

## **CAPITAL ADEQUACY (E) TASK FORCE**

Capital Adequacy (E) Task Force Dec. 6, 2009, Minutes

Capital Adequacy (E) Task Force Procedures (Attachment One)

Life Risk-Based Capital (E) Working Group Dec. 4, 2009 Minutes (Attachment Two)

Life Risk-Based Capital (E) Working Group Nov. 17, 2009, Conference Call Minutes (Attachment Two-A)

Life Risk-Based Capital (E) Working Group Nov. 12, 2009, Conference Call Minutes (Attachment Two-B)

Property and Casualty Risk-Based Capital (E) Working Group Nov. 30, 2009, Conference Call Minutes (Attachment Three)

Capital Adequacy (E) Task Force Nov. 23, 2009 Conference Call Minutes (Attachment Four)

Capital Adequacy (E) Task Force Nov. 3, 2009 Conference Call Minutes (Attachment Five)

Property and Health RBC TALF proposals (Attachment Five-A)

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Capital Adequacy (E) Task Force  
San Francisco, CA  
December 6, 2009

The Capital Adequacy (E) Task Force met in San Francisco, CA, Dec. 6, 2009. The following Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Jim L. Ridling represented by Richard Ford (AL); Steve Poizner represented by Ron Dahlquist and Perry Kupferman (CA); Thomas R. Sullivan represented by Richard Mareks (CT); Gennett Purcell represented by Philip Barlow (DC); Karen Weldin-Stewart represented by Al Franz (DE); Kevin M. McCarty represented by Robin Westcott (FL); Sandy Praeger represented by Larry Bruning (KS); Glenn Wilson represented by Blaine Shepherd and Jaki Gardner (MN); Mary Jo Hudson represented by Dale Bruggeman and Mary Miller (OH); Joel Ario represented by Steve Johnson (PA); Scott H. Richardson represented by Leslie Jones (SC); Kent Michie represented by Jake Garn (UT); Mike Kreidler represented by Patrick McNaughton (WA); and Sean Dilweg represented by Peter Medley (WI). Also participating was: Matti Peltonen (NY).

1. Discuss the Residential Mortgage-Backed Securities (RMBS) Proposal

Mr. Peltonen said the proposal had been adopted several weeks ago. Several conference calls had been held on the model assumption, which was now finalized. He said PIMCO had started rating securities, with a goal of having the ratings completed for company use by the last week of December. A table of the designations and the price ranges for the securities would be made available. He said approximately 1,000 RMBS CUSIPS would not be rated for foreign securities and private placements. A rating methodology for those securities would be developed for next year.

Mr. Felice said guidance regarding reporting and RBC was posted on the NAIC Web site. SSAP No. 43 was in the process of being updated in order to implement the RMBS proposal. The Statutory Accounting Principles (E) Working Group had formed a subgroup to address the valuation, reporting, RBC and accounting changes.

2. Discuss the American Academy of Actuaries (AAA) Life RBC C-3 Phase 3 Proposal

Mr. Barlow said an AAA C-3 Phase 3 proposal had been released for comment since the Fall National Meeting. As a result of comments received, the American Council of Life Insurers (ACLI) had agreed to provide proposals regarding the scope and a materiality test for C-3 Phase 3. The AAA had drafted RBC instructions, and those were released for a 45-day comment period. He said it had been the goal to get C-3 Phase 3 adopted by year-end in order to give companies more implementation time. The goal was now to have a proposal adopted by the 2010 Spring National Meeting for a year-end 2010 implementation; otherwise, a year-end 2011 implementation would be needed. Mr. Felice asked whether there were any structural changes that would require a December 2009 implementation. Mr. Barlow said the changes were to the instructions and so adoption could occur up until June 2010, according to the Task Force procedures.

3. Discuss the ACLI Derivatives Risk-Mitigation Proposal

Mr. Barlow said a derivatives risk-mitigation proposal had been released for comment by the Life Risk-Based Capital (E) Working Group. The proposal had been modified to only address one-to-one hedges. He said that, according to the current Task Force procedures, the proposal would need to be adopted at the Winter National Meeting. With changes being made to the Task Force procedures, he said he hoped the Working Group would be given until the end of December to implement the changes.

Mr. Felice said the derivatives risk-mitigation proposal had three elements: one-to-one hedges; the more intermediate one-to-many hedges; or index hedges and the advanced hedges. He said it made sense to have mitigation on the one-to-one hedges and there was broad agreement on the concept. The Working Group was close to finalizing a proposal, so it made sense to hold open the possibility of adoption until the end of December. He said the Task Force would likely need to hold an e-mail vote if the Working Group adopted a proposal. Mr. Barlow said a derivatives collateral proposal that had been released for comment might also be adopted at the end of December.

Mr. Shepherd made a motion to allow the Life Risk-Based Capital (E) Working Group until the end of December to potentially adopt the derivatives risk-mitigation proposal and the derivatives collateral proposal. Mr. Ford seconded the motion. The motion passed unanimously.

#### 4. Discuss AAA Property RBC Modernization Report

Mr. Dahlquist said the Property Risk-Based Capital (E) Working Group had received a report from the AAA regarding modernizing the property/casualty RBC formula. The AAA report had said systemic risk could have a severe effect on the property/casualty industry. The AAA wanted to look at several different items, including interdependent risks, current action levels, international standards, stochastic modeling and reinsurance. The AAA had asked the Property Risk-Based Capital (E) Working Group for approval to draft a preliminary report to address stochastic modeling, lessons of the financial crisis and improvements to the current RBC formula. The AAA group was focused on property/casualty RBC, but consultation with the other RBC Working Groups might be done for areas where there was common interest.

Mr. Felice said that the AAA report makes a lot of valid points. He agreed that there should be a review of the RBC formula, but said he thought it should be a broader review and not specific to property/casualty RBC. He noted that the Solvency Modernization Initiative (EX) Task Force would be giving charges to the applicable groups, and the priority of those items would come from those deliberations. Mr. Felice said the AAA work group for property RBC might need to be more synchronized with the NAIC solvency modernization process.

#### 5. Discuss the Property RBC Two-Year Lines Blanks Proposal

Mr. Dahlquist said objections had been raised for the proposal concerning IRS tax treatment. A decision had been made years ago to capture 10 years of data in the RBC and not the annual statement Schedule P. However, because the quality of the RBC data was not as good as it should be, the Property Risk-Based (E) Capital Working Group, asked NAIC staff to identify reporting problems and see if action could be taken to improve the quality of the data before proceeding with a blanks proposal. Mr. Felice said the Working Group should be mindful of the Blanks (E) Working Group deadlines for implementation.

#### 6. Discuss the Long-Term Mortgage Experience Adjustment Proposal

Mr. Barlow said the Life Risk-Based Capital (E) Working Group had received a long-term mortgage loan proposal from the ACLI. The Working Group did not have time to discuss the proposal at the Winter National Meeting. The Working Group would schedule a conference call in January to address the proposal. Prospects for a long-term proposal will drive the discussion of what the 2010 treatment will be.

#### 7. Discuss Fraternal RBC

Mr. Felice said the Task Force had adopted a model law request form that was being considered by Executive (EX) Committee at the Winter National Meeting. Subsequent to the adoption, comments had been received from the National Fraternal Congress of America (NFCA). Joseph Annotti (NFCA) said NFCA had the same objective as the Task Force, and that NFCA supported tools to detect and prevent insolvencies. He said that NFCA had been working with individual states to adopt RBC statutes; the most tangible example of that was Minnesota. He said the Minnesota approach used was stronger than the current RBC model act used for life insurers. He said NFCA had concerns about the enormous amount of effort it would take to implement a model act for fraternal. He said it might be more effective to work with individual states to put in place an effective way to manage solvency.

Mr. Felice said he had asked Minnesota to provide a summary of their proposed fraternal RBC statute. Ms. Gardner said fraternal could fall through the RBC action levels quickly; therefore, Minnesota wanted to take action more quickly. The life RBC statute action levels were collapsed to give the commissioner more power to take action. Mr. Felice asked what differences there were in the approach from the current life RBC statute. Ms. Gardner said there were two action levels rather than four; explaining that this cut down the options available, so that the commissioner could take action more quickly. Mr. Barlow asked whether the statute was currently in place. Ms. Gardner said the statute was being proposed in the 2010 legislative session. Mr. Felice asked Minnesota to keep the Task Force updated on the progress of the legislation.

#### 8. Discuss Health RBC as an Accreditation Standard

Mr. Felice asked if there was certain timing needed for having a recommendation to the Financial Regulation Standards and Accreditation (F) Committee. Mr. Johnson said a memorandum from the Task Force was due at the Spring National Meeting summarizing whether any of the changes made to the RBC in the previous year would require changes to accreditation standards. Mr. Felice asked what the seasoning period was for accreditation standards. Mr. Johnson said it was four years.

Mr. Felice said a conference call of the Task Force would be scheduled in February 2010 to address the issue. He asked NAIC staff to distribute a list of states that currently had health RBC statutes. Mr. Johnson said he supported having health RBC added as an accreditation standard. He said there was no longer a reason to not include the health RBC. Originally, he explained, there were reasons for not making health RBC an accreditation standard, but those issues are now in the past. A lot of health companies were going away from the single-state model of health insurance to a multi-state model; therefore, he said he felt it was a good time to make a recommendation to Financial Regulation Standards and Accreditation (F) Committee.

Mr. Felice said a memorandum to request comments before the conference call in February might be a good idea. Ms. Jones made a motion to release a memorandum requesting comments on making health RBC an accreditation standard for a comment period of 45 days. Mr. Johnson seconded the motion. The motion passed unanimously.

#### 9. Update Regarding the C-3 Phase 2 Results Subgroup

Mr. Barlow said several calls of the subgroup had been held. Actuarial memorandums for a number of companies had been requested and several of them had been reviewed. The Subgroup was in the process of putting together a list of issues. Mr. Felice said though the recommendations had not been finalized some of the issues might be significant and would likely result in added to the Task Force working agenda for next year.

#### 10. Adopt 2010 Task Force Procedures

Mr. Felice said the Task Force procedures would need to be changed for 2010 due to the NAIC moving to three National Meetings per year from four. He said NAIC staff had drafted updated procedures. Dan Swanson (NAIC) said the deadline for factor and instructional changes was changed from the Summer National Meeting to June. The Working Group review of the RBC overview and instructions was specified to be in July, which coincided with when the overview and instructions was due to be submitted to the software vendors. Structural changes made to the RBC blanks would need to be completed by December of the previous year.

Mr. Bruning made a motion to adopt the updated Task Force procedures (Attachment One). Ms. Jones seconded the motion. The motion passed unanimously.

#### 11. Adopt Interim Minutes

Mr. Johnson made a motion to adopt the Nov. 23 (Attachment Four) and Nov. 3 (Attachment Five) Task Force conference call minutes. Mr. Shepherd seconded the motion. The motion passed unanimously.

#### 12. Adopt Working Group and Subgroup Minutes

Mr. Bruning made a motion to adopt the Dec. 4 Life Risk-Based Capital (E) Working Group meeting minutes (Attachment Two) and the Nov. 30 Property Risk-Based Capital (E) Working Group minutes (Attachment Three). Mr. Barlow seconded the motion. The motion passed unanimously.

#### 13. Any Other Matters

Mr. Felice said proposals regarding deferred tax assets were released for comment. A conference call of the Task Force would be held Dec. 17 to discuss any comments received on the proposals. A longer-term review of RBC deferred tax asset treatment would also be done. A charge would need to be drafted for the AAA to review. Mr. Felice had agreed to meet with the AAA to draft a charge and bring back to the Task Force.

Mr. Felice said the approach would need to look at the issue from a global perspective. The AAA would look at the risk in aggregate for a GAAP approach and then pare down to the different statutory limits. Risk factors would be developed across life, property/casualty and health. The Task Force would discuss the charge further after the document had been drafted.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

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**CAPITAL ADEQUACY (E) TASK FORCE  
ANNUAL SCHEDULE**

<b><u>DATE</u></b>	<b><u>TASK FORCE ACTIVITY</u></b>
Feb. 1	<p><b>Receive Items for Proposed Agenda.</b> Proposed agenda items will be generated by individual Capital Adequacy (E) Task Force members, by the various RBC Working Groups, and by other NAIC task forces and working groups. Interested parties may also propose agenda items. Proposed agenda items for which the testing and/or development of factors and structural changes will most likely extend past the NAIC Winter National Meeting should be indicated as such. Agenda items for which the testing and/or development of factors and structural changes will most likely be completed by the NAIC Winter National Meeting will be assigned priority level 1.</p>
Feb. 15	<p><b>Distribute Proposal Agenda.</b> NAIC staff support will create a cohesive agenda and distribute this agenda to the individual Capital Adequacy (E) Task Force members and the Task Force's interested parties.</p>
Spring	<p><b>NAIC Spring National Meeting – Creation of Working Agenda.</b> The Capital Adequacy (E) Task Force will consider each proposed agenda item and either adopt or reject the item. In addition to the desires of the individual RBC working groups, the Task Force will consider the goal of consistency in approach between and among the formulas; the desire for relatively straightforward and verifiable formulas; and will weigh the resources required to implement a change against the potential number of companies impacted, and the materiality of the impact once the covariance calculation is performed. After due consideration of each proposed agenda item, the working agenda will be created, composed of the proposed agenda items that were adopted by the Capital Adequacy (E) Task Force. This working agenda gives the various RBC working groups their assignments for the rest of that year.</p> <p>If the Capital Adequacy (E) Task Force determines that an item should be consistent in approach among the RBC formulas, the development of that item may occur at the Task Force level (usually via formation of a subgroup of the Task Force) rather than being distributed to the working groups. Thus, the Capital Adequacy (E) Task Force, in creating a working agenda, is allocating resources to pursue further development and testing of the approved agenda items. The working groups will perform this work, and the final work products will be presented to the Capital Adequacy (E) Task Force in December for its final review and adoption. Proposals for changes to the working agenda (additions or deletions) may be brought to the Task Force from any source who could propose an agenda item. Such changes, whether retained by the Task Force or delegated to an RBC working group, must be adopted by the Task Force prior to commencement or cessation of work on the item.</p>
Spring	<p><b>NAIC Spring National Meeting – Interim Reports from Working Groups and/or Subgroups.</b> Each RBC working group and subgroup of the Capital Adequacy (E) Task Force will report to the Task Force on the progress of its ongoing assignments from the prior year and request action from the Capital Adequacy (E) Task Force in support of working group and/or subgroup activities.</p>
June	<p>Any instructional or factor changes for the current year RBC formulas must be adopted by the Capital Adequacy (E) Task Force in June in order to be effective for the current year's formula. This includes instructional changes to reflect the impact of blanks changes impacting the current year annual statement.</p>
July	<p>A complete set of the current year <i>NAIC Risk-Based Capital Report Including Overview and Instructions for Companies</i> for formula will be approved by the respective working groups prior to publication.</p>
Summer	<p><b>NAIC Summer National Meeting – Interim Reports from Working Groups and/or Subgroups.</b> Each RBC working group and subgroup of the Capital Adequacy (E) Task Force will report to the Task Force on the progress of its assignments and request action from the Capital Adequacy Task Force in support of working group and/or subgroup activities.</p>

- Fall            **NAIC Fall National Meeting – Interim Reports from Working Groups and/or Subgroups.**  
Each RBC working group and subgroup of the Capital Adequacy (E) Task Force will report on the progress of its assignments and request action from the Task Force in support of working group and/or subgroup activities.
- December      **Adopt or Reject Changes to the RBC Formulas.**  
(1) As a result of changes to blanks.  
(2) From working agenda projects completed by the RBC working groups.  
Considerations detailed in “Spring” are again to be utilized by the Capital Adequacy (E) Task Force members. Per the adopted procedures of the Capital Adequacy (E) Task Force, the Task Force will not consider proposals where development and/or testing are incomplete.
- The final opportunity to make all structural changes for the RBC formulas for the upcoming year must be adopted by the end of December. All structural changes must be adopted with complete instructions, unless the Capital Adequacy (E) Task Force adopts a motion to make the structural change, but extend adoption of instructions and/or factors beyond December. Instructional or factor changes for existing formula pages may be extended beyond December without action by the Task Force unless an objection is raised indicating that such changes are not “maintenance” or insignificant in nature. In this case, the Task Force must formally adopt a motion to extend the adoption period for the factor and/or instructional change.
- Interim  
Conference  
Calls/Meetings      The Capital Adequacy (E) Task Force may utilize interim conference call and meetings as needed to pursue completion of its agenda, subject to the deadlines noted above.
- Ongoing        **Capital Adequacy (E) Task Force Staff Support Receives Blanks Agenda Items that impact RBC.**  
The Blanks (E) Working Group’s NAIC staff support person will provide a list of the blanks agenda proposals that would necessitate changes to the RBC formulas. This list will be delivered to the Capital Adequacy (E) Task Force’s NAIC staff support person.
- Currently, annual statement blanks proposals that only affect the annual statement need to be adopted by June of the year the blanks change will go into effect. Annual statement blanks proposals that affect both the quarterly statements and the annual statement must be adopted no later than the NAIC Fall National Meeting for changes effective for the following year.

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Life Risk-Based Capital (E) Working Group  
San Francisco, CA  
December 4, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in San Francisco, CA, Dec. 4, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steven Ostlund (AL); Perry Kupferman (CA); Larry Bruning (KS); Blaine Shepherd (MN); Fred Andersen (NY); and Mike Boerner (TX).

1. Release for Comment an Updated ACLI Derivatives Risk Mitigation Proposal

Mr. Barlow said a derivatives risk mitigation proposal had been received from the American Council of Life Insurers (ACLI) and released for comment. No comments were received on the proposal, but on a previous conference call, the Working Group had asked for additional work to be completed. Wally Givler (Northwestern Mutual, representing the ACLI) said the ACLI had been requested to provide a one- or two-page executive summary of the proposal. He asked whether the summary provided what was needed for regulators. Mr. Ostlund said it did. Mr. Givler said Mr. Shepherd had asked about index-based credit default swaps. The guidance released for comment had not been explicit about how the calculation was intended to work. So the ACLI had drafted a couple additions to the instructions to clarify.

Mr. Givler said a new, more granular maturity mismatch table had been drafted to replace the table in the Nov. 17 materials. A three-step methodology had been used to calculate the new table. Typical mismatches were identified. A five-year mismatch such as with a 10-year bond matched with a five-year credit default swap. A 20% average haircut was calculated for a five-year mismatch. Using a zero haircut for a zero-year mismatch for comparison, the remaining percentages in the table were extrapolated using a 10-year swap curve. Mr. Barlow asked whether this was the methodology suggested by Ed Toy (NAIC). Mr. Givler said Mr. Toy had suggested the fundamentals of the methodology. Mr. Givler said not all the details of the methodology had been discussed with Mr. Toy yet, but further discussions were planned in the next week.

Mr. Ostlund asked whether a larger haircut could have been used. Mr. Givler said the ACLI had averaged the haircut for the six different NAIC designations. Mr. Ostlund asked whether a weighted average had been used. Mr. Givler said it had been an arithmetic average. Mr. Ostlund asked whether any starting point the Working Group wanted could be chosen. Mr. Givler said that could be done, but it would not have the technical underpinning of the current proposal. Mr. Barlow asked if Mr. Ostlund was saying that using the 20% average for all designations would give more credit than deserved for the 29% factor indicated for NAIC class-two bonds. Mr. Ostlund said that was correct, but that the Working Group could choose a different starting point if it wanted to.

Mr. Barlow said if the Working Group wanted to start with a 29% haircut, the ACLI could proportionately change the rest of the percentages in the table. Mr. Givler said that was correct. He said the ACLI could provide a more detailed paper to show the different haircuts for different NAIC designations. Mr. Shepherd requested that background material be provided to the Working Group. Mr. Ostlund asked how the 25-year mismatch had been calculated. Mr. Givler said it had not been calculated separately but had been extrapolated from the five-year mismatch haircut calculated. Mr. Shepherd asked what effect would occur for losses on bonds not in the insurer's portfolio for an indexed hedge. Mr. Givler said the credit default swap would be protecting default risk. The amount of exposure would be the amount of premium paid for the hedge against bonds that are not owned. If a bond that was not in the portfolio defaulted, it would result in a gain to the company. Mr. Shepherd asked if a company could legally have a hedge with 20% of the portfolio. Mr. Givler said it would depend on the company's derivative use policy, the company's governance and the company's state of domicile. The proposal required at least a 50% hedge in order to receive a credit. He said it would likely not make economic sense to do less.

Mr. Barlow said in order to get a proposal implemented for year-end 2010 RBC, it would need to be adopted by the end of 2009. The proposal included both intermediate and basic hedges. Mr. Barlow said he was concerned that the Working Group may not be able to get comfortable with the haircut and indexed derivatives portion of the proposal by the end of the year. Mr. Ostlund said the linear hedges were less risky. Not allowing a credit in the RBC formula would provide an incentive to not hedge. He said he would like to see a credit given. Mr. Barlow said with the one-to-one hedges, the Working Group would need to be comfortable with the haircut. Mr. Ostlund said he was willing to go part of the way with the one-to-one hedges. The Working Group might double the haircuts to be more comfortable with the proposal. Mr. Andersen said the typical process was to look at the best estimate of the experience and take into consideration the variability of the experience.

Mr. Felice said that from a Task Force perspective, he was comfortable with the concept of a direct hedge receiving some sort of credit. To the extent the Working Group was not comfortable with the proposal, he suggested that the Working Group not scuttle the entire proposal because too much was being taken on. He thought there was something basic in the proposal that everyone could agree to. If the Working Group thought it could go further and get more completed, it should go ahead. Mr. Barlow said in order to get done by year-end, the Working Group would stick to the basic hedges. It made sense to take more time to get comfortable with the indexed hedges. He asked NAIC staff to work with Mr. Givler to draft a proposal to strike the one-to-many hedges language from the proposal. Mr. Andersen asked whether changes to maturity factors could still be made. Mr. Barlow said the structural changes needed to be implemented by the end of the year, but other aspects could potentially go longer.

Mr. Ostlund made a motion to release the derivatives risk mitigation proposal updated to include only one-to-one hedges for a comment period of two weeks. Mr. Kupferman seconded the motion. The motion passed unanimously. Mr. Barlow said he expected to have a conference call of the Working Group to address the proposal the last week of December.

## 2. Discuss C-3 Phase 3 Proposal

Mr. Barlow said the Working Group had received a formal response requested from the American Academy of Actuaries (AAA) to C-3 Phase 3 proposal comment letters received. The Working Group also had received draft RBC instructions from the AAA. He said the Working Group had asked the ACLI to provide a suggestion on limiting the C-3 Phase 3 scope and a suggestion on a materiality test. John Bruins (ACLI) said language had been drafted on each of the items, and the ACLI was working to finalize. Mr. Barlow said the ACLI should provide the items to the Working Group within a month.

Mr. Barlow said the C-3 Phase 3 proposal did not require structural changes. He said the goal had been to adopt the proposal by the end of the year to give lead time for company implementation. Since the Working Group was focusing on items that could potentially reduce the amount of work required, he was not going to rule out a potential 2010 implementation of the proposal at this point in time. He said the goal was now to have the proposal adopted by the 2010 Spring National Meeting.

Mr. Ostlund made a motion to release the AAA draft C-3 Instructions for a comment period of 45 days. Mr. Shepherd seconded the motion. The motion passed unanimously. Mr. Barlow said it might be useful to have a conference call of the Working Group in January during the comment period to facilitate discussion of the exposure.

## 3. Adopt Interim Conference Call Minutes

Mr. Ostlund made a motion to adopt the Nov. 17 (Attachment Two-A) and Nov. 12 (Attachment Two-B) Life Risk-Based Capital Working Group Conference Call Minutes. Mr. Shepherd seconded the motion. The motion passed unanimously.

## 4. Any Other Matters

Mr. Barlow said a long-term proposal for mortgage loans had been received from the ACLI. The proposal would be distributed and discussed at a conference call subsequent to the Winter National Meeting. In addition, some changes to the treatment of derivatives collateral had been received. Inadvertently, some changes had been made from the short-term guidance that had been adopted. A proposed fix to the treatment would be addressed on a subsequent conference call of the Working Group.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 12/3/09

Life Risk-Based Capital (E) Working Group  
Conference Call  
November 17, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Nov. 17, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Perry Kupferman (CA); Blaine Shepherd (MN); Frank Horn (NY); and Mike Boerner (TX).

1. Discuss American Council of Life Insurers (ACLI) Derivatives Risk Mitigation Proposal

Wally Givler (Northwestern Mutual) said at the Fall National Meeting the ACLI was advised to split out work into straightforward and complex derivative hedging. Subsequently, instructions and worksheets were prepared and feedback was received from selected regulators. Mr. Givler said the ACLI wrestled with how to reflect maturity mismatch. Work still continued on that issue. The current draft instructions included a table of factors. More time was needed to work on a more granular table. He said the instructions included provisions to prevent “window dressing.” The instructions require more than one remaining year to maturity to prevent hedges entered into at the end of the year that would not provide protection for the coming year.

Mr. Barlow said the instructions appeared to have simple and intermediate hedges, but not complex hedges. Mr. Givler said that was correct. Mr. Shepherd asked about the baskets of bonds included in the example calculations. Mr. Givler said that was an example intermediate calculation. In the example, there was a 60% name overlap between the assets and the hedge. Company records would be used to see how the hedge was paired. Mark Anderson (MetLife) said it was not wanted to provide detail of a portfolio of hundreds of bonds. Mr. Shepherd said an examiner would need to request that the company provide detail in order to validate the calculation. Mr. Givler said that was the case where the relationship type was one-to-many, which was disclosed in the worksheet.

Mr. Horn asked how the risk of the credit default swap not paying was reflected. Mr. Givler said there was a charge for the derivative counterparty risk in a different part of the RBC formula for uncollateralized positions. Mr. Horn asked whether there was data to back up the derivative haircuts. Mr. Givler said the haircuts were not so significant to discourage hedges. The ACLI looked at default and survival rates, but could not develop it enough to meet objectives. There was now a potential method that focuses on the yield curve and uncertainty that was being worked on. The liquid portion of the marketplace is the five-year hedge and it was wanted to encourage companies to stay in the liquid part of the market.

Mr. Shepherd said the hedge effectiveness references Schedule DB in the draft RBC instructions. He asked whether it was specified how to calculate. Mr. Givler said the annual statement instructions for equity hedges in Schedule DB would need to be bolstered. Mr. Shepherd asked how hedge effectiveness would be determined for a basket of bonds. Mr. Givler said that if there were 100 names in the portfolio and 70 matches, then 70% would be the starting point. The maturity of the portfolio would then be taken into consideration. Mr. Barlow asked whether a one-to-one hedge would always have 100% effectiveness. Mr. Anderson said that was the case, as long as the notional amount of the hedge agreed to the par value of the bond.

Mr. Givler said he would next go over the question-and-answer document. Opinions of creditworthiness lose power over time. If credit quality declines, maturity mismatch is less important, unless credit default swap maturity is imminent. He said a question had been asked regarding statutory accounting double-counting causing discontinuity in total adjusted capital or authorized control level RBC. The conclusion was that as long as statutory accounting was applied promptly for write-downs, there would not be an issue. In situations where the decrease in the quality of the asset is offset by the increasing value of the hedge, robust write-downs would be needed on a timely basis. No effects would occur for relatively minor downgrades. SSAP No. 43R—*Loan-back and Structured Securities* does change impairment accounting for structured securities that were a subset of the total securities. He said specialized treatment for structured securities was not felt to be needed.

Mr. Barlow said one unresolved issue was the table of factors for maturity mismatch. He asked whether there was a way to get a handle on that issue. Mr. Givler said a theoretical foundation for a new table had been drafted and a new table that ranges from one year to 25 or 30 years would be completed. Ed Toy (NAIC) said the new table would not be 100% reliable, but work was being done on something that would be reasonably conservative. Mr. Shepherd asked how the hedging credit would be brought into the RBC formula. Mr. Givler said additional changes would need to be drafted to bring the credit into the bonds and common stock pages, which should be completed by the Winter National Meeting, along with the new maturity mismatch table.

Mr. Barlow asked when a proposal would need to be adopted. Dan Swanson (NAIC) said the current Capital Adequacy (E) Task Force procedures specify that the proposal would need to be adopted by the Winter National Meeting. He also noted that, because the NAIC was moving to three national meetings in 2010, the procedures would need to be updated; in the future, the deadline could potentially be at the end of December. Mr. Barlow said the Working Group would continue to work toward a year-end 2010 adoption, but if any significant issues came up, the proposal would need to be delayed for another year.

Mr. Ostlund made a motion to release for comment the draft instructions and worksheet for the derivatives risk mitigation proposal for a comment period of two weeks. Mr. Kupferman seconded the motion. The motion passed unanimously. Mr. Ostlund asked that the ACLI question-and-answer document also be posted on the NAIC Web site for informational purposes only. Mr. Ostlund asked the ACLI to draft a one- or two-page summary for the Winter National Meeting describing why the proposal was drafted.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Life Risk-Based Capital (E) Working Group  
Conference Call  
November 12, 2009

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Nov. 12, 2009. The following Working Group members participated: Philip Barlow, Chair (DC); Steve Ostlund (AL); Blaine Shepherd (MN); Bill Carmello (NY); and Mike Boerner (TX). Also participating was: Dennis Lauzon (NY).

1. Discuss AEGON C-3 Phase 3 Comment Letter

Bill Schwegler (AEGON) said there was a lot of confusion regarding how the solvency structure would be changed in the future to be consistent with international solvency standards. The current RBC system calculates one risk at a time and sums the individual risk charges. The American Academy of Actuaries (AAA) proposal uses a different structure. A large number of stochastic scenarios are run and a slice of the bad scenarios are selected to calculate a number to be held for capital. He said a tension was created between the different methodologies. He said there were three problems with the proposal, with two of the problems related to that tension.

Mr. Schwegler said the first problem was the misplaced reserve adjustment. The proposal uses CTE 90 less statutory reserves. He said it was erroneous to classify the difference as C-3 interest rate risk. It was an adjustment to reserves and would be best reflected in the total adjusted capital amount. He said the second problem was a double-counted diversification benefit. In the proposal, diversification is accounted for in the front end. In the RBC formula, in general, diversification is done on the back end with the covariance calculation so that the diversification benefit was given twice.

Mr. Schwegler said the third problem was the altered definition of mismatch risk. The proposal uses the greatest present value of accumulated deficiencies. Future balance sheet amounts are projected. Some items are valued at market value, but most of the items are valued at amortized cost. As interest rates change, the market value of the bond is changed. The value of the assets changes to a different degree than the liabilities. The value of assets accounted for at amortized cost does not change unless there is an impairment. Book value accounting conceals the mismatch risk.

Peter Boyko (Manulife, representing the AAA) said he had a different view. He said it was not accurate to state that the AAA was trying to fix the reserve amount. The AAA was trying to take a total balance sheet approach that recognizes the level of reserves held. Subtracting a CTE 65 or CTE 70 amount from the total asset requirement had been considered. The differences between the approaches will go away as more of the reserves become principle-based. He said double-counting of diversification depended on the assets and the modeling done. There was not necessarily a double diversification benefit. If it was felt to be a material issue, the covariance treatment could be mandated. Currently, it is left up to actuarial judgment.

Mr. Barlow asked if there were any changes needed to the proposal because of the comments. Mr. Boyko said one potential change would be disclosure of the allocation methodology. Mr. Lauzon said he thought double-counting did occur. He said he thought the calculation should be brought outside of the square root calculation. Mr. Ostlund said he agreed with that solution. Mr. Boyko said when there was a situation where there was an interest rate guarantee, it seemed appropriate that it would be included with other interest rate risk in C-3a. In the proposal, the actuary would be making the allocation according to the risks. Mr. Barlow said the C-3 Phase 3 instructions would now be able to be changed if regulators wanted to change the treatment. Mr. Boyko said the AAA was in the process of drafting new appendices to the instructions for the C-3 Phase 2 and C-3 Phase 3 calculations for the Winter National Meeting.

2. Discuss Unum C-3 Phase 3 Comment Letter

Bill Olbert (Unum) said he believed group life should not be included in the scope for the proposal; instead, the focus of the proposal should be on universal life with secondary guarantees. He also said that a materiality test should be added to the extent that the business has little impact on the overall results. The stochastic exclusion test was based on the volatility of the business and not the materiality. Regarding the alternative amount, he said it should allow companies to use a smaller scenario set. Finally, he said the documentation required was more extensive than for cash flow testing, such as for internal controls and sensitivity tests. He said a C-3 phase 3 section should be added to the existing cash flow testing memorandum.

Mr. Boyko said his group was supportive of the documentation changes. For group business, the AAA had not focused on specific product types but had tried to filter out high risk from low risk. There would be a problem with defining exactly what universal life with secondary guarantees was. Hedging programs and reinsurance might not be specific to the block. Mr. Barlow said some of those problems might still exist with a stochastic exclusion test excluding certain blocks. Mr. Boyko said a small scenario set was discussed. It was not feasible to apply it to all lines of business. He said the materiality test would be something for the Working Group to consider on its own.

Mr. Barlow asked about the work being done by the Economic Scenarios Subgroup of the Life and Health Actuarial Task Force. Mr. Carmello said no decision had been reached by the Subgroup. Nancy Bennett (AAA) said a document was being prepared on the pros and cons for three different approaches. The document would be presented to the Life and Health Actuarial Task Force at the Winter National Meeting.

Mr. Barlow asked whether the Working Group had any interest in pursuing a materiality test. Mr. Boerner said it could be considered. Mr. Barlow asked if the American Council of Life Insurers (ACLI) was willing to propose something. John Bruins (ACLI) said he would look into it. Mr. Barlow said the sensitivity tests were something that regulators found useful. Perhaps there was not enough specificity, but Mr. Barlow said he was reluctant to eliminate them. However, he said he was not opposed to items that could be reasonably eliminated without losing information about what the company was doing.

### 3. Discuss ACLI C-3 Phase 3 Comment Letter

Mr. Bruins said it would be useful initially to limit the required scope. The area where mismatch risk was greatest was for universal life with secondary guarantees. Limiting the scope would address company concerns about whether there would be enough time to set up the modeling. Regulators could then assess how well the calculation worked and eventually require it for other products. But if the products were managed together, it should be allowed to have the products modeled together. He said he would like a safe harbor specified on the number of scenarios.

Regarding documentation, Mr. Bruins he would like the C-3 requirements tied to an appendix in the asset adequacy memorandum. It was not clear why internal controls needed to be documented here. The list of key risk measurement tracking tools was more like an enterprise risk management measure. Quantifying of the effects of material assumption changes would require an extensive amount of work to quantify the values. For sensitivity testing, he said he would like regulators to identify the value added. Mr. Barlow asked the AAA to review the comments regarding documentation.

Mr. Barlow asked if any Working Group members were interested in looking at limiting the scope of the proposal. Mr. Boerner said he was open to considering it — and that it might be a “necessary evil” to define a more limited scope. Mr. Shepherd also said he would be open to a more limited scope, as it would allow more time to see what the results of the calculations were. Mr. Barlow asked whether the ACLI was interested in defining a more limited scope. Mr. Bruins said the ACLI could work on that.

Mr. Carmello said there had been a proposal regarding VM-20, *Requirements for Principle-Based Reserves for Life Products*, to limit the calculation to 16 specified scenarios. Mr. Barlow said it would be a worthwhile discussion to have at the Winter National Meeting. Mr. Shepherd asked whether a more formal response to the AEGON comments could be drafted by the AAA for the Winter National Meeting. Mr. Boyko said they would try.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 12/4/09

Property Risk-Based Capital (E) Working Group  
Conference Call  
November 30, 2009

The Property Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met via conference call Nov. 30, 2009. The following Working Group members participated: Anne Kelly, Chair (NY); Ron Dahlquist (CA); Richard Marcks (CT); Alan Seeley (NM); Mary Miller and Dale Bruggeman (OH); and Mike Boerner (TX). Also participating was: Russell Jones (NJ).

1. Discuss Schedule P – Two-year Lines Expansion to 10 Years in Electronic Format Only

Ms. Kelly indicated that a couple of comment letters from interested parties regarding the Schedule P – Two-year Lines Expansion proposal were received in September 2009. Based on the comments, Ms. Kelly stated that the tax-liability issue was the interest parties' major concern. Instead of revising the Schedule P – Two-year lines, one of the recommendations was that regulators handle data problem through examination. Mr. Seeley expressed that the impact on the tax liability from the industry should not be a major concern for the Working Group. Mr. Marcks agreed and said that companies would need to recognize the importance of better data quality. Ms. Kelly also said that many regulators run into data problems while performing data analysis. However, Mr. Bruggeman said he believed that expanding the two-year lines would probably generate some tax timing differences, which could have a significant impact on a company's tax strategy. Ms. Kelly said she thought that the overall data quality could be improved if the larger companies, which generate a significant impact on the data problem, could be identified. Ms. Kelly recommended that the Schedule P – two-year lines data be reviewed by NAIC staff for the 2009 reporting year, with a conference call to discuss the findings. Mr. Bruggeman suggested that the jurat page's attestation would also need to be revised to recognize data items that are filed electronically.

2. Update from Catastrophe Risk (E) Subgroup

Mr. Dahlquist stated that the Catastrophe Risk (E) Subgroup had not made any progress in the past quarter. However, a conference call to discuss the outstanding issues would be held in the near future.

3. Update on Underlying Risk Charge Review

Alex Krutov (Navigation Advisors representing the American Academy of Actuaries—AAA) said that the AAA encountered some data problems at the beginning of the project, but the issues had been resolved. Because the methodology for calculating the risk charges remained the same as last year, Mr. Krutov said he anticipated that the proposed underlying risk charges should be ready for review by the Spring National Meeting.

4. Review the Factor for State Deposits

Ms. Kelly said that the state-mandated deposit issue was brought up by Pennsylvania last year. This Working Group would like to ask the AAA to review the appropriate charge for the state-mandated deposits. Ralph Blanchard (Travelers) indicated that this issue could be material for some companies. Mr. Krutov stated that this issue would be reviewed by the AAA with Mr. Dahlquist's assistance.

5. Discuss AAA Report

Ms. Kelly said that a report from AAA regarding the potential improvements to the property and casualty RBC formula was received Oct. 1. Mr. Krutov stated that the original formula was developed 20 years ago; therefore, it would be good to review the RBC formula for possible enhancements within the RBC framework. Robert Butsic (Fireman's Fund representing the AAA) said that some recommendations call for addressing the weakness of the P&C RBC formula. First, a preliminary report would be developed to provide a background of the project and a general outline of potential improvements to the P&C RBC formula. After that, separate analyses would be performed to determine the types of events that could potentially trigger mass insolvencies. Third, an analysis would be performed on the guaranty fund system to determine its ability to handle insolvencies that occurred simultaneously. Mr. Butsic said that reviewing and analyzing advantages and disadvantages of the stochastic modeling approaches to solvency regulation would be the next project that the AAA would like to pursue. Mr. Butsic also indicated that the European Union's Solvency II framework allowed insurers to use internal models to calculate their individual company's capital requirement. Then, a review would be performed to measure the potential failure

of the reinsurance during an insurance solvency crisis. Mr. Butsic said he believed that this could involve some major changes to the annual statement data. Ms. Kelly said the current reinsurance charge in the P&C RBC formula was higher than the life RBC formula, and that this would provide an opportunity to review whether the charge was appropriate in P&C RBC formula. Mr. Butsic said that evaluating the potential improvements to the RBC formula would be the last item the AAA would like to address. Mr. Butsic said he thought that simulating an industry macro-event, such as a catastrophe or a financial collapse, could possibly determine the need to change current RBC methodology or individual components in the RBC formula. Mr. Krutov said that the report was considered to be preliminary thoughts from the AAA, and that no specific timeline had been set for the project. Mr. Marcks suggested that by developing a preliminary report first, regulators would be able to generate more feedback from interested parties. Ms. Kelly said she thought that the current formula was still able to identify what companies were at risk, and that keeping the current formula with some adjustments would be worthwhile to consider.

Mr. Blanchard said that the residential mortgage-backed securities proposal was adopted recently for P&C and life companies. He suggested that it would be beneficial to determine the impact to the P&C RBC formula.

Having no further business, the Property Risk-Based Capital (E) Working Group adjourned.

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Draft: 12/3/09

Capital Adequacy (E) Task Force  
Conference Call  
November 23, 2009

The Capital Adequacy (E) Task Force met via conference call Nov. 23, 2009. The following Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Jim L. Ridling represented by Sean Duke (AL); Steve Poizner represented by Ron Dahlquist and Perry Kupferman (CA); Thomas R. Sullivan represented by Richard Marcks (CT); Gennet Purcell represented by Philip Barlow (DC); Kevin M. McCarty represented by Al Willis (FL); Glenn Wilson represented by Blaine Shepherd and Jaki Gardner (MN); Neil N. Jasey represented by Russell Jones (NJ); Mary Jo Hudson represented by Mary Miller (OH); Scott H. Richardson represented by Tim Campbell (SC); Kent Michie represented by Jake Garn (UT); Mike Kreidler represented by Dennis Julnes and Patrick McNaughton (WA); and Sean Dilweg represented by Peter Medley (WI). Also participating was: Joe Fritsch (NY).

1. Release for Comment a Tax Sensitivity Test for the Additional Deferred Tax Asset

Mr. Felice said a referral had been received from the Statutory Accounting Principles (E) Working Group regarding deferred tax assets (DTAs). He said that in the accounting proposal for DTAs companies would be allowed to admit additional DTA amounts if the company's RBC ratio was greater than 300%. He said a proposal had been drafted for consideration by the Task Force to expand the existing sensitivity test to show the affect of the additional admitted DTA amount on the RBC percentage (RBC ratio). He noted that the RBC ratio was not disclosed elsewhere in the RBC formula. Mr. Shepherd asked whether it was clear what the RBC percentage meant. Mr. Felice said the calculation was given on the RBC page and would be the total adjusted capital amount divided by the authorized control level amount.

Connie Woodroof (StoneRiver) asked whether it was expected that the proposal would be implemented in the 2009 RBC formula. Mr. Felice said he thought it might be filed as an addendum to the RBC report. Dan Swanson (NAIC) said it was likely the calculation would not be able to be filed as part of the electronic filing, although he was not sure whether it could be included as part of the filing PDF. Mr. Barlow asked whether the proposal was for 2009 and 2010 only. Mr. Fritsch said the additional DTA would go away in two years without further action by the Statutory Accounting Principles (E) Working Group.

Ms. Miller made a motion to release the sensitivity test proposal for comment until Dec. 15. Mr. Dahlquist seconded the motion. The motion passed unanimously.

2. Release for Comment a Proposal for an RBC Charge for the Additional Deferred Tax Asset

Mr. Felice said the referral from the Statutory Accounting Principles (E) Working Group included developing a charge for the additional DTAs. He said the property RBC formula already had a charge for DTAs. He said a report had been completed by NAIC staff that showed the average RBC charge after taking the reduction for the covariance was 0.6%. He noted the RBC charge could be higher or lower for individual companies depending on the particular covariance calculation. Based on that data, a 1% RBC charge outside of the covariance was proposed for the additional DTA amount for life RBC.

Mr. Felice said there were a couple of places where a 1% C-0 charge might be implemented. One place was the off-balance sheet risk page. However, reporting the amounts there might cloud the disclosure of other important information that was normally reported on that line. Another place would be on the affiliate risk page. The advantage of that page would be that the additional DTA could be separately identified. Ms. Miller asked what other kind of assets might have a comparable charge. Mr. Felice said that for life RBC, a NAIC Class 2 debt investment or the off-balance sheet risk charge might be similar.

Mr. Medley said the referral from the Statutory Accounting Principles (E) Working Group had mentioned a referral to the American Academy of Actuaries (AAA) to study the appropriate factor. He asked whether a referral would be made. Mr. Felice said he had no problem with charging the AAA to study this issue. Mr. Medley said he would like the charge to the AAA to include consideration of having a troubled holding company. He said there would be some credit risk or business continuation risk. Mr. Felice said he would like to get further information on the subject before a charge was made. The issue could be discussed further when a charge was made to the AAA.

Ralph Blanchard (Travelers) asked whether the AAA review would be done for both life and property RBC. Mr. Felice said that was the case. Mr. Blanchard said a report from the AAA had been provided to the Property Risk-Based Capital (E) Working Group and asked whether the issue would be addressed as part of that. Mr. Felice said the AAA report was a broader review of the RBC formula. He said that consideration of a charge to the AAA would be added as part of the Winter National Meeting agenda for the Task Force.

Ms. Miller made a motion to release the additional DTA RBC charge proposal for comment until Dec. 15. Mr. Garn seconded the motion. The motion passed unanimously.

### 3. Discuss the Referral Regarding Affiliate Guarantees

Mr. Felice said a referral had been received from the Statutory Accounting Principles (E) Working Group regarding affiliate guarantees. Julie Gann (NAIC) said the Working Group was considering a proposal to recognize a liability for company guarantees. The Task Force might need to consider RBC changes. Because intercompany guarantees are not excluded, a liability disclosure would also be required. Comments had been received indicating that a “negative stacking effect” in the RBC calculation could occur when affiliate guarantees granted to subsidiaries are rolled up in the RBC report of a Parent insurer. Finally, unlimited guarantees were excluded from setting up a liability. The Task Force will hold further discussion on whether an additional RBC charge might be needed for the unlimited guarantees.

Mr. Felice asked whether the accounting guidance would be in effect for year-end 2009. Ms. Gann said the guidance had not been adopted yet and it was not certain whether it would be approved. Implementation was currently planned for year-end 2010. Mr. Felice said the issue would be added to the Task Force agenda. Changes to the RBC formula for 2010 would be constrained by the Task Force procedures. He said the Task Force would move toward an RBC recommendation and see when it could be implemented.

### 4. Any Other Matters

Mr. Felice said Alan Seeley (NM) had volunteered to be the chair of the Task Force’s Solvency Modernization Subgroup. He asked NAIC staff to distribute a listing of the Subgroup members and the updated Subgroup agenda for the Winter National Meeting.

Mr. Felice said Joseph Annotti (National Fraternal Congress of America) would have some comments on the approach for fraternal law development. He asked Mr. Annotti to be prepared to give those comments and the Task Force would also discuss the Minnesota approach to a fraternal RBC law at the Winter National Meeting.

Mr. Felice said a proposal had been received from the American Council of Life Insurers regarding a longer-term approach to calculating the RBC for commercial mortgage loans. A short-term change to the calculation was adopted for year-end 2009. He said it had been indicated previously that the 2010 mortgage loan treatment was not going to be discussed until a proposal for a more permanent change was received. Mr. Barlow indicated that the Life Risk-Based Capital (E) Working Group would schedule a conference call after the Winter National Meeting to address the mortgage proposal.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

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Draft: 11/18/09

Capital Adequacy (E) Task Force  
Conference Call  
November 3, 2009

The Capital Adequacy (E) Task Force met via conference call Nov. 3, 2009. The following Task Force members participated: James J. Wrynn, Chair, represented by Lou Felice (NY); Steve Poizner represented by Perry Kupferman (CA); Gennet Purcell, represented by Philip Barlow (DC); Kevin M. McCarty represented by Al Willis (FL); Glenn Wilson represented by Blaine Shepherd (MN); Mary Jo Hudson represented by Dale Bruggeman (OH); Joel Ario represented by Steve Johnson (PA); Mike Kreidler represented by Dennis Julnes (WA); and Sean Dilweg represented by Peter Medley (WI).

1. Consider Adoption of the Fraternal Risk-Based Capital (RBC) Model Act Request Form

Mr. Felice said a model law request form to develop a fraternal benefit society risk-based capital model act had been developed. Mr. Johnson said that approximately 10 years ago, the Task Force had decided to not explore the idea of a Fraternal RBC model. He said he supported exploring the concept but the conclusion may be that a model act is not needed. Joseph Annotti (National Fraternal Congress of America—NFCA) said NFCA supports fraternal RBC standards, perhaps with adjustments made for fraternal societies. NFCA had been working with several states to develop fraternal RBC statutes. He was not sure a model act was needed. Mr. Felice said that as the Task Force moved forward in the process, he would want to know what the drawbacks would be for having a model.

Mr. Shepherd made a motion to adopt the Fraternal RBC Model Law Request Form. Mr. Medley seconded the motion. The motion passed unanimously.

2. Consider Adoption of the Property and Health RBC Term Asset-Backed Securities Loan Facility (TALF) Proposals

Mr. Felice said a proposal for a reduction in the off-balance-sheet charge for Term Asset-Backed Securities Loan Facility (TALF) assets had been adopted for Life RBC previously. This proposal was to adopt similar treatment for Property and Health RBC. Mr. Johnson made a motion to adopt the Property and Health RBC TALF proposals (Attachment Five-A). Mr. Medley seconded the motion. The motion passed unanimously.

3. Discuss the Solvency Modernization Subgroup

Mr. Felice said several states had volunteered to be members of the Task Force's Solvency Modernization Subgroup, but no one had come forward to chair the Subgroup. Subsequent to the formation of the Subgroup, the Solvency Modernization Task Force had been formed. The working agenda items for the Subgroup will probably change, but most of the items will still exist. He said he would like the Subgroup to start addressing the agenda items. Items such as confidence level and time horizon would likely be reviewed first. Other items, such as economic capital, would not be as high a priority. Mr. Felice said he was trying to recruit an individual to chair the Subgroup, but if that individual declined, he wanted regulators to think about whether they were interested in chairing the Subgroup regardless of whether they were members of the Task Force.

4. Any Other Matters

Mr. Felice said the Valuation of Securities (E) Task Force was taking the lead on the residential mortgage-backed securities (RMBS) proposal, but the proposal would ultimately impact the RBC treatment. The proposal was to have an independent third party to review the RMBS structured securities. The third party would provide the NAIC designation, which would receive the associated RBC charge for the designation. He said an Executive (EX) Committee/Plenary conference call was scheduled that week to address the proposal.

Mr. Felice said the Task Force would likely schedule a conference call in the next couple of weeks to address a referral from the Emerging Accounting Issues (E) Working Group regarding parental guarantees. Certain specific guarantees would be accounted for as liabilities and may not need an additional accounting charge. Mr. Johnson said there were also unlimited guarantees where there would be a footnote disclosure and not a liability that might still require an additional RBC charge. Mr. Felice said the Task Force would need to consider whether the current RBC charge was adequate.

Mr. Felice said there was currently disparate treatment of deferred tax assets (DTAs) in the RBC formulas. For P&C RBC, there would be a 5% charge for the DTAs and for write-ins. Health RBC would have a 5% for write-ins, and life RBC would not have an RBC charge for DTAs or write-ins. The Task Force will need to decide how to handle DTAs for all three formulas. Other aspects of the proposal would also be under discussion by the Statutory Accounting Principles (E) Working Group in a conference call scheduled for sometime during the week. A referral to the Task Force was expected as a result of the conference call.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

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## OFF-BALANCE SHEET ITEMS – XR005

Off-balance sheet items, such as contingent liabilities, pose a risk to insurers. A 1% factor was chosen on a judgment basis to allow for this risk. For securities-lending programs, a reduced charge may apply to certain programs that meet the criteria as outlined below.

### *Specific Instructions for Application of the Formula*

#### Line (1)

Securities-lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities-lending activities and how cash collateral received will be invested.
2. Written operational procedures to monitor and control the risk associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:
  - a. Documented investment guidelines between lender and investment manager, with established procedure for review of compliance.
  - b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality and average life/duration requirements.
  - c. Approved borrower lists and limits to allow for adequate diversification.
  - d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross-currency loans).
  - e. Daily mark-to-market of lent securities and obtaining additional collateral needed to maintain a margin of 102% of market.
  - f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.
3. A binding securities-lending agreement (standard “Master Securities Lending Agreement” from Securities Industry and Financial Markets Association) in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.
4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-rated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases, the collateral held must be permitted investments in the state of domicile for the respective insurer.

Collateral included in General Interrogatories Part 1, Line 22.5 of the annual statement should be included on Line (1).

#### Line (2)

Collateral from all other securities-lending programs should be reported in General Interrogatories Part 1, Line 22.6 and included in Line (2).

#### Lines (3) through (11)

Non-controlled assets are any assets reported on the balance sheet that are not exclusively under the control of the company, or assets that have been sold or transferred subject to a put option contract currently in force. Examples of these may be: securities subject to reverse repurchase agreement; dollar repurchase agreement; pledged as collateral; placed under an option agreement; placed under an option agreement involving “asset transfers with put options”; letter stock or otherwise restricted as to sale; or other investment securities not under the exclusive control of the company. **For Line (7), include assets pledged as collateral reported in the General Interrogatories Part 1, Line 23.25 other than assets related to the Federal Reserve’s Term Asset Loan Facility (TALF).**

**PR013 - Miscellaneous Off-Balance Sheet Items**

Off-balance sheet items, such as contingent liabilities, pose a risk to insurers. A 1% factor was chosen on a judgment basis to allow for this risk. For securities-lending programs, a reduced charge may apply to certain programs that meet the criteria as outlined below.

*Specific Instructions for Application of the Formula*

Line (1)

Securities-lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.
2. Written operational procedures to monitor and control the risk associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:
  - a. Documented investment guidelines between lender and investment manager, with established procedure for review of compliance.
  - b. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality and average life/duration requirements.
  - c. Approved borrower lists and limits to allow for adequate diversification.
  - d. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross-currency loans).
  - e. Daily mark-to-market of lent securities and obtaining additional collateral needed to maintain margin of 102% of market.
  - f. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.
3. A binding securities-lending agreement (standard "Master Securities Lending Agreement" from Securities Industry and Financial Markets Association) in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.
4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-rated securities. Affiliate issued collateral would not be deemed acceptable. In all cases, the collateral held must be permitted investments in the state of domicile for the respective insurer.

Collateral included in General Interrogatories Part 1, Line 22.5 of the annual statement should be included on Line (1).

Line (2)

Collateral from all other securities-lending programs should be reported in General Interrogatories Part 1, Line 22.6 and included in Line (2).

Lines (3) through (11)

Non-controlled assets are any assets reported on the balance sheet that are not exclusively under the control of the company, or assets that have been sold or transferred subject to a put option contract currently in force. **For Line (7), include assets pledged as collateral reported in the General Interrogatories Part 1, Line 23.25 other than assets related to the Federal Reserve's Term Asset Loan Facility (TALF).**

Line (13)

Guarantees for affiliates include guarantees for the benefit of an affiliate which result in a material contingent exposure of the company's assets to liability. The definition of "material" exposure or financial effect is the same as for annual statement disclosure requirements.

Line (14)

Contingent liabilities include any material contingent liabilities that are disclosed in the Notes to Financial Statements. *This category includes all structured securities for which the company has not received a full release from liability from a third party.*

Confidential when Completed

	Annual Statement Source	(1) Bk/Adj Carrying Value	Factor	(2) RBC Requirement
<b>OFF-BALANCE SHEET RISK (See instructions for explanation)</b>				
(1) Loaned to Others – Conforming Securities Lending Program	General Interrogatories Part 1 Line 22.5		0.002	
(2) Loaned to Others – Securities Lending Program	General Interrogatories Part 1 Line 22.6		0.010	
(3) Subject to Repurchase Agreements	General Interrogatories Part 1 Line 23.21		0.010	
(4) Subject to Reverse Repurchase Agreements	General Interrogatories Part 1 Line 23.22		0.010	
(5) Subject to Dollar Repurchase Agreements	General Interrogatories Part 1 Line 23.23		0.010	
(6) Subject to Reverse Dollar Repurchase Agreements	General Interrogatories Part 1 Line 23.24		0.010	
(7) Pledged as Collateral	<del>General Interrogatories Part 1 Line 23.25</del> <b>Company Records</b>		0.010	
(8) Assets Placed Under Option Agreements	General Interrogatories Part 1 Line 23.26		0.010	
(9) Letter Stock or Other Securities Restricted	General Interrogatories Part 1 Line 23.27		0.010	
(10) On Deposit with State or Other Regulatory Body	General Interrogatories Part 1 Line 23.28		0.010	
(11) Other	General Interrogatories Part 1 Line 23.29		0.010	
(12) Total Non-controlled Assets	Sum of Lines (1) through (11)			
(13) Guarantees for Affiliates	Notes to Financial Statements 10E		0.010	
(14) Contingent Liabilities	Notes to Financial Statements 14A(1)		0.010	
(15) Total Miscellaneous Off-Balance Sheet Items = L(12) + L(13) + L(14)				

Denotes items that must be manually entered on filing software.

9/17/2009

XR005

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MISCELLANEOUS OFF-BALANCE SHEET ITEMS PR013

	Annual Statement Source	(1) Statement Value	Factor	(2) RBC Requirement
<u>Non-controlled Assets</u>				
(1) Loaned to Others – Conforming Securities Lending Program	General Interrogatories Part 1 L22.5	0	0.002	0
(2) Loaned to Others – Securities Lending Programs – Other	General Interrogatories Part 1 L22.6	0	0.010	0
(3) Subject to Repurchase Agreements	General Interrogatories Part 1 L23.21	0	0.010	0
(4) Subject to Reverse Repurchase Agreements	General Interrogatories Part 1 L23.22	0	0.010	0
(5) Subject to Dollar Repurchase Agreements	General Interrogatories Part 1 L23.23	0	0.010	0
(6) Subject to Reverse Dollar Repurchase Agreements	General Interrogatories Part 1 L23.24	0	0.010	0
(7) Pledged as Collateral	<del>General Interrogatories Part 1 L23.25</del> Company Records	0	0.010	0
(8) Assets Placed Under Option Agreements	General Interrogatories Part 1 L23.26	0	0.010	0
(9) Letter Stock or Other Securities Restricted	General Interrogatories Part 1 L23.27	0	0.010	0
(10) On Deposit with State or Other Regulatory Body	General Interrogatories Part 1 L23.28	0	0.010	0
(11) Other	General Interrogatories Part 1 L23.29	0	0.010	0
(12) Total Non-controlled Assets	Sum of L(1) through L(11)	0		0
(13) Guarantees for Affiliates	Notes to Financial Statements Item 10e	0	0.010	0
(14) Contingent Liabilities	Notes to Financial Statements Item 14a1+Item 26a	0	0.010	0
(15) Total Miscellaneous Off-Balance Sheet Items = L(12) + L(13) + L(14)	Unrecorded Loss Contingencies	0		0

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