NAIC 2012 SPRING NATIONAL MEETING

March 9, 2012

To Our Clients and Friends:

The National Association of Insurance Commissioners (the "NAIC") held its 2012 Spring National Meeting from March 3 to 6, 2012 in New Orleans, Louisiana. This Client Update highlights some of the developments from the Spring National Meeting that are of particular interest to many of our insurance industry clients, including developments relating to: (1) implementation of the 2011 amendments to the NAIC Credit for Reinsurance Model Law and Model Regulation and the development of accreditation standards relating to those amendments, (2) adoption of the Own Risk Solvency Assessment Guidance Manual and a request to develop a model law to require insurers to conduct an annual assessment, (3) continued discussion of "ComFrame," (4) corporate governance of insurers, (5) solvency modernization, (6) Actuarial Guideline 38, (7) principles-based reserving for life insurers, (8) receivership issues relating to life insurer separate accounts, (9) contingent annuities for life insurers, (10) an NAIC review of the use of captives and special purpose vehicles, (11) an NAIC review of Insurer Receivership Model Act § 711 relating to the treatment of qualified financial contracts in an insurance insolvency proceeding, (12) securities valuation developments, and (13) risk-based capital developments.

For purposes of this report, the NAIC Securities Valuation Office is referred to as the "SVO."

CREDIT FOR REINSURANCE MODEL LAW AND REGULATION AMENDMENTS – IMPLEMENTATION AND ACCREDITATION

Implementation of 2011 Amendments

The **Reinsurance (E) Task Force** discussed implementation of the revised Credit for Reinsurance Model Law and Regulation that were adopted by the NAIC in 2011. The steps the Task Force intends to take to implement the revised models include:

- Develop accreditation standards to evaluate states' reinsurance collateral rules for purposes of maintaining NAIC accreditation;
- Establish a system for review and approval of qualified jurisdictions for assuming insurers under the reduced reinsurance collateral structure of the revised models;

- Create an NAIC group to provide advisory support and assistance to states in the review of reinsurance collateral reduction applications; and

- Develop reporting instructions for Forms CR-F and CR-S applicable to certified reinsurers, to be filed annually with the assuming insurer's domiciliary state to meet information filing requirements under the revised models.

Accreditation Standard – Certified Reinsurers

The Task Force then exposed for comment the Draft Key Elements for Accreditation with Respect to Revised Credit for Reinsurance Models. This draft document adds a new section, "Reinsurance Ceded to Certified Reinsurers," to the existing NAIC accreditation standard on reinsurance ceded. This new section would import key elements of the revised models into the accreditation standards:

- A state's laws and regulations may allow credit for reinsurance ceded to a certified reinsurer, including affiliated reinsurance transactions;

- The state would have to apply the rule governing the effective date for reduced collateral for reinsurance ceded to a certified reinsurer set forth in Section 8.A(5) of the revised Credit for Reinsurance Model Regulation;

- In order to be a certified reinsurer, an assuming insurer must be certified by the commissioner in accordance with a process similar to the revised Credit for Reinsurance Model Law and Regulation;

- The commissioner is required to publish a list of qualified jurisdictions under which an assuming insurer licensed and domiciled in any such jurisdiction is eligible to be considered for certification by the commissioner;

- A state's laws and regulations may allow the commissioner to defer to the certification and rating of a reinsurer issued by another NAIC accredited jurisdiction; and

- Reinsurance contracts entered into or renewed with a certified reinsurer must include a proper funding clause, which requires the certified reinsurer to provide and maintain sufficient security to avoid the imposition of any financial statement penalty on the ceding insurer for reinsurance ceded to the certified reinsurer.

These proposed accreditation standards, if adopted, would not require any state to change its existing credit for reinsurance rules. Rather, any state that chooses to adopt a reduced collateral reinsurance structure going forward would have to adhere to these standards.

Accreditation Standard – New Notice Requirements

The Task Force also exposed for comment a new accreditation standard requiring ceding insurers to be subject to notification requirements with respect to reinsurance concentration risk similar to those in the revised Credit for Reinsurance Model Law. If adopted by the Financial Regulation Standards and Accreditation (F) Committee, states would have to affirmatively adopt this accreditation standard to remain accredited by the NAIC.

Accreditation Committee Action

The **Financial Regulation Standards and Accreditation (F) Committee** also discussed the 2011 revisions to the Credit for Reinsurance Model Law and Model Regulation. The Committee explained the process for establishing NAIC accreditation standards with respect to these revisions as follows:

- The Reinsurance (E) Task Force will expose proposed significant elements to the Committee. These significant elements will highlight the key aspects of the Reinsurance Framework that will be put in place by the revised models that should be considered when reviewing the level of conformity of a state's initiatives with the revised Model Law and Regulation.
- Once the Executive and Plenary Committees have voted on the significant elements, the review of states' laws and regulations will begin, which would be a more expedited implementation than usual.

The Committee discussed the fact that a waiver of formal waiting procedures was desired in order to avoid further delay in creating uniform standards related to the Reinsurance Framework.

OWN RISK SOLVENCY ASSESSMENT (ORSA)

ORSA Guidance Manual (Adopted) and Model Act (Requested)

The **Own Risk Solvency Assessment (E) Subgroup** reported on developments related to the Own Risk Solvency Assessment ("ORSA"). The ORSA would evaluate the adequacy of an insurer's capital levels in light of the insurer's unique business mix and strategy. This would consist of internal modeling and stress testing, designed and conducted by an insurer in accordance with prescribed regulatory criteria. The ORSA Guidance Manual would provide assistance to insurers on how to conduct an ORSA.

As part of the review of the ORSA Guidance Manual, the Subgroup was charged in 2011 with arranging a feedback pilot project. Under the pilot project, undisclosed industry participants voluntarily submit a confidential ORSA summary report. The pilot project is meant to allow state insurance regulators to provide feedback to industry before the effective date of the ORSA summary report and to identify portions of the ORSA Guidance Manual that require clarification or amendment. There are currently about 15 volunteer insurers for the pilot project, which includes representatives of life, property/casualty, health and title insurers and reinsurers. The pilot project summary reports are due for submission on June 30, 2012, after which time the Subgroup will review the results at an interim meeting.

The **Joint Executive (EX) Committee and Plenary** adopted the ORSA Guidance Manual developed by the Group Solvency Issues Working Group of the Solvency Modernization Initiative (E) Task Force, as well as a Model Law Development Request to commence drafting of an ORSA Model Act. The proposal to develop the ORSA Model Act authorizes the Financial Condition (E) Committee to develop a model law that would require certain insurers and/or groups to conduct an annual self-assessment of the regulated entity's risk management and solvency and, upon request, provide a summary report to the requesting state insurance regulators. The Development Request proposes that an ORSA Model Act could be produced within one year.

NAIC to Develop ORSA Enterprise Risk Management Education Program

The **Own Risk Solvency Assessment (E) Subgroup** also discussed the development of an Enterprise Risk Management Education Program for state insurance department staff. The training will be conducted in phases over the next few years with the first program occurring at the 2012 Financial Summit. During the meeting, the Subgroup solicited input from state insurance regulators, firms and industry for guidance in developing the program. In addition, the Subgroup reviewed a memorandum from the select chief risk officers outlining their comments regarding the knowledge and skills that a potential state or NAIC enterprise risk management specialist should have.

THE COMMON FRAMEWORK FOR THE SUPERVISION OF INTERNATIONALLY ACTIVE INSURANCE GROUPS (COMFRAME)

The **International Solvency and Accounting Standards (EX) Working Group** discussed the ongoing efforts of the International Association of Insurance Supervisors to promote cross-border regulatory cooperation in the supervision of internationally active insurers through the proposed "Common Framework for the Supervision of Internationally Active Insurance Groups" ("ComFrame"). The Working Group reported that the International Association of Insurance Supervisors Solvency and Actuarial Issues Subcommittee met throughout January 2012 to develop ComFrame guidance on group capital, culminating in a full committee meeting in Basel from January 30-31, 2012. The version of ComFrame that was then submitted to the Technical Committee meeting on February 22-24, 2012 generally reflected guidance provided by U.S. chief financial regulators. A subsequent drafting team meeting is set for early April 2012 in anticipation of the next goal, which is to prepare the ComFrame Concept Paper for the second round of consultation to be released on July 1, 2012. In response to industry participant comments at the Working Group meeting, a draft of ComFrame Module 3 (Qualitative and Quantitative requirements) will be exposed, with an open conference call to follow in order to discuss the industry's position.

The current draft of Module 3 (Qualitative and Quantitative requirements), Element 5 (Capital Adequacy), provides that the group-wide supervisor (to be determined by the involved supervisors of an internationally active insurance group – see Module 4, Element 2 (M4E2-2)), in collaboration with other involved supervisors, will:

- Apply a total balance sheet approach to determine and address all relevant and material risks. Valuation will be based on International Financial Reporting Standards as a working assumption with filters and complements where necessary.
- Establish the group capital risk measurement, after taking into account applicable solvency regulation in the jurisdictions where the internationally active insurance group operates, and establish the available capital resources of the internationally active insurance group.
- Determine the composition of eligible capital resources for group capital assessment purposes.
- Require the internationally active insurance group to maintain available capital resources to meet capital requirements.
- Take proportionate action (to be spelled out) in the event that a solvency control level in the group's capital assessment is breached.

Module 3, Element 5, sets forth both specific characteristics that should factor into capital resources suitability criteria and group-wide factors relevant to the determination of group-wide capital resources. The measurement should be set at a level sufficient to continue meeting policyholder obligations as they come due if the internationally active insurance group experiences adversity. The group-wide supervisor may adjust the group capital assessment of the internationally active insurance group in limited circumstances. The internationally active insurance group will be required to carry out stress testing and scenario analysis as an adjunct to the capital adequacy assessment.

The **International Insurance Relations (G) Committee** provided additional updates on ComFrame. The Solvency Modernization Initiative (EX) Task Force reported that the International Association of Insurance Supervisors Solvency and Actuarial Issues Subcommittee determined that it will define internationally active insurance groups based on size and business activities. The Accounting & Auditing Issues Subcommittee met on November 28-29, 2011 to discuss ComFrame valuation and disclosure issues and decided to adopt the same structure as the U.S. for statutory accounting, which is to accept, modify or reject public accounting pronouncements. In addition, in light of ICP 20 (Public Disclosure), there probably will not be additional disclosures for internationally active insurance groups. The Subcommittee also met on January 19, 2012 in Zurich to discuss prudential filters to modify International Financial Reporting Standards in ComFrame. It is currently developing a draft on such filters.

CORPORATE GOVERNANCE OF INSURERS

The **Corporate Governance (E) Working Group** met to discuss its timeline and deliverables for identifying and addressing potential "gaps" in the U.S. insurance regulatory system with respect to corporate governance. The Working Group previously had released a final version of a paper entitled "Existing U.S. Corporate Governance Requirements," which summarizes the various powers in both current state and federal law through which regulatory bodies have the ability to enforce certain corporate governance principles. The paper categorizes the existing corporate governance laws into several key principles. Going forward, the Working Group intends to:

- Identify potential gaps in the U.S. insurance regulatory structure;
- Discuss how to address these potential gaps;
- Draft documents on how to address these potential gaps; and
- Refer suggestions to other NAIC committees and working groups as appropriate.

The Working Group adopted a timeline that sets the end of 2012 as the goal for finalizing the documents addressing potential gaps.

There was some objection, by both state insurance regulators and industry representatives, to the use of the word "gap." The Working Group agreed that, in practice, its task would be to perform a comparative analysis of the principles of existing U.S. corporate governance requirements with the Insurance Core Principles adopted by the International Association of Insurance Supervisors, as well as general regulatory needs, to identify ways to refine the existing U.S. insurance regulatory structure. The Working Group then allocated the comparative analysis of principles to small teams of regulator members for discussion at future biweekly conference calls.

SOLVENCY MODERNIZATION INITIATIVE

The **Solvency Modernization Initiative (E) Task Force** exposed for comment and revision the 2010 white paper, "The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative." The Task Force intends to take comments to update the white paper, which consists of four main sections:

- The United States Insurance Financial Solvency Framework, describing the U.S. insurance regulatory framework for solvency and the framework's core principles;
- U.S. Insurance Financial Regulatory Oversight, expanding on the U.S. regulatory framework and the mechanics of the processes in U.S. insurance solvency regulation;
- Market Regulation, providing an overview of financial and market regulation together and describing the insurance marketplace and considerations for insurance regulators; and
- Solvency Modernization Initiative, documenting the Solvency Modernization Initiative's self-review, improvements made to the Initiative and the reasoning behind changes by U.S. regulators in conjunction with the Initiative.

The Task Force invited comments on the white paper's cohesiveness as well as its substantive content, and released the document for comment until April 30, 2012.

LIFE INSURERS – ACTUARIAL GUIDELINE XXXVIII (AG 38)

The **Financial Condition (E) Committee** adopted the actions of the Joint Working Group of the Life Insurance and Annuities (A) Committee and Financial Condition (E) Committee with respect to issues relating to Actuarial Guideline XXXVIII (AG 38) and statutory reserve requirements for insurers offering universal life with secondary guarantee and term universal life products. The Joint Working Group had exposed for comment a Draft Framework providing an overview of its plans to address AG 38 reserving issues, and then adopted revised Sequence of Key Decisions, Phase I Decisions, from the Draft Framework document. The Phase I Decisions adopted by the Joint Working Group were limited to (1) an agreement on a bifurcated approach to in-force and prospective business, addressing each block separately for purposes of evaluating reserve adequacy, and (2) the retention of one or more independent, consulting actuaries to advise the Joint Working Group going forward. The actions of the Joint Working Group ultimately were adopted by the **Joint Executive Committee (EX) and Plenary**.

LIFE INSURERS – PRINCIPLE-BASED RESERVING

The **Principles-Based Reserving (E) Working Group** discussed the continued work of the Life and Health Actuarial Task Force on various topics relating to the principle-based reserving approach to regulation and capital standards for life insurers.

The Working Group focused on a summary report provided by Towers Watson on the study it conducted on the probable impact of Valuation Manual-20. The impact study investigated the effect of proposed principle-based reserving methodologies on the life insurance industry and compares the results to current reserving methodologies. Life insurers participated in the impact study by testing the proposed principle-based reserving methodology on their internal data. Towers Watson reported that, of the original 42 life insurer participants, results were obtained from 26 life insurers, representing 35 product segments, in phase one. Phase two sensitivities were performed on a subset of the baseline established in phase one. A total of 18 insurers submitted results for phase two, representing 22 product segments. There were no submissions from life reinsurance or index universal life participants.

The Towers Watson impact study results showed that Alternative 1 stochastic reserves as applied to universal life with secondary guarantees and term products were significantly higher compared to Alternative 2. This finding, in addition to comments received from the industry, caused the Life and Health Actuarial Task Force to adopt a modified version of Alternative 2 in January 2012. On average, impact study participants reported that term product reserves calculated with Valuation Manual-20 for the hypothetical one year of new business and five years of new business were lower than the reserves calculated using Commissioners Reserve Valuation Method. Towers Watson also stated that they did not make an official finding regarding the differences found with regard to universal life products with secondary guarantees. Towers Watson did not make such a finding because the results from the impact study were not consistent due to the different ways in which participating insurers interpreted Actuarial Guideline XXXVIII (AG 38).

Additional key findings from the impact study summary report are:

- The exclusion tests performed within expectations and appear to support the effectiveness of the exclusion tests.
- The impact study showed significant volatility in net premium reserve as a component of the Commissioners Reserve Valuation Method and suggests that net premium reserve is ineffective as a floor for the minimum reserve.
- The American Academy of Actuaries economic scenario generator was found to be generally effective but Towers Watson recommended that adjustments be made to average simulated interest rates as they are below historical levels by approximately 1.6% to 1.9% depending on maturity.
- Despite the fact that no reinsurer participated in the impact study, Towers Watson analyzed the impact of reinsurance and found that the inclusion of reinsurance did not change the direction of the impact of the Valuation Manual-20 reserves.
- As a general matter, setting best estimate assumptions was not reported as an issue for participants; however, setting overall margins and in particular, the mortality assumption and blending with the industry table was reportedly very difficult.

Commissioner Julie McPeak of Tennessee stated that she would like to have a draft of Valuation Manual-20 complete by the end of 2012, so that it may be packaged with the standard valuation law and presented to state legislatures in 2013. She acknowledged that Valuation Manual-20 may not be final by that point, but she would like a reasonably complete draft to be finished by that time.

LIFE INSURERS – SEPARATE ACCOUNT RECEIVERSHIP ISSUES

The **Receivership Separate Accounts (E) Working Group** discussed ways to improve guidance to state insurance regulators administering the receivership of an insurer with separate accounts. Coverage of separate account products varies according to the language of the governing state law, and largely depends upon interpretation of which products are required to be supported by a separate account.

The Working Group discussed the next steps for revising and enhancing the case studies of insurer receivership scenarios that may serve as guidance for state insurance regulators dealing with receivership of insulated, non-insulated and hybrid separate accounts. These case studies and additional guidance are intended for eventual inclusion in the NAIC Receivers' Handbook. It was suggested that the Securities and Exchange Commission has significant institutional knowledge regarding the ability of contract holders to access assets. The Working Group plans to meet with the Securities and Exchange Commission to discuss registered products put forth ideas on what receivership of an insurer with separate accounts would look like and how legislation to address the issue might be designed.

The Working Group compared the definition of "insulated" found within each of statutory accounting principles and generally accepted accounting principles and asked what "insulated" should mean from a receivership perspective. One state insurance regulator raised concern that insurance receivership laws in some states may not define and use "insulated" consistently. The Working Group also discussed the meaning of the terms "allocated" and "non-allocated" from an insurance receivership perspective. The Working Group expressed a desire to hear from state insurance regulators and interested parties on the appropriate meaning of the terms "insulated", "allocated" and "non-allocated", each of which has a special meaning for separate accounts.

LIFE INSURERS – CONTINGENT ANNUITIES

The **Life Insurance and Annuities (A) Committee** received a report from the Contingent Deferred Annuity Subgroup. The Subgroup evaluated contingent deferred annuities with input from interested parties between December 2011 and February 2012. The Subgroup concluded that although contingent deferred annuities present risks similar to those found in financial guaranty insurance, life insurers are better suited to write such products because the products include life contingent pricing components. The report notes that contingent deferred annuities closely resemble guaranteed life benefit withdrawal products and many of the same regulatory issues apply. The Subgroup raised concern over the lack of regulatory discussion regarding solvency and consumer protection issues. Consequently, the Subgroup recommended that the Committee charge a new working group to evaluate the solvency and consumer protections appropriate for contingent deferred annuity products. It was recommended that the new subgroup engage the Financial Condition (E) Committee to review solvency issues related to contingent deferred annuity and guaranteed life benefit withdrawal products. The Committee adopted the Subgroup's report and in doing so created the recommended working group.

NAIC REVIEW OF THE USE OF CAPTIVES AND SPECIAL PURPOSE VEHICLES

The **Captive and SPV Use (E) Subgroup** discussed the results of a survey that the Subgroup sent to all state insurance regulators requesting information and opinions regarding the use of captives and special purpose vehicles ("SPVs"), including (1) whether there were laws related to the creation and use of captives and SPVs, (2) whether the ceding of risk from a domestic insurer to captives or SPVs is permitted, (3) the business purposes given by domestic insurers for using captives and SPVs, (4) whether the use of SPVs and captives created a possible competitive advantage for insurers that could use them, and (5) what would be the effect if captive or SPV arrangements were unwound. State insurance regulators from 31 states responded to this Subgroup survey. Since the Subgroup received multiple inquiries about whether the survey was intended to cover self insurance through the use of captives and SPVs, the Subgroup clarified that they were only focusing on the ceding of third-party risk to captives or SPVs, and not first-party risk, *i.e.*, self insurance.

The stated purpose of the survey was to give the Subgroup a tool to analyze what issues the Subgroup should focus on as it proceeds. Accordingly, the Subgroup plans to hold a series of conference calls prior to the NAIC's 2012 Summer National Meeting in August 2012 to discuss the responses received to the survey in more depth. Following these conference calls, the Subgroup currently plans to expose a draft proposal to the Financial Condition (E) Committee or a white paper regarding best practices related to the use of captives and SPVs. However, the final work product of the Subgroup is uncertain.

Throughout the Subgroup meeting, Commissioner Eleanor Kitzman of Texas stated that the Subgroup might need to reevaluate its approach and consider reframing the issues the Subgroup was tasked with exploring. No significant variations in approach were discussed.

QUALIFIED FINANCIAL CONTRACTS – STATUS IN AN INSURER RECEIVERSHIP (IRMA SECTION 711)

The **Receivership and Insolvency (E) Task Force** discussed the Draft Report by the Insurer Receivership Model Act ("IRMA") Section 711 (E) Subgroup relating to IRMA Section 711. IRMA Section 711 relates to the treatment of qualified financial contracts in an insurer insolvency. Nineteen states have enacted laws based on IRMA Section 711, with 13 of those states (including New York and New Jersey) taking action in 2010 and 2011. The Draft Report reviewed IRMA Section 711 to provide a better understanding of its purpose, mechanics, implications and related policy issues in addition to providing receivership-focused input on regulatory issues related to qualified financial contracts. The Draft Report was formally exposed to the Subgroup and received only positive comments from industry on a recent Subgroup conference call. Among other recommendations, the Draft Report promotes uniform adoption of IRMA Section 711. However, the Subgroup is not endorsing legislative attempts to broaden the narrow scope and application of IRMA Section 711. The Draft Report was forwarded to the Financial Condition (E) Committee after the motion to adopt it was accepted by the Task Force.

SECURITIES VALUATION DEVELOPMENTS

Working Capital Finance Notes

The **Invested Assets (E) Working Group** continued its analysis regarding the treatment of Working Capital Finance Notes as invested assets. Working Capital Finance Notes are created when a buyer of goods (an obligor) accepts goods from a supplier and confirms that the obligation to pay contained in an invoice is a binding and enforceable payment obligation, and the supplier then transfers that obligation together with other similar obligations to a third party (such as an investing insurer). Working Capital Finance Notes are not issued with standard terms and the Working Group is developing an analytical framework to ensure that the investments are sound and will pay according to their terms.

The Working Group reviewed and exposed for comment a Connecticut Department of Insurance proposal regarding treatment of Working Capital Finance Notes as admitted assets. Among other requirements, the Connecticut proposal (1) requires program documents, including any amendments, to be reviewed and approved by SVO, (2) limits the transaction to a single recognized obligor that is an investment grade corporate entity, (3) prohibits insurers from engaging in such a transaction with their affiliates, and (4) requires obligors to confirm that all requirements of the vendor have been fully and completely satisfied. After the 15-day comment period, the Working Group plans to refer the proposal to the Valuation of Securities (E) Task Force.

Loan-Backed and Structured Securities Valuation Methodology Review

Eric Kolchinsky, a consultant to the SVO, presented a preliminary report regarding the valuation of loan-backed and structured securities to the **Valuation of Securities (E) Task Force**. The report compared the relative performance of the range of risk-based capital approaches for structured finance and analyzed the sufficiency of the dollars allocated by the risk-based capital process to cover expected losses. The preliminary conclusions of the report were:

- The various approaches used to set risk-based capital for structured finance instruments appear to be methodologically inconsistent and return varying results.
- Approximately 20% of bonds are not sufficiently "cushioned" with respect to expected loss because of the combination of the carrying value adjustment and the calculation of the risk-based capital as a percentage.
- A significant loss of credit information occurs when vendor results are mapped into traditional NAIC designations.

SVO Proposed Recalibration of NAIC Designation (Rating) Framework

The **Valuation of Securities (E) Task Force** discussed a proposal to introduce an "S" suffix on the NAIC Designation of certain securities. The "S" suffix would apply to securities that meet a particular NAIC Designation but do not comport with the traditional notions of that type of security. One state insurance regulator provided an example: if SVO reviewed a bond and determined that it has the characteristics of common stock then it would be rated at NAIC Designation 6-S. The hope is that this will clarify inconsistencies between the SVO Purposes and Procedures Manual and the NAIC Accounting Practices and Procedures Manual. The Task Force moved to expose the proposal to a 60-day comment period and the Task Force estimated that implementation of the "S" suffix would not occur until January 2013.

NAIC Acceptable Rating Organization Requirements

The **Valuation of Securities (E) Task Force** has previously received a motion from one of its members that the Task Force revisit the requirement that a rating agency rate 10% of the insurance industries' invested assets to qualify as an NAIC Acceptable Rating Organization, which presents a high barrier to entry for smaller rating agencies. The Task Force moved to amend Part One, Section Four of the SVO Purposes and Procedures Manual by deleting the 10%, requirement thereby allowing additional rating agencies to more easily qualify as NAIC Acceptable Rating Organizations.

RISK-BASED CAPITAL DEVELOPMENTS

Corporate Bond Modeling Project

The **C-1 Factor Review (E) Subgroup** received an update from the American Academy of Actuaries on the status of the corporate bond modeling project. The Academy will be reviewing the methodology used to rate securities and attach NAIC designations to the securities. The Academy is planning to build an overarching model and sub-models for each rating category. Many questions remain to be answered regarding the way the model will function and how the model will be populated. The Academy hopes to deliver a discussion document in two months and a working construct of the methodology to be used in the modeling within six months.

Risk Factors for Different Bond Types

The **C-1 Factor Review (E) Subgroup** also discussed the need for establishing a separate risk-based capital factor for different types of bonds. It was pointed out that a significant percentage of insurer holdings are in asset classes other than corporate bonds (e.g., special revenue bonds, municipal bonds and structured products). The Subgroup recognized that it may be rational to eventually revise the risk-based capital factors to take into account the various categories of bonds. The Subgroup followed up on the discussion from the 2011 NAIC Fall National Meeting regarding the need to expand the number of NAIC designations from the current 6 categories. One state insurance regulator advised the Subgroup that corporate debt has a rate of default significantly under 1% while other categories of bonds are much higher. The idea would be to work within the existing framework and not unnecessarily complicate the revision.

NAIC TASK FORCE RESTRUCTURING

The **Executive (EX) Committee** voted to restructure its task forces and implement the restructuring through revisions to the 2012 Adopted Committee Charges. As a result, certain Committee task forces have been disbanded, while other task forces have had their reporting and charges transferred to another committee. Among the more noteworthy changes, the Surplus Lines Implementation (EX) Task Force is now disbanded, and its remaining charges related to implementation of the surplus lines subtitle of the federal Nonadmitted and Reinsurance Reform Act have been transferred to the Surplus Lines (C) Task Force. Additionally, the Solvency Modernization Initiative (EX) Task Force now will report to the Financial Condition (E) Committee, to which its charges have been transferred.

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If you would like more information on these or other topics of interest, please contact the undersigned or any insurance industry lawyer at Debevoise & Plimpton LLP.

Thomas M. Kelly
+1 212 909 6907
tmkelly@debevoise.com

Nicholas F. Potter
+1 212 909 6459
nfpotter@debevoise.com

Ethan T. James
+1 212 909 6562
etjames@debevoise.com

John Dembeck
+1 212 909 6158
jdembeck@debevoise.com

Sean P. Neenan
+1 212 909 6420
spneenan@debevoise.com

Kevin J. Saponaro
+1 212 909 6856
kjsaponaro@debevoise.com

Matthew J. Termine
+1 212 909 6622
mjtermine@debevoise.com

Emily Zand
+1 212 909 6807
ezand@debevoise.com