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NAIC Update Winter 2013

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- Corporate governance model hits snag
- Reinsurance changes move forward at NAIC, states
- 2013 ORSA pilot results are positive
- Life insurer-owned captive use concerns regulators
- A private equity leader provides assurances on the staying power of the sector's capital

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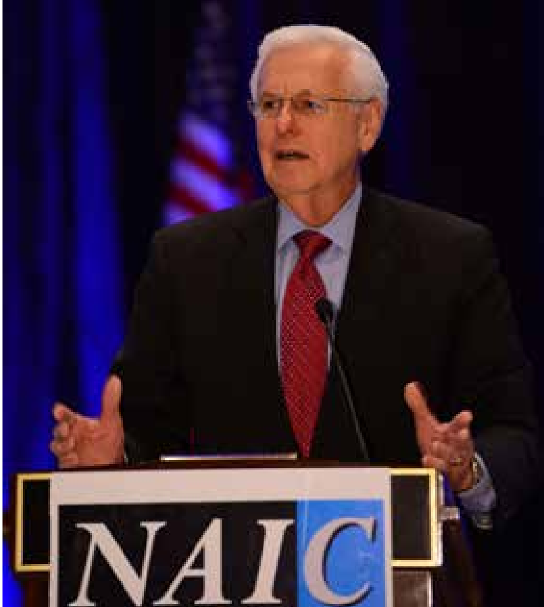
What's next
- March 7-9: NCOIL Spring Meeting; Savannah, GA
- March 29-April 1: NAIC Spring National Meeting; Orlando, FL
- October 20-25: IAIS Annual Conference; Amsterdam, The Netherlands

Après the FIO report



Outgoing NAIC President Louisiana Insurance Commissioner James J. Donelon presided over the first open nomination and election of officers at the organization.

Courtesy of the NAIC

WASHINGTON, D.C. — For the National Association of Insurance Commissioners (NAIC), its national meeting in December in Washington, D.C., may have been both the best of times and the worst of times.

For regulators and others concerned that the long-awaited report on the modernization of insurance regulation by the Federal Insurance Office (FIO) would signal an aggressive push to end state regulation, it was the spring of hope, as that report, issued days before the meeting, did little more than nibble at the edges of the current regulatory structure.

But for state regulators who might have hoped to maintain a united front in the face of any federal intrusion on insurance regulation, it might have been the winter of despair, as disputes among regulators burst into the open in various forums, often accompanied by what in diplomatic-speak is usually referred to as a frank and open exchange of views.

Still, overall the meeting could have been considered a season of light for state regulation. Whatever else, the FIO report means the NAIC has more time to continue with its improvements. In addition, a joint EU-U.S. forum held before the official start of the session heard strong support from various industry representatives for the NAIC's position in opposition to the imposition of global insurance capital standards, perhaps strengthening the NAIC's standing internationally.

There was the usual decrying of the lack of insurance expertise on the Financial Stability Oversight Council (FSOC) and some less usual fireworks over accounting rules governing health insurers in the wake of the Affordable Care Act. But movement continued apace on revamping risk-based capital (RBC).

Not all went as planned. Industry opposition to the inclusion of and reference to a guidance manual in the Corporate Governance Model Act stalled the planned adoption of that next leg of the Solvency Modernization Initiative.

But even that could be considered merely a hint, not a season of darkness for state regulation. In the case of the Corporate Governance Model Act, it would be hard to argue that the regulators' hand was not strengthened by the recommendations for strong corporate governance contained in the FIO report. Indeed, regulators could well choose to use the FIO report to encourage more compromise on the part of industry.

Noticeable was the lack of heat surrounding the discussion of Principle-Based Regulation (PBR) for life insurers. Despite the previously expressed strong opposition of some large states and an FIO report that urged caution, very little was said at this meeting.

NAIC President-Elect Adam Hamm of North Dakota, left, joined Secretary-Treasurer Michael F. Consedine of Pennsylvania, right, and Vice President Monica Lindeen of Montana in presenting outgoing President James J. Donelon with a retrospective look at his year at the NAIC's helm.

Courtesy of the NAIC

In the end, perhaps one of the more momentous occasions at this meeting came at its end. Outgoing NAIC President James J. Donelon of Louisiana, who handed the gavel to incoming President Adam Hamm of North Dakota, announced the nomination, nominating speeches, and acceptance speeches for candidates for the office of Secretary-Treasury — traditionally the first step on the ladder to the NAIC Presidency — would take place in open session beginning with this closing plenary.

This step, Donelon said, was one of a series in reaction to recommendations for improvements in the NAIC's corporate governance suggested by an internal study.

Corporate governance law yes, manual no

Despite a request from Pennsylvania regulator Steve Johnson to "give us a little love," most industry representatives at the Corporate Governance Working Group meeting expressed strong opposition to the inclusion of a guidance manual with the proposed Corporate Governance Annual Filing Model Act.

Regulators explained that the role of the guidance manual would be to provide concrete information as to filing requirements, whereas the model act itself was intended to be more descriptive than prescriptive. Insurers expressed concern that the manual would be subject to revision in the future, since legislative approval would not be necessary as it would be for any changes in a model act.

Trade organizations, including America's Health Insurance Plans, PCI, and ACLI all expressed reservations to the guidance manual, and in general said that while they supported the Model Act the inclusion of the guidance manual would trigger their full opposition.

Not all industry representatives were so opposed. Representatives from the Blue Cross Blue Shield Association and the Reinsurance Association of America supported exposing the current draft, including the guidance manual. Regulators including Working Group Chair Commissioner Susan Donegan of Vermont expressed disappointment with the general industry opposition given that, in their view, they had worked hard to address industry concerns during this process.

"I'm a little disappointed that you come with such lines in the sand," said Johnson, pointing out that the Working Group had added procedures for adopting changes to the manual, including the requirement that a super-majority of Working Group members would have to vote in favor of any change.

Despite the industry opposition, the Working Group voted to expose the Corporate Governance Annual Filing Model Act and the guidance manual for a 45-day comment period.

Courtesy of the NAIC

Holding company definition still a concern in ICP 23

The impact of a directive from the Financial Stability Board (FSB) to the International Association of Insurance Supervisors (IAIS) to empower insurance regulators to have authority over holding companies is still unresolved, the Group Solvency Issues Working Group was told.

The NAIC's Rob Esson told the Working Group that as the IAIS continues its work on Insurance Core Principle (ICP) 23 on group-wide supervision, it was clear that direct authority over the holding company, was implicit. However there is a split in opinion as to where the holding company regulation should properly be directed: should it be at the level of the ultimate holding company or at the level of a financial or group insurance holding company?

Esson said that it seemed that the idea that the group should be defined more clearly and that the holding company referred to should be the insurance holding company seems to be gaining traction, but that was not a certainty.

Esson also told the Working Group that the Joint Forum is continuing its work on the Point of Sale disclosure paper and on a longevity risk transfer paper. Both are out for consultation and to be modified, and likely will be published in early 2014.

U.S. state regulators already largely comply with the recommendations in the point of sale disclosure paper, he said. He added that the longevity risk paper seemed more forward-looking, and may suggest considering an explicit longevity risk charge.

Additionally, the Joint Forum is continuing the workstream related to Asset Encumbrance, including a stock-taking exercise with regard to Credit Risk Management, and will conduct an exercise to assess jurisdictions' compliance with the Principles of Supervision of Financial Conglomerates and use of cross-sectoral colleges.

Lastly, the Working Group deferred action until an unspecified future date on the draft letter to the Financial Examiners Coordination (E) Working Group related to group-wide supervision.

ORSA pilot shows much improvement

Regulators seemed pleased by the results of the 2013 ORSA Feedback Pilot Project, and now plan one last pilot in 2014 before the requirements become effective beginning January 1, 2015.

"The overall robustness of the reports was much improved," Texas regulator Danny Saentz, Chair of the ORSA Subgroup, told the Financial Condition Committee. "Overall, we're moving in the right direction."

During a conference call in January, more information will be provided on the results of the pilot project and questions on the next steps will be answered. Saentz did tell the committee that the ORSA Subgroup expected to structure the 2014 pilot differently. The Subgroup hopes that more states would be able to participate, and that states, not the subgroup, would make the decision as to which insurers should participate in the pilot program.

Saentz also had high praise for the regulators participating in the pilot.

"I've been very pleasantly surprised by the quality of the folks participating in this [from the states]," said Saentz. In its written report to the committee, the Subgroup noted that "first-time participants ORSA Summary Reports generally met the expectations as outlined in the ORSA Guidance Manual and overall were better than the report submitted in 2012."

The report went on to say that of the 22 submissions in 2013, regulators agreed that only three reports could greatly benefit from material improvements. The Subgroup made numerous recommendations for improvement based on the pilot project. These will be discussed at its January conference call.

Frederick Heese of the Missouri Department of Insurance (center), here with NAIC President James J. Donelon (left) and Missouri Insurance Director John M. Huff (right) was one of two regulators recognized with the NAIC's highest individual award, the Robert Dineen Award.

Courtesy of the NAIC

Cathy Belfi of Connecticut was one of two regulators recognized with the NAIC's highest individual award, the Robert Dineen Award, presented by Connecticut Commissioner Thomas B. Leonardi, left, and NAIC President James J. Donelon.

Courtesy of the NAIC

Reinsurance collateral reform keeps moving swiftly

Even as the FIO report recommended that the Treasury Department and the U.S. Trade Representative begin entering into covered agreements to implement reinsurance collateral reform, adoption of the Revised Credit for Reinsurance Model Act is proceeding expeditiously, Reinsurance Task Force Chair Michael Consedine of Pennsylvania told the Task Force members.

Eighteen states representing 53% of primary insurance premiums have so far adopted the model, Consedine said. Five additional states are currently considering adoption, and that would raise the premium percentage covered to almost 75%. Consedine noted that other states also intend to adopt the Model Act.

John Finston of California reported on the recent work of the Qualified Jurisdiction Working Group. The Working Group recommended that four jurisdictions — Bermuda, Germany, Switzerland, and the United Kingdom — be recognized as conditional qualified jurisdictions effective January 1, 2014 by the NAIC.

Steve Johnson of Pennsylvania told the Task Force that the Reinsurance Financial Analysis Working Group (FAWG) had made substantial progress evaluating certified reinsurers for the passporting process. Johnson said six of the 28 reinsurers certified thus far have not been approved for passporting, and regulators were unable to agree on one reinsurer. The remaining 21 certified companies have been approved for passporting and should have been notified by their lead state.

In 2014, the Reinsurance FAWG intends to continue its work, including addressing reconciling de minimis reporting differences with respect to slow payment. The group will also consider new applications for passporting, creating a standard form for states to use, developing procedures for annual reviews, and developing a renewal process, in addition to the slow pay de minimis issue.

Tracy Laws of the Reinsurance Association of America expressed concern about reinsurers from the United States facing barriers in Europe, and requested that the NAIC consider these concerns in its interactions with international regulators. Regulators noted that interested parties could avail themselves of the provisions of the Qualified Jurisdiction Working Group's review process allowing for the airing of such complaints.

Déjà vu all over again at auto study group

The ongoing discussion concerning the availability and affordability of auto insurance in low income and underserved communities continued without resolution at the meeting of the Auto Insurance Study Group. As at previous meetings, consumer groups argued that regulators were not properly focusing on affordability and availability, while industry groups argued the insurance market was affordable, available and highly competitive.

Stephen Brobeck of the Consumer Federation of America told the Study Group that rating factors serve as proxies for income and race, and the Study Group needed to do research on pricing in low income and underserved communities. He suggested that other states should provide a program similar to California's for good drivers with low-income.

Dave Snyder of PCI told the Study Group that it was not accurate to use the presence or absence of special low income driver programs as an indicator of whether states care about low-income drivers. Low residual markets, competitive markets, and risk-based pricing all helped low-income consumers find affordable insurance, he argued.

The Study Group adopted the "Summary of State Laws Related to Auto Insurance" and the "Results of State Survey Concerning Programs and Initiatives Related to the Availability and Affordability of Automobile Insurance."

Courtesy of the NAIC

Consumer Affairs hears ACA concerns

Problems with implementation of the Affordable Care Act (ACA) dominated discussion at the Market Regulation and Consumer Affairs Committee meeting.

Jessica Waltman of the National Association of Health Underwriters told the committee her organization remained concerned about ACA implementation with the biggest worry being the then-looming December 23 deadline. She noted there was still a significant backlog of clients — thousands in some cases — facing difficulty being processed. Agents or brokers were not able to enroll clients without their physical presence, and there simply was not enough time, especially with the various registration technical glitches, she noted.

Wes Bissett of the Independent Insurance Agents and Brokers of America agreed, saying that while agents would like to help consumers, the process itself is difficult, especially given the requirement that the consumer be physically present with the agent. The lack of communication to agents from the exchange and the inability of agents to assist consumers as they would like to, given the restrictions imposed by the exchanges, has caused not just difficulty for consumers, but concerns about liability for agents and brokers.

Johnny Lee of the Professional Insurance Agents agreed with the challenges caused by the technical issues afflicting the exchange. He also called for new measures to ease the financial burden on the business community, and to allow agents reasonable compensation for their work.

Timothy Jost of Washington and Lee University School of Law, said that many of the worst stories about premium increases and insurance cancellations were debunked upon further review. He did agree that agents needed to have more information, but also said that numerous consumers had been helped by the ACA.

Andrea Routh of the Missouri Health Advocacy Alliance said her group had found that there was significant misinformation about the Affordable Care Act, with many believing the Act had been overturned.

Courtesy of the NAIC

Regulators express varying degrees of concern over captives

Days after the FIO report expressing concern over the use of affiliated captives by life insurance companies for reinsurance purposes was released, an extensive discussion in the Principle-Based Reserving (PBR) Implementation Task Force revealed a clear split between regulators on such ongoing use of captives. Some regulators would terminate such use immediately if possible, but certainly upon implementation of PBR, while others saw value in allowing such use to continue, even after the implementation of PBR.

The Task Force spent the majority of the meeting discussing a consultant's report regarding captives and alternative mechanisms. The consultant opened by sharing his understanding of the Task Force's sense of the issue. He said he had gotten the sense from Task Force members that current captive transactions should continue within the suggested framework. He said he had also gotten the sense from Task Force members that such transactions should not continue once PBR becomes effective. Thus the focus should be on fleshing out a framework and using an actuarial standard close to VM-20 in order to eliminate incentives to such use of captives when PBR is implemented.

Superintendent Joseph Torti of Rhode Island, co-chair of the Task Force, said he would prefer to end such captive use now. Even if such captive use were to be allowed to continue now, Torti said, it could be with changes and should end once PBR is implemented.

A Vermont regulator spoke in favor of continuing the current use of captives, but with increased disclosure and standardization.

Torti offered his own alternative. "I contend we have a regulatory structure – reinsurance – and they should be subject to that." He stated that he did not believe that keeping the status quo is the direction in which the working group should head.

"These transactions, the way I've seen them done, do not belong in the captive market," Torti said. "I do fear that there could be regulatory arbitrage as a result of the different standards. We've got some issues with letters of credit we need to look at."

One major concern with captives has been that they may use letters of credit that may, for example, be conditional or guaranteed by the parent to satisfy capital requirements. This would not normally be allowed under statutory accounting for the parent insurer.

Torti noted that the Credit for Reinsurance Model Act allows for "other collateral permitted by the commissioner" to be used as capital, and that has to be looked at and perhaps limited. He did agree that the current use of captives reflected an issue that needed to be addressed. "I do believe we have a problem with requiring companies to hold three times the economic reserves," he said.

Jim Armstrong of Iowa requested a small subgroup be established to work on an appropriate reserve for XXX and AXXX, whether it is VM-20 or not. Several Task Force members supported this proposal, however, the ACLI objected. That organization proposed an alternative solution involving the assessment of a capital standard versus a reserve standard. Superintendent Torti expressed skepticism as to the workability of an alternate standard to VM-20.

The Task Force also received without much discussion a report on the draft PBR company outreach plan, the tracking report showing the current status towards meeting the threshold for the Valuation Manual to become operative, and the Life Actuarial (A) Task Force report.

Private equity responds to regulator concerns

As investments by private equity (PE) firms in insurers and reinsurers have come under enhanced scrutiny by regulators, the newly formed Private Equity Issues Working Group heard a strong defense of PE's involvement by some sector leaders at its meeting.

The co-founder of one leading firm recounted his company's history, noting that in December 2012 it became an insurance holding company, making private equity just one of its businesses. According to him, the private equity segment of the company had $48 billion in assets under management while the credit business had approximately $110 billion in assets under management.

He noted that the private equity business had nothing to do with the related insurance business. Investment in the insurer is from the publicly traded company, not from private equity, he said.

The executive told Working Group Chair Doug Stolte his company simply wants rules applied in a non-discriminatory fashion, with the same rules applying to all participants.

"Applying different rules to [one company] for being PE-owned is inappropriate given that the company is not structured in the way that gives rise to the concerns underlying the recommendations," he said. He sought to dispel concerns about a possible mismatch between the investment horizons of PE companies and those of insurers, indicating that PE companies in general would have a longer investment horizon than hedge funds or public companies forced to answer to stockholders quarterly and provide short-term profits.

The executive said that PE had fulfilled a valuable role in providing capital to the industry and in purchasing businesses that are up for sale in what has been a depressed environment for some insurance companies.

"Asymmetric application of the rules will repel, not attract capital to an industry that has had difficulty attracting capital," he said.

Courtesy of the NAIC

Supervisory colleges still evolving, Forum told

While Americans and Europeans share the conviction that group supervision is essential to proper insurance regulation, the most effective structure and mechanics of supervisory colleges is still to be decided. This became evident during a discussion on the current state of best practices for supervisory colleges at the Supervisory Colleges Best Practices Forum, held as part of the EU-U.S. Dialogue Project.

"We are not going to be able to answer all your questions today with great certainty," said FIO Director Michael McRaith, who co-chaired the Forum. That truth, if not evident at the beginning, became self-evident as the proceedings continued.

Panelist Thomas Leonardi, Commissioner of the Connecticut Insurance Department said, "It became clear to me that group supervision was a key." By this he meant group supervision was key to not allowing a repeat of the gaps in supervision that helped enable the 2008 financial crisis. Leonardi, who said Connecticut had gone during his tenure from three supervisory colleges to 15 and from leading none to leading seven supervisory colleges recapped the changes enacted by the NAIC in order to enable effective group supervision.

This included items such as the Holding Company Model Act.

Jörg Krause, Head of Section of the Federal Financial Supervisory Authority in Germany (BaFin), said there were 92 supervisory colleges in Europe, 15 of which were supervised at BaFin. He noted some colleges may be as small as two regulators.

Looking outside the insurance industry for guidance, panel chair Michael Consedine, Commissioner of the Pennsylvania Insurance Department, asked panelist and Associate Director of the Division of Banking Supervision and Regulation at the Federal Reserve (the Fed) Ann Misback, how its banking experience could translate to insurance supervisory colleges.

Misback said the Fed has been very involved in banking colleges internationally for many years. Noting one of the major challenges facing supervisory colleges, she said the home and host supervisory experiences were sometimes different and the Fed's experience with both could help add some perspective. "One of the challenges of the colleges how to address that (home vs. host supervisor concerns)," she said.

The banking regulator said she had seen an evolution in supervisory colleges for banking from static, casual, formal meetings to ongoing regular dialogue. Among the challenges she identified was how to structure a given supervisory college and how many participants should be in a given college.

In banking, there may be a dual structure with the host and most active supervisors forming a core supervisory college, and a global supervisory college with every affected supervisor invited.

One concern she noted was how to address the issue of a regulator of a location where the company itself is important to the economy, but the country in question may not necessarily be as important to the company. Another challenge she identified was sharing information and the confidentiality provisions. In banking, protocols are developed to ensure that all participants are subject to strict security and confidentiality rules, and this is done in banking through bilateral MoUs, she explained.

Giving an industry perspective, the Chief Risk Officer and Chief Actuary of a leading multinational multi-line property and casualty insurer called supervisory colleges an "effective mechanism for us to be able to quote communicate with supervisors."

He did however cite areas where he thought the current supervisory college system was still inefficient. These included needing to file duplicate document such as the explanation of the risk management process or ORSA or model validation information in various jurisdictions. Overall, he said, it was early in the process. "It will clearly evolve, but I think there are immediate opportunities to improve the process."

The Chief Enterprise Risk Officer of another multinational insurer said he, coming from banking, had been struck by the sheer focus on models and the cost of getting them validated and approved. He wondered if the emphasis on models could lead to the risk of building the best possible models at the cost of other controls, given limited resources. He warned of the risk of groupthink as Solvency II approaches, especially with firms all having the same consultants. To him, models were useful tools, but not something to bet the company on.

Commissioner Leonardi agreed. "We don't necessarily understand the tail risk that may be buried in those models," he said.

The Chief Enterprise Risk Officer asked about structure. Is a college, he wondered, a collection of individual regulations or is it a more federalist structure? He repeated his concerns over how regulators think about the tail effect.

Responding to a question asked about who would lead supervisory colleges in the future, the Fed or the states, Misback said historically banking colleges have included co-hosting, but for insurance, she did not yet know.

The Chief Enterprise Risk Officer also warned that regulators need to work on how fungibility works across groups, and how each jurisdiction would react in a crisis. His fellow industry panelist warned that the next crisis may not be a financial crisis. We're insurers, he noted, and there were numerous risks covered in the normal course of business. He encouraged regulators to look on liabilities and not just the asset side for risk.

Summing up, Leonardi said the goal for supervisory colleges is that they would be able to provide early warnings of any concerns.

Courtesy of the NAIC

Trust, communication needed in supervisory colleges; FIO, capital standards not so much

Industry and regulators shared thoughts on how to improve supervisory colleges during a discussion on the "Future State" of these colleges at the EU-U.S. dialogue project. U.S. regulators found themselves in agreement with industry representatives on the panel who expressed concern about the need for Insurance Capital Standards (ICS).

Asked for an opinion on how to improve current colleges, the Chief Risk Officer of a leading multinational insurer based in the United States suggested that colleges should have a more structured agenda, including information technology human resources and succession planning. Colleges could also be more effective if they involved not just the leadership of the company being regulated but the leadership of the regulators as well, he suggested.

While some raised concerns about confidentiality, he said, "I think the confidentiality issue is something of a red herring." Confidentiality is a stand-in for trust, he thought, and suggested that communication and trust among the participants needed to be improved. He also suggested candor was needed and that colleges should be set up so communication and work flowed throughout the year and not just at discrete meetings.

"We have to put the issue of confidentiality behind us," said Steve Johnson, Deputy Commissioner of the Pennsylvania Insurance Department and a panelist at the discussion. He suggested that participating regulators should all sign onto multilateral MoUs, and agreed that in future colleges there should be more representation. This should include business unit heads, board of directors' members, possible lead accounting firm partners, and others. The goal should be to make sure that there are no gaps and that everything is laid out in risk matrices, he said.

One disagreement was over the need for additional structures or colleges. The first Chief Risk Officer was opposed to more colleges, while the Chief Risk Officer of a leading European insurer said that he could see something akin to carving out special issue colleges. This could be, for example, on topics such as internal model validation that would be populated by technical talent.

ICS were an issue of concern. The U.S.-based Chief Risk officer said that he was not sure insurers would ever actually get to ICS, so a common language was needed. The European Chief Risk Officer opined that the ICS may be a desirable endgame but the path there would be potentially painful and the challenge would be to try and do as little harm as possible along the way.

Johnson challenged the current timetable for Insurance Capital Standards, saying that both for ComFrame and ICS, regulators and industry should let the supervisory colleges and the ORSA be implemented first and see how that worked.

The Chief Enterprise Risk Officer of another major leading multinational insurer also expressed concern about ComFrame. "I worry about what problem ComFrame is trying to solve," he said. One concern he cited was that compliance costs could lead to consolidation because of the cost of capital, and that would lead to more "too big to fail" organizations, not the intended goal of current regulation.

"Regulation is not a free good… let the colleges operate before we overlay another structure," he said.

The Chief Risk Officer of yet another major multinational joined the conversation, expressing skepticism. "How about a cost-benefit analysis around the ICS?" he asked. "I have yet to see one."

Johnson noted that so far as he was concerned there was already a common language which included governance, enterprise risk management, and capital management. "We don't need a ComFrame to tell us this," he said.

Johnson also expressed concern about the inclusion of the Federal Insurance Office on supervisory colleges. He was not sure, he said, if FIO was a proper player for supervisory colleges. Connecticut insurance Commissioner Tom Leonardi agreed, saying that while the European Insurance and Occupational Pensions Authority (EIOPA) was a regulator and thus suitable for a supervisory college, FIO was not a regulator. Participation by the Federal Reserve, which is a regulator, may be better, he said.

In brief

Mission accomplished, SMI Task Force ends

The Solvency Modernization Initiative (SMI) Task Force is no more. After adopting reports from its working groups for the last time and receiving reports from the SMI RBC Subgroup and the G Committee, the Task Force danced into the sunset, it's memorialized by commemorative chocolate bars provided by its Chair, Director John Huff, to the first 300 members of the audience at this last meeting.

The SMI initiative will continue, but the E Committee will take over that work from the Task Force. Huff thanked all those — including regulators and staff — who had worked on the Task Force. Not one to let the moment pass unnoticed, Pennsylvania's Steve Johnson suggested better branding in the future, noting that while the NAIC has been continuously modernizing regulation since Congressman John Dingell's 1990 report, *Failed Promises: Insurance Company Insolvencies,* and would continue to do so, the branding of SMI made it seem like modernization was a one-shot initiative.

Deputy Commissioner Johnson did not provide chocolate bars.

Cat risk attestation and charges

The Catastrophe Risk Subgroup heard concerns about the confidentiality of the required attestation for the RBC charge for the year ending 2013. This is a concern because while the attestation is formally part of the RBC formula, it is not yet contained within the software and is filed separately. While this affects only the filings done in calendar year 2014 for the year ending 2013, some industry representatives were concerned that confidentiality might be compromised. This is particularly important as disclosure of the information included in this filing could cause competitive harm. NAIC staff said they expected confidentiality to be maintained under the Risk-Based Capital for Insurers Model Act, but would research the subject and address concerns in an upcoming conference call.

Subgroup chair David Altmaier of Florida also asked for proposals for the treatment of contingent credit risk – the R6 and R7 components. This followed numerous discussions in which agreement was reached that the current contingent credit risk charge is too high.

CDA guidance coming soon

The Contingent Deferred Annuity (CDA) Working Group adopted a timeline that would enable it to develop and adopt a guidance document by the NAIC's 2014 Summer National Meeting. The Working Group's charge included reviewing existing model laws and regulations relating to annuities in light of the NAIC's designation of CDAs as annuities. The group is also charged with developing guidelines that would serve as a reference for states. Issues the group will review as it seeks to fulfill its charge include the impact of policyholder behavior and decisions on the overall value of CDAs; any feature that may allow insurers to significantly change the value of CDAs without consumer recourse; consumer understanding of CDAs; producer compensation structures; and a general overview of CDA sales. The Working Group will seek to gather this information at the 2014 Spring National Meeting, in preparation for the creation of the guidance document.

Operational risk charge exposed

The Capital Adequacy Task Force exposed for comment an operational risk charge proposal that could lead to the incorporation of operational risk into RBC for the 2014 reporting year. While some regulators expressed concern at the pace of possible adoption of this operational risk charge, this may partly be driven by the upcoming International Monetary Fund's (IMF) Financial Sector Assessment Program (FSAP). This was one of the areas for improvement noted in the IMF's last FSAP report on the United States.

E Committee plays hardball

After an extended and vigorous exchange more reminiscent of New York playground basketball than of a genteel discussion of statutory accounting principles, a divided E Committee pulled off an effective LeBron James impersonation, rejecting a rejection by the Accounting Practices and Procedures Task Force of a proposal from the Statutory Accounting Principles Working Group with respect to SSAP No. 35R and Issue Paper No. 148 to address the fee payable by insurers under Section 9010 of the Affordable Care Act (ACA). The E Committee's acceptance of the Working Group's proposal not only reinforces every English teacher's lesson about the affirmative result of a double negative, but also means the liability and expense of the ACA fee will be recognized on January 1 of the fee year.

Financial Stability (EX) Task Force gets capital proposal

The Vice-Chair of a major U.S. insurer provided a presentation on a group capital proposal, which was generally consistent with a factor-based approach. He said that banking supervisors must understand the key business for insurers is loss absorption. Additionally, he said capital adequacy metrics for insurance groups should recognize: 1) risks to which insurance companies are exposed; 2) unique product designs and legal structures; 3) the principle of matching long duration assets with long duration liabilities; and 4) unique insurance accounting. In concluding his presentation, he stated that his company has had a constructive conversation with federal regulators, who appeared to demonstrate a willingness to listen.

The NAIC's Elise Liebers provided an update on Globally Systemically Important Insurers (G-SIIs) Process and Measures. She stated the Basic Capital Requirement (BCR – formerly the Backstop Capital Requirement) would be released for consultation and described the principles surrounding the BCR, including: 1) major risk categories should be reflected; 2) comparability of outcomes across jurisdictions; 3) resilience to stress; 4) simple design and presentation; 5) internal consistency; and 6) optimize transparency and use of public data. Liebers also described the timeline, change in terminology and the application of factor-based approach that may include five to 10 factors. She also described several potential issues with BCR, including but not limited to: 1) asset liability matching considerations not being feasible; 2) how to achieve a best estimate with technical provisions; 3) application at the ultimate holding company level; and 4) breach of capital standard considerations. Liebers stated more detail would be in the second consultation in July/August 2014.

International Solvency and Accounting Standards (E) Working Group

NAIC staff updated the Working Group on the status of the IAIS of Field Testing Task Force on ComFrame. Field testing has begun as a survey is being sent to state insurance supervisors who are group-wide supervisors of potential IAIGs and host supervisors of potential IAIGs in order to collect responses related to ComFrame Module 1. Additionally, volunteers will be given a spreadsheet in March 2014 to complete by the end of May 2014 with four consolidated balance sheet valuation approaches: 1) current statutory approach (if available); 2) GAAP valuation approach; 3) market adjusted valuation approach; and 4) economic valuation approach (i.e., internal capital model, if available). As Valuation Approach #3 builds from #2, they will both be required. The volunteers are expected to stress each approach submitted using four basic stress tests. As a result, some volunteers might have a total of 16 stresses.

Actuarial update

Life Actuarial Task Force and Health Actuarial Task Force (LATF and HATF)

Amendments to the PBR Valuation Manual continue, while progress on adoption of the new Standard Valuation Law (SVL) has been moving at a slower pace than hoped, with the latest estimate for achieving the required thresholds (42 states and at least 75% of inforce premium) being sometime in 2015, resulting in a 1/1/2016 effective date for the Valuation Manual. Other activities include work on new Life and Disability tables, principles based annuity reserving standards, and expansion of mandatory Experience Reporting. Following are highlights from LATF and HATF from the Fall 2013 NAIC Meeting:

New Mortality Tables

The American Academy of Actuaries (AAA) gave another update of the mortality work being performed by the Society of Actuaries (SOA) and AAA toward developing the 2014 VBT/CSO mortality tables and tables for PreNeed and Simplified Issue products.

Regarding the 2014 VBT (industry experience) tables, the AAA indicated that additional review was being conducted to evaluate the reasonableness of the impact of smoker/non-smoker differentials, and expects the Subcommittee to release a draft of the smoker/non-smoker tables by the end of March 2014. Work on the 2014 CSO table is underway, which will be based on the VBT and include a margin, and will be used for the Net Premium Reserve (i.e. "floor reserve") calculations under PBR, and for non-forfeiture and tax reserve purposes.

The Group Long-Term Disability Valuation Table Implementation (B) Subgroup adopted the proposed 2012 Group Long-Term Disability Valuation Table and an Actuarial Guideline to implement use of the table, and the proposed revisions to the Health Insurance Reserves Model Regulation to refer to the new table. The new table was forwarded to the Health Insurance and Managed Care (B) Committee consideration. The new table will replace the 1987 Commissioners Group Disability Income Table.

The AAA gave an update on the work of the AAA/SOA Individual Disability Table working group. Some discussion ensued regarding the use of claim incidence modifiers for policies issued in certain states. The AAA indicated that the criteria used for a state to receive an incidence modifier (at least 5% of the data in the study and the state's incidence is at least 15% higher than the overall average incidence) is significant, and that if the data supports the use of this modifier it is consistent with Actuarial Standards of Practice (ASOPs), particularly ASOP No. 12 on Risk Classification. The 2013 Individual Disability Insurance Valuation Tables working group report was exposed for comment until June 30, 2014. The new table will replace the long outdated 1985 CIDA table.

Life PBR (VM-20)

Work continues on refinements to the Life portion of the Valuation Manual from LATF members, the American Academy of Actuaries (AAA) and industry interested parties (such as the ACLI). LATF also agreed on a list of items that need to be completed prior to the anticipated 1/1/2016 Valuation Manual operative date including the following:

- Completion of 2014 VBT and CSO tables,
- Develop accounting smoothing mechanism to address reserve volatility,
- Changes needed to support the experience data collection process detailed in PBR Implementation Plan,
- Changes to address small company issues (i.e. minimum thresholds, simplified methods),
- Refinement or implementation of procedures to update certain asset related assumptions (i.e. asset spreads and default costs), and
- Refinement of documentation requirements, corporate governance considerations, and product classification guidelines.

LATF indicated that most of these tasks should be completed by the Summer 2014 meeting except for the mortality tables which are expected to be complete by Spring 2015 (2014 VBT) and Summer 2015 (2014 CSO).

General Account Annuity PBR (VM-22) Subgroup

The AAA Annuity Reserve Working Group provided an update on industry input toward drafting PBR requirements for fixed deferred and payout annuities (i.e. "general account annuities"). Highlights included discussion of appropriate formulaic "floor" reserve that incorporates the existing CARVM methodology and an appropriate utilization assumption for guaranteed lifetime benefits. Mark Birdsall of the Kansas DOI presented results of a field test of two Kansas domiciles. The test includes five products – thus far they have matched the CARVM reserves and have preliminary results on the "floor" reserve – they expect to complete the testing for the modeled reserve by the Spring 2014 meeting.

PBR Experience Reporting (VM-50/51):

The Experience Reporting (VM50/51) Subgroup discussed and voted to expose a report on a proposal to implement mandatory expense reporting. Fred Anderson, chair of the Subgroup, indicated that mandatory expense reporting will ensure such expenses are reflected in product pricing and cash flow testing, and could be a tool for regulators to assess reasonableness of expense assumptions across companies. The ACLI expressed concern that company-specific expense differences might be perceived negatively, and the MIB commented that voluntary expense reporting coordinated by the Society of Actuaries (SOA) should be pursued before mandatory expense reporting is implemented. The report was exposed for comment through March 15, 2014.

The actuarial update was prepared by Russell Menze.
For your comments and suggestions please contact the author – rmenze@deloitte.com.

Accounting update

This section of the NAIC Update focuses on accounting and reporting changes discussed, adopted and exposed during the 2013 Fall Meeting.

Statutory Accounting Principles Working Group

Current Developments: The SAPWG adopted the following amendments as final during the 2013 Fall Meeting:

Reference	Title	Sector	Amendments adopted as final	Financial statement impact	Disclosure	Effective date
2011-38	**SSAP No. 35R — Guaranty Fund and Other Assessments**	Health	**Substantive Change** – Revisions adopted, with modifications, *ASU 2011-06, Fees Paid to the Federal Government by Health Insurers* to prescribe the accounting for the federal Affordable Care Act (ACA) Section 9010 Assessment for 2014 and after. ASU 2011-06 recognizes the liability for the ACA fee in the year the ACA fee is paid. The modifications were to (1) recognize in full the expense and liability on January 1st of the fee year (i.e., no deferred expense); and (2) segregate surplus in the data year for the amount payable in the fee year. Also, adopted *Issue Paper No. 148—Affordable Care Act Section 9010 Assessment* which includes an analysis of the adopted guidance under the statutory accounting Statement of Concepts, as well as dissenting opinions. **NOTE**: The NAIC Financial Condition (E) Committee adopted SSAP No. 35R and Issue Paper No. 148 as adopted by the SAPWG; however, the Executive Committee and Plenary only received the E Committee report and will take up the matter at a future meeting.	Y	Y	2014
2013-03	**SSAP No. 104R —Share-Based Payments**	P&C Life Health	**Substantive Change** – Revisions adopted, with modification, the generally accepted accounting principles (GAAP) guidance as reflected in *Accounting Standards Codification 505-50–Equity Payments to Non-Employees*, with a December 31, 2014, effective date.	Y	Y	2014
2013-10	**SSAP No. 105—Working Capital Finance Investments**	Life	**Substantive Change** – Adopted *SSAP No. 105 and Issue Paper No. 147—Working Capital Finance Investments*, with an effective date of January 1, 2014, which allows working capital finance investments to be admitted assets if certain criteria are met.	Y	Y	2014
2013-21	**SSAP No. 26—Bonds, Excluding Loan-backed and Structured Securities**	P&C Life Health	**Nonsubstantive Change** – Adopted revisions to clarify the "yield to worst" concept should be followed for all callable bonds and that make-whole call provisions shall not be considered unless known by the reporting entity (i.e., such as when the issuer is expected to invoke the make whole call provision).	Y	N	2014

The SAPWG exposed the following items for written comments (due by February 12, 2014) by interested parties – one proposal is **substantive** (see Ref # 2013-36 below) and all other proposals are categorized as **nonsubstantive**:

Reference	Title	Sector	Amendments exposed	Financial statement impact	Disclosure	Effective date
2013-29	**SSAP No. 3 and 68 —Acct. Changes and Correction of Errors and Business Combinations and Goodwill**	P&C Life Health	**Nonsubstantive Change** – Exposed revisions to clarify that the disclosure limitation for mergers with shell entities does not change the January 1 date used to determine how the cumulative effect in accounting principle is measured.	N	N	2014
2013-31	**SSAP No. 97 — Investments in Subs, Controlling and Affiliated Entities**	P&C Life Health	**Nonsubstantive Change** – Exposed revisions to the flowchart in Appendix B, Determining the Valuation Method Under SSAP No. 97, which reference the downstream holding company guidance (the sum of all SCAs are calculated as the investment in the downstream holding company).	N	N	2014
2013-32	**SSAP No. 86 — Accounting for Derivative Instruments, Hedging, Income Generation and Replicat. Transactions**	P&C Life Health	**Nonsubstantive Change** – Exposed revisions to adopt *ASU 2013-10, Derivatives and Hedging – Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes*. The proposal incorporates the Fed Funds Effective Swap Rate (OIS) as a U.S. benchmark interest rate for hedge accounting and removes the restriction on using different benchmark rates for similar hedges.	N	N	2014
2013-34 2013-35	**Rejected GAAP Pronounce-ments**	P&C Life Health	**Rejected** the following GAAP Pronouncements as not applicable: • *ASU 2012-04: Technical Corrections and Improvements, and* • *AICPA SOP 09-1: Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy or Consistency of XBRL-Tagged Data.*	N/A	N/A	N/A
2013-36	**Various SSAPs related to investments**	P&C Life Health	**Substantive Change** – Definition of Mutual Funds, Bonds and Equity Securities: This agenda item proposes a comprehensive project to review the "investment SSAPs" (such as SSAP No's 21, 26, 30, 32, 43R and 48) and clarify definitions, scope, accounting methods and reporting guidance. As an initial exposure of the project concept, comments are requested on the overall proposal (i.e., key elements and possible actions identified, in addition to comments that identify additional elements or possible actions that should be considered).	Y	Y	2014
2013-37	**SSAP No. 92 and 2013—Accounting for Postretirement Benefits and Pensions**	P&C Life Health	**Nonsubstantive Change** – Exposed revisions to adopt by reference *ASU 2011-09: Compensation–Retirement Benefits–Multiemployer Plans (Subtopic 715-80): Disclosures about an Employer's Participation in a Multiemployer Plan* and incorporate limited additional disclosures about an employer's participation in a multiemployer pension plan.	N	Y	2014

The SAPWG discussed, or received an update, on the following outstanding agenda items:

Reference	Title	Discussed — or received an update on — the following agenda items
2013-13	**SSAP No. 86—Accounting for Derivative Instruments and Hedging**	**Derivative Investment Reporting** – NAIC staff developed preliminary elements for a centrally-cleared derivative issue paper and will begin consulting with regulators and industry representatives.
2013-17	**SSAP No. 40—Real Estate Investments**	**Single-Member and Single-Asset Limited Liability Corporations (LLCs)** – Underlying Asset is Real Estate: Received comments from interested parties and agreed to send an updated referral to the Capital Adequacy Task Force. The interested parties' comments suggested expanding the proposed scope of the agenda item, and the Working Group agreed to limit this agenda item's focus to only address single-member/single-asset LLCs.
2013-26	**SSAP No. 101—Income Taxes, A Replacement of SSAP No. 10 and 10R**	**Tax Positions and Their Settlement** – Received comments from interested parties and directed NAIC staff to further analyze the interested parties' recommended language and compare it to the GAAP guidance in order to subsequently provide an explanation of the differences.
2013-28	**Reinsurance, Risk Adjustment and Risk Corridors under ACA**	**Risk-Sharing Provisions of the Affordable Care Act** – Received comments from interested parties and referred this item to the Emerging Accounting Issues Working Group (see below).
N/A	**Restricted Asset Subgroup Update**	Restricted Asset Subgroup has been receiving information regarding the structure and federal requirements of FHLB transactions from consultations with NAIC staff (a conference call to discuss liquidity issues will occur in early 2014).
N/A	**FASB – Insurance Contract Project**	Received information on the FASB insurance contracts project, including industry updates FASB's roundtable discussions. The Working Group did not believe comment letters were necessary for the items currently exposed.

Emerging Accounting Issues Working Group

During the meeting, the Emerging Accounting Issues Working Group:

- Adopted *INT 13-03, Clarification of Surplus Deferral in SSAP No. 92 and SSAP No. 102*. INT 03-03 clarifies that that the transition guidance in *SSAP No. 92—Accounting for Postretirement Benefits Other Than Pensions* and *SSAP No. 102—Accounting for Pensions* was not intended to result in a more favorable, subsequent pension/other postemployment benefit (OPEB) surplus position when there are remaining unrecognized liabilities as a result of a reporting entity's initial election for surplus deferral.
- Exposed *INT 13-04, Risk Sharing Provisions of the Affordable Care Act* to prescribe the statutory accounting treatment for the risk adjustment, reinsurance and risk corridor sections of the Affordable Care Act (ACA). The deadline for submitting comments is January 16, 2014.

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