... (i.e., those) issued by ... Moody's ... , Standard & Poor's ... and Fitch ... All other bonds ... should be valued as shown in the Book on Valuations of Securities published (by the NAIC) ..." Proceedings of the Seventy-Second Annual Session of the National Association of Insurance Commissioners, December 2-4, 1940 and June 9-11, 1941, page 161.
9. NAIC Proceedings, 1941, pages 124 – 127.
10. A similar resolution was adopted for 1942 through 1949. See, NAIC Proceedings, 1942, pages 123 – 127; NAIC Proceedings 1947, pages 331 – 333; NAIC Proceedings 1949, pages 503 - 514.
11. "The ... Sub-Committee ... (discussed that) ... Moody's (decided) ... to discontinue ... valuing securities ... on account of the war, ... (and concluded) ... it would be best for the Committee to do the work itself ... RESOLVED, ... the Committee on Valuation of Securities ... is itself authorized to undertake the valuation of securities and determination of amortizability ... (on the) basis ... adopted by the Association and may employ such assistants ... as may be necessary to do all the work ..." Proceedings of the Seventy-Fourth Annual Session of the National Association of Insurance Commissioners, November 29-30 and December 1 and June 7 - 9, 1943. page 126-127.
12. " President Harrington reported that the establishment of the Valuation of Securities office with its permanent staff, directly employed by the National Association, has enabled us to do better work and inaugurate more efficient methods for determining the value of securities and to promulgate uniform rules governing the amortization of bonds. Proceedings of the Seventy-Seventh Annual Session of the National Association of Insurance Commissioners. Mid-Winter Meeting, December 2- 5, 1945 page 47.
13. NAIC Proceedings, 1949, pages 503 – 514; NAIC Proceedings, 1951, (Mid-Winter meeting) pages 269 – 283.
14. NAIC Proceedings, 1985 Vol II page 530.
15. NAIC Proceedings, 1949, pages 503 – 514.
16. NAIC Proceedings, 1951, (Mid-Winter meeting) pages 269 – 283. "Pricing of Direct Placements Determined Not to Be Eligible for Amortization -
17. NAIC Proceedings, 1951, (Mid-Winter meeting) pages 269 – 283.
18. NAIC Proceeding, 1952 Mid-Winter Meeting, pages 211 – 289. [The cited text contains a detailed discussion by industry of the NAIC proposal]
19. NAIC Proceedings 1953 Mid-Winter Meeting Vol. 1, pages 292 – 300.
20. NAIC Proceedings 1985, V II pages 528 – 530 - 531.
21. "... Section 1. Association Values. - (A) Definitions. Association Value as used herein shall mean the value determined under the appropriate procedures of the National Association of Insurance Commissioners and recommended for use in the Annual Statement of insurers. Such values will be listed in the task force's publication, Valuation of Securities. (a) Bonds. Association Value shall comprise two parts: a numerical notation and a statement as to eligibility for amortization. (b) Preferred Stocks. Association Value shall comprise two parts: a numerical notation and a statement as to eligibility for "Good Standing." (c) Common Stocks. Association Value shall comprise a single part: a numerical notation...." NAIC Proceedings 1985, V II pages 528 – 531.
22. NAIC Proceedings 1985, V II pages 528 – 531.

23. NAIC Proceedings 1985, V II pages 528 – 531.

24. NAIC Proceedings 1985, V II pages 528 – 531.

25. "... Change in Language of the SVO Procedures – Change 86-2; Date of Exposure: June 9, 1986 (Boston); Proposed Effective Date: January 1, 1987; Purpose of Change: Proposal to limit the Valuation of Non-Investment Grade Bonds or Preferred Stocks "Not In Good Standing" to the Lower of Current Amortized Cost, Market Value, or Historic Cost ... Market value or historic cost. The SVO Procedures will be modified accordingly. Existing Language – None; Proposed New Language (Underlined) ... Section 6 (A) Annual Statement Values for Bonds and Stocks and Mandatory Securities Valuation Reserve Classification. (a) After the sentence "The term, Association Value, refers to the numerical notation preceding the word and symbol bond designations "YES", "NO*", "NO**", and "NO"." Add this language: (b) Preferred Stocks - After the sentence "The term Association Value, refers to the numerical notation preceding the designation "SF", "S", and "N"." NAIC Proceedings 1986, V II, page 504.

26. "Section 1. Official Purposes and Use of the Valuation of Securities (VOS) Manual - The ... NAIC created the ... SVO to provide insurers with a source for uniform prices and quality ratings called "NAIC Designations" for their securities holdings ... Insurers are required by The NAIC Annual Statement Instructions Manual to use the prices and ratings in preparing their Annual Statements to be filed with state regulatory authorities and the NAIC ... Section 2. Association Values - Association Value (ASV) ... mean the appropriate accounting value to be entered in the "Investment or Amortized Value" column of Schedule D of the NAIC Annual Statement form ... An Association Value is made up of an actual or estimated market price and an NAIC Designation for quality ... NAIC Designations (Yes, No*, No** and No) for bonds and (S and N) preferred stocks are quality ratings from which the required Schedule D accounting value is determined ... Section 3. General Procedures for Rating Bonds (A) Purpose - The purpose of assigning an NAIC designation or quality rating is to determine which bonds are eligible for stabilized value accounting in the NAIC Annual Statement. Stabilized value ... means amortized cost ... bonds not so eligible are usually accounted for at the current market value ... "Sample of SVO Procedures Adapted for Use With New Model. NAIC Proceedings 1989 Vol. I page 565.

27. NAIC Proceeding, 1990 V2 at page 541. See also, Purposes and Procedures of the Securities Valuation Office of the National Association of Insurance Commissioners effective for Statements ending December 31, 1996, Publication date: December 31, 1996.

28. See, Summary of Proposal to Enhance SVO Process, March 5, 2003 - SVO Oversight Working Group - Submitted by the New York Insurance Department - Proposal: Enhancement of Securities Valuation Office (SVO) Process. NAIC Proceedings 2003 1st Quarter, page 739; Securities Valuation Office Oversight Working Group, Conference Call, June 5, 2003, in NAIC Proceedings 20013 2nd Quarter, page 818. NAIC Proceedings 2003 4th Quarter page 1887-1888. See, the P&P Manual at Part Two (Filing with the SVO) Section 4 (Reporting Exceptions) d) (Filing Exemption for Certain NAIC CRP Rated Securities) (i) ... (A) Bonds - Bonds, excluding RMBS and CMBS, ... assigned an Eligible NAIC CRP Rating ... are exempt from filing with the SVO. Bonds assigned Eligible NAIC CRP Ratings will be assigned the equivalent NAIC Designation. If two Eligible NAIC CRP Ratings have been assigned, then the lowest rating will be assigned. In the case of a security-assigned three or more Eligible NAIC CRP Ratings, the Eligible NAIC CRP Ratings for the security will be ordered according to their NAIC equivalents and the rating falling second lowest will be selected, even if that rating is equal to that of the first lowest.

29. See, the P&P Manual - Part One (Purposes, General Policies and Instructions to the SVO) Section 2 (Policies Defining the SVO Staff Function) a) (Directive to Conduct Ongoing SVO Operations) - The SVO shall conduct the following ongoing operations: (i) Analysis of credit risk for purposes of assigning an NAIC Designation; Valuation analysis to determine a Unit Price ... Compile and publish the AVS+ products in accordance with instructions in

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(continued)

this Manual. For the details pertaining to the SVO compilation of the list of insurer owned securities see, Part One (Purposes, General Policies, and Instructions to the SVO) Section 3 (Internal Administration) g) through k).

30. Consider the following examples of the methodologies or approaches used to determine the quality of an investment security in the P&P Manual as of December 31, 2015. Special Instructions require SVO to assign an NAIC 6 if a security is between related parties. SVO may not assign an NAIC Designation if the security, asset or obligation is regulated on a basis other than NAIC Designations. Terms or characteristics of certain securities may require SVO to notch down from the obligor's NRSRO assigned credit rating to reflect concerns with Other Non-Payment Risk a concept unique to the NAIC reporting framework. Certain US government securities are assigned NAIC 1 Designations pursuant to a policy decision specified in Part Two, Section 4 (c) and NAIC reporting instructions.

31. Part Two (Filing with the SVO) Section 2 (General Reporting Framework) a) (Obligation to Report) "Insurance companies domiciled in any state of the United States, or any of its territories or possessions, and required by the law of their domiciliary state or territory to report NAIC Association Values for their Investment Securities in the NAIC Financial Statement Blank, shall report purchases of Investment Securities to the SVO or, in the case of Investment Securities exempt from filing with the SVO, for example, pursuant to Section 4 (d) of this Part below, to the NAIC, as required by this Manual.

32. "...The purpose of the Part A: Laws and Regulations standards are to assure that an accredited state has sufficient authority to regulate the solvency of its multi-state domestic insurance industry in an effective manner. ... A state may demonstrate compliance with a Part A standard through a law, a regulation, an established practice, which implements the general authority granted to the state or any combination of laws, regulations or practices, which achieves the objective of the standard ..." 2014 Accreditation Program Manual. "...For those standards included in Part A ... where the term "substantially similar" is included, a state must have a law, regulation, administrative practice or a combination of the above that addresses the significant elements included in the NAIC model laws or regulations. ... Accreditation Interlineations (Substantially Similar).

33. "...Part B sets out standards required to ensure adequate solvency regulation of multi-state insurers ... In addition to a domestic state's examination and analysis activities, other checks and balances exist in the regulatory environment. These include ... analyses by NAIC's staff, ... and to some extent the evaluation by private rating agencies..." 2014 Accreditation Program Manual.

34. See, Financial Regulation Standards and Accreditation Program, August 2016, page 3 under the heading: Who is Accredited?

35. The SFRS requires that securities owned by insurance companies be valued in accordance with standards promulgated by the NAIC's Capital Markets and Investment Analysis Office approved by VOS TF while other invested assets should be valued in accordance with procedures promulgated by the Financial Condition (E) Committee. The Investment Analysis Office refers to two independent staff functions: i.e., that of the SVO and that of the NAIC Structured Securities Group (SSG). The SSG was formally established as an NAIC staff function in 2013 and assumes responsibility for the conduct of the year-end financial surveillance of insurer owned residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS), conducted by the SVO since 2009. The SSG is also presumptively the segment of NAIC professional staff that would lead the assessment of structured finance products.

NAIC valuation procedures, applicable to corporate, municipal and asset-backed securities (ABS) are contained in Part Five of the Purposes and Procedures Manual of the NAIC

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(continued)

Investment Analysis Office (Purposes and Procedures Manual). These procedures seek to identify a market value and in certain circumstances to require the use of a market value. Insurance companies either report the fair value determined by the SVO for security or determine fair value in accordance with one of the valuation methodologies described in the Purposes and Procedures Manual. The fair value determined in accordance with the Purposes and Procedures Manual is reported in the fair value column and the book/adjusted carrying value column of the NAIC financial annual statement blank. In addition, the Annual Statement Instructions require insurers to report a fair value, so that even an insurer entitled to use amortized value in the "Book/Adjusted Carrying Value" column, must use fair value in the "Rate Used to Report Fair Value" column. The financial modeling process administered by the SSG generates intrinsic price values (referred to Price Grids) for RMBS and CMBS instead of an NAIC Designation. These standards are contained in Part Seven of the Purposes and Procedures Manual. Price Grids are used by insurers to generate NAIC Designations in accordance with procedures specified in paragraph 25 of Statement of Statutory Accounting Principles (SSAP) No. 43R Loan-Backed and Structured Securities of the NAIC Accounting Practices and Procedures Manual. Accordingly, to the extent that the NAIC Accounting Practices and Procedures Manual are incorporated by reference in any standard, Price Grids and NAIC Designations derived by reference to them would also be incorporated.

36. The SFRS requires the adoption of the Risk-Based Capital (RBC) for Insurers Model Act (#312) or a substantially similar law or regulation. RBC factors are tied to NAIC designations assigned by the SVO or in certain cases, for example in the case of Mortgage Referenced Securities, by the SSG; NAIC Designations assigned by insurance companies pursuant to the filing exempt rule contained in the Purposes and Procedures Manual or NAIC Designations derived by insurance companies for RMBS and CMBS from Price Grids produced by the SSG pursuant to paragraph 25 of SSAP No. 43R. "...This standard does not articulate a threshold level of minimum capital and surplus required for insurers to transact business ... Risk-based capital will, however, effectively require minimums when adopted by states." Accreditation Interlineations - Financial Regulation Standards.

37. The SFRS requires the use of the codified version of the Accounting Practices and Procedures Manual. Valuation procedures applicable to long-term invested assets are determined by the nature of the insurer (life or property/casualty) and the NAIC designation assigned to the security by the SVO or SSG; NAIC Designations assigned by insurance companies pursuant to the filing exempt rule contained in the Purposes and Procedures Manual or NAIC Designations derived by insurance companies for RMBS and CMBS from Price Grids produced by the SSG pursuant to paragraph 25 of SSAP No. 43R. " ...To satisfy this standard, ... specific adoption of the NAIC Annual Statement Blank, NAIC Annual Statement Instructions, and the NAIC Accounting Practices and Procedures Manual [is required]...Accreditation Interlineations - Financial Regulation Standards

38. The SFRS requires a diversified investment portfolio. Although the Investment of Insurers Model Act (Defined Limits or Defined Standards) is not specifically identified, portions of one or the other model acts have been adopted by many of the states and these relate specific asset allocations to NAIC designations provided by the SVO or in some cases by the SSG; NAIC Designations assigned by insurance companies pursuant to the filing exempt rule contained in the Purposes and Procedures Manual or NAIC Designations derived by insurance companies for RMBS and CMBS from Price grids produced by the SSG pursuant to paragraph 25 of SSAP No., 43R. " ... This standard ... [will require] that statutes, together with related regulations and administrative practices, provide an adequate basis ... to prevent, or correct, undue concentration of investment by type and issue and unreasonable mismatching of maturities of assets and liabilities. The standard is not interpreted to require an investment statute that automatically leads to a fully diversified portfolio of investments. Accreditation Interlineations - Financial Regulation Standards

The Role of NAIC Designations in Financial Solvency Monitoring in State Insurance Regulation

(continued)

The NAIC Investment of Insurers Model Act (Defined Limits Version) (# 280) imposes a 3% limit on the amount an insurer can invest in a single person (the threshold diversification limit) and also imposes a percentage limit on total investments of a defined credit quality, expressed by reference to NAIC Designation categories (the threshold credit quality limit). An additional percentage limit is then assigned to specific asset categories, which may or may not be subject to adjustment with the two threshold requirements. The limits identified in the Model Act are what would guide portfolio allocation decisions. Once made the insurer would shift to monitoring changes in the portfolio and rebalancing the allocations accordingly. Assuming a process for the identification of concentrations caused by indirect exposures, the insurer would aggregate such exposures with similar risks across all activities.

39. The SFRS requires the adoption of the Credit for Reinsurance Model Act (#785), Credit for Reinsurance Model Regulation (#786) and Life and Health Reinsurance Agreement Model Regulation (#791) or substantially similar laws. The SVO maintains a list of banks that meet defined eligibility criteria to issue letters of credit in support of reinsurance obligations or that are eligible to serve as trustees under various arrangements required by state insurance law.

Implementing ORSA Aligning ORSA Reporting with Existing Frameworks

By ***Kristina Narvaez, Donna Galer, and Max Rudolph***

Background:

In light of the financial crisis, it became clear that U.S. state insurance regulators need to be able to assess the holding company's financial condition, as a whole, and also its impact on the subsidiary insurers. In 2011, as part the NAIC Solvency Modernization Initiative (SMI), the NAIC adopted a significant new addition to U.S. insurance regulation: the U.S. Own Risk and Solvency Assessment (ORSA). An ORSA report will require insurance companies writing more than $500 million of annual direct written and assumed premium, and/or insurance groups that collectively write more than $1 billion of annual direct written and assumed premium to issue an internal risk self-assessment of their current and future risks relative to current and future levels of capital. The inclusion of complex insurance organizations will allow regulators to form an enhanced view of an insurer's resilience and ability to withstand financial stress.

The NAIC Risk Management and Own Risk and Solvency Assessment Model Act (#505) went into effect on January 1, 2015. Many companies have just filed their second ORSA report, although some also participated in the three pilot studies that preceded adoption. An ORSA report will require insurers to analyze all reasonably foreseeable and relevant material risks (i.e., underwriting, credit, market, operational, liquidity, etc.) that could impact an insurer's ability to meet its policyholder obligations. This encourages senior management to anticipate potential capital needs and to take action before a crisis occurs.

ORSA is not a one-off exercise, but rather a continuously evolving component of an insurer's Enterprise Risk Management (ERM) framework. Moreover, there is no mechanical way of conducting an ORSA; how to conduct the ORSA is left to each insurer to decide, and the actual layout and contents will vary from company to company. The output demonstrates the results of management's self-assessment and is shared with the Board prior to regulator submission.

The ORSA Guidance Manual, adopted by the NAIC Executive (EX) Committee and Plenary in 2012, provides information for insurers on performing its ORSA and documenting risk policies and procedures. Pursuant to the ORSA Guidance Manual and Model Act #505, the ORSA has two primary goals: 1) to foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risk identified by the insurer, using techniques that are appropriate to support risk and capital decisions; and 2) to provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view.

Implementing ORSA Aligning ORSA Reporting with Existing Frameworks

(continued)

There are three parts to the ORSA Summary Report:

1. **Section 1** - Description of the Insurer's ERM Framework
2. **Section 2** - Insurer's Assessment of Risk Exposures
3. **Section 3** - Group Assessment of Risk Capital and Prospective Solvency Assessment

ERM Frameworks:

Organizations that use ERM may choose from several ERM frameworks, guidelines and standards to create an ERM program or develop their own. Two prominent ERM frameworks are

a. COSO II: 2004 Enterprise Risk Management-Integrated Framework and its 2016 revisions COSO II Enterprise Risk Management: Aligning Risk to Strategy and Performance; and

b. ISO 31000: 2009 Risk Management-Principles and Guidelines, developed by the International Organization for Standardization (ISO), the world's largest developer and publisher of international standards.

The COSO and ISO frameworks are generic to all companies; so many insurers will incorporate framework-type elements from the ORSA guideline and other guidance such as the Actuarial Standards of Practice or from consulting firms that deal specifically with insurance.[1]

COSO was created in 1985 by several US accounting organizations. During the late 1990s after accounting frauds including Enron and World Com, the COSO I internal controls framework became a benchmark to measure a corporation's internal controls. Sarbanes-Oxley passed in 2002, leading some COSO member organizations to expand their risk management focus beyond internal controls to include broader categories like strategic risk, operational risk, technology risk, environmental risk, and hazard risks.

In 2009, the International Organization for Standardization issued ISO 31000, combining the best aspects of several formal ERM frameworks, including the Canadian Standards Association (CSA) Guidelines CAN/CSA-Q850, COSO II ERM Framework and the Australian/New Zealand AS/NZS 4360. A primary objective of ISO 31000 was to achieve a level of consistency in risk management practices without the rigid uniformity that COSO II offers.

ORSA Guidance Manual on ERM:

According to Section 1 of the ORSA Guidance Manual, an effective ERM framework should, at a minimum, incorporate the following key principles:

- ***Risk Culture and Governance*** – Governance structure that clearly defines and articulates roles, responsibilities and accountabilities; and a risk culture that supports accountability in risk-based decision-making.

[1] The Actuarial Standards Board is working on a standard of practice titled Capital Adequacy Assessment for Insurers. As of September 2016 it was issued as an exposure draft and is expected to become an ASOP in 2017.

- ***Risk Identification and Prioritization –*** Risk identification and prioritization process that is key to the organization; responsibility for this activity is clear; the risk management function is responsible for ensuring that the process is appropriate and functioning properly at all organizational levels.
- ***Risk Appetite, Tolerances and Limits –*** A formal risk appetite statement, and associated risk tolerances and limits are foundational elements of risk management for an insurer; understanding of the risk appetite statement ensures alignment with risk strategy by the board of directors.[2]
- ***Risk Management and Controls –*** Managing risk is an ongoing ERM activity, operating at many levels within the organization.
- ***Risk Reporting and Communication –*** Provides key constituents with transparency into the risk-management processes and facilitate active, informal decisions on risk-taking and management.

Aligning COSO II ERM Framework and ISO 31000 with the ORSA Guidance Manual:

Risk Governance and Culture

COSO

COSO II ERM Framework revisions, Section 6, defines risk governance as setting the tone for reinforcing the importance of Enterprise Risk Management and establishing oversight responsibilities for it. It defines culture as pertaining to ethical values, desired behaviors and understanding of risk in the organization. Together, both risk governance and culture form the basis for all other components of Enterprise Risk Management.

The 2016 COSO II ERM Framework revisions outline six principles relating to risk governance and culture. They are:

1. **Exercises Board Risk Oversight** - The board of directors provides oversight of the strategy and carries out risk governance responsibilities to support management in achieving strategy and business objectives.
2. **Establishes Governance and Operating Model** - The organization establishes governance and operating structures in the pursuit of strategy and business objectives.
3. **Defines Desired Organizational Behaviors** - The organization defines the desired behaviors that characterize the entity's core values and attitudes toward risk.

[2] In a Spring 2010 Examiner article, Max Rudolph described how companies can leverage their ERM program with their strategic planning process. ERM as a Competitive Advantage pages 12-15. http://www.rudolph-financial.com/The_Examiner_Spring2010_Rudolph_extracted.pdf

4. **Demonstrates Commitment to Integrity and Ethics** - The organization demonstrates a commitment to integrity and ethical values.
5. **Enforces Accountability** - The organization holds individuals at all levels accountable for Enterprise Risk Management and holds itself accountable for providing standards and guidance.
6. **Attracts, Develops and Retains Talented Individuals** - The organization is committed to building human capital in alignment with the strategy and business objectives.

ISO

Section 2.9 of ISO 31000 defines both the external and internal parameters to be taken into account, setting the scope and risk criteria for the risk management policy. Section 2.10 defines the external context as the external environment in which the organization seeks to achieve its objectives. The external context includes:

1. The cultural, social, political, legal, regulatory, financial, technological, economic, natural and competitive environment, whether international, national, regional, or local;
2. Key drivers and trends having impact on the objectives of the organization; and
3. Relationships with, and perceptions and values of, external stakeholders

Section 2.11 describes the internal context used to achieve objectives. It includes:

1. Governance, organizational structure, roles and accountabilities
2. Policies, objectives, and the strategies that are in place to achieve them
3. The capabilities, understood in terms of resources and knowledge (e.g. capital, time, people, process, systems and technologies)
4. Information systems, information flows and decision-making processes (both formal and informal)
5. Relationships with, and perceptions and values of, internal stakeholders
6. The organization's culture
7. Standards, guidelines and models adopted by the organization
8. Form and extent of contractual relationships

ORSA Summary Report Applications

Insurers face a complex set of risks that includes: 1) underwriting, 2) reserving, 3) investing, 4) operating, 5) financial 6) market/competition. The CRO and each risk owner must have clear mandates and parameters as well as consistent methods for sharing, and integrating, risk information. An ORSA report should provide an organizational chart showing formal and informal reporting relationships relating to risk management. Culture is hard to show transparently in a report, but regulators should look for signs that management and the board of directors are engaged and supportive of initiatives.

Risk Identification and Prioritization

COSO

The 2016 COSO II ERM Framework revisions (under Principle 12 - Identifies Risk in Execution) states that the organization must identify new, emerging, and changing risks to the achievement of its strategy and business objectives. A risk inventory should be initially established and, in subsequent identification processes, later confirm existing risks as being still applicable and relevant. How often an organization goes through this process will depend on how quickly new risks emerge or evolve. Where risks are likely to take months or years to materialize, the frequency at which risk identification occurs may be less than where risks are less predictable or may occur at a greater speed. Risk identification should occur at all levels of a company; entity, division, operating unit, function, and process. A risk owner should be identified for each risk at its highest level in the organization. As long as the risk owners are aligned, there can be someone different listed at lower levels of the organization to show ownership of the risk at that level.

There are a variety of approaches for identifying risks. These range from simple questionnaires to sophisticated facilitated workshops. Some approaches may be enabled by technology, such as on-line surveys, data tracking, and complex analytics. The risks captured by the risk identification process are commonly referred to as a risk universe- a qualitative listing of the risk the entity faces. Depending on the number of individual risks identified, an organization may utilize a specific taxonomy, or hierarchy of risk types, which provides standard definitions and categories. This allows organizations to group similar risks together, such as strategic, financial, operational or compliance risks. Within each category, organizations may choose to further define risks into more detailed sub-categories. The risk universe can be updated to reflect the changes identified by management.

Principle 13 states that risks identified in an entity's risk universe are assessed against the achievement of the entity's strategy and business objectives. The risk universe aggregates exposure within the entity for each risk to construct a risk profile.

Risk assessment approaches may be qualitative, quantitative, or both. The anticipated severity of a risk may influence the type of approach used. Types of approaches include scenario analysis, simulation, data analysis,

Implementing ORSA Aligning ORSA Reporting with Existing Frameworks

(continued)

and interviews. Levels of adversity tested should be included in the ORSA report and could include periods of normal volatility, plausible catastrophic events, and extremely unlikely adverse conditions. In assessing risks that could have extreme impacts, management may use scenario analysis, but when assessing the effects of regular business volatility, management might find simulations useful. Conversely, high-frequency, low-impact risk (e.g., car accidents for a block of insurance policies) may be more suited to data analysis. To reach consensus on the severity of risk, organizations may employ the same approach they used as part of the risk identification, such as workshops and interviews. The overall goal is to better understand what risks could impact an insurer's specific risk profile and how company management expects to react.

Organizations prioritize risk on an aggregate basis where a single risk owner is identified or a common risk response is likely to be applied. This allows risk to be clearly identified and described using a standard risk taxonomy, which enables common risks to be prioritized consistently across the entity. Using a standard taxonomy, the risks are grouped and prioritized on an aggregate basis. The result is a more consistent and efficient risk response that would have occurred if each risk had been prioritized separately. Principle 14 states the criteria for prioritizing risks are applied to assessed risks in order to identify and select risk responses. There are three primary components used to assess a risk. The likelihood (also frequency, probability) estimates how often an event occurs, the severity (also impact) how big a deal it is, and velocity (a more recent category) considers how quickly an event could unfold. Note that risks with similar assessments of severity may be prioritized differently. That is, two risks may both be assessed as "high" but management may give one more priority because it has greater velocity and persistence. How a risk is prioritized typically informs the risk responses management considers. The most effective responses address both severity (impact and likelihood) and prioritization (velocity, complexity, etc.). Many companies develop risk mitigation strategies by combining frequency and severity to prioritize their efforts.

Risk prioritization occurs at all levels of an entity, and different risks may be assigned different priorities at different levels. For example, high-priority risks at the operating level may be low-priority risks at the entity level. The organization assigns a priority at the level at which the risk is owned and with those who are accountable for managing it. It is important for all of these activities to be aligned with the strategy at the highest level of the firm.

ISO

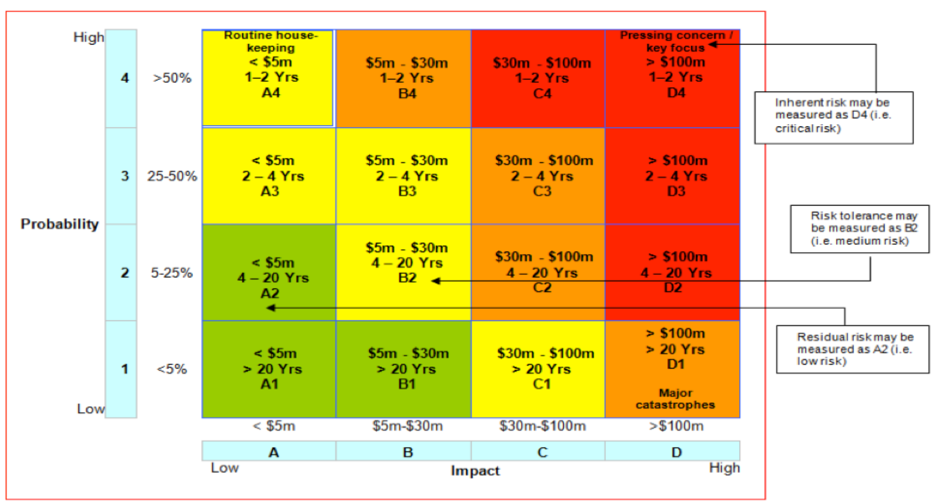
Section 2.14 defines risk assessment as the overall process of risk identification, risk analysis and risk evaluation. Section 2.15 defines risk identification as the process of finding, recognizing and describing risks.

Risk identification involves the identification of risk sources, risk events, their causes and their potential consequences. Risk identification can involve historical data, theoretical analysis, informed expert opinions and stakeholder's needs. Risk source is the element which alone or in combination has the intrinsic potential to give rise to risk. A risk source can be tangible or intangible.

ORSA Summary Report Applications

Because the business of insurance is accepting risk, the "rank and file" of the organization can provide risk insights to a far greater degree than those in other industries. The report should describe the process used to identify and prioritize risks, and how the process evolves as new risks emerge and recognized risks develop over time. Heat maps can readily convey a great deal of information as risks are shown based on frequency, severity, and velocity, and modeled using a red/yellow/green light analogy. The prioritization should be reflected in risk strategies employed during the year and plans for future years.

Chart 1 – Sample heat map



A heat map can be a useful tool to prioritize risks for mitigation efforts. By ranking (even qualitatively) by probability and impact, then segmenting the chart into low, medium, and critical risks, this can provide a blueprint for an insurer's risk plan.

Risk Appetite, Tolerance and Limits

COSO

The 2016 revisions of the COSO II ERM Framework, in Section 7, it states that risk appetite guides an organization in determining the types and amount of risk it is willing to accept. There is no standard or "right" risk appetite that applies to all entities. Management and board of directors choose a risk appetite with full understanding of the trade-offs involved. Risk appetite may combine qualitative and quantitative elements, and may consider exposures pre and post mitigation efforts.

There are a variety of approaches to determine risk appetite, including facilitating discussion, reviewing past or current performance targets, and modeling. It is up to management to communicate the agreed-upon risk appetite at various levels of detail throughout the entity. With the approval of the board, management also revisits and reinforces risk appetite over time in light of new and emerging considerations. Also, while risk appetite is extremely important in the consideration of strategy and when setting business objectives and performance targets, once an entity considers risk in execution, the focus shifts to managing risks with acceptable levels and variation. As organization ERM maturity increases, their description of risk appetite becomes more precise. Some will develop a series of cascading expressions of risk appetite referencing targets, ranges, floors and ceilings.

An organization may consider any number of parameters to help frame its risk appetite and provide greater precision. For example:

1. Strategic parameters- Such as new products to pursue or avoid, the investment for capital expenditures, and merger and acquisition activity.
2. Financial parameters- Such as the maximum acceptable variation in financial performance, return on assets or risk-adjusted return on capital, target debt rating, and target debt/equity ratio.
3. Operating parameters- Such as environmental requirements, safety, quality targets, and customer concentrations.

Management may also consider the entity's risk profile, risk capacity, and maturity when determining risk appetite:

1. Risk profile provides information on the entity's exposure to risk and how it is distributed across the entity as well as on the different categories of risk for the entity.
2. Risk capacity is the maximum amount of risk the entity can absorb. This amount is generally set by stakeholders, especially regulators, and exceeding this level may result in mandatory actions to reduce risk or lose independence. If the entity's risk capacity significantly exceeds its risk appetite, the organization may lose opportunities to add value for its stakeholders. If the goal is to maximize returns, excess risk capacity is viewed as a negative, but if the goal is to ensure solvency, it is encouraged.
3. Enterprise Risk Management capability and maturity provide information on how well ERM is functioning. A mature organization is

often able to define ERM capabilities that provide better insight into its existing risk appetite and factors influencing risk capacity. A less mature organization with undefined ERM capabilities may not have the same understanding, which can result in a broader risk appetite statement or one that will need to be redefined sooner.

Risk appetite guides resource allocation, both through the entire entity, and in individual operating units. The goal is for alignment with the entity's mission, vision, and core values. Management aligns people, processes and infrastructure to successfully implement strategy while aligning with its risk appetite.

Risk appetite is incorporated into decisions on how the organization operates, and management, with board oversight, continually monitors risk appetite at all levels and accommodates change when needed. In this way, management creates a culture that emphasizes the importance of risk appetite and holds those responsible for implementing Enterprise Risk Management within the risk appetite parameters.

ISO

Section 2.5 includes a brief reference to risk attitude, instead of risk appetite, as an organization's approach to assess and eventually pursue, retain, take or turn away from risk.

ORSA Summary Report Applications

Insurers typically set appetite statements for the organization in terms of metrics like: 1), a risk based capital ratio based on NAIC or economic capital results, 2) Combined Ratio that cannot be exceeded 3) a minimum reserve confidence ratio that must be maintained, 4) underwriting profit, 5) a rating agency rating level. The risk appetite may be presented as a range and units of the company have their own risk limits that are aligned with those of the enterprise. How the insurer defines risk (e.g., volatility, loss, failure to meet objectives) is generally included in this discussion, but may not be explicitly described.

Risk Management and Controls

COSO

Principle 15 discusses how organizations identify and select responses for each of the identified risks. Risk responses fall within the following five categories:

1. ***Accept:*** No action is taken to affect the severity of the risk.
2. ***Avoid:*** Action is taken to not pursue a risk, or if already present to remove it. This can mean ceasing a product line, declining to expand to a new geographical market, or selling a division.

3. ***Pursue:*** Action is taken to exploit an opportunity by accepting risk to achieve increased performance. This may involve continuing current practices, adopting more aggressive growth strategies, expanding operations, or developing new products and services.
4. ***Reduce:*** Action is taken to mitigate the frequency or severity of the risk.
5. ***Share:*** Action taken to reduce the severity of the risk by transferring or otherwise sharing a portion of the risk. Common techniques include outsourcing to specialist service providers, purchasing insurance products, and engaging in hedging transactions. As with the reduce response, sharing risk lowers residual risk in alignment with risk appetite but does not eliminate risk (e.g., counterparty risk replaces financial risk).

When an organization chooses to avoid a risk, it is consciously taking action to remove the risk to the achievement of strategy and business objectives.

These categories assume the risk can be managed within the organization's risk appetite and within an acceptable variation in performance. In some instances, management may also need to consider the following:

1. ***Review business objectives:*** The organization chooses to review and potentially revise a business objective given the risk profile and risk appetite.
2. ***Review strategy:*** The organization chooses to review and potentially revise the strategy given the expected frequency and severity of identified risks and risk appetite of the entity.

An organization may choose to exceed the risk appetite if they perceive greater benefits are received. For example, management may accept the risks associated with the expedited vetting of an expanded sales team in favor of the opportunities and competitive advantage from the larger sales team. Where an entity repeatedly accepts risks that approach or exceed appetite as part of its usual operation, a review and recalibration of the risk appetite may be warranted.

Management selects and deploys risk responses while considering the following factors:

1. ***Business context:*** Risk responses are selected or tailored to the industry, geographic footprint, regulatory environment, or operating model.
2. ***Cost benefits:*** Anticipated costs and benefits are generally commensurate with the analysis of the risk exposure.
3. ***Obligations and expectations:*** Risk response addresses, generally accepted industry standards, stakeholder expectations, and alignment

with the mission and vision of the entity.

4. ***Risk priority:*** The priority assigned to the risk informs the allocation of resources. Risk reduction responses that have large implementation costs (e.g., system upgrades, increases in personnel) for lower-priority risks may not be appropriate given the assessed severity.
5. ***Risk severity:*** Risk responses should reflect the size, scope, and nature of the risk and its impact on the entity. For example, in a transaction or production environment, where risks are driven by changes in volume, the proposed response is scaled to accommodate increased activity.
6. ***Risk appetite:*** Risk response either brings risk within risk appetite of the entity or maintains its current status. Management identifies the response that brings residual risk to within the appetite.

Often, any one of several risk responses will bring the residual risk in line with acceptable risk and return performance, and sometimes a combination of responses provides the optimal result. Conversely, sometimes one response will affect multiple risks, in which case management may decide that additional actions to address a particular risk are not needed.

The risk response may interact with the risk profile in ways that could impact the risk appetite. Once management selects a risk response, control activities are necessary to ensure that those risk mitigation activities are executed as intended. Management must recognize that risk is managed but not eliminated. Some residual risk will always exist, not only because resources are limited, but because of future uncertainty and limitations inherent in all tasks. An evolving risk profile becomes a driver in the strategic planning process.

Management is responsible for risk responses addressing regulatory obligations, which may not be an optimal solution, but comply with legal or other obligations and provide a margin of safety for the company and policyholders. In selecting the appropriate risk response, management must consider the expectation of stakeholders such as shareholders, regulators, and customers.

A risk response may introduce new, previously unidentified risks, or may have unintended consequences. For a newly-identified risk, management should assess the impact to the risk profile and determine the effectiveness of the proposed response. On the other hand, management may identify innovative responses that are new to the entity or industry. Existing risk response options may reach the limit of effectiveness and further refinements may provide only marginal changes to the severity of a risk.

ISO

Section 5 states that risk treatment involves selecting one or more options for modifying risk, and implementing those options. Once implemented, treatments provide or modify the controls.

Risk treatment involves a cyclical process of:

1. Assessing a risk treatment
2. Deciding whether residual risk levels are tolerable
3. If not tolerable, generating a new risk treatment
4. Assessing the effectiveness of that treatment

Risk treatment options may not be mutually exclusive or appropriate. Options include the following:

1. Avoiding the risk
2. Taking or increasing the risk in order to pursue an opportunity
3. Removing the risk source
4. Changing the likelihood
5. Changing the consequences
6. Sharing the risk with another party or parties (including contracts and risk financing)
7. Retaining the risk by informed decision

A number of treatment options can be considered and applied either individually or in combination. The organization should consider the values and perceptions of stakeholders and the most appropriate ways to communicate with them. At times, they may provide input and be involved in choice selection.

The treatment plan should be clearly prioritized. Risk treatment itself can introduce risks. A significant risk can be failure or ineffectiveness of the risk treatment measures. Monitoring needs to be an integral part of the risk treatment plan to give assurance that the measures remain effective. Risk treatment can also introduce secondary risks that need to be managed.

Risk treatment plans document how the chosen treatment options will be implemented. The information provided should include:

1. The reasons for selection of treatment options, including expected benefits to be gained
2. Those who are accountable for approving the plan and those responsible for implementing the plan
3. Proposed actions

4. Resource requirements including contingencies
5. Performance measures and constraints
6. Reporting and monitoring requirements
7. Timing and schedule

ORSA Summary Report Applications

The output generated by the ERM process should inform insurers' decision-making. In the past, many insurers waited too long to exit a line of business because they hoped a loss trend was temporary or engaged in alternative investments because they saw others doing so with some success. In fact, they were not taking a deep or prospective enough look at the risks associated either with the book of business or the asset class. ERM is a methodology that provides for looking at current and emerging risk on its own merits, allowing a methodology to counter popular industry trends if they do not make sense for a company's unique risk profile and risk appetite. The ORSA report should communicate when an insurer has used its ERM output to make decisions or change its strategic direction, and provide a blueprint for how the company expects to react to an adverse capital event or breach of the risk capital threshold minimums. These results could be viewed on a marginal basis as well as how it all fits together at the enterprise level, considering risk exposures on both a gross and net exposure level.

Management must consider the potential costs and benefits of a risk response. Generally, anticipated costs and benefits are commensurate with the severity and prioritization of the risk. Cost and benefit measurements for selecting and deploying risk responses are made with varying levels of precision. Costs comprise direct costs, indirect costs (where practicably measurable) and for some entities, opportunity costs associated with the use of resources.

Measuring benefits may be more subjective, as they are usually difficult to quantify. In many cases, the benefit of a risk response can be evaluated in the context of the achievement of strategy and business objectives. In some instances, given the importance of a strategy or business objective, there may not be an optimal risk response from the perspective of costs and benefits. In such instance, the organization can either select a response or choose to revisit the entity's strategy and business objectives.

Risk Reporting and Communications

COSO

Principle 20 discusses how organizations can use their communication channels to support an ERM program. Various channels are available to the organization for communicating risk data and information to internal and external stakeholders. These channels provide relevant information for use in

Implementing ORSA Aligning ORSA Reporting with Existing Frameworks

(continued)

decision-making. Internally, management communicates the entity's strategy and business objectives clearly throughout the entity so that personnel at all levels understand their individual roles. Specially, communication channels enable management to convey:

1. The importance, relevance, and value of Enterprise Risk Management
2. The characteristics, desired behaviors, and core values that define the culture of the entity
3. The strategy and business objectives of the entity
4. The risk appetite and acceptable variation in performance
5. The overarching expectation of management and personnel in relation to Enterprise Risk and Performance Management
6. The expectation of the organization on any important matters relating to Enterprise Risk management, including instances of weakness, deterioration, or non-adherence

Management communicates information about the entity's strategy and business objectives to shareholders and other external parties. ERM is a key topic in these communications so that external stakeholders understand the performance against strategy and the actions consciously taken to achieve it. External communication may include holding recurring analyst meetings to discuss performance.

Effective communication between the board of directors and management is critical for organizations to achieve their chosen strategy and business objectives. Communication about risk starts by defining risk responsibilities; who needs to know what and when they need to act. Organizations should examine their risk governance structure to ensure that responsibilities are clearly defined at the board and management levels and that the structure supports the desired risk dialogue. The board's responsibility is to provide oversight and ensure that appropriate measures are in place so management can identify, assess, prioritize, and respond to risk.

As part of its oversight role, the board ensures that communications regarding risk appetite remain open. It may do this by holding formal quarterly board meetings, and by calling extraordinary meetings to address specific events (e.g., cyber terrorism, CEO succession, mergers). The board and management can use the risk appetite statement as a touchstone, identifying those risks that are on or off strategy, monitor the entity's risk profile, and track the effectiveness of ERM programs. Given the strong link to strategy, the risk appetite statement should be reviewed as strategy and business objectives evolve.

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Common approaches to communicating with the board include:

1. Address risks as determined by the entity's strategy and business objectives
2. Capture and align information at a level consistent with directors' risk oversight responsibilities and with the level of information determined necessary by the board
3. Ensure reports present the entity's risk profile as aligned with its risk appetite statement, and link reported risk information to policies for exposure and tolerances
4. Provide a longitudinal perspective of risk exposures including historical data, explanations of trends, and forward-looking trends explained in relation to current positions
5. Update at a frequency consistent with the pace of risk evolution and severity of risk
6. Use standardized templates to support consistent presentation and structure of risk information over time

A dynamic and constructive risk dialogue must exist between management and the board, including a willingness to challenge assumptions underlying the strategy and business objectives. Boards can foster an environment in which management feels comfortable bringing risk information to the board by discussing emerging risks qualitatively with the board at a time when the severity of these types of risks is often unclear.

ISO

Section 5.2 states communication and consultation with external and internal stakeholders should take place during all stages of the risk management process. These should address issues relating to the risk itself, causes, consequences (if known) and the measures being taken to treat it. Effective external and internal communication and consultation should take place to ensure that those accountable for implementing the risk management process and stakeholders understand the basis on which decisions are made, and the reasons why particular actions are required.

A consultative team approach may:

1. Help establish the context
2. Ensure that interests of stakeholders are considered
3. Ensure that risks are adequately identified
4. Bring different areas of expertise together for analyzing risks
5. Ensure that different views are appropriately considered when defining risk criteria and in evaluating risks

Implementing ORSA Aligning ORSA Reporting with Existing Frameworks

(continued)

6. Secure endorsement and support for a treatment plan
7. Enhance appropriate change management
8. Develop an appropriate external and internal communication and consultation plan

Communication and consultation with stakeholders is important in order to ensure that the objectives and concerns of external stakeholders are considered when developing risk criteria. The external context includes:

1. The social and cultural, political, legal, regulatory, financial, technological, economic, natural and competitive environment, whether international, national, regional or local
2. Key drivers and trends having impact on the objectives of the organization
3. Relationships with, perceptions and values of external stakeholders

ORSA Summary Report Applications

Insurers, especially public insurers, must contend with many audiences which are interested in understanding the risks they face. In addition to internal management and the board of directors, these include regulators such as the State Insurance Departments, watchdogs such as the SEC, rating agencies, investors, and other stakeholders. It becomes important not only to disclose accurate information but also consistently communicate across audiences. There could be serious reputation and other damage if contradictory statements about the organization's risks were to be put into circulation by the organization itself. Financial analysts should compare and contrast what an organization has reported about itself to gain insight into the governance and reliability related to its reporting overall.

Corporate Governance Annual Disclosure

In 2014 the NAIC adopted the Corporate Governance Annual Disclosure Model Act (#306) and supporting Model Regulation. This article is not intended to cover it in any detail. At this point only a few states have implemented Model Act #306, and examiners should continue to monitor its implementation.

Conclusion:

An ORSA report is designed to communicate the insurer's ERM program to management, the board of directors, and the primary regulator. It must describe the risk culture, governance, and tools used to ensure resilience during good times and bad. The industry will evolve on a regular basis, so it is important to regularly review the annual ORSA report for changes in practice

Implementing ORSA Aligning ORSA Reporting with Existing Frameworks

(continued)

and changes in risk profile and strategy. Tools to aid this analysis are available from a variety of groups, and regulators should seek out alternative views to risk and risk management to remain as principles based as possible.

Both of the ERM frameworks considered in this article, the 2016 revisions to the COSO II ERM Framework and the 2009 ISO 31000, extend beyond the minimum guidelines offered in Section 1 of the ORSA Guidance manual. The manual is designed to be a checklist of items for insurance carriers and regulators when evaluating an ERM program, not a complete evaluation of all the necessary parts. The frameworks describe risk assessment techniques, how to determine root causes of potential risk events, how to set up a risk monitoring system, evaluating risks to strategy as well as risks to performance metrics. ORSA provides a starting point for an insurance carrier to discuss their ERM program in a capital assessment context.

Post-Election Analysis 2016: Insurance

L. Charles Landgraf, Paul A. Howard

November 2016

KEY TAKEAWAYS

- President-elect Trump will take office with two big unfinished items from the Obama Administration – a covered agreement with the EU and finalization of the Federal Reserve's capital standards for insurers.
- Congress will be focused largely on reauthorization of the NFIP for most of 2017, where dramatic changes to the program could result.

<u>Transition Team for Insurance and Financial Services</u>

William Hagerty – Director of Appointments, Trump Transition Team
Eric Ueland – Staff Director, Senate Budget Committee
Paul Winfree – Heritage Foundation Economist
Daris Meeks – Attorney

<u>Insurance and Financial Services Advisors</u>

Stephen Moore – Heritage Foundation
Peter Navarro – Professor, Univ. of California Irvine
Wilbur Ross – Investor, WL Ross and Co.
Anthony Scaramucci – Managing Partner, SkyBridge Capital
Steve Feinberg – CEO of Cerberus Capital Management
Stephen Calk – Founder and Chairman, The Federal Savings Bank
Howard Lorber – Chairman of Douglas Elliman (real estate brokerage)
David Malpass – Founder of economic consulting firm Encima Global
Steven Mnuchin – Former Goldman Sachs banker and film producer
John Paulson – President and CEO of investment firm Paulson & Co.
Steven Roth – Founder and Chairman of Vornado Realty Trust

ADMINISTRATION PRIORITIES

President-elect Trump's policy agenda in the insurance realm will likely be limited – as it is for most administrations – given the state-based regulatory system. Nevertheless, the Trump Administration will inherit a number of outstanding insurance matters that will require high-level attention.

Covered Agreement Negotiations with the European Union. The Obama Administration's Treasury Department and the US Trade Representative (USTR) have been in the process of negotiating a "covered agreement" with the European Union (EU) over the past year to address concerns regarding the treatment of US firms by European regulators under Solvency II, as well as concerns by non-US reinsurers about state-level reinsurance collateral requirements.

While negotiations are ongoing, both sides continue to express optimism that an agreement will be reached. An agreement is likely to grant the United States "temporary equivalence" under Solvency II, while providing for some form of collateral reduction for EU-based reinsurers (likely based in part on the National Association of Insurance Commissioners' (NAIC) Credit for Reinsurance Model Law). An agreement along these lines was contemplated even prior to the enactment of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank) – indeed, the covered agreement provisions of Title V were crafted with this purpose in mind – and there is increasing interest on both sides of the aisle to see an agreement concluded. Should an agreement be reached, it may only take effect after a 90-day "layover" period for congressional review.

The ability of a covered agreement to preempt state law on a limited basis, while seen as necessary to effectuate international commitments, is the NAIC's principal reason for opposing the current negotiations. The NAIC's opposition, however, may not be enough to prompt congressional action to stop a deal if it is seen as positive for the United States.

If an agreement is not reached prior to President-elect Trump taking office, several of the US negotiators are likely to change, and an agreement is likely to be delayed further. It is unclear, however, whether there would be any substantial shift in position on the covered agreement from the Obama Administration to the Trump Administration.

Insurance Capital Standards. The Federal Reserve (Fed) continues to develop capital standards tailored for insurers that they supervise by virtue of the fact that the insurer (a) has been designated as a systemically important financial institution (SIFI) by the Financial Stability Oversight Council (FSOC), or (b) owns a bank or thrift.

The Fed issued a long-awaited advance notice of proposed rulemaking laying out a proposed regulatory framework in June 2016, but final regulations do not appear imminent. The next administration will be tasked with finalizing these regulations while continuing to engage with stakeholders.

Cyber Insurance. The Treasury Department, particularly Deputy Secretary Sarah Bloom Raskin, has taken an active interest in promoting the development of the cyber insurance market. Treasury, as well as some members of Congress, have taken the view that such insurance can be an effective market-based driver of better cyber hygiene among businesses of all sizes. While this issue has generally not been a partisan one, it is unclear whether the incoming administration will take a similar interest in monitoring the growth of the cyber insurance market and pursuing policies to foster its development.

AGENCY LEADERSHIP

There are only two positions at the federal level that deal specifically with insurance: the independent insurance expert serving on the FSOC and the Director of the Federal Insurance Office (FIO).

In the case of the FIO Director, that position is appointed by the Treasury Secretary – not the President – so the most likely candidates may not be known until after the new Treasury Secretary is named. Current FIO Director Michael McRaith is almost certainly not a candidate to continue in the position in a Trump Administration.

The FSOC's Independent Member with Insurance Expertise, Roy Woodall, is nearing the end of his six-year term, which will expire in September 2017, and thus the Trump Administration will need to either reappoint Mr. Woodall or appoint a replacement.

CONGRESSIONAL LEADERSHIP

House. Rep. Jeb Hensarling (R-TX) will remain chair of the House Financial Services Committee, a position he has held since 2013. His Democratic counterpart on the committee will once again be Ranking Member Maxine Waters (D-CA).

Senate. Sen. Michael Crapo (R-ID) will likely be the new chair of the Senate Banking Committee, as the outgoing chair, Sen. Richard Shelby (R-AL), is term-limited. Sen. Crapo previously served as ranking member of the committee from 2013-2014. Sen. Sherrod Brown (D-OH) will remain as ranking member.

CONGRESSIONAL PRIORITIES

With Republicans retaining control of the Senate and the House and gaining the White House, they will have a freer hand to pursue legislative priorities in Congress provided it is not contrary to the administration's agenda. The Republicans' narrow majority in the Senate combined with procedural rules that give the minority party substantial power, however, mean that Democrats will be able to obstruct certain policy measures. The dynamics may be similar to what Senate Republicans did in the first two years of the Obama Administration. All that having been said, insurance regulatory policy debates do not always fall neatly along party lines.

Flood Insurance Reauthorization. *The Biggert-Waters Flood Insurance Modernization Act of 2012* is due to sunset on September 30, 2017, perhaps making the reauthorization of the National Flood Insurance Program (NFIP) the most pressing congressional insurance priority. The issue is likely to remain in the forefront given that Sen. Chuck Schumer (D-NY), who has been extremely active on flood insurance issues following Superstorm Sandy, will take over as Senate Minority Leader.

With a current debt estimated at $23 billion, the NFIP remains controversial on a variety of fronts, and we anticipate numerous proposals to drastically change the program in the coming year. Chair Hensarling and a number of his Republican colleagues have made no secret of their desire to see greater participation of the private sector in flood insurance, while Ranking Member Waters has advocated forgiveness of the $23 billion debt as part of the reform effort.

There have been a number of flood insurance-related hearings in Congress during 2016 in preparation for the reauthorization, and we expect there will be more throughout 2017. Given the timing of the program's expiration, action on reauthorization legislation is likely to commence quickly in the new year. The Trump Administration will be, to some extent, a latecomer to this debate, but will play no less critical a role.

International Capital Standards. With Republicans holding their majority in the House, we expect that congressional scrutiny of US participation at the International Association of Insurance Supervisors (IAIS) will continue much as it has in recent years. In particular, the concern that the IAIS may adopt an international capital standard that is inconsistent with the US regulatory structure has led to numerous congressional hearings over the past several years focused on how the US participates at the IAIS, and what the implications such standards could have for US competitiveness.

Terrorism Risk Insurance Act. While the *Terrorism Risk Insurance Act* (TRIA) is not set to expire until 2020, some industry stakeholders have suggested that Congress continue to examine potential changes to the program far in advance of that sunset, given the market disruption caused by last-minute reauthorization (or, in the case of the latest reauthorization, the brief lapse of the program). To this end, congressional hearings on TRIA are possible in the 115th Congress, although we do not anticipate any effort to move legislation.

L. Charles Landgraf
+1 202.942.6408
charles.landgraf@aporter.com

Paul A. Howard
+1 202.942.6235
paul.howard@aporter.com

www.pwc.com/us/insurance

NAIC Meeting Notes

Global Insurance Industry Group, Americas

NAIC 2016 Summer National Meeting

The National Association of Insurance Commissioners held its Summer National Meeting in San Diego August 26-29. This newsletter contains information on activities that occurred in some of the committees, task forces and working groups that met there, as well as summarizes conference calls after the Summer National Meeting through September 19. For questions or comments concerning any of the items reported, please feel free to contact us at the address given on the last page.

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Executive Summary

- The Executive Committee and Plenary adopted a recommendation for a January 1, 2017 operative date for implementation of principles-based reserving.
- The Cybersecurity Task Force exposed its significantly revised second draft of the Insurance Data Security Model Law and received preliminary comments of continued concern from interested parties.
- The Big Data Working Group heard presentations on predictive analytics in insurance and discussed three potential work streams it plans to undertake.
- The Financial Condition Committee discussed a memo from its chair entitled "Contingency Plan Regarding Consumer Protection Collateral" as part of its charge to address potential adverse effects from covered agreement negotiations.
- The Statutory Accounting Principles Working Group adopted guidance on short sales and PBR implementation, and agreed to retain the current accounting and disclosures for leases. The working group exposed an issue paper on special hedge accounting for variable annuities and agreed to allow both fair value and "systematic value" in an issue paper for rated bond ETFs. A compromise proposal for insurers to report additional detailed investment information each June 30 was also exposed for comment.
- The Blanks Working Group adopted 22 proposals as final and exposed two new items for consideration.
- The Investment RBC Working Group heard comments on its proposed "A Way Forward" document and exposed proposed changes to the RBC formula and instructions to implement 20 bond designations for RBC reporting; AVR would also be expanded to 20 categories.
- The Life RBC Working Group adopted instructional changes for the RBC shortfall calculation and discussed a workplan for review of commercial mortgage RBC factors. The Joint Longevity Risk Subgroup heard survey results indicating that longevity risk is generally considered in asset adequacy analysis.
- The Property/Casualty RBC Working Group adopted proposals on the 2016 underwriting risk factors and multiple financial strength ratings and discussed a referral on hedge fund investments.
- The Catastrophe Risk Subgroup rejected a proposal on earthquake model losses to move to a 1-in-250 year standard and discussed comments on the 2017 Rcat implementation proposal.
- The Health RBC Working Group adopted three proposals for 2016 RBC filings, withdrew the Medicaid pass-through payments proposal, and discussed a comment letter related to the Way Forward document.
- The Operational Risk Subgroup adopted the 2016 informational factors, heard updated results of the growth risk test and basic operational risk test, and discussed the timeline for the operational risk factors to be effective in 2017.
- The Valuation of Securities Task Force adopted a proposal to amend SSAP43R and considered refinements to its RMBS/CMBS modeling procedures. The task force also held a special session on infrastructure investments.
- The newly formed Reporting Exceptions Working Group made significant progress on its analysis of a large population of securities that are reported as filing exempt by insurers but do not appear on credit rating provider data feeds.
- The Group Capital Calculation Working Group exposed its draft "Questions on Various Aspects of the Inventory Method," and discussed ways to address both U.S. insurers and non-U.S. entities that are not subject to RBC requirements.
- The Group Solvency Working Group discussed disappointing survey results related to Form F Enterprise Risk filings and shared best practices for ORSA information sharing.
- The ComFrame Development and Analysis Working Group discussed capital issues related to the IAIS Insurance Capital Standards and received an update on field testing and the ComFrame revision process.

- The International Insurance Relations Committee and the Financial Stability Task Force received updates on various activities of the IAIS, Federal Reserve and FSOC.
- The Reinsurance Task Force adopted the XXX/AXXX Credit for Reinsurance Model Regulation, newly renamed the Term and Universal Life Insurance Reserve Financing Model Regulation.
- The Variable Annuity Issues Working Group presented the results of the VA Quantitative Impact Study and proposed related changes to AG 43 and the C3Phase 2 calculation to address the issues identified. The working group also adopted a proposal for a new Variable Annuities Supplement for 2017 annual statements.
- With PBR now becoming effective January 1, 2017, the Life Actuarial Task Force focused on PBR Valuation Manual amendments and discussed matters related to aggregation of reserves, governance, and the role of the valuation actuary. Other discussions included mortality table development and application of AG 49 to inforce policies.
- The PBR Review Working Group adopted its annual statement VM-20 Reserves Supplement, which was then exposed by the Blanks Working Group.
- The Health Actuarial Task Force's Long Term Care Actuarial Working Group heard several presentations on topics related to LTC valuation.
- The Casualty Actuarial and Statistical Task Force had extensive discussions of the sharing of rate filing information among regulators.
- The Financial Examiners Handbook Technical Group discussed documentation of suitability of key individuals during financial examinations.
- After years of development, the Mortgage Guaranty Insurance Working Group released its draft proposed capital models for public review. The working group also continues finalization of a revised Mortgage Guaranty Insurance Model Act and related standards manual.
- The Climate Change and Global Warming Working Group heard a presentation of a public-private partnership working to mitigate wildfire risk.

Executive Committee and Plenary

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

Adoption of Revised Models and Other Guidance
The Executive Committee and Plenary adopted as final the following items during its June 10 interim conference call and at the Summer National Meeting, which were the subject of public hearings and debate as they were considered by various groups of the NAIC:

- The recommendation of the Principle-Based Reserving Implementation Task Force of a January 1, 2017 operative date for the Valuation Manual (See further discussion in the summary of the task force on page 4.)
- Recent Valuation Manual amendments
- Amendments to Actuarial Guideline 48 to eliminate use of the net premium reserve percentages for valuation dates after December 31, 2015
- Amendments to Actuarial Guideline 49
- Amendments to the Health Insurance Reserves Model Regulation (#10) (Individual Disability Table)
- New Actuarial Guideline L—2013 Individual Disability Income Valuation Table (AG 50)
- Amendments to the Model Regulation to Implement the NAIC Medicare Supplement Insurance Minimum Standards Model Act (#651)
- NAIC Model Bulletin on Federal Gramm-Leach-Bliley Act Annual Privacy Notices
- Market Conduct Annual Statement Health Line of Business Blank

Cybersecurity Task Force

Update Regarding Cybersecurity Legislation
In San Diego, the task force received an update that the White House has appointed a Commission for Enhancing National Cybersecurity, which has issued a request for information to develop recommendations for President Obama on ways to strengthen cybersecurity in the public and private sectors. The commission is comprised of 12

cybersecurity experts established through a presidential executive order. The National Institute of Standards and Technology is tasked with supporting the commission. An area of inquiry is cybersecurity insurance. The comment period for the information request ended September 9 and the commission's final report will be submitted to President Obama by December 1. The NAIC will consider providing written comments through its Government Relations Leadership Council.

It was noted that U.S. Representative Edwin Perlmutter plans to introduce the Data Breach Insurance Act which will amend the Internal Revenue Code to incentivize businesses to purchase data breach/cybersecurity insurance by providing a tax credit to those who purchase a policy. However, businesses will only be eligible to receive the tax credit if they adopt the NIST Cybersecurity Framework, the International Organization for Standardization or similar standards specified by the Department of the Treasury in coordination with the Department of Homeland Security.

On September 9, the New York Department of Financial Services issued proposed regulations for a 45-day public comment period that would require insurance companies and banks licensed in New York to establish written cybersecurity programs and policies and to designate a Chief Information Security Officer. The proposed effective date is January 1, 2017. The regulations would also require an annual certification of compliance with the regulation, with the first certification proposed to be filed January 15, 2018.

Draft Insurance Data Security Model Law

Extensive comments were received on the draft Insurance Data Security Model Law, originally exposed in March 2016, which were echoed during the Spring National meeting. During the interim period, the task force met in person in Washington, D.C. on May 24 and 25 and via conference call June 29.

In D.C., the task force and interested parties performed a detailed section by section review of the draft model law, and many interested parties reiterated their concerns raised in previous comment letters that significant revisions are warranted. As was expected based on prior discussions, Section 7, Notification of a Breach of Data Security, and Section 8, Consumer Protections Following a Breach of Data Security, garnered primary focus. Interested parties discussed whether judgment as to harm to insureds should be considered, i.e., a "harm provision," that would trigger notification of insureds. The required timeframe for issuance of breach notification was discussed, taking into consideration a potential requirement for the state commissioner to approve the notification. In addition, others noted the potential significant costs of preventive measures, especially on smaller agencies and licensees, as well as identity theft or credit freeze requirements.

After considering the comments received on each section of the draft model law, the task force met via conference call on June 29, where several states provided detailed comments or submitted written updates to the task force for consideration. Several voiced their optimism that the updates to the draft model law will address many of the concerns of interested parties.

On August 17, a second draft of model law was released for comment, and in San Diego, the chair asked interested parties for initial comments (limiting verbal comments to three minutes per speaker). Overall, interested parties voiced continued concerns on the second draft noting that the model does not address the 47 different state data breach notification laws. In addition, the model does not provide for harm standards in the data breach notice which will ensure that consumers are not being notified on matters that do not injure them. Interested parties cited the need for uniformity and non-duplicative standards. There were also concerns that the model will conflict with the Health Insurance Portability and Accountability Act standards. Written comments were due September 16, and the working group will schedule a conference call to discuss comments received. At the Spring National Meeting, the chair stated that the goal of the working group is final adoption of a model by the end of 2016; no timeline was discussed in San Diego.

Cybersecurity Insurance Coverage Supplement

The task force heard an update regarding the data collected from insurers regarding the sale of cybersecurity insurance products and identity theft coverage, as filed in the Cybersecurity Insurance and Identity Theft Coverage Supplement to the 2015 P/C annual statement. More than 500 insurers, comprising $1.5 billion in direct written premium, provided businesses and individuals with cybersecurity insurance. The vast majority of these coverages ($1 billion in direct written premium) were written as endorsements to commercial and personal policies. Insurers writing stand-alone cybersecurity insurance products reported approximately $500 million in direct written premium and was comprised of 48 insurer groups. The top 10 insurers wrote 79% of the total U.S. market. It was noted that the $1.5 billion in direct written premium is a very small percentage of the $522 billion in net written premium reported by the

P/C insurers for 2015. The task force may consider soliciting comments from interested parties on how the instructions or the format of the supplement could be improved.

Georgia Tech Study on Cyberinsurance
The task force heard a presentation by a Georgia Institute of Technology faculty member on a project supported the Department of Homeland Security to study ways to improve cybersecurity insurance markets by applying behavioral economics principles to translate technical cyber risks into actionable business terms. The goal is to use cybersecurity insurance premiums to be reflective of cybersecurity behaviors by businesses. It was noted that insurance underwriters need to provide coverage reflective of the risks they assume and businesses need motivation through tangible incentives to improve security. To make improvements, businesses must obtain realistic quantitative tools encouraging sound cyber risk management. The presenter encouraged insurers and regulators to become involved in the project by providing data, participating in interviews and surveys, and joining topical workshops.

Big Data Working Group

Since its inaugural meeting at the Spring National Meeting, the working group met via conference call twice in May and in person in San Diego. The discussion during the conference calls focused on the insurers' use of big data in rating and underwriting practices as well as transparency regarding the use of big data in claims processing. The discussion also focused on how state regulators can enhance their expertise in reviewing the insurers' models and how the reviews can be better coordinated among the states.

In San Diego, the working group heard two presentations on predictive analytics in insurance. The Center for Economic Justice presentation focused on the potential for discrimination or disparate impact of big data and predictive analytics on low-income and minority consumers. Birny Birnbaum pointed out that data mining and models are premised on correlation; however, because correlation is not causation, insurers are relying on "spurious correlation" which is a statistically-valid association between variables that are not causally related. Mr. Birnbaum also noted that models may perpetuate historic discrimination based on biased data, biased models and assumptions and faulty model specifications, resulting in inequities. It was noted that the insurers' use of big data has huge potential to benefit consumers and insurers by transforming the insurer-consumer relationship and by discovering new insights into loss mitigation. Conversely, the insurers' use of big data also has enormous implications for fairness and affordability of insurance and for regulators' ability to keep up with the changes and protect consumers from unfair practices. Mr. Birnbaum noted that big data has massively increased the market power of insurers versus consumers versus regulators; the balance of knowledge between insurers and consumers has grown sharply in favor of insurers.

The working group also heard a presentation from TransUnion on how data analytics can be used for better predictability of risk, which described how the use of other sources of data for a consumer may give the consumer access to more affordable products. One example is trended credit information, which may give an indication of a better credit risk than a traditional credit score. The presenter also discussed how data can be used to better identify fraud which will help reduce claims costs.

Following the presentations, the working group discussed ideas for its formal charges and potential workstreams. Prior to the Summer National Meeting, the working group had exposed and received comments on the definition of big data. At the meeting, the chair stated her preference for the working group to focus on the uses of data and data sets, rather than wordsmithing the definition. The working group discussed three workstreams:
1) address public policy and regulatory framework,
2) understand what data is being used and how, and
3) consider an expedient effective regulatory process by introducing better tools for reviewing models and increasing regulator collaboration. The working group members also noted that they would like specific topics to be covered including the segmented use of data and use of data for claims optimization.

Principles-Based Reserving Implementation Task Force

PBR Adoption by States
As noted in a PwC special alert emailed June 17, during its Executive Committee and Plenary conference call June 10, the NAIC unanimously adopted the task force's recommendation of a January 1, 2017 operative date for the implementation of Principles-Based Reserves, a huge milestone for this project in process since 2004. The operative date of January 1, 2017 was achieved after 45 NAIC jurisdictions representing 79.5% of direct premium adopted the revised Standard Valuation Law (which includes the PBR Valuation Manual) and the revised Standard Nonforfeiture Law for Life Insurance. In early July, after the appointment of a new superintendent, New York also adopted PBR with a

January 1, 2018 effective date which brings the total to 46 states and 85% of premium; Massachusetts and Wyoming have bills pending.

At the Summer National Meeting, the task force requested that states issue announcements of the January 1, 2017, operative date; as of the date of the meeting, 24 states had issued bulletins or other announcements. The task force also expects to recommend to the Financial Regulation and Accreditation Committee a proposed effective date of January 1, 2020 for the accreditation standard to adopt PBR.

PBR Pilot Project and PBR Company Experience Reporting Pilot
See the summary of the PBR Review Working Group for discussion of these pilot projects.

Financial Condition Committee

Guaranty Model Act
The committee voted to adopt a proposed change to the Life and Health Insurance Guaranty Association Model Act (#520) is to clarify that guaranty association coverage is not intended to be provided to factored structured settlement annuity benefits that have been sold to a third-party by the original annuitant. The chair noted that the basis for this distinction is that these are "sophisticated buyers who have considered such risk in the price they offered the original annuitant."

Covered Agreements and Collateral Protection
At the Spring National Meeting, the committee adopted a new charge to develop contingency plans to protect U. S. consumers and U. S. ceding companies from potential adverse effects resulting from covered agreement negotiations, which could possibly reduce reinsurance collateral to zero. At the Summer National Meeting the committee discussed a memo from the chair entitled "Contingency Plan Regarding Consumer Protection Collateral," which suggested three methods to better protect consumer collateral: expand the certified reinsurer process, require additional capital for U.S. ceding companies, or require all reinsurers to file certain limited information with the NAIC.

Given the significance of suggestions 2 and 3, the chair reiterated that the process is just beginning, is for contingency planning only and is not in response to specific language proposed by any covered agreement. The RAA responded that it "welcomed the discussion on a different approach towards reinsurers in general." The committee solicited feedback on the memo, which will be summarized for future discussions.

Statutory Accounting Principles Working Group

The working group met via conference call June 9 and at the Summer National Meeting to discuss the following projects. (After each topic is a reference to the Statutory Accounting Principles Working Group's agenda item number.)

Adoption of Revisions to SSAPs

Short Sales (2015-02) – During its June 9 conference call, the working group adopted as final both Issue Paper 152, Short Sales, and revisions to SSAP 103 after limited technical comments from interested parties were accepted. The revisions (new paragraphs 79-84 to SSAP 103R) provide guidance for situations in which state regulations do not prohibit, or otherwise provide specific guidance for short-sale transactions. The guidance deviates from U.S. GAAP and requires a short sale to be recorded as a contra asset in the balance sheet. The guidance is effective prospectively to short sales on or after January 1, 2017 (unless a company had previously been following similar guidance, and would therefore continue to do so). Annual statement and instructions changes related to short sales were adopted by the Blanks Working Group effective January 1, 2017 (2016-15BWG).

Prepayment Penalties and Amortization on Callable Bonds (2015-23) – The working group concluded its year-long discussion of this topic and adopted revised guidance to SSAP 26 and 43R to clarify what portion of proceeds reflects the prepayment penalty of a callable bond with make-whole provisions, with an effective date of January 1, 2017 and with early adoption permitted. The regulators also adopted a new disclosure for 2017 financial statements; insurers will disclose the total number of CUSIPs and total amount of investment income of callable bonds sold, redeemed or otherwise disposed as a result of a callable feature. The working group agreed with an interested party comment not to require this disclosure by type of call feature.

With respect to the related proposal to the Blanks Working Group to adopt this change and have reporting by individual security (2016-26BWG), industry identified that the proposal creates a conflict between the SSAPs and annual statement and instructions for Schedule D Verification Between Years. After significant discussion at both the June and August Blanks Working Group calls, that working group agreed to defer the effective date of Schedule D changes to January 1, 2018. Disclosure of the aggregate information on prepayment penalties will still be January 1, 2017.

SSAP 1 - Clarification of Permitted and Prescribed Practices Disclosure (2015-52) – The working group adopted additional clarifying guidance related to its proposal to require disclosure of all permitted and state prescribed practices that differ from NAIC, not just those that affect surplus or RBC. Disclosure will now be required for such practices that "result in different statutory accounting reporting (e.g., gross or net presentation, financial statement reporting lines, etc.)." Related annual statement illustration and instructions changes referred to the Blanks Working Group were also adopted by that working group for 2016 reporting (2016-13BWG).

SSAP 26 (2015-41) – In connection with the Valuation of Securities Task Force proposal to remove the SVO from the 5* process and have insurers self-designate all 5* securities held, (proposed effective date is January 1, 2017), the working group adopted a new disclosure for 2016 financial statements to capture current and prior period information on the number of 5* securities and the book adjusted carrying value and the fair value for those securities by category: bonds, loan-backed and structured securities and preferred stock. The related blanks changes for the disclosure was adopted by the Blanks Working Group during its June 16 call (2016-14BWG). The proposal to add a new quarterly and annual general interrogatory for insurers to confirm they have completed all the requirements to self-designate 5* securities was approved by the VOS Task Force this summer and was exposed for comment by the Blanks Working Group (2016-28BWG) in August with comments due by October 24.

SSAP 97 Data Capture Disclosure (2015-25) and (2016-04) – The working group adopted a revised proposed data capture disclosure template (first required in 2015 financial statements) to include the company's ownership percentage of the SCA and an inclusion of a code column to assist companies in completing the disclosure. The related blanks proposal (2016-16 BWG) was also adopted by the Blanks Working Group on June 16, so the disclosure will be data captured for year-end 2016. The working group agreed to a modification to exclude insurance entities from the disclosure since all insurers file annual statements. The regulators also clarified that the disclosure does not include SSAP 48 entities (even those entities controlled by an insurer which are therefore subject to other provisions of SSAP 97).

SSAP 1 - Collateral Received (2016-09) – The working group adopted a previously exposed disclosure to capture the aggregate total of collateral assets reported as assets on the insurer's financial statement and the corresponding recognized liability to return the assets. Interested parties commented that the disclosure is duplicative of other disclosures since collateral received for securities lending and derivatives is already disclosed. However, since the proposal was the result of a regulator request, the working group adopted it for year-end 2016. The disclosure will be data-captured as part of the revisions adopted by the Blanks Working Group in agenda item 2016-21BWG.

SSAP 26 – Common Stock and SSAP 30 Preferred Stock (2016-05) – During its June conference call, the working group adopted necessary revisions to SSAPs, 2 26, 30 and 32 to remove the Class 1 Bonds Fund designation from the guidance in response to actions taken by the VOS Task Force as a result of the regulations adopted by the SEC to preclude the use of a stable value NAV for these institutional money market funds. With this adoption, there will still be two reporting lines on Schedule DA for short-term investments: one for Exempt Money Market Mutual Funds and one for All Other Money Market Mutual Funds, which would include the former Class 1 bond funds. The related blanks changes were also adopted (2016-18BWG) by the Blanks Working Group in June.

As part of this agenda item, there was an extended discussion of whether these MMFs should be classified as cash equivalents to be consistent with U.S. GAAP and SEC requirements and to avoid any possible state investment law limitations of these MMFs with the removal of the Class 1 designation. The SAP Working Group had previously considered this issue in 2002 and had concluded the MMFs should be classified as short-term investments, but that was before the SEC reclassified these investments as cash equivalents in 2003.

At the Summer National Meeting, the working group exposed for comment a proposal to reclassify these MMFs as cash equivalents (from short-term investments) effective January 1, 2018. Industry has requested a 2017 adoption.

SSAP 51 Life Contracts (2015-47) – During its June 9 conference call, the working group adopted proposed revisions to the life insurance guidance to incorporate references to the Valuation Manual and to facilitate the implementation of principle-based reserving, which can be voluntarily adopted January 1, 2017. Although the adoption of PBR is very significant, the proposed changes to SSAP 51 are not pervasive, as the guidance references the adopted Valuation Manual.

At the Summer National Meeting the working group exposed for comment the related Issue Paper 15x, Implementation of Principles-Based Reserving, which provides a useful overview of PBR, including the following summary: "under PBR, companies will hold the higher of; a) the reserve using prescribed factors or b) the reserve computed using justified company experience for mortality, expenses and policyholder behavior and a single economic scenario or c) the reserve based on a wide range of future economic conditions, computed using justified company experience factors, such as mortality, policyholder behavior and expenses."

Change in Valuation Basis for Life Contracts (2016-15) – During its June conference call the working group exposed for comment proposed changes to SSAP 51R to provide guidance on which revisions to reserve assumptions would be considered changes in valuation basis (and recorded through surplus not operations) once PBR is effective. The proposal includes the following key guidance:

- change in valuation basis includes items that represent changes in methodology or voluntary choices in the application of the methodology,
- change in valuation basis excludes updates to reserving assumptions based on experience as required under the existing methodology, and
- initial application of PBR is not expected to result in a day one impact to surplus because the Valuation Manual requires prospective application upon adoption.

The working group adopted this guidance at the Summer National Meeting and directed staff to draft the related issue paper to provide historical documentation.

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

SSAP 1 - Insurance-Linked Securities (2016-11) – As a follow-up to the new 2015 disclosure requirement of insurance-linked securities, the working group adopted a proposed data-capture disclosure template for these securities and language clarifying how disclosure components should be completed. No changes have been made to SSAP 1, just a change to the illustrative disclosure template. The related blanks changes (2016-17BWG) was also adopted by the Blanks Working Group.

Method for Applying Discount Rates to Measure Net Periodic Benefit Cost (2016-08) – During its June conference call, the working group adopted revisions to SSAP 92 and 102 to reflect the allowance of the alternative Spot Rate method for measuring service cost and interest cost components of net periodic benefit cost. This is in addition to allowing the single weighted average discount rate method.

Fees Incurred for Salvage and Subrogation (2015-21) After discussion during the past four National Meeting, the working group adopted the following additional guidance for paragraph 14 of SSAP 55: "Estimated salvage and subrogation recoveries (net of associated expenses) are reported as a reduction to paid losses/claims."

SSAP 97 SCA Appendix (2015-25) – At the Summer National Meeting, the working group adopted a new appendix to SSAP 97 that will move guidance on the SCA Reporting/Filing process for SUB 1 and SUB 2 filings from the SVO manual to the APP Manual. This guidance also clarifies that SSAP 48 entities are not subject to the filing guidance. The working group will address a proposal to exclude filing requirements for nonadmitted or immaterial SCA investments as a separate agenda item. NAIC staff also reported that starting September 1, all SCA filings will be done using the new VISION software application, and the SVO staff is currently working on P&P Manual amendments which will include filing instructions.

SSAP 97 Data Capture Disclosure (2016-04) – The working group adopted a revised data capture disclosure template to include the company's ownership percentage of the SCA and an inclusion of a code column to assist companies in completing the disclosure. The working group also clarified that the disclosure, first effective for 2015 financial statements, does not include SSAP 48 entities (even those entities controlled by an insurer and therefore subject to other provisions of SSAP 97).

Appendix F Policy Statements (2016-12) – The working group adopted policy statement revisions to address voting requirements to adopt interpretations, concurrent exposures, definitions of types of revisions, adoption of revisions, editorial processes, issues papers for nonsubstantive revisions and other editorial revisions.

Swaptions (2016-14) – During its June conference call, the working group exposed for comment a proposed revision to SSAP 86 to add swaptions and a related definition as a type of derivative, which was adopted at the Summer National Meeting. A related blanks proposal to add instructions to Schedule DB for insurers to provide a hedge ID number and other details related to swaptions was adopted by the Blanks Working Group (2016-25BWG), effective January 1, 2017.

Weather Derivatives (2015-43) – The working group adopted EITF 99-02 Weather Derivatives with the modification to require these derivatives to be reported and valued consistently with other derivatives under SSAP 86. This includes adopting an illustration as a new appendix.

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

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

Comments on exposed items are due to NAIC staff by October 10, unless otherwise noted.

ASU 2016-02 Leases (2016-02) – At the Spring National Meeting, the working group began its review of the new FASB standard on leases, ASU 2016-02 – Leases, which is intended to increase the transparency across companies by recognizing all leases on the balance sheet and by disclosing key information about the lease agreements. The regulators released for comment three proposed options for the accounting of operating and financing leases under SAP, which recommended varying degrees of adoption from disclosure only to full adoption.

At the Summer National Meeting, based on compelling arguments from interested parties, the working group agreed to continue the current accounting and disclosures required by SSAP 22. These comments included the significant effort to classify and capitalize lease transactions which are incidental to insurance operations and the fact that lease disclosures are already "robust." The working group did approve NAIC staff's recommendation to further evaluate ASU 2016-02 to consider enhancements in certain areas such as sale leaseback transactions, leveraged leases and lease identification. This is likely to include consideration of SAPWG agenda item 2015-03, Sale-Leaseback with Nonadmitted Assets.

ASU 2015-05-Fees Paid in a Cloud Computing Arrangement (2015-15) – The working group had previously deferred action on this ASU until the GAAP leasing guidance was issued. At the Summer National Meeting, the working group exposed for comment a proposal to retain the current guidance in SSAP 16R which refers users to SSAP 22 and to follow that operating lease guidance.

Variable Annuities - Special Accounting Treatment for Limited Derivatives (2016-03) – At the Spring National Meeting, the working group discussed its "high priority charge" to develop and adopt changes to SSAP 86, Derivatives, for certain limited derivative contracts (e.g. interest rate hedges with counterintuitive effects) that otherwise do not meet hedge effectiveness requirements. At the Summer National Meeting, the working group noted that NAIC staff had worked with Oliver Wyman over the summer to develop a new Issue Paper, Special Accounting Treatment for Limited Derivatives, which hedge variable annuity guarantees subject to fluctuations as a result of interest rate sensitivity; the issue paper was exposed for comment until November 28. The working group now plans to provide guidance in a standalone SSAP separate from SSAP 86. The NAIC had hoped to have guidance for VA insurers (both hedging requirements and revisions resulting from the Quantitative Impact Study) effective for January 1, 2017 but acknowledged additional time is needed. At the meeting of the Financial Condition Committee, the regulators approved a request by the working group to work towards a January 1, 2018 effective date. (See the summary of the VA Issues Working Group for additional discussion of the QIS.)

Discussion included in the 25-page issue paper includes the following key conclusions, which differ significantly from the concepts exposed for comment at the Spring National Meeting, including moving from a closed portfolio to an open portfolio and from a cash flow hedge to a fair value hedge.

- Hedging and other allowances included in the issue paper are only permitted if all of the components of the issue paper are met, and shall not be inferred as an acceptable statutory accounting approach for derivative transactions that do not meet the stated qualifications or that are not specifically addressed within this guidance.

- Eligibility for the special accounting provision is "strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with variable annuities that are reserved for in accordance with Actuarial Guideline 43, CARVM for Variable Annuities."

- The special accounting provision allows reporting entities to use a form of "macro-hedging" in which a portfolio of variable annuity policies are jointly designated as the hedged item, in a fair value hedge, pursuant to a Clearly Defined Hedging Strategy.

- The insurer must obtain explicit approval from the domiciliary state commissioner allowing use of the special accounting provision and an external, qualified actuary, approved by the domiciliary regulator, must provide certification as to whether the hedging strategy is incorporated within the establishment of AG 43 reserves, and the impact of the hedging strategy is within the AG 43 Conditional Tail Expectation Amount.

- A financial officer of the company (as defined) must certify that the hedging strategy meets the definition of a Clearly Defined Hedging Strategy within AG 43 and that the Strategy is the hedging strategy being used by the company in its actual day-to-day risk mitigation efforts.

- Hedge effectiveness assessment is required whenever financial statements are reported, at least every three months.

- The concepts within this issue paper, particularly the allowance for macro-hedges and dynamic (rebalancing) hedging instruments are not permitted by SSAP 86.

<u>Variable Annuity Disclosures (2016-27 and 2016-28)</u>
The SAP Working Group exposed two recommendations from the VA Issues Working Group related to variable annuity guarantees and VA business ceded to captives. See the summary of the VA Issues Working Group for additional discussion of the proposed changes.

<u>SSAP 3 – Accounting Changes and Corrections of Errors (2015-46)</u> – The working group re-exposed this controversial agenda item requiring companies to refile annual or quarterly statements when material errors are found unless "otherwise directed by the domiciliary regulator." The issue was also referred to the NAIC/AICPA Working Group to identify audit issues or other unintended consequences.

<u>Quarterly Investment Schedules (2015-27)</u> – In San Diego, the working group continued its discussion of possible filings of additional quarterly investment information by all insurers. At the Spring National Meeting, the working group had exposed for comment three alternatives suggested by interested parties: 1) hire a consultant to aggregate NAIC investment data, 2) extend the deadline to complete an electronic-only supplemental investment filing, or 3) replace the quarterly acquisition and disposition schedules with a schedule of owned holdings. Comments from regulators did not show strong support from any of these options, and a compromise solution evolved for a proposal for insurers to submit a mid-year electronic only data filing for Schedule D investments detailing CUSIP, par value, book/adjusted carrying value and fair value to be filed with the second quarter filing due August 15, i.e. not with an extended deadline.

<u>Investment Classification Review Project (2013-36)</u>
A proposed exposure of an issue paper on exchange traded funds had the lengthiest discussion at the SAP Working Group meeting in San Diego. Controversy focused on whether the issue paper should include an alternative to allow use of a "systematic value" (meant to approximate amortized cost) or whether only fair value/NAV should be permitted for ETFs until additional work is done on the systematic value methodology. Ultimately, the regulators agreed to allow exposure of the systematic value alternative so as to not create market disruption for those entities which buy and hold these ETFs and which cannot tolerate the surplus volatility created by the use of fair value.

The working group will post BlackRock's responses to "Questions Raised on BlackRock's Calculated Amortized Cost Valuation Proposal," and the suggested systematic value calculation, to its webpage and will send a referral to the Valuation of Securities Task Force to request a review of BlackRock's calculation. In addition to ETFs, the issue paper will include the definition of a "security," as well as definitions for non-bond items (e.g., loan participations and loan syndications).

<u>ASU 2016-01 – Financial Instruments (2016-06)</u>
At the Spring National Meeting, the working group discussed the new ASU on the classification and measurement of financial instruments and amendments to certain fair value disclosure requirements and proposed rejection of ASU 2016-01 for statutory accounting. During the discussion in San Diego, interested parties agreed with the proposal to reject the ASU except in three areas: allowing the use of cost less impairment for equity securities without a readily determinable fair value and reduced fair value disclosures in two areas. The working group then finalized rejection of ASU 2016-01 but agreed only to remove the disclosure of the fair value of deposit liabilities with no defined or contractual maturities.

<u>ASU 2016-13 Credit Losses (2016-20)</u> –The working group very quickly added this new FASB standard to its maintenance agenda: the ASU, which significantly revises existing U.S. GAAP guidance, was just issued in June and is effective for SEC filers January 1, 2020. The working group asked interested parties for comments as to how the ASU should be considered for statutory accounting, and the meeting materials include the following "[t]o

prevent GAAP to SAP differences on the recognition of impairment, concepts from ASU 2016-13 are anticipated to be incorporated into SAP, it is initially recommended that a new "Credit Loss" SSAP will be developed (reflecting updated impairment guidance) that will nullify INT 06-07, as well as the paragraphs in various SSAPs that address impairment." However, adoption of the "expected loss" guidance, compared to the current "incurred loss" conceptual framework, seems inconsistent with RBC and AVR. The issue was exposed for an extended comment period ending November 28.

Definition of Notional Principal for Derivative Contracts (2015-51) – At the Spring National Meeting, the working group re-exposed proposed revisions to SSAP 86 to provide a broad definition of notional and provide examples on how to apply the definition. Interested parties commented that they had been unable to reach a consensus on one single appropriate methodology due to diversity in practice among the industry. At the Summer National Meeting, the working group exposed two new options with Option 1 requiring calculation of notional based on the type of contract and Option 2 being based on the type of underlying investment i.e. fixed income or non-fixed income.

2013 Individual Disability Income Valuation Table (2016-17) – The working group exposed for comment in San Diego proposed revisions to Appendix A-010 Health Reserves Model Regulation to incorporate the 2013 individual disability income valuation table recently adopted by Health Actuarial Task Force. The valuation table is the basis of the new minimum standard for individual disability claims incurred and contracts issued after January 1, 2020, with early adopted allowed January 1, 2017.

Repurchase and Reverse Repurchase Disclosures (2016-16) – As recommended by the Restricted Asset Subgroup, the SAP Working Group exposed proposed amendments to SSAP 103R, which would significantly increase the amount of information disclosed for these investments. The working group also exposed eight detailed templates developed by the subgroup using guidance from a Financial Stability Board consultation document and ASU 2014-11 – Transfers and Servicing, Repurchase to Maturity Transactions, Repurchase Financings, and Disclosures. The templates could become the basis for a future Blanks Working Group proposal and require disclosure of "flow data" and "position data" by quarter. There is no proposed effective date suggested in the exposure documents.

ASU 2014-09 – Revenue Recognition (2016-19)
The working group exposed a proposal to reject most of ASU 2014-09 as not applicable to statutory accounting since the ASU explicitly does not apply to insurance contracts. The regulators also voted to reject related accounting in ASU 2016-10 (Identifying Performance Obligations and Financing). The working group plans to undertake separate projects to consider "principle versus agent considerations" and guidance on equity-based payments to non-employees that is currently addressed in SSAP 104R.

Market Value Approach for SCA Entities (2016-21) and SCA Foreign-Language Support (2016-22)
The working group exposed for comment proposed amendments to SSAP 97 to update the references to the acceptable stock exchanges that support market valuation of publicly traded SCAs, due to name changes to the exchanges over the years. In addition, the working group will consider additions to the list of approved exchanges for those with market capitalization of over $1 trillion when additional information is received from interested parties. The working group also proposed a clarification to SSAP 97 to require all supporting information on SCAs be in English.

Receivables of Government Plans (2016-23) and (2011-44) – The working group addressed an issue raised by a regulator related to pharmacy rebates related to Medicare Part D plans that had been classified as a government receivable, which are not subject to the 90 day rule. The working group tentatively concluded that receivables must originate from the government, not just be related to a government plan, to be exempt from the 90 day rule. This raises additional issues due to the complexity of pharmacy rebates including performance network rebates. As a result, the working group agreed to consider whether additional time to collect such receivables should be allowed and re-exposed issues from agenda item 2011-44, Pharmacy Rebates Under Medicate Part D Gap, Discount.

Clarification of Investment Proceeds Disclosure (2016-24) – The working group is looking for feedback as to whether the fair value-related disclosures included in paragraph 21 of SSAP 26 were intended to apply just to SSAP 26 bonds or all bonds including SSAP 43R investments, which is the view of the working group. Also included in this agenda item is whether the "investment proceeds" disclosure of paragraph 21 should include maturities, paydowns and other redemptions in addition to sales.

Foreign Currency (2016-25 and 2016-26) – The working group exposed two agenda items related to foreign currency; the first attempts to clarify guidance revised in 2015 related to translating Canadian insurance operations and the second proposes adoption of ASU 2013-05 – Parents' Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity.

ASU 2016-05 – Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (2016-29) – The working group is proposing adoption of this ASU which clarifies that a change in counterparty to a derivative instrument does not, by itself, result in the termination of the derivative. The working group proposes prospective application of the guidance, but no effective date in included in the meeting materials.

ASU 2016-06 – Contingent Put and Call Options in Debt Instruments (2016-32) – The working group exposed for comment a recommendation to reject the ASU as it provides amendments to guidance on separately recognizing certain embedded derivatives, which is contrary to SSAP 86 guidance.

Appendix A-200 Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts – The working group gave a "heads up" that it plans to expose later this year proposed amendments to A-200 to adopt guidance recently approved by the Life Insurance Committee related to standards used in determining the discount rate applied to the calculation of the minimum value of guaranteed contract liabilities and a definition of the blended spot rate. The guidance is expected to be effective January 1, 2017.

ASU 2015-09 – Disclosures about Short-Duration Contracts –The working group received a brief update on the anticipated industry proposal on whether/how the new disclosures for short-duration P/C and health contracts should be addressed for statutory accounting. An industry representative noted that they are working with the AICPA/NAIC Task Force as that task force considers the statutory OCBOA (other comprehensive basis of accounting) disclosures required generally accepted auditing standards. The groups hope to have a proposal by the Fall National Meeting. The disclosures are effective for non-public companies for year-end 2017.

Report of the Restricted Asset Subgroup
The subgroup plans to begin discussing reinsurance assets and asked that regulators and interested parties provide comments as to whether reinsurance assets are/should be captured in General Interrogatory 25.1 on assets not under the exclusive control of the insurer. The subgroup believes there are differing interpretations of the guidance.

Blanks Working Group

The working group met by conference call June 16 to finalize changes for 2016 annual statements and instructions and also met in August to continue work on 2017 items.

Adoption and Exposure of Proposals
Twenty-two blanks proposals were exposed for a public comment period at the Spring National Meeting and all were adopted on June 16 conference call. The more significant revisions, all for 2016 annual statements, include the following:

- Adds a column to schedule Y, Part 1A to identify SCAs where an initial or annual NAIC filing is required. The proposal also adds an electronic-only column for legal entity identify, and a column to schedule D, Part 6, Section 1 to identify non-admitted amounts (2016-01BWG). Interested parties commented during discussion of this proposal that the Blanks Working Group continues to adopt new requirements that result in duplicative information being included in different parts of the annual statement. The chair agreed that there "could be further discussion on how to coordinate reporting data" prior to exposing new proposals: the proposed revisions were then adopted by the working group.

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

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

- Modifies the Annual Statement Instructions for Schedule D, Part 1 to provide clarification on the Bond Characteristic Column and provides examples for each code. (2016-07BWG)

- Adds an electronic-only column to Schedule F, Parts 3, 5 and 6, to capture the "secure code" (based on credit rating), which will be used to adjust the RBC charge for reinsurance recoverables. (2016-08BWG)

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

- Modifies the restricted asset disclosures to add a column for total nonadmitted restricted assets and clarifies that the total columns include total admitted and nonadmitted restricted assets. (2016-12BWG)

- Adds a definition of "SVO-Identified Funds" which replaces the term SVO Designated Securities, to the Investment Schedules General Instructions. These include exchange traded funds and bond mutual funds. (2016-18BWG)

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

- Adds two new disclosures and related illustrations to Note 24 as required by revisions to SSAP 107, Risk-Sharing Provisions of the Affordable Care Act. (2016-20BWG)

- Modifies the General Interrogatories to provide additional information on the use of investment managers as a result of a "dramatic increase in reliance by reporting entities on external investment managers." New interrogatories will disclose all investment advisors, investment managers, broker/dealers, including individuals that have the authority to make investment decisions on behalf of the reporting entity and including affiliates of the insurer (2016-22BWG). The new requirement was developed by the Investment Reporting Subgroup and was subject to much debate in 2016.

During its conference calls this summer, the working group exposed two significant items:

- A new PBR supplement, VM-20 Reserves Supplement, and other related changes developed by the PBR Blanks Reporting Subgroup was exposed for comment until September 16.

- A new Variables Annuities Supplement as recommended by the VA Issues Working Group, proposed for year-end 2017 was exposed until October 24. (See that summary for additional discussion.) This proposal would also delete General Interrogatories 9.1 and 9.2 regarding variable annuities with guarantees.

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

Investment Reporting Subgroup

The subgroup met July 12 and continued discussions of its proposal to reduce the current collateral type codes for Schedule D, Part 1 from 21 codes to 8 or 10 for annual 2017 reporting. The subgroup will seek input from the VOS Task Force and the SAP Working Group before developing the final proposal for the Blanks Working Group. At the Summer National Meeting, the VOS Task Force concluded that it does not have any concerns with reducing the number of codes.

Capital Adequacy Task Force

The task force met April 29 and June 30 to finalize proposals for 2016 RBC filings.

2016-08-CA Receivables for Securities

The task force adopted a proposal for 2016 RBC factors for receivables for securities which are based on an updated weighted average calculation of bonds, and common, preferred and hybrid stock. Because the factors do not change much from year to year, the task force also adopted a policy to update the factors every three years, versus the current annual requirement.

Other 2016 RBC Proposals

At its April and June conference calls, the task force adopted nine proposals for 2016 reporting that had previously been adopted by its working groups; those items are discussed in their relevant working group summaries.

Restricted Assets on Deposit

The task force renewed its discussion of whether assets on deposit at state insurance departments for the benefit of all policyholder should incur an additional RBC charge. The task force decided to ask the Receivership and Insolvency Task Force whether it had any analysis on this topic and also ask NAIC staff to provide financial statement data on such deposits.

Affiliated Investments Charge

After being shuffled among various working groups and the task force, a project to reconsider affiliated investment risk across all formulas will be assigned to an ad hoc group composed of members from all RBC groups. The ad hoc group is being formed and may meet later this fall.

Next Meeting
The task force is holding a conference call September 26 to discuss its 2017 agenda.

Investment Risk-Based Capital Working Group

At the Spring National Meeting, the working group exposed for comment until May 19 its new document "A Way Forward" which proposes a process and related principles for the working group to complete its original charge to recommend revisions to the current asset risk structure and factors for each of the three formulas. The "Way Forward" document recommends focusing all of the working group's attention on finalizing revised factors for bonds and common stock with a goal of completion of revised factors for 2017 RBC filings. The working group held four interim meetings in June, July and September via conference call to continue these discussions.

During its June 2 conference call, the working group discussed the nine comment letters received on the Way Forward document. None of the health and P/C trade associations voiced support for adopting the proposed bond structure of 2o designations or an increased common stock factor. The American Academy of Actuaries supports expanding the number of bond factors from 6 to 20 and implementing updated factors for corporate bonds, common stock, and investment real estate for year-end 2017 RBC.

The ACLI noted that it has concerns about 2017 adoption because of the amount of work to be done, but also because of "potential RBC volatility resulting from a series of significant changes to asset risk classifications and charges." The ACLI comment letter also noted that "initial estimates indicate that the proposed C-1 factors …are expected to result in a 10% pre-covariance increase in RBC producing an average 9% reduction, or 45 percentage point reduction, in Company Action Level RBC," requiring the industry to hold an additional $50 billion in capital to maintain current RBC ratios. (However, during the May 13 Life RBC Working Group meeting, the Academy estimated the impact on the industry average C-1 component would increase it from "approximately 1.16% to 1.56% on a pre-tax basis before covariance and before any size or concentration adjustment," and these different estimates have not been reconciled by the RBC working groups.)

After discussing the comment letters, the chair observed that the working group will need to make recommendations in two main areas: the structure of the formula to measure investment risk and the factors to be used. The working group spent the remainder of its June 2 meeting and following two conference calls focusing on the structure of the life formula and developed a Key Decision Points matrix to document their discussion and conclusions. Below is a summary of significant issues and working group recommendations.

- Granularity – The working group and interested parties reached a consensus that life bond designations should increase from 6 to 20 for RBC purposes, and will continue to include an "exempt" category. The current 1-6 designations would still be used for accounting and Schedule D reporting. It is envisioned that an electronic only column will contain the new 1-20 designations.

- AVR – Because AVR reporting feeds directly into the Life RBC formula, the working group and interested parties agreed the categories for AVR should be increased to 20 as well. However, the classification of a realized gain or loss as AVR or IMR will not change, i.e. a change in designation by more than one in the current 1-6 designation would be classified in AVR. The basic contribution and reserve objective factors for the 20 categories would need to be discussed at a later time; the AAA's August 2015 report on recommended bond factors included proposals for these factors as well.

- Other assets using corporate bond factors – The working group recommends maintaining the current 6 categories for RBC purposes for Schedule BA, Schedule DB and preferred stock instead of moving to 20 designations. The working group will consider updating the six factors as part of its overall discussion on bond factors.

- Asset concentration (LR010) – This calculation would have to be revised to reflect the 20 designations and the working group will need to recommend how many designations will be exempt from the calculation. NAIC 1s are currently exempt (along with U.S. government guaranteed securities).

- SSAP 43R securities – The consensus reached for both modeled and non-modeled SSAP 43R securities is to establish new breakpoints based on the 20 designations and eliminate the modified FE process for non-modeled securities.

- Identification and validation – Appropriate subtotals for verification and validation purposes between Schedule D and the RBC schedules will be proposed. The working group will also recommend another electronic only column for municipal and sovereign debt in the event different factors for these bonds are adopted in the future.

Proposed Changes to RBC Blanks and Instructions
During its September 8 conference call, the working group voted to expose until October 6 detailed proposed changes to the Life RBC formula and instructions to implement the conclusions reached above, e.g. 20 categories for bonds. The proposal includes designating the 20 bond categories as, for example, RBC Factor Category 1-A, 1-B, 2-A, 3-A, etc to distinguish the designations from the 1-6 designations for valuation. Subtotals to reconcile back to each category for NAIC 1-6 bonds have been incorporated into the RBC schedules. The chair noted that he expects to have several iterations of exposures and comments before these documents are finalized.

Bond Structure in the P/C and Health RBC Formulas
During the September 8 conference call, the working group began its "high level discussion" of whether/how to include the decisions reached for the Life RBC formula into the other two formulas. There was extensive discussion but no tentative conclusions were reached. One regulator said that the many differences between life and non-life companies needs to be addressed before concluding 20 factors are appropriate, including differences in use of the bonds and their accounting. For example, NAIC 3-6 are valued at lower of cost or fair value by P/C and health entities and they do not hold AVR. Several industry representatives had similar objections, but a representative of the ACLI noted that their multi-line members are in support of the same structure for all three formulas.

Next steps
Work on the above projects, and consideration of the factors associated with 20 designations, will continue into the fall. The chair of the Investment RBC Working Group noted that in order for all formulas to implement the revised bond structure and factors for 2017 RBC, the P/C and Health Drafting Groups (formed to address the bond structure issue discussed above) would need to be done with their work by "late fall" of this year, which seems to be a very optimistic goal.

Life Risk-Based Capital Working Group

The working group met via conference call in May, June and July to discuss its projects in process.

RBC Shortfall Instructional Change (2016-03-L)
During its May 13 conference call, the working group exposed for comment revised instructional changes to clarify that "captive subsidiaries whose contribution to the ceding company's C-0 RBC component is based on the captive's carrying value are subject to the RBC shortfall calculation with a credit for the captive's actual C-0 contribution." The May 13 exposure reflected revisions to eliminate the possibility of some potentially nonadmitted assets contributing to a captive's surplus. During its June 10 conference call, the working group adopted the instructional changes without any additional revisions, effective for 2016 RBC filings. The Capital Adequacy Task Force also adopted the final instructions during its June 30 conference call.

Commercial Mortgage RBC Factors
During its June conference call, the working group discussed a charge of the Investment RBC Working Group to review the commercial mortgage factors adopted in 2013 and to determine whether any changes are necessary. The primary focus of having the working group review the methodology was to "make sure that the safety levels and time horizons were consistent" with what is being proposed for other assets in the investment RBC project. As established by the Life RBC Working Group in 2013, if no recommendation is provided by the 2017 Spring National Meeting, the commercial mortgage factors will be revised to the higher factors contained in an alternative proposal that was submitted by Connecticut and New York in 2013. The issue now is that the Investment RBC Working Group has not started this analysis and does not expect to do so in time for the 2017 deadline.

The working group discussed possible solutions and agreed to pursue analysis of individual company commercial mortgage data (which was contemplated in 2013). However that data is in RBC worksheets that are not submitted to the NAIC. The working group approved a plan to recruit a state to make the data requests from individual companies and work with NAIC staff to obtain the information necessary to make decisions in time for 2017 RBC reporting.

Joint Longevity Risk (A/E) Subgroup
The subgroup met in May and June for its first public conferences calls; the joint subgroup was formed by the Life RBC Working Group to provide recommendations for recognizing longevity risk in statutory reserves and/or RBC. During the May conference call, the chair noted companies are "likely under reserved for longevity risk" and that no recognition of this risk in reserves or RBC is "no longer an option."

The subgroup received a presentation from its Nebraska member who reviewed 2015 annual statements and related actuarial memoranda for its largest five domestic insurers with material longevity risk. Her primary conclusion from this analysis is that companies with significant longevity exposure appear to recognize this risk within asset adequacy testing.

The subgroup members then agreed to survey their own domestic life insurers using a template developed by Nebraska which asks for the follow information by product group:

- What is the base mortality assumption
- What longevity sensitivities were analyzed
- Which interest rate scenarios were used for sensitivity analysis
- Was longevity risk combined/offset by mortality risk
- Was longevity sensitivity analysis modified from year-end 2014
- Key observations or concerns regarding the longevity sensitivity analysis.

The key questions to be addressed by the survey are to the extent longevity risk is material to the company, does the sensitivity analysis appear to be sufficient with respect to reserves only or with respect to reserves and total capital (which is not generally addressed in asset adequacy testing)?

Two action items that appear to have support among the subgroup are amending the asset adequacy testing instructions to be explicit that consideration of longevity risk is required, and consideration of a "modest charge" in RBC for longevity risk as a short-term solution, perhaps as early as 2017.

At the LATF's meeting in San Diego, the task force heard a brief update on the results of the survey. Four domestic regulators and 17 companies participated. The results suggest that longevity risk is generally considered in asset adequacy analysis either explicitly or implicitly, using a variety of approaches and assumptions. Additional discussion is expected at the subgroup's next meeting, which has not yet been scheduled.

Also during the LATF meeting, the AAA's Longevity Risk Task Force presented an update on its activities, which include research into reserve and required capital methods to capture longevity risk in a number of regulatory jurisdictions covering approximately 85% of the global life insurance market including Europe Solvency II, Japan, Mexico, Bermuda, Canada and others. The scope of the review included current regulations as well as new regulations in various phases of analysis. The task force also analysed mortality trends, reviewed company approaches to reflecting longevity risk and conducted a preliminary modelling exercise to evaluate different approaches to quantifying the impact on capital of a longevity stress event. Results of these activities support changes to capture longevity risk in U.S. reserving and capital.

Stress Testing Subgroup
The subgroup did not meet this spring or summer.

Property/Casualty Risk-Based Capital Working Group

The working group met by conference call on April 29, June 10 and July 22 to discuss the following projects.

Underwriting Risk Line 1 Factors (2015-23-P)
The working group discussed a proposal that provides a routine annual update to Line 1 industry underwriting factors for premiums and reserves in the P/C RBC formula. The proposal was exposed through May 30 and adopted during the June conference call.

Multiple Financial Strength Ratings (2016-09-P)
The working group discussed a proposal that provides two alternatives for applying reinsurer ratings for recoverable balances subject to the reinsurance credit risk charge. Alternative 1 changes the instructions to allow a current rating from an approved rating agency instead of requiring the lowest rating when two or more ratings have been assigned. This alternative addresses interested parties' concerns about the complexity of applying multiple ratings and the issue of notching. Alternative 2 applies the same factors in PR012A to the Secure 3 and Secure 4 equivalent ratings categories consistent with the underwriting default risk associated with these ratings categories. The working groups discussed two comment letters received in support of Alternative 1. Following the discussion and after noting that Alternative 1 will

have minimal impact on RBC, the working group adopted Alternative 1.

Impact of PR012A (Credit Risk for Receivables)
The working group discussed a question raised previously on whether it is the working group's intention to impose an RBC charge on negative amounts in ceded balances payable in PR012A (Schedule F, Part 3). The subgroup's consensus was that negative balances are considered a part of the company's assets and an RBC charge should be imposed given the credit risks associated with it. The working group decided that no proposal was needed and the computation methodology remains unchanged.

2015 RBC Results
The working group discussed the results of the 2015 P/C RBC filings noting that consistent with prior years, the risk retention groups made up a sizable portion (one-third) of the companies that were flagged by the trend test or in an action level, which is likely due to their use of a different accounting treatment (U.S. GAAP). Of approximately 2,500 companies, 56 and 55 companies triggered an action level event with and without considering the catastrophe risk charge, respectively. The results indicate that one company triggered an action level due to the catastrophe risk charge in 2015 compared to 17 in 2014. The chair sought help from interested parties on ways to improve the statistics in order to provide more useful analysis in the future.

Hedge Funds/Hedge Fund-like Investments
The working group discussed a referral from the Financial Analysis Working Group noting that hedge fund managers have been marketing hedge funds/hedge fund-like investments by highlighting the negligible impact the investments have on P/C RBC. The Financial Analysis Working Group noted the minimal impact of asset risk allocated to these investments within the RBC formula and further noted that in 2015, 40 P/C insurers with total assets of less than $250 million recorded increases in hedge funds/hedge fund-like investments. In the view of the FAWG, many of these investments can be illiquid, subject to complex structures and funding obligations, prone to unpredictable cash flows, and subject to significant volatility and high fees, and as a result, the FAWG is seeking steps to communicate its concerns in this area to all states. The working group was asked to consider monitoring this type of investment and to make changes to the formula if necessary. No action was taken by the working group as a more in-depth analysis on Schedule BA is needed. The working group will continue its discussion of this matter in future meetings.

RBC Charge for Affiliate Type 7 (2014-29-P)
At the 2015 Spring National Meeting, the working group had proposed to simplify the RBC charge for the ownership of investment affiliates to be a fixed factor times the carrying value of the common stock, preferred stock and bonds. The current RBC charge for the ownership of an investment affiliate is a "look-through" approach based on the RBC of the underlying assets and prorated for the degree of ownership. Because investment affiliates do not submit RBC filings, the RBC charge for the ownership of the investment affiliate under the current P/C RBC instructions cannot be verified. Given comments received opposing the proposal because the fixed factor appears to contradict the principle that the RBC charge should be the same as if the assets were held directly, no action was taken.

During the July 22 conference call, the chair discussed option 2 which is to include additional worksheets to list all the investments owned by the subsidiaries. Industry representatives commented that they support option 2 as it provides additional transparency into the composition and carrying value of the investment affiliate's underlying assets. The factors and framework of option 2 would be based on the structure of the Asset Concentration page. A working group member raised concerns with option 2: 1) difficulty in verifying the reporting information; and 2) different accounting basis and reporting formats between the reporting company and the investment affiliates. The working group will continue to discuss this issue in upcoming meetings.

Catastrophe Risk Subgroup

The subgroup met by conference call on April 29, June 10 and July 5 to discuss its projects.

Earthquake Model Losses (2015-22-CR)
During its April 29 conference call, the subgroup discussed a proposal to revise the 2016 blanks and instructions to calculate the earthquake risk charge by using the worst year in 250 standard, a change from the worst year in 100 standard. The change is based on an analysis discussed at the Spring National Meeting whereby it was noted that the industry appears to be adequately capitalized to withstand a 1-in-250-year earthquake event as modeled earthquake losses at this level will not cause a significant number of insurers to change RBC action levels. The working group exposed the proposal until May 30.

Several comment letters were received noting concerns in the following areas: 1) the 1-in-250 year measure does not replicate the standard used by rating agencies in their capital models; 2) the RBC formula is intended to be an indicator for a minimum capital standard and not an indicator of appropriate operating capital adequacy; 3) the inconsistency between earthquake and hurricane catastrophe risk charge may affect the overall RBC; and 4) having an inconsistent methodology will affect the development of the group capital calculation. The chair noted that going to the 1-in-250 year standard would result in a modest increase in overall industrywide RBC requirements and the covariance adjustment would reduce the impact to a small effect. Based on this information, the subgroup agreed to keep the requirement at the current 1-in-100 year standard and reject the proposal.

2016 Ex-Cat Factors (2015-24-CR)
The subgroup discussed a proposal that provides a routine annual update of the 2016 ex-catastrophe factors for use on Lines 1 and 4 on page PR018A based on new data. The proposal was exposed through May 30 and adopted on its June conference call.

Revised PR027 Interrogatories (2015-25-CR)
The subgroup discussed a proposal to clarify the 2016 instructions and interrogatories for determining exemption qualification. From the analysis of statistics discussed at the Spring National Meeting, NAIC staff reported that the industry appeared to have confusion on reporting the PR027 Interrogatories based on the observations that: 1) a significant number of companies reported no exposure to hurricane and earthquake losses but did not fill in the section needed to claim exemption; 2) some companies filled in the section claiming exemption and at the same time reported catastrophe risk charges; and 3) a significant number of companies reported premium for earthquake coverage but did not report modeled losses. The subgroup exposed the proposal through May 30, discussed a comment letter supporting the proposal, and adopted the proposal on June 10.

2017 Rcat Implementation (2016-07-CR)
The subgroup discussed a proposal that provides an overview of changes for the implementation of the catastrophe risk charge in the RBC formula for 2017 reporting. The proposal was exposed through June 14 and six comment letters were received. During the July 5 conference call, the subgroup heard industry recommendations on including a tax offset to the modeled losses and allowing the use of models other than the five approved models if the reported modeled losses are consistent with the insurer's internal risk-management process. A regulator raised a concern on how a company's proprietary model can be validated. Other comments include identifying a competent and independent third-party to assist in designing the appropriate criteria for evaluating the suitability of an internal model, and reviewing the possibility of using the similar modeling and assumptions as the Own Risk and Solvency Assessment. The chair pointed out that the subgroup had previously determined that the tax offset should be excluded in the catastrophe risk calculation in order to be consistent with the rest of the P/C RBC formula. The chair inquired if any subgroup members wished to reopen the matter and no one responded. No action was taken by the subgroup and the subgroup will discuss the proposal of using company models in future meetings.

PR027 Interrogatory Enhancement (2011-11-CR)
The subgroup discussed a proposal to separate the earthquake and hurricane exemption interrogatory into two sections so that companies have to complete this interrogatory if they are claiming exemption from either the earthquake or the hurricane RBC charge. The proposal was exposed through August 5.

Annual Catastrophe Event Lists Update Process
The chair stated that the subgroup had challenges in generating the annual catastrophe lists earlier this year and asked if industry or interested parties could assist in compiling the lists in a timely manner. Representatives from a trade organization and an insurer noted that they could provide the information to the subgroup by October, after which NAIC staff will compile the lists for the subgroup to consider for adoption at the Fall National Meeting. Any events that occur in November and December would be considered for adoption in February 2017.

Health Risk-Based Capital Working Group

The working group met four times by conference call during May through July to discuss the following matters. Adopted proposals are all effective for 2016 filings unless stated otherwise.

Health Entity Definition Proposal (2016-04-H)
The working group adopted a previously exposed proposal to add a definition for "health entity" to Appendix 1 – Commonly Used Terms in the Health RBC instructions.

Excessive Growth Charge for Start-Up Companies (2014-28-H Modified)
The working group has been considering since 2014 a revised methodology for the excessive growth charge that does not overly penalize start-up entities which report zero premiums in the prior year. The working group first considered a discount factor that did not work as intended. In 2016, a second option was developed and exposed that includes instructional changes and the addition of a footnote

to page XR021 Business Risk page. This proposal will allow a start-up company to explain what projections are used. The proposal was adopted on June 1; because it is a structural change to the formula, the revised guidance will not be implemented until 2017

Health Care Receivable Factors (2016-06-H)
The working group discussed a previously exposed proposal in which two factors, 0.19 and 0.50, were being considered for Claim Overpayment Receivables, Loan and Advances to Providers, Capitation Arrangement Receivables, Risk Sharing Receivables, and Other Health Care Receivables, with the intent of implementing one factor. Three comment letters were received. Two representatives from industry indicated support for the Academy's 0.19 factor while the third representative cautioned the use of the Academy's report due to limited data and limited analysis. Following the discussion, working group adopted 0.19 as the factor for the health care receivable factors.

Other Non-Health Factor Proposal (2015-14-H)
Following the adoption of a 13% factor for a new column for Other Non-Health in the Underwriting Risk Experience Fluctuation Risk page (XR012 and XR012A), NAIC staff became aware of the need for editorial changes due to the inadvertent double-counting of stop loss, disability and long-term care insurance. Editorial changes were adopted to provide guidance that the amounts should come from company records.

Medicaid Pass-Through Payments (2015-26-H)
Following the adoption of an informational-only proposal to add a new column for Medicaid pass-through payments to the Underwriting Risk Experience Fluctuation Risk page (XR012 and XR012A), NAIC staff received comments that identified areas of concern that could result in multiple crosscheck failures and reporting issues. The working group determined it would withdraw the proposal for 2016 reporting and apply the guidance used in 2015 for 2016 reporting. The working group also agreed to continue to discuss and determine an alternative method of reporting that will not double count pass-through payments in the RBC formula. One consideration discussed was a survey to companies that write either Medicare or Medicaid business on how they account for these payments and report them for RBC. The working group directed NAIC staff to draft a survey to be discussed at the September 27 conference call.

2017 Health Insurance Provider Fee Moratorium
As previously discussed in this Newsletter, the Consolidated Appropriations Act 2016 imposed a moratorium on the federal Affordable Care Act fee for calendar year 2017. The chair commented that, because of this moratorium, state regulators may notice some anomalies in the ACA fee sensitivity test included in the 2016 Health RBC formula. Because there is no fee due in September 2017, companies will not accrue for the 2017 fee in special surplus in 2016; therefore, the ACA fee amount in the ACA fee sensitivity test will be zero. Companies will begin accruing the fee in special surplus effective January 1, 2017 for the 2018 fee year.

Way Forward Document
The working group discussed the work being carried out by the Investment RBC Working Group with regard to the asset risk factors in the health RBC formula. A drafting group was formed by the working group, comprising of regulators, industry and Academy members, in August 2015 to study and identify the rationale and document the historical treatment of asset risk in the health RBC formula. The drafting group identified several key items which are included in their comment letter to the Investment RBC Working Group. The drafting group concluded:

- Little time and effort had been spent on analyzing investment/asset risks for Health RBC since underwriting risk is the predominant risk for health entities
- A detailed comparison of the health formula to the life and P/C formulas for asset and credit risk was done in 1997 and it was determined that the P/C RBC asset risks (with some modification) are more applicable to health companies.

The comment letter also indicated that the results of an impact study of increasing the common stock factor for health from 15% to 19.5% show very little impact overall. As such, the working group agrees with the P/C Drafting Group recommendation against including a beta adjustment in the health formula.

Operational Risk Subgroup

The subgroup held four conference calls since the Spring National Meeting to continue its discussion on various topics relating to development of the operational risk charge, will again be informational-only for 2016 filings.

Revised Factors for 2016 Basic Operational Risk
During its June 15 conference call, the subgroup discussed four comment letters on the previously exposed factors for basic operational risk, which were revised from the 2015 factors. Both the AAA and ACLI stated that they support a measured

approach that recognizes the implicit operational risk embedded in the C-4a factor or an approach that provides some offset to the factor in the Life RBC formula. The AAA recommended that the subgroup consider a rationale for the factors and calibration and avoid relying solely on approaches imposed by other jurisdictions.

The chair responded noting that it is “universally difficult” to quantify operational risk without initially relying on other jurisdictional approaches. The chair further stated that a review of the factors over time and their relationship to insolvencies will dictate future improvements. NAIC staff noted that the revised informational factors are meant to align the proxy-based approach with the 3% of total RBC after covariance targeted in the add-on approach. Other comments raised pointed to regulatory tools other than capital to address operational risk and that recognition of qualitative measures at the company level is important. The regulators reminded interested parties that ORSA filings and enterprise risk management analyses need to be complemented by capital requirements, and the balance between qualitative and quantitative considerations could evolve over time. Following the discussion, the subgroup adopted the proposal as exposed for 2016 filings.

Growth Risk Test Results

The subgroup heard an update after adding a fifth year of data (2015) to the analysis that compared the existing growth risk charge results to those generated by the proposed informational-only methodology for P/C and health; the analysis is only partially completed. NAIC staff provided preliminary results noting no materially different results for the P/C RBC formula. For health growth risk, significantly different results between the existing and proposed methods were noted. Additional review is needed including assessing whether the health growth risk charge should be associated with the H2 underwriting risk factor rather than the H4 business risk factor in the covariance square root. In addition, the health informational-only factor of 2% appears to be too high; a factor of 1.25% appears more appropriate based on five years of data. For life growth risk, the AAA Operational Risk Working Group is currently doing that review.

Basic Operational Risk Test Results

The NAIC staff updated the subgroup on the test results for basic operational risk for P/C, health and life after incorporating 2015 data. In addition to the original informational factors, revised proxy-based factors (yielding an after-covariance target of approximately 3%) were tested. A 3% capital add-on option was also tested. Analysis will continue as the working group and NAIC staff investigate why a significant amount of companies reported no proxy data and would therefore have no basic operational risk calculated under the exposure proxy method.

Timeline

The subgroup also discussed the aggressive timeline for adopting the structure and factors for operational risk to be effective for 2017 RBC filings. Structural revisions must be developed and exposed by year-end 2016 and factors must be chosen for exposure by the end of April 2017 and adopted by June 30, 2017.

Valuation of Securities Task Force

The task force met via conference call in June and July and in person in San Diego and discussed the following projects.

SSAP 43R Proposed Amendments

At the Spring National Meeting, the task force exposed for comment proposed amendments to SSAP 43R to address concerns that too many securities had been scoped into the standard when it was amended in 2010. The ACLI submitted a letter recommending several modifications to the definition, including adding the term “multiple unrelated obligors.” The distinction between SSAP 26 and SSAP 43R is the differences in the cash flow characteristics of the obligors. In the view of the task force, the trust is not the most important element in the definition in SSAP 43R as trusts can be used for different purposes, implying different cash-flow characteristics. If the trust is holding a collateral pool with multiple obligors, the collateral pool is the source of cash to pay the obligation issued by the SPV, which is different from a trust that turns over an asset to the investor in the event of default. After discussion of the ACLI’s comment letter and agreeing to many of the proposed revisions, the task force adopted the proposed amendments and referred it to the SAP Working Group; SAPWG did not discuss the proposed revisions at its meeting in San Diego.

International Accounting Standard Consideration

The task force adopted Italian GAAP as a National Financial Presentation Standard and also exposed for comment an amendment to the P&P Manual to add Belgian GAAP as a NFPS. This will allow insurers to file securities with the SVO with audited financial statements prepared on the basis of Italian and Belgian GAAP without a reconciliation to U.S GAAP or IASB IFRS. The recommendation to include Belgian GAAP is exposed till September 26.

HR Ratings de Mexico
The task force adopted an amendment to the P&P Manual to add HR ratings to the NAIC CRP List. This entity rates government, municipal and foreign government securities and the SEC has designated it as an NRSRO.

Filing Process Modernization
The task force approved the Rules and Systems Modernization Statement as a guideline for the re-design of the SVO system and related filing rules that had been previously exposed for comment. One significant issue is the "lead lender rule" which creates an incentive for insurers to wait until the filing deadline in September for other insurers to file first to avoid paying the lead lender fee. The task force discussed that the rule causes an avoidable backlog at year-end and requested that the SVO develop an alternative fee process. Two trade associations also appeared to support eliminating the lead lender rule and instituting a filing assessment instead of a filing fee per security structure.

Through-the-cycle
The task force heard industry comments on a proposed SSG methodology adjustment to the financial modeling of RMBS and CMBS. The SSG is responding to concerns expressed by the ACLI that the "procyclicality" of the financial modeling process is difficult for life insurers to predict capital needs. The methodology is focused on changing economic conditions throughout the business cycle causing capital treatment to vary from year to year. The staff proposed conducting a through-the-cycle model that will be 1) based on historical and publicly available data; 2) generates several forecast "paths" that can statistically represent various percentile paths; 3) quantitatively mimics historical extremes when extreme scenarios are used; and 4) is "memoryless," which focuses only on the present state, not the events that preceded it. The task force asked the ACLI to present more detail on its concerns and directed the SSG to begin the study.

RMBS/CMBS Assumption Setting
At the Spring National Meeting, the SSG proposed that the task force eliminate the existing requirement for a series of public meetings to set macro-economic assumptions, scenarios and risk weightings for the annual financial modeling of RMBS and CMBS. The proposal was adopted at the task force's June 8 conference call. The SSG will still post macro-economic assumptions and scenarios on the task force's website and will still present reports on the financial modeling process.

Definition of Loans and DIP Financings
At the Spring National Meeting, the task force had proposed P&P Manual amendments for definitions of different types of loans and guidance regarding the proper documentation requirements; no comments were received on the proposal. However as the SAP Working Group has not completed its review of bank loans, the task force deferred action of the proposed SVO amendments until the SAPWG has finalized its definitions project. The task force voted to refer the amendments to the SAP Working Group with a recommendation to consider the guidance as it develops definitions for banks loans.

Another issue is debtor-in-possession financings, which are a type of bank loan extended to a debtor to finance a corporate reorganization, and which can be assessed for quality and assigned an NAIC Designation. Since DIPs are a type of bank loan, the SVO considers these instruments to be in scope of SSAP 26. However, since DIPs are not specifically discussed in the P&P Manual, SAPWG staff noted they may be considered collateral loans in the scope of SSAP 21. The task force approved a referral to the SAPWG recommending clarifying the treatment of DIPs.

Vendor's CMBS Financial Model
The task force heard a report from the SSG discussing enhancements to BlackRock's CMBS financial model, which focuses on capturing the potential effect on credit risk related to specific property level events. Property cash flows are now projected using a Monte Carlo simulation of tenant lease renewal and lease-up of vacant space in order to allow for the divergence of property and market level performance. The enhanced model uses actual reported property level financials and tenancy as the starting point of cash flow forecasting. The probability of lease renewals is based on projected market level vacancy and property values are determined using a discounted cash flow approach. Implementation of the CMBS modeling enhancement is expected for the 2017 year-end analysis.

Modified FE Population
The task force heard a SSG report on the modified FE process to address the SSAP 43R securities that are not modeled. The task force asked SSG to confirm that nearly $300 billion of SSAP 43R securities are not modeled and to describe the MFE rating on a certain percentage of them. SSG envisions work that includes a deeper examination of these dynamics, vintages, consideration of the potential capital impact, pre-covariance and consideration of what would happen if the dataset were adjusted directly to Filing Exempt.

Regulatory Nature of NAIC Designations

In connection with discussions with the IAIS on its field test of a proposed capital standard, the task force deliberated the purpose of NAIC designations and whether they are intended to be the same as credit ratings. The SVO believes the designations are not "strictly associated with credit risk assessment methodology" and studied the issue in depth. This resulted in a 10 page proposal to amend the P&P Manual to clarify the regulatory intent of the designations. Revisions includes the statement that the SVO does an analysis of the quality of an obligation that may make use of a credit assessment methodology; "quality means the likelihood that an Investment Security, asset or other Obligation owned by an insurance company will be available to pay policyholder claims." The proposed amendments were exposed for comment until November 15.

Surplus Notes

The task force adopted revisions to the P&P Manual to make its guidance consistent with recent revisions to SSAP 41R, Surplus Notes, effective January 1, 2o17. This includes deletion of the financial assessment instructions for unrated and NAIC 3-NAIC 6 equivalent surplus notes (as those will now be valued at the lower of cost or fair value), and a listing of all surplus notes rated at an NAIC 1 and NAIC 2 equivalent that are eligible for amortized cost valuation.

Infrastructure Investments

In San Diego, the Valuation of Securities Task Force held a special session on infrastructure investments, focusing on defining infrastructure investment and how regulators can work to address regulatory impediments. NAIC President and Missouri Insurance Director John Huff opened the session by emphasizing that the priority of state insurance departments is the solvency of the insurance companies they regulate. Director Huff explained that the session is exploratory in nature and noted that critical to these considerations is not to encourage or improperly incentivize insurers to do anything that does not make sense from an investment perspective or is not financially prudent. ACLI President and CEO and former Governor of Idaho Dirk Kempthorne discussed how the life insurance industry's investments can support the nation's infrastructure. Governor Kempthorne noted that there is a growing urgency to improve the critical capital infrastructure in the nation. The American Society of Civil Engineers estimates that in the next three years, $3.6 trillion in infrastructure investment will be needed in the U.S. The governor stated that the long-term promises made by life insurers to their customers and beneficiaries could be financed by long-term investments that align with the financing that accompanies most infrastructure investments. He quoted infrastructure investment as a "win-win-win" scenario, with states winning by accessing valuable capital that further stimulates economic growth; the industry winning by matching its liabilities with high-quality, long-term assets; and the consumers winning by getting safer roads and bridges and state-of-the-art care at modern hospitals.

Industry leaders from Oliver Wyman, Pacific Life Insurance Company, TIAA, Swiss Re, AIG, and MetLife discussed different aspects of the infrastructure market and explored ways to encourage more investments by insurers. The task force also heard a case study of the I-595 Express LLC, an investment in which TIAA purchased a 50% stake in 2009; I-595 is a major east-west highway in southeast Florida. The LLC is the concessionaire responsible for designing, building, financing, operating and maintaining the I-595 corridor improvements project over a term of 35 years. The transaction is the first availability-based road concession lease in the U.S. which means the revenues are provided by contractual availability payments with no traffic demand risk; this arrangement leads to a steadier level of investment return.

The chair ended the special session noting that the task force will take into consideration the information shared by the presenters and will discuss this matter in upcoming meetings.

Reporting Exceptions Analysis Working Group

Subsequent to the Spring National Meeting, the Valuation of Securities Task Force formed the Reporting Exceptions Analysis Working Group to investigate why a large population of securities (totalling $100 billion per the SVO) are reported as filing exempt but do not appear on credit rating provider data feeds. The working group, chaired by Louisiana, met four times by conference call in June and August to make progress on this issue.
The source for the exception analysis is the SVO's Jumpstart Exception Report, which classifies the exceptions into five primary categories. The largest population of exceptions is private letter rating (private placement) securities, which comprises 41% of the nearly 5,000 exceptions. These exceptions have arisen because the securities are reported as filing exempt but are not shown in the CRP data feeds. The primary reason is that the issuer in these transactions must agree not to disclose the rating before the NRSRO agrees to give the security a private rating. The SVO staff has drafted a referral to the Blanks Working Group to propose a suffix

change to identify private letter ratings in Schedule D. The largest issue with private letter rates is confidentiality and extent of regulator review.

The working group exposed for comment three options on how the credit ratings can be verified: 1) the insurer or rating agency provides the private letter rating to the SVO; 2) the insurer should file the security with the SVO for a credit assessment; or 3) the insurer does not file and accepts a 5*/6* rating. The industry expressed their view that the private CRP ratings are verified as part of the financial examinations. During these extensive discussions, the chair of the working group reiterated his view that "public CRP ratings are verified annually or more frequently, so there is no reason that regulators should not verify private letter ratings as frequently" and that it is "not adequate to review a potentially risky population once every five years" i.e. as part of financial examinations.

During the working group's August 31 conference call, interested parties suggested an automated delivery for private ratings to resolve the exception. The NRSRO would provide the SVO with access to the private ratings, either through direct data feeds, or by providing the SVO with access to the rating agencies' electronic databases. The ACLI, NASVA, and the PPIA Board proposed an effective date of December 31, 2017. During its September 19 conference call, the working group instead adopted a July 1, 2017 "file by" date so that all issues can be resolved by year-end 2017.

The second population includes 1) securities dropped or never included in the CRP data feeds, and 2) securities using Bloomberg as a rating source, which is not an official Credit Rating Provider. The SVO recommended that the production of NAIC designations through the FE process be made an administrative function of the AVS+ system where insurers would have the right to use any source to determine the designation in their financial statements. Interested parties provided comments that Bloomberg can provide accurate credit ratings and includes all identifiers. Representative from Bloomberg said that Bloomberg would work with the SVO, the working group and insurers to reduce these exceptions.

The working group took two actions; first, it directed SVO staff to provide recommendations for communicating investment reporting exceptions to insurers to encourage developing other solutions. Secondly, the task force asked SVO staff to draft amendments to the P&P Manual to reconcile compilation instructions to the current FE instructions. The FE process would become an SVO administrative function, and all designations would be compared against those found on the AVS+ system; any differences would be considered exceptions.

The third population involves pre-refunded securities which are shown on the NRSRO websites as rated but not in CRP data feeds. Pre-refunded securities are those in which the issuer is sold a new security and the proceeds are used to purchase a portfolio of securities and the cash-flows are used to make payments on the previously issued bonds. Exceptions have arisen when these securities are not filed with the SVO. The ACLI/NASVA responded that pre-refunded securities are required to be filed with the SVO and a security not shown to be rated by a CRP is to be considered unrated. The working group directed the staff to prepare a proposal and recommendation that pre-refunded securities no longer rated by CRPs are not filing exempt and should be filed with the SVO.

The fourth population involves company errors in filing securities with U.S. governmental guarantees; NAIC staff will investigate and propose a recommendation to the task force. The last population is international securities; the SVO systems currently do not recognize International Securities Identification Numbers. To resolve the exception, ISINs will be incorporated into the VISION and AVS+ systems.

During its September 19 conference call, the working group exposed for comment a report of its recommendations to the Valuation of Securities Task Force and proposed changes to the P&P Manual to implement the recommendations for the five populations discussed above.

Group Capital Calculation Working Group

The Group Capital Calculation Working Group met monthly via conference call May through August and in person in San Diego to work on its charge to "construct a U.S. group capital calculation using an RBC aggregation methodology."

<u>Industry Group Capital Calculation Proposals</u>
In connection with the working group's "standing invitation" for interested parties to provide their views on a group capital calculation, the working group heard in San Diego a presentation from BCBSA regarding its viewpoint on a group capital calculation, which leverages the existing life, health and property casualty RBC formulas. The proposal requires identification of all legal entities (insurance and non-insurance affiliates) and the related risks of the parent holding company utilizing existing RBC

formulas, rather than applying a single factor to the holding company's equity based on GAAP.

Inventory Method
As suggested by the joint trade associations this spring, the working group identified the inventory method as a possible viable approach to the NAIC group capital calculation. During the Summer National meeting, the working group identified nine questions regarding the calculation of group capital for three types of entities not subject to capital requirements. Among other issues, the working group is seeking feedback as to whether a flat charge should be applied to the entity's book adjusted carrying value (BACV). If a flat charge is appropriate, the current RBC charge for non-insurance affiliates of 22.5% of BACV may be appropriate. There was discussion that the use of this charge may be appropriate as the factor was developed with the understanding that most non-U.S. entities utilize GAAP (as applied in their jurisdiction), which is generally less conservative than U.S. statutory accounting.

Utilizing a flat charge would be the simplest approach and require limited additional data, but is not risk-sensitive. If the use of a flat charge is not appropriate, the working group discussed the use of a hybrid approach, where a flat charge would be used initially and a more risk-sensitive charge could be used after additional data is collected. If the hybrid approach is used, the working group is seeking feedback as to the type of data to be collected.

The working group then discussed the possible use of scalars to address comparability of capital requirements between jurisdictions. Non-U.S. insurers are subject to capital requirements in their home jurisdiction, but it may be difficult to compare foreign capital requirements to those in the U.S., primarily due to differences in accounting systems and regulatory environments. The working group conceptually agrees with the use of scalars, but does not believe the NAIC has sufficient data to develop scalars for particular countries. Over time, the group capital calculation could obtain financial information for non-U.S. insurers that could be analyzed and used to develop country-specific scalars. Alternatively, a data call could be performed to obtain the information.

After repeated requests from interested parties during all its conference calls, the working group agreed that an additional question on the appropriate level for establishing the scope of the group capital calculation will be included in the proposed Questions on Various Aspects of the Inventory Method, which is exposed for comment until October 25.

U.S. Insurers not subject to RBC Requirements
The working group discussed the approach for U.S. insurers that are not subject to risk-based capital requirements such as mortgage and financial guaranty companies and title insurers, and insurers with significant permitted practices such as captives. The NAIC staff discussed one basis for the group capital calculation be applied to these entities, such as the minimum capital per state law. The NAIC staff suggested that the calculation be further specified by type of company.

For the valuation of U.S. captives, NAIC staff suggested an approach similar to SSAP 97 par. 9 which provides a listing of required adjustments, but which are primarily designed to address valuation of asset differences but not liability differences. This calculation would also require the captive insurer's financials to utilize the valuation basis used by the direct writer of the business. The only exception to this requirement might be captives established for XXX/AXXX issues, as the majority of states have recognized a different valuation may be reasonable for this type of captive. This could be implemented as an "on-top adjustment" that calculates the surplus effect of all permitted/state prescribed adjustments, subject to an adjustment threshold deemed to be material.

The working group also discussed adjustments for top-tier companies that utilize U.S. GAAP. NAIC staff stated that a bottom-up approach to aggregation, which is the sum of the entity-based underlying available capital, is preferable to consolidated GAAP at the holding company level. If a consolidated approach is chosen, it was suggested that adjustments similar to SSAP 97 and captives, as discussed above, would be reasonable. The working group will continue discussing this matter in future meetings.

Group Solvency Issues Working Group

The working group met at the Summer National Meeting and discussed its projects in progress.

Form F Survey
At the Spring National Meeting, the working group agreed to survey regulators to evaluate the effectiveness and value of the Form F Enterprise Risk process. In San Diego, the working group reviewed the responses, and the results were not positive. Of the 36 jurisdictions that responded, 21 said that the information obtained from the Form F process was "somewhat effective" while 10 others said the information was "not effective." Only three states said the information was "very effective" or

"effective." Comments as to the reason for the ineffectiveness included that many filers did not provide enough information on non-insurance risks; that some insurers referenced a long list of generic risk that could affect all insurers, with no additional detail, and others referenced publicly available information without any additional insight.

The working group discussed solutions to improve the process including more detailed instructions for completing the Form F filings and/or developing a short guidance manual. The scope of the Form F may also need to be clarified; the reporting level of the filing is required to be the Ultimate Controlling Person whereas the ORSA report allows discretion in the reporting level. NAIC staff will work on documents for the working group to consider in future meetings.

Update on IAIS Activities
The chair noted that the IAIS has projects in progress that could affect subject areas the working group is interested in. This include revising Insurance Core Principle 3, Information Exchange and Confidentiality Requirements and ICP 25, Supervisory Cooperation and Coordination, and developing a self-assessment peer review framework for both these ICPs.

ORSA Implementation Subgroup
The subgroup was formed earlier this year to "identify, discuss and address issues that arise in state implementation and review of ORSA reporting requirements," which will also include enhancement of an ERM educational program for regulators. The subgroup held an open conference call August 10 and received a presentation from the American Academy of Actuaries on two recent papers by the Academy entitled "ORSA and the Regulator" and "Quantifying Risk Exposures for Own Risk and Solvency Assessment Reports." These papers have been posted the Academy's website at actuary.org.

The subgroup then discussed a draft ORSA Confidentiality/Sharing Best Practices document that is meant to preserve confidentiality when documents are shared among lead states, non-lead states, the NAIC and third party consultations. One proposed best practice is as follows:

> "In support of the Lead State framework, encourage the sharing of and reliance on the Lead State's analysis of the ORSA Summary Report as opposed to sharing the full ORSA Summary Report with other regulators. If other regulators require the full ORSA Summary Report, they should work with the Lead State to obtain access. (The providing state should verify that the receiving state has another statute that affords similar confidentiality protection for ORSA information before sharing related work products.)"

The draft Best Practices document was exposed for comment until September 9.

ComFrame Development and Analysis Working Group

IAIS Insurance Capital Standard
The working group met via conference call in June to discuss ongoing development of the ICS, including the desired treatment of surplus notes, senior debt and contract boundaries. Under the proposed ICS criteria, senior debt issued by a holding company would not qualify as either Tier 1 or Tier 2 capital. The proposed ICS criteria does not recognize structural subordination but only legal or contractual subordination in the assessment against the relevant criteria. Additionally, while many surplus notes issued by U.S. holding companies are expected to qualify as Tier 2 capital, they would not qualify as Tier 1 capital under the current proposed ICS criteria. The current IAIS field specifications on contract boundaries are consistent with other design aspects of the capital formula, including valuation, and do not include renewals or new business. The working group plans to continue discussion of this matter in future meetings.

Field Testing and ComFrame Revision Process
During the Summer National Meeting, the working group received an update that ICS field testing is well underway and that the submission of ICS data by internationally active insurance group volunteers is being carried out in two phases. Phase 1 data and information, which includes the ICS and basic capital requirement balance sheets, capital resources, and deferred taxes, were submitted to the IAIS in early August. Phase 2 data and information, covering margin over current estimate and the ICS standard method, were due by September 15. A Phase 2+ had been developed to cover supplementary life and supplementary health information and is due October 31. Per the update, it is currently too early to provide any aggregate preliminary results as follow up on specific data elements is being conducted with individual IAIG volunteers. It was also noted that revised versions of the ComFrame material on governance, supervisory process and resolution are scheduled to be out for consultation following the November IAIS committee meetings.

IAIS ICS Consultation Document
The working group discussed the ICS consultation document for the Insurance Capital Standard, which this year is more focused on technical issues that

provide context for a number of issues. This year's consultation had four key areas: 1) scope of group in the context of an IAIG, 2) a more comprehensive GAAP+ approach, 3) capital resources, and 4) capital requirements. NAIC staff reported that the process to develop initial draft comments is underway and a list of 100 questions that the NAIC is considering responding to has been circulated. The working group will discuss initial NAIC comments on the ICS consultation document on September 27. The comment deadline is October 19.

International Insurance Relations Committee

The International Insurance Relations Committee via three times in May and July via conference calls and in person in San Diego and discussed the following projects.

Solvency II Implementation
See the Reinsurance Task Force summary for discussion of potential barriers to doing business in the EU as a result of Solvency II implementation.

Update on IAIS
Standard Setting
The committee reported that consultations were held over the summer on two IAIS application papers on Approaches to Supervising the Conduct of Intermediaries and the Regulation and Supervision of Mutuals, Cooperatives and Community based Organizations in Increasing Access to Insurance Markets and that the NAIC submitted comments on these papers. The IAIS will finalize this guidance for adoption at the IAIS meeting in November

Financial Stability
The IAIS published an updated assessment methodology for global systemically important insurers (G-SIIs) and a paper addressing systemic risk from insurance product features. The significant changes have already been implemented in this year's G-SII annual assessment process, such as moving away from a relative ranking for certain indicators to absolute reference values and an enhanced qualitative assessment. The IAIS gave an overview of the five phases of the G-SII assessment process. The IAIS is expected to make a recommendation on a list of G-SIIs to the Financial Stability Board, which is expected to publish the list of designated companies in November.

Implementation Activities
The committee heard that there are three reviews underway, specifically in market conduct, solvency and macroprudential surveillance and reinsurance. The IAIS is performing an assessment of supervisory cooperation and information exchange and is expected to conclude its work in 2017.

Update on the OECD
The Insurance and Private Pensions Committee of the Organization for Economic Co-operation and Development met in early June in Paris. The IPPC held a roundtable discussion on technology and innovation in the insurance sector and what policy and regulatory impact such innovations may have, and the benefits from innovation in the insurance sector. In late June, the OECD and the Asian Development Bank Institute held a roundtable in Tokyo on the key developments and challenges facing insurance and retirement saving given the economies and demographic changes in some Asian countries.

Financial Stability Task Force

The Financial Stability Task Force met in person in San Diego and discussed the following issues.

FSOC Developments
The Financial Stability Oversight Council of the U.S. Treasury released its annual report (160 pages) in June, which cited the low interest rate environment as a challenge to profitability and a potential driver toward higher credit risk. The report also highlighted concerns regarding the lack of transparency with captive reinsurance transactions.

At the NAIC's Plenary session in San Diego, Peter L. Hartt, Director of New Jersey's Insurance Division, was appointed to a two-year term as the state insurance commissioner representative on the FSOC. Director Hartt replaces North Dakota Insurance Commissioner Adam Hamm when his term expires in September.

Brexit Implications
The task force heard a presentation from Prudential plc regarding the implications of Brexit, which resulted in a crash of equity markets, the British pound and interest rates. The presentation discussed that while there is no clear timeline for Article 50 of the Treaty on Europe Union to implement Brexit, the potential long-term implications of Brexit could be an economic recession resulting in lower demand of UK products, low interest rates and increased volatility of debt and equity markets. The speaker also noted that as a condition for the UK to continue trading with the EU, the EU will likely require UK equivalence with EU regulations, including Solvency II.

Federal Reserve Activities
The task force heard a report from Prudential Financial and New York Life regarding the Federal Reserve's NPR (notice of proposed rulemaking) on Enhanced Prudential Standards for Systemically Important Insurance Companies, and the Federal Reserve's ANPR (advanced NPR) on Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities. A comment provided to the NPR is that insurance companies have business models and risk profiles different from banks and standards should be tailored for insurance companies. Prudential discussed that a number of principles in the insurance capital standards have been recognized in the ANPR, particular the recognition of loss absorption capacity. New York Life provided a report that they have not been designated systemically important and are not considered an international insurance company, so the NPR and ANPR standards should not apply. However, concerns have been raised that these standards may become the industry standard for best practices.

Reinsurance Task Force

The task force met in July and at the Summer National Meeting with the primary goal of completing its model regulation as discussed below, along with an update of its other projects in process.

XXX/AXXX Credit for Reinsurance Model
The task force met via conference call on July 28 to discuss comments received on the June 17 revision to the draft XXX/AXXX Credit for Reinsurance Model Regulation, which was previously exposed for a 30 day period. Among other edits, the task force's revisions included updates to the collateral shortfall and remediation consequences, consideration of reinsurer exemptions based on RBC and/or permitted practices, and AG 48 language alignment to certain sections. However, the "all or nothing" requirement, i.e. credit for reinsurance only allowed if the entity maintains primary security holdings equal to the principal-based reserve, has been retained over the objections of industry. During the summer NAIC staff was assisted by the LAFT AG 48 Drafting Group.

A revised draft was then again exposed for comment on August 4 along with a summary of changes memo with comments due by August 22. The most significant revision in the August 4 draft was removal of recapture as a remediation option. However, a drafting note was added to not prohibit a commissioner from granting a disclosed permitted practice to extend the period of time to remediate or to permit recapture of the ceded business as an alternative form of remediation "under limited and extraordinary circumstances and for good cause shown."

At its meeting in San Diego, the task force heard comments from the ACLI representative who remarked how far the project had come since inception by noting that the ACLI's first comment letter on the model regulation last year was 54 pages, and its August 19 letter is just 3 pages. The most significant comment was a request to reconsider the exclusion of affiliates from the exemption for small professional reinsurers. The chair note that the Life Actuarial Task Force and the Reinsurance Task Force wanted to retain this provision and no change was made.

The task force then voted to adopt the (newly renamed) Term and Universal Life Insurance Reserve Financing Model Regulation and asked the NAIC Legal Department to perform a final detailed review and develop a project history memorandum to be submitted along with the model regulation for consideration by the Financial Condition Committee during its September 30 call. Final adoption by the Executive Committee and Plenary is expected at the Fall National Meeting.

Uniform Checklist for Certified Reinsurers
The task force heard a report from the Reinsurance Financial Analysis Working Group, which met twice this summer to discuss revisions to the Uniform Checklist for Certified Reinsurers that had been exposed for comment. These proposals include the following: a) a note to address the requirement to continue to fund any trust accounts that may become deficient; 2) language to ensure against stale financial strength ratings either during the initial application or renewal process; and 3) clarifying language for the reconciliation of IFRS to U.S. GAAP by the certified reinsurer.

As a result of comments from the interested parties, the working group agreed to use 5% as the materiality threshold for IFRS to U.S GAAP adjustments instead of the proposed 1% threshold. The Reinsurance Task Force then adopted the Uniform Application Checklist at the Summer National Meeting, which will be used for future certified reinsurance applications.

Effect of Solvency II on U.S. Companies
The task force then discussed a significant emerging concern related to EU member implementation of Solvency II. The chair noted that recently both Germany (BaFin) and the UK through its Prudential Regulator Authority have begun restricting the ability of U.S. insurers and reinsurers to access their markets. Several trade associations also expressed

their concerns, and have requested that their member companies notify the FIO and the Office of the U.S. Trade Representative detailing the effect of the actions by Germany, the UK and other EU member states have had on their operations. The task force then adopted a referral to the Qualified Jurisdiction Working Group to study and report to the task force EU member state implementation of Solvency II and the potential impact on Qualified Jurisdiction status.

Insurance Financial Strength Ratings
The task force discussed the recent Fitch white paper entitled "Lack of Comparability of A.M. Best's 'A-' IFS Ratings to Those of Fitch," which key conclusion is that an "IFS rating of 'A–' from A.M. Best is most comparable with a 'BBB' IFS rating from Fitch, as well as Moody's and Standard & Poor's (S&P)." It was noted that A.M. Best "strongly disagrees" with the white paper. The task force deferred immediate action noting the issue will be reviewed in detail during the next evaluation of the appropriate amount of collateral that should be posted for certified reinsurers.

Variable Annuities Issues Working Group

The VA Issues Working Group met for a full day immediately preceding the Summer National Meeting; the first half of the day-long session was a regulator-only session, followed by an open session during which representatives from the NAIC's consultant, Oliver Wyman, presented their proposal to modify Actuarial Guideline XLIII—CARVM for Variable Annuities (AG 43) in order to mitigate the use of captive reinsurance.

In September 2015, the NAIC engaged Oliver Wyman to study the statutory accounting for VA products and their work over the past year and a half included a quantitative impact study (QIS) which influenced their recommendations. The proposal had been exposed only the week before for a public comment period ending November 14. During opening remarks, the working group chair noted that the consultant will also draft marked-up changes to AG 43 and the C3Phase 2 calculation, which will also be exposed for a public comment period ending November 14. The purpose of these exposures is to "initiate the NAIC process of gathering input on such proposed changes."

The Oliver Wyman team started with a walkthrough of the stated reasons to use a captive, which were included in their 2015 report and which they confirmed during the QIS: 1) mitigate non-economic volatility between reserves and capital, 2) align market risk profiles of reserves and hedging programs, 3) mitigate funding requirements in downturn scenarios, 4) consolidate exposure across legal entities, and 5) reduce DTA admissibility limitations of ceding companies.

Oliver Wyman representatives then detailed the proposed changes to AG 43. In order to address reason #1 above the following changes are proposed:

- A general endorsement of issue paper "Special Accounting Treatment for Limited Derivatives" which would allow hedge accounting treatment for assets held in a Clearly Defined Hedging Strategy (CDHS) for VA's. (See the SAP Working Group summary for a discussion of this issue paper.)

- Remove the working reserve from the reserve calculation in order to align the accumulated deficiency definition with that proposed in Life PBR as well as eliminate accounting mismatches between the cash surrender value and the changes in hedge assets.

- In the AG 43 "adjusted" run (a run whereby no new hedge assets can be added) allow companies to replace current hedge assets with cash equal to asset market values. The goal of this change is to eliminate the current situation whereby long-dated hedges must stay static in the projection as the economic environment changes, resulting in potential market value losses in the projection.

- Allow higher credit for CDHS in the projection, assuming such approach can be supported based on back-testing results.

Representatives from Oliver Wyman also recommended that the working group consider proposed changes to reform the standard scenario in order achieve a mixture of the industry goals. These include:

- Align the C3Phase 2 calculation with the AG 43 calculation by proposing that C3P2 be a higher CTE than the AG 43 CTE70 but using the same scenario and model results. This will ensure that the liability side will move in tandem through time and economic scenarios.

- As part of the alignment of C3Phase 2 and AG 43, remove the standard scenario from the C3P2 framework since the standard scenario will now serve that purpose.

- Include a fuller set of scenarios in the standard scenario calculation including an interest rate shock, volatility movements, and FX movements.

- Consider new policyholder behavior assumptions for the various types of VA products. Oliver Wyman representatives did not specify a new assumption but rather promoted an enhanced disclosure for VA writers to include in their annual submissions.

Oliver Wyman representatives then proposed further changes to align TAR with the reserve calculation in order to align C3 with reserve calculation:

- Use the Life PBR metric for starting assets of [98-102%] in order to calculate the reserve to mitigate having excess assets in the starting position, which can create excess volatility.

- Per the previous discussion of alignment of C3Phase 2 and AG 43, Oliver Wyman representatives proposed setting the C3 component as 1/4 of the after tax CTE(98) amount and the post-tax projected AG 43 reserve amount (or more specifically use pre-tax with an assumed 35% effective tax rate).

Oliver Wyman representatives also made some proposals that would increase admissibility limits for designated VA hedges and DTA's. However, it was also noted that regulators should not consider taxes in making decisions around solvency.

Finally, Oliver Wyman also included proposals to standardize capital market assumptions across the VA world and the general PBR world by suggesting harmonizing interest rate and GA investment income assumptions including using the Life PBR generator for interest rates and asset assumptions as prescribed in VM-20 including spreads and defaults and new calibration requirements for the equity scenarios and other market risk factors.

Immediately following the presentation, the working group proposed using NAIC resources to create a marked-up version of AG 43 for exposure. At this point, industry began providing feedback noting that careful review and testing of the proposal had not been possible considering that the proposal had only been released one week earlier. Industry comments also emphasized the need for feedback from insurers not involved in the QIS. Further commentary from industry participants concerned requirements around policyholder behavior reporting, which some participants worried would reveal competitive secrets. Other industry comments raised technical questions and concerns that the proposals may create a bias toward using certain products and also may create more complexity. After much discussion, the working group voted to expose a marked up version of the guidance for a public comment period ending November 14, and to proceed with a second QIS. The working group hopes to have the new VA regime in effect as of January 1, 2018.

Proposed 2016 and 2017 Disclosures
The working group also met in April and June to continue work on proposed disclosures related to variable annuities. During its April 25 call, the drafting group presented a revised proposal to replace Interrogatory 9.2 with a new supplement. During its June 13 meeting, the working group adopted the Variable Annuities Supplement for consideration by the Blanks Working Group. The supplement has separate tables for individual and group business and requires disclosure of the following information: type of benefit (guaranteed death or guaranteed living), number of contracts/certificates, benefit base, net amount at risk for the guaranteed death benefit, guaranteed annual income for the guaranteed living benefit, account value (for both the general and separate account), reserve for guaranteed benefits and percentage of guaranteed benefits reinsured. The Blanks Working Group subsequently exposed the proposal until October 24, with a proposed effective date of year-end 2017.

The working group also adopted a recommendation to remove disclosure of the total maximum guarantee for separate accounts currently required by paragraph 31.c.i of SSAP 56, effective year-end 2017, as the working group will be suggesting revisions to the life insurance interrogatories and to the actuarial opinion required under AG 43. The working group also recommended that the SAP Working Group revise the SSAP 61R variable annuity captive disclosure adopted in 2015 for entities ceding to VA captives. The revisions clarify disclosure of the "purpose of the transaction" and would require disclosure of any permitted or state prescribed practices that differ from NAIC prescribed that apply to the VA captive. The proposed revisions also remove the provision for the disclosure to sunset after 2015 and would be effective for year-end 2016. The SAP Working Group exposed these two items for comment at the Summer National Meeting.

NAIC/AICPA Working Group

The working group met by conference call August 9 and discussed the following topics below.

Premium Threshold
The annual review of premium thresholds showed that 93% of all gross written premium is subject to the Model Audit Rule; therefore the working group agreed no adjustment to the threshold is necessary.

State Adoption of Internal Audit Requirement
In 2014, the Corporate Governance Working Group adopted revisions to the Model Audit Rule to require large insurers ($500 million in annual premium and above) to establish and maintain an effective internal audit control function. As of the August, only four states (GA, IN, OH and VA) have adopted the revisions, which are expected to be accreditation standards by January 1, 2020; the chair again encouraged states to adopt the internal control guidance.

Access to Audit Workpapers
The chair noted that in 2015, the AICPA/NAIC Task Force, in coordination with the working group, developed a white paper entitled "Best Practices: Insurance Regulator Access to Workpapers." During its conference call, the working group asked for feedback as to whether the white paper had been successful in resolving workpaper access challenges. Regulators responded that the white paper has been helpful, especially with respect to obtaining "native" files in Excel and Word, although perhaps not all of the CPA firms had previously been aware of the best practices document. The chair encouraged regulators and CPA firms to be aware of and use this document.

Life Insurance and Annuities Committee

The committee met via conference call in July and at the Summer National Meeting and discussed projects in process.

July 27 Conference Call
The committee voted to adopt key items so that they could be considered by various groups at the Summer National Meeting. The first three items were also adopted by Executive Committee and Plenary in San Diego.

- Revisions to AG 49 addressing issues related to policy designs with dual accounts.
- Revisions to AG 48 eliminating the use of net premium reserve percentages for valuation dates subsequent to December 31, 2015. The NPR approximations are now replaced with the 2017 CSO table.
- Nineteen amendments to the Valuation Manual which primarily clarify the application of the requirements in the Valuation Manual. One key amendment noted by the chair of LATF limits the level of aggregation within PBR to products that have been tested. LATF has committed to studying the issue and the possibility of adding products that could be aggregated.
- Request to revise the Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts Model Regulation (Model #200) to make it more consistent with Synthetic Guaranteed Investment Contracts Model Regulation (Model #695).
- Request to revise Standard Nonforfeiture Law for Individual Deferred Annuities (Model#805) to clarify the model does not apply to contingent deferred annuities.

Unclaimed Benefits Model Drafting Subgroup
The subgroup met at least twice a month since May 2015 to draft an NAIC model to address the issue of unclaimed life insurance and annuity benefits, including procedures insurers should follow to find beneficiaries. The proposed model's guidance include provisions similar to those in the National Conference of Insurance Legislator's Model Unclaimed Life Insurance Benefits Act and requirements in the regulatory settlement agreements reached with a number of insurers. The subgroup completed its draft of the Unclaimed Life Insurance and Annuities Model Act for submission to its parent committee. The Unclaimed Life Insurance Benefits Working Group will now consider the model and is expected to solicit input from the various interested parties.

Model Law Review Subgroup
The subgroup discussed the models it has been tasked to review and has concluded the following models will be retained with no revisions necessary: Variable Annuity Model Regulation (Model #250), Life Insurance and Annuities Replacement Model Regulation (#613), Viatical Settlements Model Act (#697), Standard Nonforfeiture for Life Insurance (#808), Model Regulation Permitting the Recognition of Preferred Mortality Tables for Use in Determining Minimum Reserve Liabilities (#815), and Preneed Life Insurance Minimum Standards for Determining Reserve Liabilities and Nonforfeiture Values Model Regulation (#817).

In addition, there are some models that will be retained after revision including Annuity Disclosure Model Regulation (#245) and Suitability in Annuity Transactions Model Regulation (#275). The committee formed a new working group to assess disclosures necessary to inform consumers in light of the innovations in products currently in the marketplace (#245); revisions related to contingent deferred annuities are still being assessed by the subgroup (#275). Finally, the working group will continue to study the following two models which have low adoption rates: Annuity Nonforfeiture Model Regulation (#806) and Modified Guaranteed Annuity Model Regulation (#255). The Model Law Review Subgroup intends to complete its review by the Fall National Meeting

Life Insurance Policy Locator Service
The committee heard a presentation on the life insurance policy locator service. The NAIC website now has a page that helps direct consumers to various state resources. By the end of 2016, it is expected that there will be a single location where consumers can make an inquiry and insurers will receive the requests and search for the consumer's policies.

Life Insurance Buyer's Guide
A new working group was formed to revise the Life Insurance Buyer's Guide to help ensure the consumer understands information about the policies they purchase. The current guidance was last updated in 2007.

Life Insurance Illustrations Issues Working Group

The working group met three times since the Spring National Meeting via conference call to address its 2016 charge to explore how the narrative summary required by Section 7B of the Life Insurance Illustrations Model Regulation (#582) and the policy summary required by Section 5A(2) of the Life Insurance Disclosure Model Regulation (#580) can be enhanced to promote consumer readability and understandability of these life insurance policy summaries. The NAIC had previously acknowledged that the current materials provided to consumers are overly complex and not thoroughly explained. The working group recommended that the Life Insurance and Annuities Committee develop a one to two page policy overview document that would make illustrations more consumer friendly. The working group is drafting the short policy overview document first; then it will consider whether additional revisions to the policy and narrative summaries are necessary.

Life Actuarial Task Force

During the day and a half dedicated to the LATF meeting, the lengthiest discussions related to mortality table development, a report from the Longevity Risk Subgroup and application of AG 49 to inforce policies. These topics and other highlights from the Summer National Meeting are summarized below.

Valuation Mortality Tables

Guaranteed and Preneed Mortality
During an interim conference call and in San Diego LATF received an update from the Joint Academy Life Experience Committee and Society of Actuaries Preferred Mortality Oversight Group (POG) on the development of Guaranteed Issue and Preneed mortality tables. In particular, the POG sought guidance from LATF regarding the level of loading to reflect in the table, as well as whether to reflect mortality improvement and use of the tables for reserves only or also for nonforfeiture values. The POG also presented issues related to Simplified Issue and Accelerated Underwriting mortality under VM-20.

The Guaranteed Issue experience basic tables reflect data from calendar years 2005-2009 for 11 of 15 contributing companies. The study participants excluded some very large GI writers, and data from four of the contributing companies was excluded due to outlier characteristics. The draft valuation table uses the 2017 CSO loading formulas as a starting point, which equates to roughly 17% loading. This loading basis results in close to 100% coverage of the underlying exposure, but only about 55% of contributing companies. An alternative approach is to use a 55% loading to achieve 70% to 80% coverage, which the POG noted would be very punitive to large carriers.

No definitive decisions were made regarding application of mortality improvement or use of the tables for non-forfeiture values. LATF instructed the POG to move forward with the 2017 CSO loading basis and develop actual-to-expected mortality ratios for the participating companies as well as large companies that didn't participate in the study. Discussion of this topic will continue on a future conference call.

A 2015 Preneed mortality experience table was developed based on data from calendar years 2005-2009 for 11 contributing companies. Data was combined for all underwriting segments to minimize volatility observed in different underwriting segments. A loading of 3.9% on this 2015 Preneed table covers 100% of exposure and 90% of contributing companies. However, POG analysis shows that reserves based on a new Preneed table may not be sufficiently different from those based on the current 1980 CSO valuation basis to warrant a change. The POG requested that the charge be modified to indicate development of an experience table, but not a valuation table; LATF supported this change.

2017 CSO Mortality Table
In related business, during this session the POG proposed and LATF agreed to technical changes to some rates in the previously adopted 2017 CSO table. Industry review and use of the tables identified an anomaly where for certain younger ages (i.e. <37) the composite rates in the ultimate period were higher than the smoker rates. The POG recommendation was to cap the rates at the smoker

rates, rather than redevelop the composite tables. LATF agreed with the recommendation and the tables will be updated.

SI and Accelerated Underwriting Mortality
The POG also presented LATF members with a status update on the charge to develop new basic and valuation mortality tables for Simplified Issue (SI) business. The task has proved challenging due to significant changes in SI pricing and underwriting processes since the data was collected (from calendar years 2005-2009) as well as data limitations and the absence of any clear fit of the experience to a current mortality table. The presentation emphasized the need to clearly define SI business, noting that this is becoming more difficult with the advancement of Accelerated Underwriting (AUW) practices in which medical and non-medical information gathered for underwriting is customized to the individual applicant such that less invasive underwriting approaches (i.e. appearing like SI) can be used to arrive at the same underwriting decision that full underwriting would yield.

This blurring of the lines between SI and AUW business is important in the context of PBR and setting the mortality assumption because it is not clear how the prescribed guidance in VM-20 Section 9.C applies to these different types of underwritten experience, nor is it clear what industry mortality tables are applicable to these different types of businesses. The lack of clarity in the guidance will result in variation in industry practice in setting mortality assumptions. LATF members engaged in earnest discussion of the challenges and implications for experience reporting as well as valuation; however no decisions were made regarding next steps other than to continue with the development of the SI composite table. A conference call will be scheduled to discuss the issues further.

PBR VM and Related Matters
(The PBR Implementation Task Force summary starts on page 4 of this Newsletter; PBR Review Working Group is directly after the LATF summary.)

Valuation Manual Amendment Proposals
During the interim period LATF discussed, exposed and adopted several clarifying amendments to VM-20, VM-31, VM-G and VM-M, as well as more substantive amendments. The change to VM-M incorporates the 2012 IAR valuation table into the guidance. The changes to VM-G clarify definitions, guidance for the Board and senior management, and responsibilities of qualified actuaries. Clarifications to the responsibilities of qualified actuaries with respect to assumptions, methods, models and internal controls were discussed on several different conference calls, exposed and ultimately adopted. Related changes were also made to VM-20 and to VM-31 to clarify that the responsibilities apply to each qualified actuary responsible for a group of policies or contracts. These revisions were adopted by the Life Insurance and Annuities Committee July 27 and by Executive Committee/Plenary at the Summer National Meeting.

One substantive change to VM-20 was to require the separation of term and ULSG reserves when aggregating policies for purposes of determining minimum reserves, thereby addressing regulator concern that PBR amounts in excess of the NPR may be allocated to a product that did not generate the excess.

Another substantive change to VM-20 was to prohibit inclusion of post-level term profits in the deterministic reserve calculation. This change addresses concerns of some regulators that the NPR floor reserve was too low following VM changes that effectively eliminated offsetting levels of conservatism in the assumptions for mortality and post-level term profits. In the absence of time to study and make further changes to the NPR before the effective date of PBR, LATF members agreed to address the issue in the deterministic reserve calculation for the 2017 VM. This change ensures that solvency protection is preserved in PBR and levels the playing field regarding reliance on post-level term profits.

The updated Valuation Manual reflecting these amendments has been posted to the LATF webpage.

VM-20 Spread Tables
Under the VM-20 framework investment spreads and default costs are provided based on source data from vendors J.P. Morgan Chase and Bank of America; default costs will be updated annually while investment spread costs will be updated quarterly. During the interim period LATF exposed and adopted the March 31 spread tables and also exposed the June 30 spread tables, which were subsequently adopted at this meeting. Following adoption of the June 30 spread tables, LATF discussed an ACLI proposal for a 1-month lag in data used to develop the spreads, so that spreads applicable for the current valuation period are available before the end of the quarter. The 1-month lag would facilitate more timely production and use of the data. NAIC staff analysis of the potential impact shows such lag would have a very small impact on the spreads. No action was taken at the meeting and the matter will be discussed during a future conference call.

2018 VM Issues
LATF heard remarks from the ACLI regarding a framework and calendar for making VM changes on a regular basis once PBR is being applied. The ACLI proposes a schedule whereby all material updates effective on the following January 1 would be adopted by Executive Committee/Plenary session at the preceding Summer National meeting. The proposal includes dates by which other committees and task forces would need to complete their work. Some regulators were supportive of the concept, noting it would help with VM version-control, while others expressed resistance to greater restrictions on the process. No decision was made and the matter will be discussed further at a later date.

VM-22 Fixed Annuity PBR
LATF received a report from the VM-22 Subgroup on work related to development of PBR methodology for non-variable annuities. During the interim period the subgroup completed a proposal for the maximum valuation interest rate for income annuities. The proposal is based on work performed by the Academy SVL Modernization Working Group to evaluate the SVL interest rate methodology for non-variable annuities, and also incorporates recommendations from regulators and industry.

The proposed methodology is more complex than the current one and addresses shortfalls in the current framework. Under the proposed methodology, valuation rates would be adjusted quarterly or daily depending on contract size, would be based on treasury rates plus a spread less default costs and expenses, and would be established based on the expected duration of the payout period. The plan is for the NAIC to publish the valuation rates similar to the way VM-22 spreads are published. The proposal is exposed for public comment through November 11.

The subgroup also reported that changes to Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts Model Regulation (#200) were drafted to achieve consistency with changes made to the Synthetic Guaranteed Investment Contracts Model Regulation (#695) revised in 2015. The proposed changes affect the asset maintenance requirements for market value separate accounts supporting other than index contracts. The proposed changes will be presented for a LATF vote in September.

A representative of the ACLI provided an update on efforts to test a simplified VM-22 floor reserve. Five member companies volunteered to participate and the focus is on products with guaranteed living benefits, which for this group are primarily indexed annuities. The simplified floor reserves will be compared against CARVM reserves, cash surrender value and the AG 43 standard scenario reserve. Results are in for three of the five companies and suggest that the simplified method consistently produces the highest reserve values. No date was given for completion of this testing.

Longevity Risk Subgroup
See the Life RBC Working Group summary.

Indexed UL Illustration Subgroup
The IUL Illustration Subgroup was established to consider post-adoption enhancements to Actuarial Guideline 49, adopted by the NAIC in June 2015. At the Spring National Meeting LATF adopted revisions to the guideline to address policies with dual accounts; these revisions were ultimately adopted by the full NAIC at the Summer National Meeting. The revisions provide guidance regarding the credited rates to be used to illustrate each Index Account where there are multiple account options within one policy, and also require that each set of Index Accounts corresponding to a Benchmark Account Index independently pass the self-support and lapse-support tests under the Life Insurance Illustrations Model Regulation (#582).

Another issue discussed was applicability of the revised AG 49 guidance to new policies (i.e. as currently prescribed based on issue dates set forth in the guideline) or to new illustrations on all inforce policies, regardless of when they were sold. During the interim period the subgroup requested comments on this suggestion and received mixed support, noting potential benefits from having all IUL illustrations performed on a consistent basis, but also the potential for consumers to be confused about changes in the illustrations and for companies to incur significant costs to implement the changes. No decisions were made at this meeting and discussion will continue in September.

Academy Council on Professionalism
The task force received an update from the American Academy of Actuaries Council on Professionalism and activities within the Actuarial Standards Board and the Actuarial Board for Counseling and Discipline (ABCD). Final revisions to Actuarial Standards of Practice 21 Responding to or Assisting Auditors or Examiners in Connection with Financial Statements for All Practice Areas are expected to go before the ASB in September. The ASB had adopted a pending Life PBR ASOP, Principle-Based Reserves for Life Products, to be finalized after the VM effective date became known. Following the Spring National Meeting the ASB Life Committee formed a task force to consider VM changes since the original adoption of the ASOP that are relevant to the standard. Depending on the relevance of such

changes, there may be another exposure. Exposure drafts for these and other standards are available on the ASB webpage.

The ABCD representative noted a continued increase in the number of requests for guidance (a core function of the ABCD) in 2016 relative to 2015. The ABCD expects to see another record high number of inquiries by the end of 2016. An increase in rate filings have prompted more regulator inquiries, particularly regarding attestations on qualifications.

A third exposure of the Modeling ASOP is open for comments through October 31. The ASOP would apply to actuaries in all practice areas performing actuarial services involving models that are not simple models. The ASB is also drafting a new standard specific to assumption setting and plans to present an exposure draft to the ASB in September.

Generally Recognized Expense Table

The SOA Committee on Life Insurance Company Expenses presented analysis to assist LATF in considering for adoption the recommended 2017 GRET factors for use with individual life insurance sales illustrations. A total of 381 companies were included in the base data for the analysis. The methodology used to develop the recommended factors was similar to that used to develop the factors in recent prior years.

For the Independent, Career, Niche and Other distribution channels, the factors are relatively unchanged from the prior year. For the Direct channel both the acquisition and maintenance expense factors are about 10% higher than in the prior year, attributable primarily to the change in the small number of companies in this category. LATF voted to expose the 2017 GRET factors for comment until September 28. Typically GRET exposures get few if any comments, and according to a SOA survey only 26% of responding companies use the GRET, compared to 25% in the prior year.

Streamlining Actuarial Reporting

LATF received a progress report from the Actuarial Resources Corporation on the project to streamline actuarial reporting to facilitate regulator access to standalone reports and increase effectiveness of actuarial reviews. Phase 1 of the project resulted in development of the "Actuarial Reporting Template," which is a combination of new summary reports and existing required opinions, certifications, memoranda and reports. Also included is a "Data and Information Points" section, comprised of thirteen questions regarding significant changes, actions or judgments impacting the reported results.

Phase 2 is underway and includes a voluntary field test using the 2015 required reports and converting them into the template format. Several companies are participating in the field test and some want to use the template for 2016 reporting. The ARC team recommends that the template be optional until more people are comfortable with it, then make use of the template the required approach. More discussion is needed to confirm the template content and identify opportunities to leverage the template for data capture. A conference call will be scheduled to discuss the matter further and agree on next steps.

PBR Review Working Group

The working group met in San Diego and received updates from its subgroups.

PBR Blanks Reporting Subgroup

The subgroup completed its project to develop PBR reporting in the annual statement; the new VM-20 Reserves Supplement was adopted by the subgroup and subsequently exposed for comment until September 16 by the Blanks Working Group. The subgroup was then disbanded, having completed its charge.

PBR Review Procedures Subgroup

The subgroup held a regulator to regulator call August 8 to discuss its projects in process. The subgroup is continuing its work to develop PBR-related guidance for the Financial Analysis Handbook and Financial Condition Examiners Handbook, including adding a PBR chapter to Examiners Handbook. The subgroup also discussed the status of work being done by the American Academy of Actuaries to develop PBR review procedures, including a Model Governance checklist and a paper discussing the actuarial components of risk-focused examinations. The chair of the subgroup noted there is current limited guidance on the actuarial elements of such examinations.

2016 PBR Pilot Project

The PBR Pilot Project is testing three aspects of principles-based reserving: 1) PBR calculations, 2) VM-20 Reserves Supplement and 3) VM-31 Actuarial Report; as of the Summer National Meeting, one company had dropped out, leaving eleven companies in nine domiciliary states to work on the pilot project. The first VM-20 Supplements were due to the NAIC August 19 but several companies requested extensions. Weekly regulator-to-regulator conference calls to discuss the results of the pilot will begin the week of September 19, with a final report expected at the Fall National Meeting.

SOA Survey on PBR Readiness
A representative of the Society of Actuaries reported that 72 companies responded to its second confidential survey on PBR readiness, sixteen of which indicated they would be valuing at least one product under PBR in 2017. Many of the other responders replied that they will use the three year phase-in option. Three companies noted they will still cede PBR-subject business to captives. A complete report should be available by the middle of September.

PBR Company Experience Data Collection Project
At the Spring National Meeting, the Executive Committee adopted a preference for the NAIC to serve as a statistical agent for collection of company experience data on behalf of the states. Since that time, the working group reported that NAIC staff have made significant progress in developing and implementing technology to collect company experience data and maintain confidentiality of the data collected. NAIC staff will continue participating in the pilot program with Kansas to further develop and refine NAIC technology and internal processes. As part of the pilot, the NAIC received data from 17 companies.

Health Actuarial Task Force

Long-Term Care
At the Summer National Meeting, the LTC Actuarial Working Group heard an update from the LTC Valuation Subgroup on its discussions during the interim period of a proposal for stand-alone asset adequacy requirements for long-term care insurance. The proposal stems from the subgroup's discussions of potential changes to Health Insurance Reserves Model Regulation (Model #10) to reflect a principles-based framework for minimum reserve standards. Model #10 lacks specific guidance related to LTC asset adequacy testing and premium reserve calculations, creating variation in practice among insurers for evaluating asset adequacy, and varying levels of regulator comfort in the overall level of insurers' LTC reserves. Much of the debate centers around the differences between gross premium valuation reserves generally accepted as the current standard and based on best estimates, versus minimum requirements under stand-alone asset adequacy testing that some regulators believe are consistent with principles-based reserves. Proposed guidance in the form of an actuarial guideline was exposed for 60 days.

The proposed guidance includes a requirement that LTC reserves be strengthened by any resulting asset deficiencies, and conditions for reflecting anticipated rate increases in the analysis. In the course of their general review of LTC reserve standards regulators noted that future rate increases can be factored into the considerations, but there is concern among regulators about companies reflecting significant rate increases far into the future. Industry representatives anticipate the proposal will be met with some resistance, noting assets are generally managed at the company level and product level asset adequacy testing is contrary to the spirit of the asset adequacy regulation. The regulators recognize that the proposal is a "straw-man," to invite discussions on LTC reserve adequacy.

During the interim period the LTC Valuation Subgroup also submitted a request to the SOA and AAA to develop mortality and voluntary lapse tables to replace the current prescribed tables. In particular, the replacement for the currently prescribed mortality table is to be based on the 2012 Individual Annuitant Mortality table, and both the mortality and lapse replacement tables are to reflect data from the recent SOA/LIMRA LTC policy termination experience study, for which results were first presented at the 2015 Summer National Meeting. No timeframe was provided for development of the tables.

The LTC Actuarial Working Group heard a presentation by Warren Jones from PwC representing the American Academy of Actuaries introducing the final published LTC Credibility Monograph developed by the Academy; see the link. The Monograph is intended to increase awareness of the application of credibility to LTC-related work; provide information on current practice, relevant publications and underlying theory; outline considerations for selecting and applying credibility procedures to LTC actuarial work; and to suggest next steps for advancing actuarial practice.

Cancer Claims Costs
The Health Actuarial Task Force received a report from the Joint AAA/SOA Cancer Claims Cost Tables Work Group on the proposed 2016 Cancer Claim Cost Valuation Tables to replace the current 1985 tables. The report documents the full development of the tables and includes initial data, basic tables and valuation loaded tables. The report was exposed for public comment until October 6. The HATF chair observed that development of these tables began in 2004 and spanned a longer period than LATF had been working on PBR.

Financial Regulation Standards and Accreditation Committee

The committee met in person in San Diego and discussed the following projects.

Revisions to Modernize the Accreditation Guidance
At the Spring National Meeting, changes were proposed to the Review Team guidelines and the Accreditation Review Process and Procedure to enhance and modernize the accreditation program. The proposed changes included eliminating the numerical scores for each state as the sole basis for the review team's recommendation and focusing on an overall recommendation regarding the state's accreditation status. The changes separated the guidelines into either process-oriented or results-oriented guidelines. At the Summer National Meeting, the committee adopted these changes effective January 1, 2017.

Self-Evaluation Guide/Interim Annual Review
NAIC staff developed a proposal to update the Self-Evaluation Guide|Interim Annual Review to be in compliance with the newly adopted Review Team Guidelines. The SEG|IAR is completed by the state insurance departments on an annual basis to demonstrate compliance with accreditation standards between full accreditation reviews. The proposed changes try to make the process more efficient e.g. there would be no requirement to include documents that have not changed from the prior year and a new section was added to centrally track responses to review recommendations received during an IAR. At the Summer National Meeting, the working group exposed the proposed changes for comment until October 25.

CPA Audit Standard for RRGs
The committee considered two issues related to the Model Risk Retention Act (#705). The Risk Retention Group Task Force reported that the AICPA had informed them that Model Audit Rule (#205) provides relief from the auditor rotation requirement in certain circumstances, but the Model Risk Retention Act does not. The committee agreed to add a drafting note to Model 705 proposed by the RRG Task Force that auditor rotation relief would be permissible under the new accreditation standard for Model #705 effective January 1, 2017.

The committee then exposed for comment proposed revisions to the Part A: Laws and Regulations-Risk Retention Groups (RRGs) Organized as Captives CPA Audits to provide guidance in areas where the Model #705 guidance and Model #205 guidance overlap. The RRG Task Force recommended incorporating the proposed revisions into the accreditation standard effective January 1, 2017, which will coincide with the effective date of the Model Risk Retention Act. NAIC staff recommended updating the CPA Audits standard to allow for application of either Model #205 or Model #705 when assessing compliance. The proposal was exposed for comment until September 25.

Casualty Actuarial and Statistical Task Force

The task force met by conference call June and July, and met in San Diego to discuss the following matters.

Information-Sharing Among Different States
The task force discussed the challenges facing regulators as insurance companies increasingly use more complex models to substantiate their P/C insurance rates in rate filings. The added complexity requires a higher level of expertise which may not be available at the individual state level. The task force discussed three potential options:

1. A charge to the task force to facilitate regulatory discussion regarding individual rate filings
2. A filing with a common component being filed nationally similar to the Interstate Insurance Product Regulation Commission.
3. A charge to the task force to establish a group of regulatory experts on rate filings, sophisticated P/C models, and/or rating plan analysis using a mechanism similar to the Financial Analysis Working Group and the Valuation Analysis Working Group.

The task force discussed that option 1 is preferred, at least as a starting point, which was compared to the task force's annual regulator-to-regulator calls to discuss specific actuarial opinions and other regulator discussions. Option 2 appears to be a nonstarter as there is no evidence states are ready to cede any authority to such a group. Option 3 may be a possibility but would require significant agreement on details before it would be supported.

Issues identified with any national discussions included the following: 1) specifics in a company's rate filing are rarely identical from state to state, especially with models that evolve over time; 2) filings are not submitted in each state at the same time; 3) state laws differ; 4) states have a short amount of time to review rate filings so the timing of discussions would need to be considered; 5) the scope would need to be identified, such as whether pieces of filings or entire filings would be discussed; and 6) the shelf-life of any advice or discussion would need to be considered.

The task force had significant discussion on this matter on its July 12 conference call. On the same call, Birny Birnbaum (Center for Economic Justice) suggested the task force consider requesting an NAIC resource to assist the states with capabilities that not all states have. Mr. Birnbaum submitted a proposal noting a concept that the NAIC would provide actuarial, statistical and data collection/ management/ processing assistance to state insurance departments seeking assistance in the analysis of complex pricing models. The proposal states that the resource is not an additional layer of regulation or a new regulator, and would not provide regulatory opinions on whether a pricing model complies with any state's laws or whether the filing should or should not be approved. The proposal notes that there is no issue with protection of confidential data as the resource would be subject to the same confidentiality requirements of the state requesting assistance. The task force also discussed costs related to the services to which Mr. Birnbaum commented that there is typically not a charge for NAIC assistance. An example is PBR actuaries are being hired to be a shared resource and there is no specific charge to the states.

The chair commented on the potential for multiple groups to work together on this issue, namely the Big Data Working Group, the Property and Casualty Insurance Committee, and the Auto Insurance Working Group, and noted that he would discuss a potential project with the respective chairs.

<u>Risk-Focused Enhancements</u>
The task force discussed a referral from the Financial Analysis Handbook Working Group related to a project to reorganize and enhance the handbook to incorporate risk-focused assessments. The task force is being asked to review the enhanced reserve chapters.

The task force discussed a proposed response drafted by the Actuarial Opinion Working Group, comprising five documents; two relate to the analysts' review of the Statement of Actuarial Opinion and three relate to the analysts' review of an insurer's reserve risk. Key recommendations include removing procedures asking the analyst to review calendar year loss ratios as they are not a valid indicator of an insurer's reserve adequacy for prior accident years given that such ratios are significantly affected by losses incurred in the most recent calendar year; and removing procedures asking the analyst to review information on loss sensitive contracts in Schedule P, Part 7 as this information cannot be used to make conclusions on reserve adequacy. Rather, Part 7 was added to Schedule P so that an insurer could provide support for its credit for loss sensitive business in the RBC formula. The proposed response was exposed for comment through September 26. The task force will discuss comments received during an upcoming conference call.

<u>Survey to Review GLM-Based Rate Filings</u>
The task force discussed development of a proposed survey on how states review auto and homeowner insurance rate filings that are based on generalized linear models (GLMs) and other advanced modeling techniques. The task force plans to use the information to document best practices in reviewing filings and assessing challenges facing regulators. The task force also discussed what it can make public given the survey focuses on the states' regulatory review processes. Following the discussion, the task force exposed the proposed survey through October 11.

Financial Examiners Handbook Technical Group

The technical group discussed a previously exposed proposal to revise Exhibit M – Understanding the Corporate Governance Structure and Exhibit Y – Examination Interviews of the Financial Condition Examiners Handbook. The revisions are in response to a referral from the Financial Condition Committee addressing the need for state regulators to require examiners and supervisors to document more clearly their observations of properness, aka suitability, of key individuals.

A joint industry comment letter was discussed, which concluded that such revisions are unnecessary and undesirable. The technical group clarified that the revisions are the result of recommendations from the Financial Sector Assessment Program review, which compares international standards to U.S. standards for regulating insurance activities. It was also noted that international standards are far more stringent than U.S. standards, and include requirements to assess the suitability of key individuals, specific criteria to consider in assessing suitability and specific action that may be taken when individuals are deemed not suitable. The chair stated that the U.S. insurance regulators have explicitly rejected such a prescriptive approach to corporate governance and have instead advocated for an approach that focuses on regulator review and assessment. It was also clarified that an examiner is not expected to be responsible for selecting or removing members of the board or management; instead, the assessment should be used to identify potential red flags or other areas of concern for ongoing monitoring.

The technical group discussed a compromise to the proposed language requiring a specific conclusion on whether an individual is either suitable or not suitable and suggested revising the language for the examiner to document any concerns or issues identified. The technical group exposed the updated proposal until September 19.

Risk-Focused Surveillance Working Group

The working group met by conference call on April 20 and July 14 to discuss the following topics.

Financial Analysis Guidance
The working group discussed a previously exposed draft financial analysis planning guidance on "Understanding the Company in Risk-Focused Financial Analysis." The guidance outlines steps for obtaining information necessary to understand the company and suggests sources of information. After making revisions suggested by Connecticut and Texas, the working group adopted to refer the proposed guidance to the Financial Analysis Handbook Working Group.

Prioritization Framework Guidance
The working group discussed draft revisions to the Financial Analysis Handbook which includes definitions for five priority ratings used by analysts and describes the solvency monitoring to be performed for each priority level. Currently, the analysis and examination handbook guidance require each state to develop and maintain its own prioritization framework for managing regulatory resources and determining the timing and extent of analysis and examination procedures to be performed. The revisions will promote uniformity and consistency in the prioritization framework and resolve challenges posed by conflicting prioritization scales used by different states, i.e. one state may use "Priority 1" to designate its lowest priority companies, while another state may use "Priority 1" to designate its highest priority companies. The working group exposed the proposed guidance through August 12.

Mortgage Guaranty Insurance Working Group

The working group met in San Diego to discuss its projects.

Capital Model
As promised at the Spring National Meeting, the working group posted the draft proposed capital models to its webpage: it includes both an Overview of Proposed RBC Approach and the Loan Level Cash-Flow Model Methodology white paper. The chair noted at the Summer National Meeting that since May, the working group has held approximately 5o hours of regulator-only meetings to review the Oliver Wyman capital model in detail. The chair observed that they have made a great deal of progress in understanding the data underlying the models, and the testing group is "about halfway through understanding the replication of the model." The third phase of the project is a sensitivity analysis. Work on the models will continue into the fall.

Model Act and Standards Manual
Because of the time spent on the capital models, the working group made less progress on the Mortgage Guaranty Insurance Model Act and the Standards Manual. Drafts of both dated August 20 were distributed with the meeting materials. The primary open issues are pool mortgage guaranty insurance (coverage on a defined portfolio of loans), state concentration limits, and reinsurance, the latter two of which have been discussed extensively in prior meetings. Industry participants would still like the working group to consider changes to dividend restrictions and release of the contingency reserve. A conference call will be scheduled this fall to continue these discussions.

Timeline to Completion
The chair stated that the model act and standards manual are on schedule to be completed by the Fall National Meeting; the expected completion date of the capital models was not discussed.

Climate Change and Global Warming Working Group

In San Diego, the working group heard a presentation from Wildfire Partners, a voluntary certification program that provides critical technical and financial assistance to help Boulder County homeowners in the foothills and mountains prepare for wildfire. The program is funded by participating homeowners, and local, state and federal governments. Since its launch in 2014, more than 900 homeowners have enrolled in the program. A public-private partnership, Wildfire Partners, with the support of over 35 partner organizations, has created a model program that has tested a new approach to mitigation that many are interested in replicating. The success of the program was evident during the Cold Springs 2016 fire which burned over 600 acres and none of the certified homes in the impacted area were burned. In order to participate in the program, homeowners are required to participate in a home assessment with a wildfire mitigation specialist. The homeowners receive a report after the assessment that lists the preventative measures needed.

After the presentation, the working group discussed that public-private partnerships provide a new way to approach mitigation to reduce home destruction resulting from increasing wildfire risk, driven in large part by climate change. The working group encouraged industry and others to replicate the efforts of Wildfire Partners.

Terrorism Insurance Implementation Working Group

The working Group met in person in San Diego and discussed the status of the state regulator terrorism risk insurance data call. The lead states discussed that the submission for workers' compensation is due September 30 and the other commercial lines data have been extended to November. NAIC staff discussed that each insurer is to provide one submission, and the NAIC and Federal Insurance Office will coordinate their requests in the future to reduce duplication of data and cost on the industry.

Sharing Economy Working Group

In San Diego, the chair proposed that the working group create a white paper on home sharing as a resource regarding the insurance implications of short-term rentals of one's personal residence. The working group agreed to begin development of the white paper, which will address the following topics:

- What homeowner and apartment hosts and customers need to know
- What owners of rental units, whose renters may be hosts, need to know
- A review of current Airbnb and HomeAway coverage (and whether this coverage constitutes insurance under state insurance laws), and
- An appendix of related NAIC presentations and notices that have been issued by some states.

The proposed timeline for the white paper is an initial draft in October, an interim conference call to discuss comments prior to the Fall National Meeting, and a final draft to be adopted at the Fall National Meeting.

The working group also heard a presentation regarding the types of insurance policies available to sharing economy companies. The presentation focused on business model challenges for traditional insurers, common underwriting challenges, and product-line specific insurer concerns and market options for certain lines of businesses, including workers compensation, automobile liability and general liability.

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The next National Meeting of the NAIC will be held in Miami December 10-13. We welcome your comments regarding issues raised in this newsletter. Please provide your comments or email address changes to your PricewaterhouseCoopers LLP engagement team, or directly to the NAIC Meeting Notes editor at jean.connolly@pwc.com.

Additional information

If you would like additional information, please contact:

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

PwC's Insurance Practice Leaders

Greg Galeaz
Insurance Sector Leader
Tel: 1 617 530 6203
gregory.r.galeaz@pwc.com

Matt Adams
Insurance Assurance Leader
Tel: 1 646 471 8688
matt.adams@pwc.com

James Yoder
Insurance Advisory Leader
Tel: 1 312 298 3462
james.r.yoder@pwc.com

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

www.pwc.com/us/insurance

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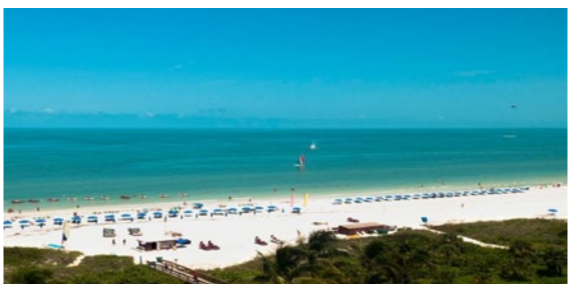


2017

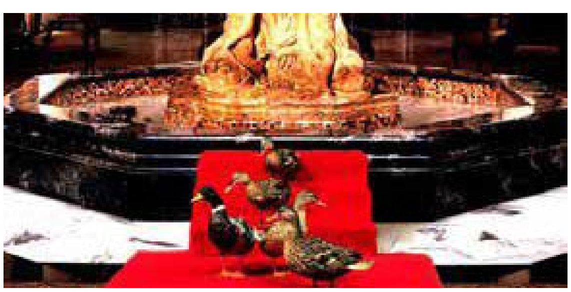
July 23–26
Marco Island, FL

JW Marriott Marco Island

2018

July 15–18
Indian Wells, CA

Hyatt Regency Indian Wells Resort & Spa



2019

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Memphis, Tennessee

The Peabody Memphis

2020

July 19–22
Orlando, Florida

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7044 S 13th St.
Oak Creek, WI, 53154

Tel 414.908.4930
Fax 414.768.8001
www.sofe.org