

CLIENT UPDATE

NAIC 2013 SPRING NATIONAL MEETING

NEW YORK

Thomas M. Kelly
tmkelly@debevoise.com

Nicholas F. Potter
nfpotter@debevoise.com

Ethan T. James
etjames@debevoise.com

Eric R. Dinallo
edinallo@debevoise.com

John Dembeck
jdembeck@debevoise.com

Sean P. Neenan
spneenan@debevoise.com

Jeremy R. Delman
jrdelman@debevoise.com

Sarah Thorndike Kelly
stkelly@debevoise.com

WASHINGTON

Amanda Greenwold Wise
agwise@debevoise.com

The National Association of Insurance Commissioners (NAIC) held its 2013 Spring National Meeting from April 6 to 9, 2013 in Houston, Texas. 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:

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For purposes of this report:

- “ACLI” means the American Council of Life Insurers.
- “SVO” means the NAIC Securities Valuation Office.
- “IAIS” means the International Association of Insurance Supervisors.

(1) REINSURANCE MATTERS

Implementation of 2011 Reinsurance Credit Model Amendments

The **Reinsurance (E) Task Force** received a report from NAIC staff summarizing the implementation of the 2011 revisions to the Credit for Reinsurance Model Law and Model Regulation. The purpose of the revisions is to allow for reduced reinsurance collateral requirements for non-U.S. licensed reinsurers that are licensed and domiciled in qualified jurisdictions. The NAIC staff report indicated that, to date, 11 states have enacted the revisions, which represents close to half of primary insurance premiums, and an additional 12 states are considering legislation implementing the Model Law. Including these additional states, over two-thirds of primary insurance premiums are represented.

Process for Developing and Maintaining the List of Qualified Jurisdictions

At the 2012 Fall National Meeting, the **Reinsurance (E) Task Force** exposed for a 45-day comment period the draft NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions. The list is referenced in the revised Credit for Reinsurance Model Law and Model Regulation, which provides that any assuming insurer, licensed and domiciled in a Qualified Jurisdiction, is eligible to be considered for certification by a state as a certified reinsurer for reinsurance collateral reduction purposes. The Task Force received an update that ten comment letters have been received and that the drafting group gave serious consideration to the comments in the revised draft. The revisions were intended to streamline the evaluation process and increase the use of existing materials, which should reduce costs. There is now further emphasis in the draft that this is an outcome-focused approach. The revisions addressed the Reinsurance Association of America's concern that insurer-specific information should not be shared unless appropriate. On-site reviews are now discretionary and the draft includes a list of factors to determine whether on-site review is necessary or advisable. Additionally, jurisdictions will not be required to undertake a self-evaluation report. The draft contains clarifications relating to an expedited review for four jurisdictions, including Bermuda, Switzerland, Germany and the United Kingdom. A number of interested parties commented on the draft, including the ACLI, which supports many of the changes. The Task Force exposed the draft for a 30-day public comment period, and explained that they are trying to position the document for NAIC approval by the 2013 Summer National Meeting with the goal of a list of conditionally approved jurisdictions by year-end.

Reinsurance Financial Analysis (E) Working Group

The **Reinsurance (E) Task Force** received a report from the Reinsurance Financial Analysis (E) Working Group on the process for insurers seeking status as a certified reinsurer. An insurer submits an initial application to a single state and can then seek multi-state recognition of certification through the Working Group process. Interested parties raised the issue of confidentiality, and Pennsylvania Deputy Insurance Commissioner Steve Johnson replied that the Working Group has put together an excellent process that he believes would stand up in court whereby the information is received by the lead state and is then shared with the NAIC through an agreement between the NAIC and the lead state.

Nonadmitted and Reinsurance Reform Act

At the 2012 Fall National Meeting, the **Reinsurance (E) Task Force** received a report from NAIC staff summarizing a survey that was conducted in an effort to obtain information regarding state reactions to the Nonadmitted and Reinsurance Reform Act (NRRRA) as provided in Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act. About two-thirds of the respondents believed that the NAIC should consider developing a standard definition and/or guidance with respect to the NRRRA defined term “reinsurer” and the NRRRA preemption of financial solvency regulation by nondomestic states of such entities. At the Spring National Meeting, the Task Force received an update that Dodd-Frank requires the Federal Insurance Office (FIO) to issue reports on the U.S. and global reinsurance markets, which includes a description of the impact of NRRRA on the ability of states to access reinsurance information for regulated entities in their jurisdiction. The NAIC received a request from FIO to survey the states on this, which the NAIC plans to do.

(2) INTERNATIONAL INSURANCE MATTERS

International Insurance Relations (G) Committee

The **International Insurance Relations (G) Committee** received updates regarding several international relations bodies. In particular:

- The IAIS is moving ahead with plans to invite, on a fee-exempt basis, up to five consumer representatives to its public meetings.
- The Joint Forum (which brings together IAIS, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions) will take

up a pilot testing program of the principles of financial supervision of conglomerates in a few pilot jurisdictions.

- The US/EU Dialogue adopted a “Way Forward” plan regarding regulatory cooperation, including site visits.
- The OECD received a report from the NAIC regarding the contribution of the insurance industry to economic growth and financial stability, and the NAIC has proposed to issue a second report on the contribution of the insurance industry to long-term investment.
- The Federal Insurance Office has proposed holding regular conferences under the NAFTA umbrella among U.S., Canadian and Mexican insurance regulators, and the Committee will consider issues to bring to such conferences.

The Committee also discussed the ongoing efforts of the IAIS to promote cross-border regulatory cooperation in the supervision of internationally active insurers through the “Common Framework for the Supervision of Internationally Active Insurance Groups,” or “ComFrame.” In particular, the Committee noted that discussion of global capital requirements had been dropped from ComFrame because the issue was preventing ComFrame from moving forward. The Committee Chair and other Committee members expressed their disagreement with the idea of a global capital regime, noting that differences between jurisdictions make a uniform global regime problematic and that overreliance on the regulation of capital levels could cause systemic risk.

International Solvency and Accounting Standards (E) Working Group

The **International Solvency and Accounting Standards (E) Working Group** received updates regarding the IAIS Solvency Subcommittee, the IAIS Accounting and Auditing Issues Subcommittee (AAISC), and two International Accounting Standards Board (IASB) exposure drafts.

The IAIS Solvency Subcommittee provided an update on the development of a scenario-based approach to assessing group solvency for the “Common Framework for the Supervision of Internationally Active Insurance Groups,” or “ComFrame,” which is a set of international supervisory requirements focusing on the effective group-wide supervision of internationally active insurance groups. NAIC staff reported that the scenarios being developed for assessing group solvency will be applied on a group basis and a legal entity basis. The ComFrame consultation draft was scheduled to be completed by July 1, 2013, but the release date was recently moved to the third quarter of 2013, which gives the

Subcommittee more time to develop the scenario-based approach. Interested parties asked questions about the objective of the assessment. NAIC staff explained that the objective is to have a collaborative effort with other supervisors to obtain a more holistic view of capital beyond the local jurisdiction's requirements. Interested parties also asked about the group legal entity issue, with one party pointing out that ComFrame is supposed to complement, not replace, existing legal entity regulation and should therefore only be applied on a group basis. For example, if ComFrame is applied on a legal entity basis, a group that has a large number of individual entities would be required to do a lot of additional work, which would be expensive. The interested party urged the Working Group to make the decision to apply ComFrame only on a group basis before the field testing phase begins. There is a full IAIS Solvency Subcommittee meeting in two weeks in Tokyo and the focus will be on further developing the scenario-based approach. The ComFrame draft released in March 2013 will be updated after the meeting.

The Working Group also heard an update from NAIC staff on the IAIS AAISC. The AAISC met in late January 2013 in Basel and discussed the appropriate approach to valuation under ComFrame. S&P and A.M. Best made a presentation on the methodologies used by the rating agencies to standardize their analysis of insurers and the AAISC will use a similar approach to compare accounting regimes. The AAISC has been working with the IAIS Solvency Subcommittee to create a structure for valuation in which adjustments would be made to Internationally Active Insurance Groups' balance sheets to create a ComFrame Adjusted Pro Forma Balance Sheet. ComFrame has not endorsed U.S. SAP yet, but the AAISC was in agreement that it would not be a good idea to require an adjustment from U.S. SAP to U.S. GAAP and then to the ComFrame Balance Sheet. NAIC staff pointed out that there is a high degree of commonality as to what regulators require insurers to have on their balance sheets, but that there are two areas where there is likely to be controversy: financial assets and technical provisions. Regarding financial assets, overseas regulators have generally utilized a fair value approach, while U.S. state insurance regulators have used amortized cost. NAIC staff suspects that there will be few at the IAIS that agree with the U.S., largely because many of the members are from jurisdictions that have legislated for fair value. NAIC staff recommendation is to allow both amortized cost and fair value with a disclosure as to the difference. Regarding technical provisions, there is likely to be a difference regarding property/casualty discounting of reserves. An interested party raised a third potential point of controversy, which is credit for reinsurance. In the U.S., insurers are subject to stricter requirements for receiving reinsurance credit than insurers globally, which will put U.S. insurers at a disadvantage in terms of capital on the ComFrame Balance Sheet. Since the goal of the

ComFrame Balance Sheet is ballpark comparability of globally active insurers, the interested party emphasized that this needs to be addressed.

The Working Group heard status reports on two exposure drafts. The first was the IASB March 2013 Financial Instruments: Expected Credit Losses exposure draft, which includes a proposal for a new accounting model for impairment of financial assets involving the recognition of credit losses based on current estimates of expected shortfalls in contractual cash flows. This proposal is different from FASB's 2012 Current Expected Credit Losses Model because it distinguishes between instruments that have deteriorated in value since initial recognition and those that have not. The Working Group was asked to comment on this proposal. The second exposure draft was the IASB Insurance Contracts exposure draft, which is expected to be released by the end of the second quarter of 2013.

Corporate Governance (E) Working Group

The **Corporate Governance (E) Working Group** received an update on the work of the IAIS. The Joint Forum held a plenary session at the end of February 2013 and one of the interesting issues discussed was longevity risk transfer and the implications for states. The IAIS Governance and Compliance Subcommittee is focused on ComFrame, as well as a new project analyzing the different approaches to corporate governance by insurers.

(3) GROUP SOLVENCY ISSUES

The **Group Solvency Issues (E) Working Group** received an update on IAIS Insurance Groups and Cross Sectorial Issues Subcommittee Initiative. Last year, the IAIS began an issues paper identifying issues relating to branches of insurers and there have been three rounds of comments. Multiple interested parties pointed out that it is important to the industry that the paper not set forth a negative view of branches of insurers as many insurers benefit from the ability to operate on a branch basis outside of their jurisdiction of incorporation.

The Working Group then received an update on the Joint Forums initiatives. At the Joint Forum plenary in February 2013, there was a discussion of future work on principles for supervision of financial conglomerates, and the plenary authorized a group to do a test of principles. District of Columbia Commissioner White volunteered to be part of the evaluation team.

The Working Group also:

- Received a report from the National Treatment and Coordination (E) Working Group regarding consolidated hearings.
- Adopted a draft memorandum with proposed NAIC Part A accreditation recommendations regarding the Risk Management and Own Risk and Solvency Assessment Model Act.
- Exposed revised NAIC Part B accreditation standards related to holding company analysis.

At the 2012 Fall National Meeting, the Working Group discussed a lack of understanding among international regulators and other parties of the U.S. regulatory approach to group supervision and expressed a desire to clarify the approach, including the role of the lead state/group supervisor. At the Spring National Meeting, the Working Group exposed, for a 60-day public comment period, a document with proposed changes to the NAIC Financial Analysis Handbook relating to the roles and responsibilities of the U.S. lead state. One key point relating to group supervision is that the groupwide supervisor cannot usurp the power of other jurisdictions. The Property Casualty Insurers Association of America distributed a copy of a white paper drafted on the topic of group supervision. PCI stated that group supervision is critical, but should be a supplement to legal entity supervision and should not interfere with the work of the legal entity supervisors. Additionally, PCI would strongly oppose a move to apply U.S. financial examinations at the group level.

(4) CORPORATE GOVERNANCE

The **Corporate Governance (E) Working Group** adopted the long-awaited paper entitled “Proposed Response to a Comparative Analysis of Existing U.S. Corporate Governance Requirements.” Vermont Commissioner Susan Donegan explained that the Working Group reached a consensus regarding certain difficult topics such as how to collect more frequent information on corporate governance policies and practices. After considering many ways to collect the information, the Working Group determined that the most direct, effective, and confidential way would be through the development of a new model law. The model law would be limited in scope and would require the collection of confidential information on an annual basis. The model law would provide the strongest confidentiality protections possible, including protecting confidential information from subpoena and open records laws, and the law would be designed to avoid overlapping requests for the same information. The ACLI expressed concerns with the development of

a model law but stated that they are willing to work with the NAIC in the process, in particular relating to the issues of confidentiality and redundancy. Another interested party also raised the issue of confidentiality, including the complexity of various confidentiality provisions and the fact that some states have strong sunshine laws. In addition to creating a new model law, the Working Group proposed adding a new section to the Annual Financial Reporting Model Regulation, which would require large insurers to maintain an effective internal audit function capable of providing the audit committee with independent assurance regarding the insurer's governance, risk management and internal controls. The Working Group adopted the paper and the related model law development and model regulation revision requests. The paper and the related model law development and model regulation revision requests were subsequently adopted by the Solvency Modernization Initiative (E) Task Force and the Financial Condition (E) Committee.

(5) FINANCIAL STABILITY (EX) TASK FORCE

The newly-formed **Financial Stability (EX) Task Force** held its inaugural meeting at the Spring National Meeting. Following the winding down of the AIG Task Force, the Executive (EX) Committee discussed financial stability and recognized the role that state insurance regulators play in ensuring domestic or global financial stability. The Task Force's charges are:

- Consider issues concerning domestic or global stability as they pertain to the role of state insurance regulators and make recommendations to the International Insurance Relations (G) Committee, the Government Relations (EX) Leadership Council or the International Insurance Relations (EX) Leadership Group, as appropriate.
- Consider state insurance regulators' input to national and international discussions on macro-financial vulnerabilities impacting the insurance sector.
- Serve as a forum to coordinate state insurance regulators' perspective on a wide variety of issues arising from the designation of U.S. insurance groups as "systemically important" both pre- and post-designation including:
 - Where appropriate, develop policy recommendations and/or guidance regarding the role, responsibilities and activities of state insurance regulators in the context of consolidated supervision resulting from designation.
 - Analyze proposed rules by the federal agencies that relate to financial stability.

- Analyze proposed policy measures regarding supervisory standards for globally systemic important insurers.
- Develop comment letters on such analysis for further consideration by the International Insurance Relations (G) Committee, the Government Relations (EX) Leadership Council or the International Insurance Relations (EX) Leadership Group, as appropriate.

The Task Force heard presentations on supervisory colleges, group supervision, macro-prudential matters and federal developments. There was no discussion by the Task Force about what the next steps of the Task Force would be.

(6) NAIC ACCREDITATION STANDARDS

Credit for Reinsurance Model Law and Model Regulation

The **Executive (EX) Committee** and the **Plenary** each adopted the 2011 revisions to the Credit for Reinsurance Model Law and Model Regulation as NAIC accreditation standards. The Model Law provisions relating to reduced reinsurance collateral requirements for non-U.S. licensed reinsurers that are licensed and domiciled in qualified jurisdictions are permitted but not required for NAIC accreditation purposes.

Risk Management and Own Risk Solvency Assessment Model Act

The **Financial Regulation Standards and Accreditation (F) Committee** exposed for a 30-day comment period adding the Risk Management and Own Risk Solvency Assessment Model Act as an NAIC accreditation standard. The Model Act requires that certain insurers perform an Own Risk Solvency Assessment which evaluates the adequacy of an insurer's capital levels in light of the insurer's unique business mix and strategy. The assessment consists of internal modeling and stress testing, designed and conducted by an insurer in accordance with prescribed regulatory criteria.

Standard Valuation Law

The **Financial Regulation Standards and Accreditation (F) Committee** voted to delay on voting whether the 2009 revisions to the Standard Valuation Law (which implement life insurer principles-based reserving) should be an NAIC accreditation standard until the 2014 Spring National Meeting while the Committee monitors the implementation process. Many states, including New York, have publicly stated that they do not currently feel that principles-based reserving should be implemented by the Model Law. If the Model Law becomes an NAIC accreditation standard, every state that does not enact the Model Law in

the time allowed would risk losing its NAIC accreditation status. If that were to happen, accredited states would not accept examination reports of insurers conducted by a non-accredited state, possibly causing domestic insurers of the non-accredited state to be subject to additional examinations, which can be time-consuming and expensive.

Insurance Holding Company System Regulatory Act and Model Regulation

The **Financial Regulation Standards and Accreditation (F) Committee** also held a lively discussion regarding the 2010 revisions to the Insurance Holding Company System Regulatory Act and Model Regulation being added as an NAIC accreditation standard in reaction to a comment letter received requesting that the laws be amended to exempt smaller insurers from having to comply with the Enterprise Risk Report (Form F) requirement. The Committee received a report that certain states had already enacted such an exception amendment. In addition, an interested party requested that the change be incorporated into the Model Act. Some Committee members pointed out that the exemption of smaller insurers from this requirement was debated when the Model Act was drafted, and that to come to the Committee to request the change now was inappropriate. They suggested that the Committee send notices to the states that enacted laws exempting smaller insurers to let them know that there may be a deficiency in their regulatory framework that should be addressed.

(7) LIFE INSURERS – PRINCIPLES-BASED RESERVING

Formed before the Spring National Meeting, the **Principles-Based Reserving Implementation (EX) Task Force** discussed the implementation of principles-based reserving (PBR) legislation throughout the U.S. The Task Force charges fall into three categories (1) PBR Implementation Plan, (2) PBR legislative packet and (3) solution for captives and special purpose vehicles within the context of PBR.

A revised draft of the Principle-Based Reserving (PBR) Implementation Plan and Timeline, which was initially released at the 2012 Fall National Meeting, was discussed and released for a 30-day comment period. Since PBR will not apply until the Standard Valuation Law is adopted by a supermajority of jurisdictions (42) that represent at least 75% of the subject premium, and following that, implementation will be phased in over a three-year period, the Plan is intended to determine how to create an orderly implementation of PBR once adopted by a supermajority of states. This includes determining what resources the states will need in order to review PBR implementation by insurers, how to collect insurer-data that will be used to verify their modeling, how data will be reported, along with other

changes to regulations and procedures that are based on the current formulaic reserving methodologies.

One of the concerns of states that did not vote for PBR raised during the 2012 Fall National Meeting was that the various state insurance regulators would have insufficient actuarial resources to implement PBR. Accordingly, the Task Force asked the Life Actuarial (A) Task Force to conduct a survey of the various state insurance regulators. The Task Force discussed the results of that survey, with many jurisdictions advising that they would need additional personnel in order to effectively review insurers once PBR was implemented. The Task Force expects to continue surveying the state insurance regulators to see if the perceived needs change as how PBR would be implemented becomes clearer in the next couple of years.

The Task Force received a report that the Standard Valuation Law has been introduced in the legislatures of nine states. In order to facilitate adoption and answer any basic questions legislators may have, the Task Force exposed a legislative brief that can be used by state insurance regulators presenting this legislation. The Task Force will hold a conference call to discuss and adopt the brief.

Finally, the Task Force received a report regarding captive and special purpose vehicle (SPV) activity from Rhode Island Superintendent Torti. Superintendent Torti explained that the white paper of the Captive and Special Purpose Vehicle Use (E) Subgroup regarding captive and SPV use was exposed for comment prior to the Spring National Meeting and that the comment period ends on April 29, 2013. Following the end of the exposure period, Superintendent Torti expects to send the white paper up to the Financial Condition (E) Committee for review. He noted that although the implementation of PBR may partially affect the use of captives and SPVs to finance redundant reserves, he still expects that insurers will still use them and that enhanced disclosure, among other changes, will be required.

(8) RISK-BASED CAPITAL DEVELOPMENTS

Life Risk-Based Capital – MEAF

The **Life Risk-Based Capital (E) Working Group** adopted, in a five-to-four vote, a proposal of the ACLI related to the life risk-based capital mortgage experience adjustment factor (MEAF) for commercial mortgages.

The purpose of the MEAF is to help calculate the appropriate amount of capital an insurer should hold based on the composition of the insurer's commercial mortgage portfolio, as

commercial mortgages are not rated. The MEAF is calculated by dividing a measure of the insurer's historical commercial mortgage default experience by an industry average of commercial mortgage defaults calculated over the previous eight quarters. Since commercial mortgage default rates were very low until the recent financial crisis, the denominator in this equation was near zero. As a result, just one or two defaults in an insurer's commercial mortgage loan portfolio could cause a significant increase in the insurer's MEAF and therefore in its required risk-based capital. Interim measures were adopted by the of the Capital Adequacy (E) Task Force in the summer of 2009, while the ACLI and the Task Force worked on a more permanent solution which was adopted by the Task Force by a narrow margin at the Spring National Meeting. Although no explanation was given for the dissenting votes, which included New York and California, assumedly it is because the ACLI's proposal would relax capital standards.

The Working Group presented the ACLI MEAF proposal to the Capital Adequacy (E) Task Force and the Task Force chose to expose the proposal for two weeks giving its members a chance to review it further.

Property/Casualty Risk-Based Capital – Reinsurance Credit Risk

The **Property/Casualty Risk-Based Capital (E) Working Group** received a presentation from the American Academy of Actuaries regarding their report on reinsurance credit risk, which was prepared at the request of the NAIC. The report reviewed the current treatment of reinsurance credit risk in the NAIC risk-based capital formula and noted that the NAIC may want to consider reviewing that treatment since the current 10% reinsurance risk charge may be too high and it may not be reasonable to apply such a charge uniformly across reinsurers. The Academy's report also noted that reinsurance credit risk should include all risks related to reinsurance transactions (*e.g.*, commutation risk) and not just risk related to reinsurer default.

Investment Risk-Based Capital

The **Investment Risk-Based Capital (E) Working Group** received a presentation from the American Academy of Actuaries on the status of the corporate bond model development. The remaining critical tasks include finalizing total loss and tax assumptions and defining the representative portfolio. The Academy expects to begin testing the model in July 2013. The Working Group will have to decide on the structure of C-1 charges, the risk-based capital protection level and the degree of consistency between asset classes.

The Working Group also received two reports from the ACLI summarizing recommendations to update life insurers' risk-based capital for derivatives and common

stock. The Working Group adopted a motion to receive and expose the reports for a 40-day comment period ending May 16, 2013.

Working Capital Finance Investments

The **Capital Adequacy (E) Task Force** discussed Working Capital Finance Investments and adopted structural risk-based capital changes that will allow this type of investment to be reported on statutory annual statement Schedule BA for the 2013 reporting year. The risk-based capital charge will be set over the next few months. Interested parties emphasized that in terms of credit risk, this type of investment should be rated NAIC 1 or 2 like the underlying credit.

(9) LIFE INSURERS – CONTINGENT DEFERRED ANNUITIES

The **Contingent Deferred Annuity (A) Working Group** continued its mandate from the Life Insurance and Annuities (A) Committee to evaluate the consumer protection and solvency issues related to contingent deferred annuities (CDAs). The Working Group previously gathered information from the life insurance industry, interested parties, SEC staff, FINRA and consumer representative, among others, in order to determine how CDAs should be regulated. These findings were published by the Working Group in a February 2013 memorandum.

The Working Group adopted and presented to the Committee its lengthy recommendations regarding CDAs. In the recommendations, a “Contingent Deferred Annuity” is defined as:

“an annuity contract that establishes a life insurer’s obligation to make periodic payments for the annuitant’s lifetime at the time designated investments, which are not owned or held by the insurer, are depleted to a contractually defined amount due to contractually-permitted withdrawals, market performance, fees and/or other charges.”

As reflected in the definition, CDAs cannot simply be described as fixed or variable annuities, and the recommendations of the Working Group reflect this point and the points that certain changes will need to be made in order to regulate and account for CDAs appropriately, including a number of items that the Working Group asked the Committee to refer to existing NAIC committees. Specific items left for referral to other NAIC committees include reserving requirements, financial reporting requirements and changes to existing model laws and regulations related to annuities. In addition, the Working

Group requested that life insurers file a CDA contract as CDA, and not as a fixed or variable annuity.

The Committee adopted the Working Group's recommendations and expects to hold a conference call during which it will be determined to which committees the various items in the recommendations will be referred.

(10) VALUATION OF SECURITIES

RMBS/CMBS Quarterly Reporting

The **Valuation of Securities (E) Task Force** received an update regarding quarterly reporting of RMBS and CMBS securities. The SVO drafted proposed text for the NAIC Purposes and Procedures Manual endorsing the view that insurers could use breakpoints from the prior year-end or credit ratings assigned by NAIC Credit Rating Providers for CMBS and RMBS. The Task Force referred this proposed approach to the Statutory Accounting Principles (E) Working Group for incorporation into NAIC Accounting Practice and Procedures Manual SSAP No. 43R (Loan-backed and Structured Securities). The Task Force also received a presentation on recent market statistics for RMBS and CMBS.

RMBS/CMBS Modeling

The **Valuation of Securities (E) Task Force** heard from Matti Peltonen of the New York Department of Financial Services on proposed changes to the SVO Purposes and Procedures Manual regarding RMBS/CMBS modeling. The first proposed change is to use the risk-free curve (U.S. Treasury strip curve) rather than the security's coupon rate as the discount rate in determining the net present value of expected loss. The idea behind this change is that a security should not have a lower risk-based capital charge just because it has a higher coupon rate. The second proposed change is to take into account interest shortfall in addition to principal loss when calculating the expected loss. The Task Force voted to expose the proposal for 30 days.

Mandatory Convertible Securities

The **Valuation of Securities (E) Task Force** adopted amendments to the SVO Purposes and Procedures Manual for mandatory convertible securities in response to statutory accounting changes. On April 6, 2013, the Statutory Accounting Principles (E) Working Group adopted changes to NAIC Accounting Practice and Procedures Manual SSAP No. 26 (Bonds, Excluding Loan-Backed and Structured Securities) to include a new definition

of mandatory convertible securities and change the pre-conversion valuation method to the lower of amortized cost or fair value. The changes to the SVO Purposes and Procedures Manual exempt mandatory convertible securities from being assigned NAIC 6S under the new SVO classification procedures. The change in definition was also referred to the Capital Adequacy (E) Task Force to ensure the definition of mandatory convertible securities in the risk-based capital instructions refers to SSAP No. 26.

Recalibration Project

At the 2012 Fall National Meeting, the **Valuation of Securities (E) Task Force** received the SVO proposed definitions for NAIC Designation categories under the Recalibration Project. The Task Force has received comment letters on the proposed definitions for the NAIC Designation categories for corporate, municipal and asset-backed securities. The comment letters request that the SVO staff wait until the Investment RBC (E) Working Group establishes recommendations for these designations before continuing work. The SVO staff is to meet with the American Academy of Actuaries representatives to discuss the objectives of the Recalibration Project, which will assist the Task Force in making more informed decisions regarding the project.

Foreign Audit Requirements

The ACLI sent a letter to the **Valuation of Securities (E) Task Force** before the 2012 Summer National Meeting regarding a proposed amendment to the SVO Purposes and Procedures Manual to modify the NAIC policy on foreign audit requirements. The letter asked the NAIC to allow the use of foreign securities GAAP without reconciliation to U.S. GAAP for issuers in certain countries. Canada, Australia and the U.K. are currently exempt from reconciliation. At that meeting, the Task Force moved to expose the letter for a 45-day comment period and requested comments as to how the SVO should evaluate the list of countries and what resources might be necessary to maintain the list.

At the 2012 Fall National Meeting, Kevin Fry pointed out that there was some concern about this in the SVO. The Task Force adopted a proposal that the SVO will work with ACLI representatives to evaluate whether there are information resources that would permit the SVO to use financial information presented on the basis of a country's GAAP to conduct credit analysis comparable to the analysis performed using U.S. GAAP or official International Financial Reporting Standards.

At the Spring National Meeting, the NAIC's Bob Carcano provided the Task Force with an update that the SVO has been working with ACLI and they have agreed to focus on German GAAP as a first step in the analysis. The objective is that once the parameters

have been finalized, they can conduct a review of actual transactions and see whether there is a big difference in the NAIC rating that results. This process is ongoing and there is no recommendation yet.

(11) OTHER MATTERS

Federal Home Loan Banks' Proposed Receivership Legislation

The **Federal Home Loan Bank Legislation (E) Subgroup** received a presentation from representatives of the Federal Home Loan Banks (FHL Banks) regarding their proposed legislation that would exempt the FHL Banks' security agreements from stay and voidable preference provisions of state insurance insolvency laws. Such legislation would acknowledge the FHL Banks' priority status as secured creditors in state insurance insolvency proceedings just as current FDIC regulations do in the banking context. The Subgroup adopted a memo to state insurance regulators requesting that approval of the FHL Banks' legislative request be granted only after the NAIC has fully studied the insurance receivership considerations and a recommendation is finalized.

Life Insurers – New Annuity Buyer's Guide

The **Annuity Disclosure (A) Working Group** adopted a final version of the Annuity Buyer's Guide, which will be distributed to potential buyers of annuities, and which is intended to allow them to make a more informed purchase. The Working Group was formed in the fall of 2008 in order to improve the disclosure of information provided for annuity products and provide insurers with uniform guidance on developing disclosure practices and monitoring the distribution of annuities. The Annuity Buyer's Guide is required to be distributed to consumers under the NAIC Annuity Disclosure Model Regulation which defines the "Buyer's Guide" as the NAIC approved Annuity Buyer's Guide.

The Life Insurance and Annuities (A) Committee accepted the Annuity Buyer's Guide adopted by the Working Group, and moved to allow the Working Group to continue its work until the end of the year in order to oversee the creation of an electronic version of the guide, to determine whether different versions will be required for variable and fixed annuities, and to handle any minor changes required as more people review the guide.

Property/Casualty Insurers – Catastrophe Insurance

The **Catastrophe Insurance (C) Working Group** received an update on the National Flood Insurance Program, which was reformed in 2012 to eliminate artificially low rates and

discounts that Congress viewed as no longer financially sustainable. The Working Group also discussed the possibility of recommending that the Government Relations (EX) Leadership Council draft a letter regarding the establishment of a national catastrophe fund. While two Working Group members noted that there was resistance from many states to government-sponsored catastrophe funds, the Working Group decided to study and analyze the issue and conduct a conference call in two months.

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Please do not hesitate to contact us with any questions.

April 12, 2013