

## FINANCIAL CONDITION (E) COMMITTEE

Financial Condition (E) Committee Oct. 20, 2010, Minutes

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Financial Condition (E) Committee  
Orlando, FL  
October 20, 2010

The Financial Condition (E) Committee met in Orlando, FL, Oct. 20, 2010. The following Committee members participated: Alfred W. Gross, Chair, and Doug Stolte (VA); Joseph Torti, III, Vice Chair (RI); Linda S. Hall represented by Gloria Glover (AK); Steve Poizner represented by Al Bottalico (CA); Susan E. Voss (IA); Ann M. Frohman represented by Jim Nixon (NE); Thomas B. Considine and Bob Kasinow (NJ); James J. Wrynn represented by Matti Peltonen, Joe Fritsch, and Lou Felice (NY); Mary Jo Hudson represented by Bill Harrington and Dale Bruggeman (OH); Leslie A. Newman represented by Larry Knight (TN); Mike Geeslin represented by Danny Saenz and Doug Slape (TX); and Sean Dilweg and Roger Peterson (WI). Also participating was Scott H. Richardson (SC).

1. Adopt Task Force and Working Group Reports

Mr. Knight made a motion to adopt the reports of the following Committee task forces and working groups: Accounting Practices and Procedures (E) Task Force; Capital Adequacy (E) Task Force; Examination Oversight (E) Task Force; Receivership and Insolvency (E) Task Force; Reinsurance (E) Task Force; Risk Retention Group (E) Task Force; Valuation of Securities (E) Task Force; Financial Analysis (E) Working Group (Attachment One); NAIC/AICPA (E) Working Group (Attachment Two); National Treatment and Coordination (E) Working Group (Attachments Three); and Separate Account Risk Charge (E) Working Group (Attachment Four).

Ed Stephenson (Group of North American Insurance Enterprises—GNAIE) requested clarification from the Committee regarding the proposed change to SSAP No. 43R—*Loan Backed and Structured Securities* within the Statutory Accounting Principles (E) Working Group agenda, item 2010-12. He stated that his organization submitted comments and a counterproposal to achieve the same objectives. He stated that he questioned the intent and effect of the change. He asked if the intent was for all direct single-payer securities to be accounted for under SSAP No. 26—*Bonds, excluding Loan-Backed and Structured Securities* and the entire universe of all other bonds be accounted for under SSAP No. 43R. Mr. Peltonen responded that he did not believe agenda item 2010-12 was intended to change the current treatment of which securities are reported under the applicable categories of the annual statement. He discussed the overall definition of a bond under SSAP No. 26, and indicated that a reporting entity should follow such guidance, but only if the guidance in SSAP No. 43R does not apply. He discussed that SSAP No. 43R was intended to provide guidance on all structured securities. He stated that the intent of 2010-12 was to clarify that all securitized assets that are issued as bonds are accounted for in accordance with SSAP No. 43R. He stated that he believed this was already clear based upon the annual statement instructions, but some companies argued that SSAP No. 43R created a conflict with such reporting. He disagreed that such a conflict was intended and proposed 2010-12 to clarify the intent. Mr. Stephenson asked if credit tenant loans would be included in this definition of structured securities. Mr. Peltonen responded that these securities are listed in SSAP No. 26, but one must go back to SSAP No. 43R to determine if that statement should be applied instead based upon its substance. In doing so, the individual would determine that the credit tenant loan was backed by other loans or other assets, and consequently reported as a structured security under SSAP No. 43R. He discussed as an example a lease transaction issued by K-Mart where the collateral represents the real estate. Mr. Stephenson asked if hybrid securities would be included in this definition of structured securities. Mr. Peltonen responded that some hybrid securities were issuer obligations, mostly European financial institutions, whereas most U.S. hybrid securities were structured securities because they were issued out of a trust. Mr. Stephenson asked if industrial revenue bonds would be included in this definition of structured securities. Mr. Peltonen responded that these were municipal bonds.

The motion was seconded by Commissioner Dilweg and passed unanimously.

2. Announcement Regarding Executive (EX) Committee Action

Commissioner Gross announced that the Executive (EX) Committee took action during the Fall National Meeting to extend the time period for which the Committee, its task forces, working groups and subgroups can continue in existence until Dec. 31, 2010. He indicated that he specifically supported this action for the Financial Condition (E) Committee.

3. Dodd–Frank Wall Street Reform and Consumer Protection Act Implementation Update

Commissioner Gross announced that the Financial Stability Oversight Council (FSOC) released proposed rulemaking regarding the supervision of nonbank financial companies as well as proprietary trading, and he urged the industry to provide comments to the FSOC on the proposed rules. Mark Sagat (NAIC) provided an overview of the Dodd–Frank Wall Street

Reform and Consumer Protection Act (the bill) and noted that the FSOC is required to provide recommendations for the implementation of the Volcker rule by January. He also provided an overview on the orderly liquidation provisions of the bill, which provide for a robust regime to wind down large financial companies that are distressed and pose a “systemic risk” to the U.S. economy. He discussed how the bill recognizes the strong insurance regulatory regime already in place, and provides for different treatment of insurance companies than other companies. He noted that the FDIC was in the process of developing rules to implement this section, and the first set of rules was published last week. Mr. Sagat stated that also included in the bill was the new regulatory regime for the over-the-counter swaps and the derivatives market in general. He discussed how the NAIC had submitted formal and informal comments intended to maintain two principles: 1) implementing rules must not conflict with the state’s regulation of insurance products and insurers; and 2) implementing rules should not create an unlevel playing field for insurers as compared to other financial institutions.

#### 4. Consider Adoption of 2011 Proposed Charges

Mr. Fritch made a motion to adopt the 2011 Proposed Charges for the Committee, its task forces and working group (Attachment Five). The motion was seconded by Commissioner Voss and unanimously adopted.

#### 5. Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation

Director Richardson discussed that as a result of the lack of activity at the federal level with regard to the NAIC’s proposed federal act to enable the Reinsurance Regulatory Modernization Framework (the Framework), New York, New Jersey and Florida had each developed regulations that, if adopted, would effectuate aspects of the Framework into those states’ regulatory regime. He announced that the Financial Regulation Standards and Accreditation (F) Committee had made an informal request to the Reinsurance (E) Task Force to consider which key elements of the Framework should be considered in reviewing any individual state initiatives, and whether these key elements should be incorporated into the *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786). The initial draft recommendations were exposed at the Summer National Meeting for a comment period ending Sept. 16, and the Reinsurance (E) Task Force modified those initial recommendations at the Fall National Meeting based upon the comments received. Director Richardson highlighted and summarized the modifications. The changes included adding the words “substantially similar” to the filing requirements of non-U.S. reinsurers, since they do not file the same annual statement reinsurance schedules as U.S. insurers. Director Richardson emphasized the discretion given to commissioners when considering the information received from non-U.S. companies in meeting these requirements. He noted that the intent was not to require a mirror image of the U.S. filing requirements, but rather most of the same information should be available. Director Richardson highlighted a change to eliminate an unintended requirement for posting collateral on top of the payment of claims when a catastrophic event had occurred. Mr. Stolte highlighted that this simply represented recommendations to the Financial Regulation Standards and Accreditation (F) Committee, as the current requirement for accreditation continues to be the *Credit for Reinsurance Model Law and Regulation*. Superintendent Torti agreed that the information provided would only be used as guidance to determine if a state is substantially similar to the current model law and regulation.

Caroline Scott (Casey Gentz, LLP) noted her appreciation for the intent of the NAIC to allow discretion as it pertains to the reinsurance reporting for non-U.S. companies. She pointed out that Schedule F and Schedule S of the NAIC Annual Statement were requirements for U.S. companies and that it would be very difficult, if not impossible, for non-U.S. companies to complete those schedules. Joseph Gunset (Lloyd’s America) discussed how Lloyd’s voluntarily put its trust funds in the United States in the 1940s and has continued to meet regulator requirements on changes ever since. He stated that they had never produced a Schedule F for regulators but met all other reporting requirements of regulators. He proposed that the “substantially similar” language be replaced with “similar to or as directed by the regulator of the trust funds.” Director Richardson indicated that he believed that the “substantially similar” language was meant to address some of these concerns. Mr. Fritch noted that he believed the language was intended to be flexible, and that the Task Force agreed that such language would not require schedules that are not applicable, such as the provision for reinsurance. He noted that as it is developed, the model could provide more specifics on this issue, but “substantially similar” should be sufficient at this time. Commissioner Dilweg noted that his state had some concerns with this area but agreed that the language developed was sufficient at this time, and further direction could be developed once the models were modified. Mr. Stolte expressed his concern with reinventing the wheel, given that U.S. regulators have used these schedules in the past and their continued use once the reinsurance provisions of the Dodd–Frank Wall Street Reform and Consumer Protection Act took effect would provide greater transparency and understanding. Commissioner Gross noted that he did believe some of these details could be settled during the revisions to the models. Mr. Fritch made a motion to adopt the recommendations from the Reinsurance (E) Task Force to the Financial Regulation Standards and Accreditation (F) Committee with respect to any state’s early adoption of aspects of the Framework. The motion was seconded by Mr. Bottalico and unanimously adopted (Attachment Six).

## 6. Proposed Disclosure Regarding Retained Asset Accounts

Commissioner Gross discussed the current activities of the Retained Asset (A/D) Working Group, which is a joint working group of the Life Insurance and Annuities (A) Committee and the Market Regulation and Consumer Affairs (D) Committee. He noted that the group's focus was on consumer disclosure and reiterated his comment from the Committee's Sept. 8 conference call that this Committee's responsibility was to explore the need for enhanced financial reporting by insurance companies to collect information on retained asset accounts, including information on the extent of use and length of time the accounts remain open. He noted that he did not believe this was a solvency issue, but the NAIC needs additional information, particularly for 2010 year-end, in order to be able to respond to questions. He suggested a more abbreviated disclosure for 2011 and beyond, and stated that he already sent a memorandum to the Blanks (E) Working Group informing them of a possible blanks proposal for 2011 that incorporates the suggestions of the American Council of Life Insurers (ACLI) on a permanent basis. Commissioner Gross stated that the Committee had received a number of helpful comments (Attachment Seven) on the proposed disclosure. He indicated that when he initially asked NAIC staff to draft the disclosure, he did not focus enough on the fact that some of these accounts can remain open for a long period of time. He stated that New Jersey, Ohio and the Center for Economic Justice (CEJ) all noted this in their comment letters. Also noted in the comment letters from New Jersey, Ohio and the ACLI was that most of the exposed disclosures do not really match how such accounts are managed and, from a solvency standpoint, the disclosure should be similar to the disclosures on similar products. Commissioner Gross stated that he agreed with New Jersey that the interest paid to the retained asset accounts, as well as the overall size of the accounts, should be the primary information collected for this year-end, along with an aging schedule. He added that he thought the information that the ACLI proposed meets many of those needs, and also better educates the people looking at the statutory financial statements in terms of how such accounts work. He indicated the one exception was the suggestion by the CEJ that the disclosure should also report the number and amount of accounts that have been transferred to a state's unclaimed property funds. He stated that he also thought the reporting entity needed to provide some narrative discussion of how they handle the accounts, even if that involves an affiliated or unaffiliated bank. Commissioner Gross stated that he asked NAIC staff to incorporate those aspects of the comments into a revised proposal, and such a proposal was distributed Oct. 15. He stated that there were some comments from the CEJ that suggested 10 years of changes in rates in fees that he believed may be too burdensome.

Paul Graham (ACLI) noted that his organization still had significant concerns because of the lack of ability to come up with alternative formats within the last five days since being redistributed. He noted that he believed much of the information had nothing to do with the financial condition of the insurance companies, and is market conduct information. He stated that in particular, the aging information and the accounts transferred to a state's unclaimed property accounts was market conduct. Mr. Graham suggested that this information would be better collected through a market conduct examination or through the market conduct annual statement. He recognized that it may be too late to incorporate the latter into that process for 2010, and recommended that the information be separately requested by insurance commissioners. He commented that regardless of the avenue in which this information is collected, there would likely be a lot of ad hoc reporting involved and, consequently, the accuracy of the data may not be as good as the industry or the regulators are looking for. Much of this was because of the current lack of tracking in these areas. Mr. Graham stated that much of this information being requested would be better captured in a regulator-only filing.

Commissioner Gross understood the concern regarding the quality of data but asked for clarification regarding the need for the escheatment of funds information to be confidential. Mr. Graham responded that the information was market-conduct-related, and such information has always been confidential. He noted that the industry was concerned that the information could be taken out of context and inaccurate accusations could be made. He stated that, as an example, some companies currently are paying interest rates that are well above market rates and therefore have lasted much longer than one year. Therefore, information showing that accounts have been open for three or four years can only be made when it is in the context of why such accounts have remained open.

Commissioner Voss stated that she was not persuaded by that argument. She said she did not see the example as a market conduct issue only. Mr. Graham stated that he was concerned that non-regulators would use that information incorrectly. He discussed his concern that some insurers could be sued for the market's incorrect perception of a problem and the costs associated with such a suit. He discussed that the regulators would be able to see that these accounts only represent about 0.5% of the total industry assets. He noted that he did not believe the aging issue was an issue of solvency and saw that as more of a market conduct issue. Commissioner Dilweg asked for clarification on the escheatment issue, given states' specific requirements in that area. Mr. Graham noted that insurers' processes are currently not revolved around determining why an account ultimately had to be escheated, and there is no process for differentiating one product's movement to escheatment over another product. Mr. Gross commented that he believed the proposed revised disclosure was an efficient way for the NAIC to respond to the allegations on abusive practices. He stated that regulators should not fragmentize their ability to respond to this question. Mr. Graham said he understands that need and suggested that, for 2010, the industry come up with a

different way to obtain that information, as free-form financial information will be difficult to collect. Commissioner Gross stated that he was concerned with a lack of time to take such an approach. Peter Kochenburger (University of Connecticut School of Law) agreed with Commissioner Voss about the comments regarding confidentiality. He stated that all information should be public unless there was a reason to maintain it as private. He discussed that the information can already be obtained by lawyers through other means and questioned that particular concern for that reason. Commissioner Voss made a motion to adopt the revised proposed disclosure for retained asset accounts for annual 2010 (Attachment Eight). The motion was seconded by Commissioner Dilweg and unanimously adopted.

7. Request from the Financial Examiners Coordination (E) Working Group to Meet at the National Meeting

Mr. Harrington summarized background information (Attachment Nine) on the origination of the Financial Examiners Coordination (E) Working Group and the recently adopted framework for coordinating work among state regulators for holding company groups. He discussed how these meetings were being requested in response to the nature of the new risk-focused exams. Both the industry and the regulators concluded that some of these changes necessitated a greater need for coordination, as the changes contemplate interviews with the holding company, which may be redundant if not coordinated. The time is being requested to fulfill the various goals outlined in the request. Mr. Harrington made a motion to request the Working Group begin to meet at national meetings starting in 2011. The motion was seconded by Mr. Bottalico and unanimously carried.

8. Sept. 8 Minutes

Mr. Fritch made a motion to adopt the Committee's Sept. 8 conference call minutes (Attachment Ten). The motion was seconded by Mr. Kasinow and passed unanimously.

Having no further business, the Financial Condition (E) Committee adjourned.

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Draft: 10/27/10

Financial Analysis (E) Working Group  
Orlando, FL  
October 20, 2010

The Financial Analysis (E) Working Group of the Financial Condition (E) Committee met in Orlando, FL, Oct. 20, 2010, in regulator-to-regulator session, pursuant to paragraph 3 of the NAIC Policy Statement on Open Meetings regarding specific companies, entities or individuals. The following Working Group members participated: Roger Peterson, Chair (WI); Kim Hudson and Louis Quan (CA); Linda Sizemore (DE); Robin Westcott and Al Willis (FL); Kevin Fry (IL); Judy Weaver (MI); Jaki Gardner (MN); Fred Heese (MO); Ray Martinez (NC); Russell Jones (NJ); Mike Moriarty (NY); Dale Bruggeman (OH); Steve Johnson (PA); Doug Slape and Danny Saenz (TX); and Doug Stolte (VA).

During the meeting, the Working Group heard presentations on nationally significant insurers and groups that were exhibiting characteristics of being potentially troubled.

Having no further business, the Financial Analysis (E) Working Group adjourned.

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Draft: 10/18/10

NAIC/AICPA (E) Working Group  
Conference Call  
October 6, 2010

The NAIC/AICPA (E) Working Group of the Financial Condition (E) Committee met via conference call Oct. 6, 2010. The following Working Group members participated: Doug Stolte, Chair (VA); Al Bottalico (CA); Linda Sizemore (DE); Jim Armstrong (IA); Eric Moser (IL); Pamela Heemer (MI); Mark Nance (MO); Jim Nixon (NE); Thomas Burke (NH); Bill Harrington (OH); Russell Latham (OR); Steve Johnson (PA); and Jake Garn (UT).

1. Status Report on Recent AICPA Activities/Actions

Ed Metzger (KPMG) reported on current projects of the American Institute of Certified Public Accountants (AICPA). The report discussed a new AICPA task force formed to review several issues related to restricted reports and reporting on an Other Comprehensive Basis of Accounting (OCBOA). The task force plans to hold a meeting in October to determine if any revisions should be made to AU Section 532, *Restricting the Use of an Auditor's Report*.

2. Consider Adoption of Changes to Implementation Guide

Mr. Stolte stated that proposed adjustments to the example management reports included in the *Implementation Guide* were recently exposed for a 45-day public comment period, but no comments were received. The exposed guidance proposed changes to provide guidance for foreign filers in using the example management reports. In addition, the proposed changes provide examples for companies to report significant control processes that were scoped out of SOX 404 reporting, including controls over related-party transactions. On a motion from Mr. Garn, seconded by Mr. Bottalico, the Working Group adopted the guidance for inclusion in the *Implementation Guide* (Attachment Two-A).

3. Discuss Annual Financial Reporting Model Regulation (#205): Other Implementation Issues

Mr. Stolte stated that a couple of items related to implementation issues have come to the Working Group's attention that need to be addressed. The first item relates to recent changes to the SOX 404 reporting process for non-accelerated filers. The changes were included in the federal Dodd-Frank Wall Street Reform and Consumer Protection Act and were recently incorporated into U.S. Securities and Exchange Commission (SEC) Rule No. 33-9142. The Working Group also received a comment letter from interested parties on the matter (Attachment Two-B). Rose Albrizio (AXA Financial) presented the interested parties' letter and asked the Working Group to provide additional guidance clarifying how non-accelerated filers are expected to comply with the requirement to file Management's Report of Internal Control over Financial Reporting. Bruce Jenson (NAIC) stated that the NAIC Legal Division reviewed the changes to SOX 404 and indicated that it would be appropriate for regulators to address the issue by providing additional guidance within the *Implementation Guide*. Mr. Stolte asked NAIC staff to draft changes to the *Implementation Guide*, including a new example report, to reflect the changes to SOX 404 and clarify reporting expectations for non-accelerated filers. The Working Group agreed to hold a follow-up conference call later this year to review and adopt the proposed changes to the *Implementation Guide*.

Mr. Stolte stated that another question the Working Group recently received related to the expectations of regulators regarding annual controls put in place by a company to ensure effective financial reporting. The industry has asked whether significant adjustments to the financial statements identified by a company after the annual financial statement is filed, but before the annual audited financial reports are completed, should be considered the result of a control failure and be evaluated for material weakness consideration. In other words, should all significant financial reporting controls be completed by an insurer prior to the annual financial statement filing due date, or is it acceptable for year-end controls to extend beyond this date. Mr. Stolte noted that Management's Report of Internal Control over Financial Reporting requires reporting on the effectiveness of an insurer's internal controls associated with the annual audited financial reports, and not necessarily the annual financial statement filing. Mr. Stolte recommended that the Working Group consider clarifying its expectations to indicate that all significant annual controls ensuring accurate financial statements values should be completed prior to the annual financial statement filing date. The Working Group agreed to address this topic further on its next conference call.

Having no further business, the NAIC/AICPA (E) Working Group adjourned.

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**APPENDIX 1**

**Illustrative Examples of Management’s Report of Internal Control over Financial Reporting**

The following are examples of Management’s Report of Internal Controls over Financial Reporting utilizing different facts and circumstances. These are only examples and individual company facts and circumstances will dictate the contents of their report. However, there are common elements that should be included in all reports as discussed in Sections 16C and 16D of the Model.

**Example A:** an SEC registrant or a member of a holding company system whose parent is an SEC registrant that had all material control processes over statutory financial reporting addressed in its Section 404 report..... Page 21

**Example B:** an SEC registrant or a member of a holding company system whose parent is an SEC registrant that did not have all material control processes over statutory financial reporting addressed in its Section 404 report ..... Page 23

**Example C:** a non-SEC registrant that voluntarily complied with Section 404 of the Sarbanes-Oxley Act and produced a report on internal controls which included an auditor’s opinion..... Page 26

**Example D:** a company that is not subject to Section 404 and utilized their own framework to evaluate controls..... Page 28

**Example E:** an SEC registrant or a member of a holding company system whose parent is an SEC registrant that had all material control processes addressed in their Section 404 report and had an unremediated material weakness..... Page 29

**Example F:** an SEC registrant or member of a holding company system whose parent is an SEC registrant that did not include all material processes over statutory financial reporting addressed in its Section 404 report and had an unremediated material weakness noted ..... Page 31

**Example G:** an SEC registrant or member of a holding company system whose parent is an SEC registrant that had all material processes over statutory financial reporting addressed in its Section 404 report. However, they recently acquired another insurer that is not included in their assessment..... Page 34



Appendix G

Implementation Guide

**EXAMPLE A: AN SEC REGISTRANT OR A MEMBER OF A HOLDING COMPANY SYSTEM WHOSE PARENT IS AN SEC REGISTRANT THAT HAD ALL MATERIAL CONTROL PROCESSES OVER STATUTORY FINANCIAL REPORTING ADDRESSED IN ITS SECTION 404 REPORT**

**Management’s Report of Internal Control over Financial Reporting**

XYZ Holding Company Inc (“XYZ”) is required to file annual reports on Form 10-K/20-F with the U.S. Securities and Exchange Commission. Each of the insurance companies listed on Attachment B is a wholly owned subsidiary of XYZ. For the purpose of XYZ’s Management’s Report of Internal Control over Financial Reporting, management has identified its “Group of insurers,” as that term is defined in [relevant state statute or Section 3H of the Model], as the insurance companies listed on Attachment B.

Management of XYZ is responsible for establishing and maintaining adequate internal control over statutory financial reporting. XYZ’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements in accordance with statutory accounting principles. Management conducted an assessment of the effectiveness, as of December 31, 201X, of the Group of insurers’ internal control over statutory financial reporting, based on the framework established in *Internal Control—Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Based on our assessment under that framework, management concluded that the Group of insurers’ internal control over statutory financial reporting is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements as of December 31, 201X.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In satisfaction of the Group of insurers’ obligation to deliver Management’s Report of Internal Control over Financial Reporting for the fiscal year ended December 31, 201X, as permitted by [relevant state statute or Section 16C of the Model], XYZ is hereby providing the Insurance Commissioner of [domiciliary state] copies of Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting for XYZ included in the attached copy of XYZ’s Form 10-K/20-F (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934); for the fiscal year ended December 31, 201X (or alternatively the Annual Report to Stockholders), ~~which includes Management’s Report of Internal Control over Financial Reporting and report of independent registered public accounting firm on internal control over financial reporting for XYZ.~~ In addition, an Addendum (Attachment A) is included to this report which identifies the material processes that were not included in the Section 404 Report (as defined in Attachment A).

Based on management review of internal controls, there were no unremediated material weaknesses as of December 31, 201X identified as part of the Group of insurers’ internal control structure over the statutory financial statements for the year ended December 31, 201X.

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Executive Officer)

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Financial Officer)

**ATTACHMENT A**

**XYZ Holding Company Inc  
Addendum to Management’s Report of Internal Control over Financial Reporting  
For the Year Ended December 31, 201X**

For purposes of this addendum, the “Section 404 Report” means Management’s Report on Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting contained in or incorporated by reference in the Form 10-K/20-F. Accordingly, as required by [relevant state statute or Section 16C of the Model], management of XYZ hereby affirms that there are no material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers that were excluded from the Section 404 Report.

**ATTACHMENT B**

**XYZ Holding Company Inc.  
Management’s Report of Internal Control over Financial Reporting  
List of Companies that are part of the Group of insurers  
Pursuant to [relevant state statute or Section 16 of the Model]**

Name	NAIC No
ABC Insurance Subsidiary	12345
DEF Insurance Subsidiary	12346
GHI Insurance Subsidiary	12347
JKL Insurance Subsidiary	12348
MNO Insurance Subsidiary	12349

Appendix G Implementation Guide

**EXAMPLE B: AN SEC REGISTRANT OR A MEMBER OF A HOLDING COMPANY SYSTEM WHOSE PARENT IS AN SEC REGISTRANT THAT DID NOT HAVE ALL MATERIAL CONTROL PROCESSES OVER STATUTORY FINANCIAL REPORTING ADDRESSED IN ITS SECTION 404 REPORT**

**Management’s Report of Internal Control over Financial Reporting**

XYZ Holding Company Inc (“XYZ”) is required to file annual reports on Form 10-K/20-F with the U.S. Securities and Exchange Commission. Each of the insurance companies listed on Attachment B is a wholly owned subsidiary of XYZ. For the purpose of XYZ’s Management’s Report of Internal Control over Financial Reporting, management has identified its “Group of insurers,” as that term is defined in [relevant state statute or Section 3H of the Model] as the insurance companies listed on Attachment B.

Management of XYZ is responsible for establishing and maintaining adequate internal control over statutory financial reporting. XYZ’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements in accordance with statutory accounting principles. Management conducted an assessment of the effectiveness, as of December 31, 201X, of the Group of insurers’ internal control over statutory financial reporting, based on the framework established in *Internal Control—Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Based on our assessment under that framework, management concluded that the Group of insurers’ internal control over statutory financial reporting is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements as of December 31, 201X.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In satisfaction of the Group of insurers’ obligation to deliver Management’s Report of Internal Control over Financial Reporting for the fiscal year ended December 31, 201X, as permitted by [relevant state statute or Section 16C of the Model], XYZ is hereby providing the Insurance Commissioner of [domiciliary state] copies of Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting for XYZ included in the attached copy of XYZ’s Form 10-K/20-F (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934), for the fiscal year ended December 31, 201X (or alternatively the Annual Report to Stockholders), ~~which includes Management’s Report of Internal Control over Financial Reporting and report of independent registered public accounting firm on internal control over financial reporting for XYZ.~~ In addition, an Addendum (Attachment A) is included to this report which identifies the material processes that were not included in the Section 404 Report (as defined in Attachment A).

Based on management review of internal controls, there were no unremediated material weaknesses as of December 31, 201X identified as part of the Group of insurers’ internal control structure over the statutory financial statements for the year ended December 31, 201X.

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Executive Officer)

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Financial Officer)

ATTACHMENT A

**XYZ Holding Company Inc**  
**Addendum to Management's Report of Internal Control over Financial Reporting**  
**For the Year Ended December 31, 201X**

For purposes of this filing, the "Section 404 Report" means Management's Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting contained in or incorporated by reference in the Company's Form 10-K/20-F. Accordingly, as required by [relevant state statute or Section 16C of the Model], management of XYZ hereby affirms that the only material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers that were excluded from the Section 404 Report are the processes discussed below. Management of XYZ hereby affirms that all other material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers were included in the Section 404 Report. The following statutory financial reporting processes were reviewed separately from the internal controls reported by the Group of insurers in its Section 404 report:

**Significant Control Processes not tested due to Group Materiality Considerations**

The Section 404 report excludes certain control processes deemed material to individual insurance legal entities included within the Group of insurers. This exclusion was due to group materiality decisions made at the parent company level. These processes, and the legal entities within the Group of insurers impacted, are listed as follows:

Workers' Compensation Claims Processing – The HIJ claims processing system is utilized to process workers' compensation claims material to ABC Insurance Subsidiary and DEF Insurance Subsidiary.

**Related Party Transactions Eliminated through Consolidation**

The Section 404 report does not consider controls surrounding related party transactions as the effects of those transactions are eliminated through consolidation at the holding company financial statement level. Significant related party transactions, and the legal entities within the Group of insurers impacted, are listed as follows:

Affiliate reinsurance agreements – A significant amount of reinsurance coverage is obtained by ABC Insurance Subsidiary and DEF Insurance Subsidiary through contracts with XYZ Parent Company.

Management service agreements – ABC Insurance Subsidiary receives all of its management services through an agreement with XYZ Parent Company.

Tax allocation agreements – ABC Insurance Subsidiary and DEF Insurance Subsidiary are subject to an intercompany tax allocation agreement with XYZ Parent Company.

**Deferred Income Taxes**

Federal income taxes are provided for XYZ's estimated current and deferred liability. Deferred taxes are provided for differences between the financial statement and tax bases of assets and liabilities. Pursuant to SSAP No. 10, Income Taxes, changes in deferred tax assets and liabilities are recognized as a separate component of gains and losses in statutory surplus, while under GAAP/IFRS, these changes are included in income tax expense or benefit. Gross deferred tax assets not meeting the realization criteria outlined in SSAP 10 are not admitted.

**Nonadmitted Assets**

Certain XYZ assets (principally furniture, equipment, prepaid expenses, agents' balances, and certain deferred tax assets) have been designated as nonadmitted assets under statutory accounting guidance (primarily in SSAP No. 4, Assets and Nonadmitted Assets and SSAP No. 20, Nonadmitted Assets). Such nonadmitted assets are excluded from assets by a charge to statutory surplus. Under GAAP/IFRS, such amounts are carried at amortized cost with an appropriate valuation allowance, as necessary.

**Asset Valuation Reserve ("AVR")**

**Appendix G**

**Implementation Guide**

The AVR represents a statutory contingency reserve for life and health insurers for credit related risk on most invested assets, and is charged to surplus pursuant to SSAP No. 7, Asset Valuation Reserve and Interest Maintenance Reserve. No such reserve is required under GAAP/IFRS accounting.

**Interest Maintenance Reserve (“IMR”)**

The IMR represents the deferral of interest-related realized gains and losses, net of tax, on primarily fixed maturity investments, amortized into income over the remaining life of the investment sold pursuant to SSAP No. 7, Asset Valuation Reserve and Interest Maintenance Reserve. No such reserve is required under GAAP/IFRS accounting.

Management of XYZ conducted an assessment of the internal controls over these processes and concluded that they were effective with respect to the audited statutory financial statements.

(Please note that this is not intended to be an all-inclusive list. It should only include material process that were not covered in the Section 404 Report. The facts and circumstances of each situation will determine the items to be included.)

**ATTACHMENT B**

**XYZ Holding Company Inc.  
Management’s Report of Internal Control over Financial Reporting  
List of Companies that are part of the Group of insurers  
Pursuant to [relevant state statute or Section 16 of the Model]**

Name	NAIC No
ABC Insurance Subsidiary	12345
DEF Insurance Subsidiary	12346
GHI Insurance Subsidiary	12347
JKL Insurance Subsidiary	12348
MNO Insurance Subsidiary	12349

**EXAMPLE C: A NON-SEC REGISTRANT THAT VOLUNTARILY COMPLIED WITH SECTION 404 OF THE SARBANES-OXLEY ACT AND PRODUCED A REPORT ON INTERNAL CONTROLS WHICH INCLUDED AN AUDITOR'S OPINION**

**Management's Report of Internal Control over Financial Reporting**

As a non-SEC registrant, XYZ Holding Company Inc ("XYZ") is not required to prepare or file with the U.S. Securities and Exchange Commission a Sarbanes-Oxley Act Section 404 report on internal control over financial reporting. However, management has elected to prepare, and have audited by XYZ's independent certified public accountant, such a report for the fiscal year-ended December 31, 201X.

Each of the insurance companies listed on Attachment B is a wholly owned subsidiary of XYZ. For the purpose of XYZ's Management's Report of Internal Control over Financial Reporting, management has identified its "Group of insurers," as that term is defined in [relevant state statute or Section 3H of the Model], as the insurance companies listed on Attachment B.

Management of XYZ is responsible for establishing and maintaining adequate internal control over statutory financial reporting. XYZ's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements in accordance with statutory accounting principles. Management conducted an assessment of the effectiveness, as of December 31, 201X, of the Group of insurers' internal control over statutory financial reporting, based on the framework established in *Internal Control—Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Based on our assessment under that framework, management concluded that the Group of insurers' internal control over statutory financial reporting is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements as of December 31, 201X.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In satisfaction of the Group of insurers' obligation to deliver Management's Report of Internal Control over Financial Reporting for the fiscal year ended December 31, 201X, as permitted by [relevant state statute or Section 16C of the Model], XYZ is hereby providing the Insurance Commissioner of [domiciliary state] the attached copy of XYZ's Section 404 Report for the fiscal year ended December 31, 201X, which includes Management's Report of Internal Control over Financial Reporting and report of independent registered public accounting firm on internal control over financial reporting for XYZ. In addition, an Addendum (Attachment A) is included to this report that identifies the material processes that were not included in the Section 404 Report (as defined in Attachment A).

Based on management review of internal controls, there were no unremediated material weaknesses as of December 31, 201X identified as part of the Group of insurers' internal control structure over the statutory financial statements for the year ended December 31, 201X.

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
Chief Executive Officer

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Financial Officer)

**ATTACHMENT A**

**XYZ Holding Company Inc  
Addendum to Management’s Report of Internal Control over Financial Reporting  
For the Year Ended December 31, 201X**

For purposes of this addendum, the “Section 404 Report” means Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting contained in or incorporated by reference in the Annual Report to Stockholders. Accordingly, as required by [relevant state statute or Section 16C of the Model], management of XYZ hereby affirms that there are no material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers that were excluded from the Section 404 Report.

**ATTACHMENT B**

**XYZ Holding Company Inc.  
Management’s Report of Internal Control over Financial Reporting  
List of Companies that are part of the Group of insurers  
Pursuant to [relevant state statute or Section 16 of the Model]**

Name	NAIC No
ABC Insurance Subsidiary	12345
DEF Insurance Subsidiary	12346
GHI Insurance Subsidiary	12347
JKL Insurance Subsidiary	12348
MNO Insurance Subsidiary	12349

Implementation Guide

**EXAMPLE D: A COMPANY THAT IS NOT SUBJECT TO SECTION 404 AND UTILIZED THEIR OWN FRAMEWORK TO EVALUATE CONTROLS**

**Management’s Report of Internal Control over Financial Reporting**

Management of ABC Insurance Company is responsible for establishing and maintaining adequate internal control over statutory financial reporting. The Company has established an internal control system designed to provide reasonable assurance regarding the fair presentation of statutory financial reporting. The Company developed its own internal framework for evaluating the effectiveness of internal control over statutory financial reporting. The Company’s framework includes the identification and evaluation of the company’s internal control environment and areas of potential material internal control risk, documentation of existing internal controls, monitoring and testing of those key controls, documentation of remedial actions planned or taken, if any, and communication of the findings of the evaluation by the Company’s senior management to the Audit committee of the Board of Directors.

Management conducted an assessment of the effectiveness, as of December 31, 201X, of the Company’s internal control over statutory financial reporting, which included identifying, reviewing, monitoring and testing significant internal controls over statutory financial reporting. Based on our assessment under the above described approach and through diligent inquiry, management has concluded that the Company’s internal control over statutory financial reporting is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements as of December 31, 201X.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on management review of internal controls, there were no unremediated material weaknesses as of December 31, 201X identified as part of the Company’s internal control structure over the statutory financial statements for the year ended December 31, 201X.

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Executive Officer)

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Financial Officer)



Appendix G

Implementation Guide

**EXAMPLE E: AN SEC REGISTRANT OR A MEMBER OF A HOLDING COMPANY SYSTEM WHOSE PARENT IS AN SEC REGISTRANT THAT HAD ALL MATERIAL CONTROL PROCESSES ADDRESSED IN THEIR SECTION 404 REPORT AND HAD AN UNREMIEDIATED MATERIAL WEAKNESS**

**Management’s Report of Internal Control over Financial Reporting**

XYZ Holding Company Inc (“XYZ”) is required to file annual reports on Form 10-K/20-F with the U.S. Securities and Exchange Commission. Each of the insurance companies listed on Attachment B is a wholly-owned subsidiary of XYZ. For the purpose of XYZ’s Management’s Report of Internal Control over Financial Reporting, management has identified its “Group of insurers,” as that term is defined in [relevant state statute or Section 3H of the Model], as the insurance companies listed on Attachment B.

Management of XYZ is responsible for establishing and maintaining adequate internal control over statutory financial reporting. XYZ’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements in accordance with statutory accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted an assessment of the effectiveness, as of December 31, 201X, of the Group of insurers’ internal control over statutory financial reporting, based on the framework established in *Internal Control—Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*.

A material weakness was noted in XYZ’s internal control over financial reporting related to the calculation of insurance reserves. Due to the manner in which the data for homeowners policies are captured by the systems used in its Southeastern US regional office, changes in XYZ’s estimate of insurance reserves for certain policies are not reviewed by XYZ’s Actuarial Department prior to being recorded in the company’s accounting records.

A material weakness is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the company’s financial statements will not be prevented, or detected and corrected on a timely basis. In connection with the weakness noted above, XYZ’s management has taken remedial actions to change its procedures for coding policies issued in the states affected so that all homeowners policy data are included in the Actuarial Department review of estimate of insurance reserves. This change was effective on July 1, 20XX.

As a result of the unremediated material weakness described above, XYZ management has concluded that, as of December 31, 201X, XYZ’s internal control over statutory financial reporting was not effective.

In satisfaction of the Group of insurers’ obligation to deliver Management’s Report of Internal Control over Financial Reporting for the fiscal year ended December 31, 201X, as permitted by [relevant state statute or Section 16C of the Model], XYZ is hereby providing the Insurance Commissioner of [domiciliary state] copies of Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting for XYZ included in the attached copy of XYZ’s Form 10-K/20-F (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934), for the fiscal year ended December 31, 201X (or alternatively the Annual Report to Stockholders), ~~which includes Management’s Report of Internal Control over Financial Reporting and report of independent registered public accounting firm on internal control over financial reporting for XYZ.~~ In addition, an Addendum (Attachment A) is included to this report which identifies the material processes that were not included in the Section 404 Report (as defined in Attachment A).

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Executive Officer)

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Financial Officer)

**ATTACHMENT A**

**XYZ Holding Company Inc  
Addendum to Management’s Report of Internal Control over Financial Reporting  
For the Year Ended December 31, 201X**

For purposes of this addendum, the “Section 404 Report” means Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting contained in or incorporated by reference in the Form 10-K/~~20-F~~. Accordingly, as required by [relevant state statute or Section 16C of the Model], management of XYZ hereby affirms that there are no material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers that were excluded from the Section 404 Report.

**ATTACHMENT B**

**XYZ Holding Company Inc.  
Management’s Report of Internal Control over Financial Reporting  
List of Companies that are part of the Group of insurers  
Pursuant to [relevant state statute or Section 16 of the Model]**

Name	NAIC No
ABC Insurance Subsidiary	12345
DEF Insurance Subsidiary	12346
GHI Insurance Subsidiary	12347
JKL Insurance Subsidiary	12348
MNO Insurance Subsidiary	12349

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**EXAMPLE F: AN SEC REGISTRANT OR MEMBER OF A HOLDING COMPANY SYSTEM WHOSE PARENT IS AN SEC REGISTRANT THAT DID NOT INCLUDE ALL MATERIAL PROCESSES OVER STATUTORY FINANCIAL REPORTING ADDRESSED IN ITS SECTION 404 REPORT AND HAD AN UNREMIEDIATED MATERIAL WEAKNESS NOTED**

**Management’s Report of Internal Control over Financial Reporting**

XYZ Holding Company Inc (“XYZ”) is required to file annual reports on Form 10-K/20-F with the U.S. Securities and Exchange Commission. Each of the insurance companies listed on Attachment B is a wholly-owned subsidiary of XYZ. For the purpose of XYZ’s Management’s Report of Internal Control over Financial Reporting, management has identified its “Group of insurers,” as that term is defined in [relevant state statute or Section 3H of the Model], as the insurance companies listed on Attachment B.

Management of XYZ is responsible for establishing and maintaining adequate internal control over statutory financial reporting. XYZ’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements in accordance with statutory accounting principles. Management conducted an assessment of the effectiveness, as of December 31, 201X, of the Group of insurers’ internal control over statutory financial reporting, based on the framework established in *Internal Control—Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness was noted in XYZ’s internal control over financial reporting related to the calculation of insurance reserves. Due to the manner in which the data for homeowners policies are captured by the systems used in its Southeastern US regional office, changes in XYZ’s estimate of insurance reserves for certain policies are not reviewed by XYZ’s Actuarial Department prior to being recorded in the company’s accounting records.

A material weakness is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the company’s financial statements will not be prevented, or detected and corrected on a timely basis. In connection with the assessment above, XYZ’s management identified a material weakness as of December 31, 201X in the controls over the calculation of insurance reserves.

As a result of the unremediated material weakness described above, XYZ management has concluded that, as of December 31, 201X, XYZ’s internal control over statutory financial reporting was not effective.

In satisfaction of the Group of insurers’ obligation to deliver Management’s Report of Internal Control over Financial Reporting for the fiscal year ended December 31, 201X, as permitted by [relevant state statute or Section 16C of the Model], XYZ is hereby providing the Insurance Commissioner of [domiciliary state] copies of Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting for XYZ included in the attached copy of XYZ’s Form 10-K (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934), for the fiscal year ended December 31, 201X (or alternatively the Annual Report to Stockholders), which includes Management’s Report of Internal Control over Financial Reporting and report of independent registered public accounting firm on internal control over financial reporting for XYZ. In addition, an Addendum (Attachment A) is included to this report which identifies the material processes that were not included in the Section 404 Report (as defined in Attachment A).

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Executive Officer)

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Financial Officer)

ATTACHMENT A

**XYZ Holding Company Inc**  
**Addendum to Management's Report of Internal Control over Financial Reporting**  
**For the Year Ended December 31, 201X**

For purposes of this filing, the "Section 404 Report" means Management's Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting contained in or incorporated by reference in the Company's Form 10-K/20-F. Accordingly, as required by [relevant state statute or Section 16C of the Model], management of XYZ hereby affirms that the only material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers that were excluded from the Section 404 Report are the processes discussed below. Management of XYZ hereby affirms that all other material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers were included in the Section 404 Report. The following statutory financial reporting processes were reviewed separately from the internal controls reported by the Group of insurers in its Section 404 report:

**Significant Control Processes not tested due to Group Materiality Considerations**

The Section 404 report excludes certain control processes deemed material to individual insurance legal entities included within the Group of insurers. This exclusion was due to group materiality decisions made at the parent company level. These processes, and the legal entities within the Group of insurers impacted, are listed as follows:

Workers' Compensation Claims Processing – The HIJ claims processing system is utilized to process workers' compensation claims material to ABC Insurance Subsidiary and DEF Insurance Subsidiary.

**Related Party Transactions Eliminated through Consolidation**

The Section 404 report does not consider controls surrounding related party transactions as the effects of those transactions are eliminated through consolidation at the holding company financial statement level. Significant related party transactions, and the legal entities within the Group of insurers impacted, are listed as follows:

Affiliate reinsurance agreements – A significant amount of reinsurance coverage is obtained by ABC Insurance Subsidiary and DEF Insurance Subsidiary through contracts with XYZ Parent Company.

Management service agreements – ABC Insurance Subsidiary receives all of its management services through an agreement with XYZ Parent Company.

Tax allocation agreements – ABC Insurance Subsidiary and DEF Insurance Subsidiary are subject to an intercompany tax allocation agreement with XYZ Parent Company.

**Deferred Income Taxes**

Federal income taxes are provided for XYZ's estimated current and deferred liability. Deferred taxes are provided for differences between the financial statement and tax bases of assets and liabilities. Pursuant to SSAP No. 10, Income Taxes, changes in deferred tax assets and liabilities are recognized as a separate component of gains and losses in statutory surplus, while under GAAP/IFRS, these changes are included in income tax expense or benefit. Gross deferred tax assets not meeting the realization criteria outlined in SSAP 10 are not admitted.

**Nonadmitted Assets**

Certain XYZ assets (principally furniture, equipment, prepaid expenses, agents' balances, and certain deferred tax assets) have been designated as nonadmitted assets under statutory accounting guidance (primarily in SSAP No. 4, Assets and Nonadmitted Assets and SSAP No. 20, Nonadmitted Assets). Such nonadmitted assets are excluded from assets by a charge to statutory surplus. Under GAAP/IFRS, such amounts are carried at amortized cost with an appropriate valuation allowance, as necessary.

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Implementation Guide

**Asset Valuation Reserve (“AVR”)**

The AVR represents a statutory contingency reserve for life and health insurers for credit related risk on most invested assets, and is charged to surplus pursuant to SSAP No. 7, Asset Valuation Reserve and Interest Maintenance Reserve. No such reserve is required under GAAP/IFRS accounting.

**Interest Maintenance Reserve (“IMR”)**

The IMR represents the deferral of interest-related realized gains and losses, net of tax, on primarily fixed maturity investments, amortized into income over the remaining life of the investment sold pursuant to SSAP No. 7, Asset Valuation Reserve and Interest Maintenance Reserve. No such reserve is required under GAAP/IFRS accounting.

Management of XYZ conducted an assessment of the internal controls over these processes and concluded that they were effective with respect to the audited statutory financial statements.

(Please note that this is not intended to be an all-inclusive list. It should only include material processes that were not covered in the Section 404 Report. The facts and circumstances of each situation will determine the items to be included.)

**ATTACHMENT B**

**XYZ Holding Company Inc.  
Management’s Report of Internal Control over Financial Reporting  
List of Companies that are part of the Group of insurers  
Pursuant to [relevant state statute or Section 16 of the Model]**

Name	NAIC No
ABC Insurance Subsidiary	12345
DEF Insurance Subsidiary	12346
GHI Insurance Subsidiary	12347
JKL Insurance Subsidiary	12348
MNO Insurance Subsidiary	12349

**EXAMPLE G: AN SEC REGISTRANT OR MEMBER OF A HOLDING COMPANY SYSTEM WHOSE PARENT IS AN SEC REGISTRANT THAT HAD ALL MATERIAL PROCESSES OVER STATUTORY FINANCIAL REPORTING ADDRESSED IN ITS SECTION 404 REPORT. HOWEVER, THEY RECENTLY ACQUIRED ANOTHER INSURER THAT IS NOT INCLUDED IN THEIR ASSESSMENT**

**Management’s Report of Internal Control over Financial Reporting**

XYZ Holding Company Inc (“XYZ”) is required to file annual reports on Form 10-K/~~20-F~~ with the U.S. Securities and Exchange Commission. Each of the insurance companies listed on Attachment B is a wholly owned subsidiary of XYZ. For the purpose of XYZ’s Management’s Report of Internal Control over Financial Reporting, management has identified its “Group of insurers,” as that term is defined in [relevant state statute or Section 3H of the Model], as the insurance companies listed on Attachment B.

Management of XYZ is responsible for establishing and maintaining adequate internal control over statutory financial reporting. XYZ’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements in accordance with statutory accounting principles. Management conducted an assessment of the effectiveness, as of December 31, 201X, of the Group of insurers’ internal control over statutory financial reporting, based on the framework established in *Internal Control—Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. This assessment excluded an evaluation of internal controls over financial reporting for RST Insurance Company which was recently acquired. Based on our assessment under that framework, management concluded that the Group of insurers’ internal control over statutory financial reporting is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of statutory financial statements as of December 31, 201X.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In satisfaction of the Group of insurers’ obligation to deliver Management’s Report of Internal Control over Financial Reporting for the fiscal year ended December 31, 201X, as permitted by [relevant state statute or Section 16C of the Model], XYZ is hereby providing the Insurance Commissioner of [domiciliary state] copies of Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting for XYZ included in the attached copy of XYZ’s Form 10-K/~~20-F~~ (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934), for the fiscal year ended December 31, 201X (or alternatively the Annual Report to Stockholders), which includes Management’s Report of Internal Control over Financial Reporting and report of independent registered public accounting firm on internal control over financial reporting for XYZ. In addition, an Addendum (Attachment A) is included to this report which identifies the material processes that were not included in the Section 404 Report (as defined in Attachment A).

Based on management review of internal controls, there were no unremediated material weaknesses as of December 31, 201X identified as part of the Group of insurers’ internal control structure over the statutory financial statements for the year ended December 31, 201X.

(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Executive Officer)  
(Signed) \_\_\_\_\_ (Date) \_\_\_\_\_  
(Chief Financial Officer)

**ATTACHMENT A**

**XYZ Holding Company Inc  
Addendum to Management’s Report of Internal Control over Financial Reporting  
For the Year Ended December 31, 201X**

For purposes of this addendum, the “Section 404 Report” means Management’s Report of Internal Control over Financial Reporting and the report of independent registered public accounting firm on internal control over financial reporting contained in or incorporated by reference in the Form 10-K. Accordingly, as required by [relevant state statute or Section 16C of the Model], management of XYZ hereby affirms that there are no material processes with respect to the preparation of the audited statutory financial statements of the Group of insurers that were excluded from the Section 404 Report.

**ATTACHMENT B**

**XYZ Holding Company Inc.  
Management’s Report of Internal Control over Financial Reporting  
List of Companies that are part of the Group of insurers  
Pursuant to [relevant state statute or Section 16 of the Model]**

Name	NAIC No
ABC Insurance Subsidiary	12345
DEF Insurance Subsidiary	12346
GHI Insurance Subsidiary	12347
JKL Insurance Subsidiary	12348
MNO Insurance Subsidiary	12349

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September 28, 2010

Mr. Doug Stolte, Chairman  
NAIC/AICPA Working Group  
National Association of Insurance Commissioners  
2301 McGee Street, Suite 800  
Kansas City, MO 64108-2604

RE: Proposal to revise MAR Implementation Guide Appendix 1 - Illustrative  
Examples of Management's Report of Internal Control over Financial Reporting

Dear Mr. Stolte,

Interested parties appreciate the opportunity to provide comment on the Proposal to revise MAR Implementation Guide Appendix 1 Illustrative Examples of Management's Report of Internal Control over Financial Reporting to the Working Group.

On September 15, 2010 the SEC issued a final rule, *Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers*. This rule provides a permanent exemption for nonaccelerated filers from the requirement to obtain an external audit on the effectiveness of internal financial reporting controls provided in Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX). Specifically, this rule adopts amendments to SEC rules and forms to conform them to Section 404(c) of SOX, as added by Section 989G of the "Dodd-Frank Wall Street Reform and Consumer Protection Act." Section 404(c) provides that Section 404(b) of SOX does not apply with respect to any audit report prepared for an issuer that is neither an accelerated filer nor a large accelerated filer as defined in Rule 12b-2 under the Securities Exchange Act of 1934. (i.e., public entities whose public float is less than \$75 million)

Entities that fall under this exemption are considered to be:

1. SEC filers who apply SOX 404,
2. Issue a management report on SOX 404, but
3. Will not have an external audit on SOX 404.

Upon review of the illustrative examples we did not find a report that fit this new set of circumstances. These additional examples are necessary to clarify that a company, or group of companies, can utilize a non-accelerated Section 404 report that did not contain an audit report, and yet still provide an addendum to the non-accelerated Section 404 report and still remain in compliance with MAR.



NAIC/AICPA Working Group  
September 28, 2010  
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Interested parties appreciate the Working Group's consideration of our comments and we look forward to discussing the topic further at the Working Group's conference call scheduled for October 6.

Sincerely,

D. Keith Bell

Sincerely,

Rose Albrizio

cc: Bruce Jensen, NAIC staff  
Interested Parties

W:\National Meetings\2010\Fall\Cmte\E\AICPA\Attachment Two-B.pdf

Draft: 10/5/10

National Treatment and Coordination (E) Working Group  
Conference Call  
September 22, 2010

The National Treatment and Coordination (E) Working Group of the Financial Condition (E) Committee met via conference call Sept. 22, 2010. The following Working Group members participated: Jill Jacobi, Co-Chair (CA); Cindy Donovan, Co-Chair (IN); Joan Nakano (CT); Mary Mostoller (FL); Stewart Guerin (LA); Anne Morgan (NC); Heidi Delorme (ND); Russell Latham (OR); Bob Brackbill (PA); Eric Showgren (UT); James Ware (VA); Jim Odiorne (WA); and Linda Johnson (WY). Also participating were: Gloria Glover (AK); Cary Cook (AZ); Louis Quan (CA); Maura Welch (CT); Nancy Ferguson (IA); Carol Anderson (ID); Gary Burchfield (OH); and Gayle Pasero (WA).

1. Dodd-Frank Wall Street Reform and Consumer Protection Act

Sarah Heidenreich (NAIC) summarized the federal Dodd-Frank Wall Street Reform and Consumer Protection Act. She said the bill was signed earlier this year by President Barack Obama and includes safeguards that ensure state insurance supervision is preserved and not unintentionally undermined. This bill is 2,300 pages and most is unrelated to insurance; however, it does establish a new federal role regarding insurance in a number of critical respects—one being the Federal Insurance Office (FIO), which is housed within the U.S. Treasury Department. The purpose of this bill is to help the federal government understand the insurance market and negotiate international agreements. The FIO has no authority over health, long-term care or crop insurance, but does have authority over all other lines of insurance. The FIO also has authority to collect information from the insurance industry, enter into information-sharing agreements, analyze and disseminate data and information, and issue reports. It also has the authority to enter into covered agreements, which are international agreements that preempt state law if they are between the U.S. government and a foreign government, authority or regulatory entity, and it relates to the recognition of prudential measures to the business of insurance or reinsurance, similar to a level of protection that a state already has. It is the opinion of the NAIC that this is most likely going to happen in the reinsurance area.

The reinsurance provision primarily preempts the extra-territorial application of state credit for reinsurance laws. Prior to this bill, any state where a reinsurer did business could have a say on credit for reinsurance; however, after the passage of this bill, only the domestic regulator can have a say. Several NAIC groups are currently redrafting model laws and accreditation standards to reduce the current requirements, so that the ceding reinsurer's domiciliary state is made solely responsible for the solvency regulation, provided that the state is accredited by the NAIC.

The surplus lines provisions were drafted with the intent of encouraging the states to enter into an interstate compact or establish uniform procedures for reporting information, as well as collecting and distributing premium taxes for surplus lines insurance. After two years, any state that is not participating in a national database for nonadmitted insurers will not be able to collect license fees. The NIPR and the Multi-State Surplus Lines Premium Tax (C) Working Group are working to get all of the states onto the NIPR database. Currently, there are 20 states not on the NIPR database. The Multi-State Surplus Lines Premium Tax (C) Working Group is developing an interstate compact for the collection and distribution of premium taxes.

The Financial Stability Oversight Council (FSOC) was created to identify risks to U.S. financial stability from activities, distress or failure of large interconnected financial companies, including insurance companies. The FSOC has 10 voting members and five non-voting members. One of the non-voting members is an insurance commissioner, Director John M. Huff (MO). FSOC can instruct the Federal Reserve's Board of Governors to regulate a financial company if the FSOC believes the company's activities or failure could threaten U.S. financial stability. Once authorized, it may issue increasingly strict rules for capital, leverage, liquidity and risk management. It also may break up those companies it deems to pose a threat to the U.S. financial system. A two-thirds vote of the Federal Reserve Board of Governors and the affirmative approval of the director of the FIO is required for an insurance company to be deemed a systemic risk and in need of winding down or rehabilitation.

Mr. Ware asked for clarification on the reinsurance issue and whether that was focused on international or domestic reinsurers. Ms. Heidenreich clarified that the NAIC is currently working on the 100% collateral requirements for overseas reinsurers. Ms. Jacobi added that the bill did not create an optional federal charter or federal insurance regulator per se, but some of these issues (such as reinsurance) are part of the primary domestic application. As such, the Working Group might want to look at the area of company licensing and the risk-focused approach in the company licensing review, and consider

the implications of the FSOC and the systemic risk to the United States for possible changes to the analysis process of the application. The Working Group will consult with the NAIC Legal Division in the future for any possible changes.

## 2. National Treatment and Coordination (E) Working Group 2011 Proposed Charges

Ms. Jacobi asked for comments or suggestions to the 2011 Proposed Charges. Mr. Odiorne suggested adding “Analyze federal law development and Solvency Modernization Initiative (SMI) for needed modifications or revisions to the work of the National Treatment and Coordination (E) Working Group.” Upon a motion by Mr. Latham and a second by Mr. Showgren, the Working Group voted unanimously to accept the current charges and the new charge proposed by Mr. Odiorne. The Working Group recommended that the Financial Condition (E) Committee consider adoption of its proposed charges at the Fall National Meeting.

## 3. Aug. 25 Issues (E) Subgroup Conference Call

Ms. Donovan summarized the changes the Issues (E) Subgroup considered on its Aug. 25 conference call (Attachment Attachment Three-A) regarding the corporate amendment instructions, the corporate amendment checklist (Form 1C), which included renumbering and adding Form 17 and the corporate amendment application form (Form 2C). The Subgroup reviewed the results of a filing fees survey and considered the wording for the expedited review of a filing via the Review of Electronic Application Coordination and Processing (REACAP) application. The Subgroup also discussed creating another survey regarding “current” date on various documents and what that means to each state.

## 4. Corporate Amendments Instructions Proposal

Ms. Jacobi summarized the substantial changes to the corporate amendments instructions that include adding the option of a cover letter with the application, which also corresponds with the application checklist as Item #1. Ms. Donovan added for further clarification that the instructions state that a cover letter may be included as a component of Item #1 of the application so that applicants would not think that the cover letter would suffice as Item #1s.

The next substantive change is regarding the addition of instructions for the statement of withdrawal. Ms. Jacobi added that the wording regarding the acceptance of current documents in the instructions raised some questions during the Subgroup call and that some states might have different views on what is considered “current.”

The item numbers on the checklist have been updated to correlate with the section numbers in the instructions. No significant changes were made.

The last substantive change in the proposal includes the addition of contacting the NAIC regarding a name change due to mergers. The instructions address the applicant to contact the NAIC once the domiciliary state has approved the name change. Ms. Welch asked if that same wording should be added under the section of redemestications. Ms. Donovan added that the purpose of contacting the NAIC is so the database can be updated prior to the applicant creating an electronic application. The electronic application pulls the company information from the NAIC company demographic table. Jane Mejia (NAIC) confirmed that the state of domicile would need to be updated in order for the correct domiciliary state to complete the electronic certificates of compliance and deposits. Several of the states indicated that they would expect to receive an updated certificate of compliance with a corporate amendments redomestication application.

Ms. Jacobi summarized additional changes noted in the proposal to include the reference to Form 15, affidavit of lost certificate of authority and the reorder of the biographical affidavit and state specific information to keep the instructions consistent throughout the instructions.

Upon a motion by Mr. Odiorne and a second by Ms. Johnson, the Working Group unanimously agreed to accept the changes to the corporate amendment instructions, with the addition of having the applicant contact the NAIC once the domiciliary state has approved the redomestication.

## 6. Form 2C Proposal

Ms. Donovan summarized the changes to the corporate amendments application Form 2C, to include the addition of Form 17, statement of withdrawal, as a change option on Page 1. Page 2 will include the proposed effective date of withdrawal and the state of domicile (or port of entry) information if the application is for a statement of withdrawal/complete surrender of

certificate of authority. The proposed effective date will meet the requirements for either a date certain or contingent on the state's approval of the withdrawal. Upon a motion by Mr. Odiorne and a second by Ms. Nakano, the Working Group unanimously agreed to accept the changes to the corporate amendments application, Form 2C.

#### 7. Update on Survey Results

Ms. Mejia reported that the chart created from the filing fees survey is now posted on the UCAA website. The remaining four states that did not respond to the survey have been notified that the survey is posted on the website and their state information is needed. The deleting line of business chart also was updated with the state changes noted in the survey. The new chart for statement of withdrawal requirements will be posted by Oct. 1. Ms. Mejia explained that any changes made to the state charts, and UCAA forms or instructions are noted in the link called "What's New," with the effective date of the change and the transition date that the states will accept the forms prior to the changes for applications currently in process. Ms. Donovan noted that the states should be cognizant of the transition date for applications that are pending more than 12 months when asking the applicant to update their application with the current forms. Ms. Donovan suggested that the state charts be listed in alphabetical order. Ms. Mejia agreed to reorganize the charts in alphabetical order.

#### 8. Solvency Modernization Initiative (SMI)

Ms. Jacobi noted that the amendments to the *Insurance Holding Company System Regulatory Act* (#440) will likely be adopted at the Fall National Meeting. Those changes could impact the *Company Licensing Best Practices Handbook* and the *UCAA Manual*. Some of the changes addressed in the model, such as change in control and risk-assessment, impact the risk-focus approach to company licensing. The Form E statement is currently part of the company licensing filing and the Working Group might need to add additional filing requirements to address those changes. Ms. Jacobi suggested that, once the model is adopted, the Working Group should review those changes and consider making necessary changes in the context of company licensing.

Ms. Jacobi suggested that the Working Group monitor the work of the Corporate Governance (EX) Working Group with regard to company licensing perspective. The NAIC focus is on policyholder protection, and the Working Group should be monitoring that work, as well, to see how to incorporate it into the company licensing area.

#### 9. Other Matters

Ms. Donovan summarized an issue that was raised regarding the current certificate of deposit, Form 7. The issue that resulted from a state using the old Form 7, which is now a note on the new form, was problematic to the expansion state. The note states that "Any state relying upon this deposit must notify the State completing this Certificate prior to granting the insurer a Certificate of Authority. This Certificate does not guarantee the deposit balance subsequent to the aforementioned date as a result of the release of securities as authorized by this State." What was problematic was if a certificate of deposit was June 15, and the application was not reviewed until a later date, then the expansion state could not place reliance on this deposit. Ms. Mejia added the expansion state was concerned that they did not contact the domiciliary state in advance and, therefore, could not rely on that deposit. Both states involved have not been active with the Working Group and, therefore, were not sure of the intent of the note. Ms. Donovan suggested educating the regulators on the intent of the form or revisiting the note for clarification. Ms. Jacobi asked if other states have experienced similar questions regarding the note on Form 7. Mr. Odiorne suggested leaving the form as-is, because it is generating communication between the states, which is what should be happening during the review of an application.

Ms. Anderson suggested that the name of the state contact person be updated on the UCAA chart, so that when the states need to contact an individual, they are not constantly transferred because that individual is no longer in that position. Ms. Donovan mentioned that a note was going to be added to the *Company Licensing Best Practices Handbook* as a reminder to the states to periodically review their state information and to notify the NAIC of any necessary changes. Ms. Mejia will draft wording for discussion at the next conference call. Ms. Donovan suggested sending a list via e-mail to the states by zone, and asking the states to verify their contact information. Ms. Jacobi suggested discussing on the next Issues (E) Subgroup conference call.

The Working Group will hold a conference call Nov. 3.

Having no further business, the National Treatment and Coordination (E) Working Group adjourned.

Draft: 10/26/10

Separate Account Risk Charge (E) Working Group  
Conference Call  
October 12, 2010

The Separate Account Risk Charge (E) Working Group of the Financial Condition (E) Committee met via conference call Oct. 12, 2010. The following Working Group members participated: Blaine Shepherd, Chair (MN); Elaine Wieche and Richard Marks (CT); Susan Christy (IL); Jim Mumford (IA); David Hippen (MO); Dan Kosmicki (NE); Matti Peltonen and Bill Carmello (NY); Dale Bruggeman (OH); and Ern Johnson (VA).

1. Harkin Amendment of the Frank Dodd Act

Mr. Shepherd introduced Mary Jane Wilson-Bilik (Sutherland Asbill & Brennan LLP) and Fred Bellamy (Sutherland Asbill & Brennan LLP), indicating that they would be providing the Working Group with an overview of the Harkin Amendment of the Dodd–Frank Wall Street Reform and Consumer Protection Act as recently adopted.

Ms. Wilson said it was important to discuss the Harkin Amendment in the context of existing U.S. Securities and Exchange Commission (SEC) requirements. She pointed out that a common misconception regarding the Harkin Amendment was that it overrides state insurance requirements. She noted that state requirements continue to exist; the only question was whether there is an additional layer of regulation at the SEC and what those requirements are. She said it is unusual in that the amendment does not amend any existing statute. Rather, it is an instruction to the SEC regarding how to treat certain kinds of life insurance and annuity products. More specifically, if certain conditions outlined in the Harkin Amendment are met, the product must be treated as an “exempt security” under Section 3(a)(8) of the 1933 Securities and Exchange Act.

Ms. Wilson described the insurance aspects of the 1933 Securities and Exchange Act. She discussed how it was enacted shortly after the Great Depression and how it was intended to prevent the kind of fraud within the marketplace that took place in the 1920s. It achieves this intent by requiring every security be registered with the SEC, accompanied by a signed registration statement and audited financial statement, with large penalties for misstatements in registration statement. She described the exceptions for registration, noting that Section 3(a)(8) of the Act provides a specific exclusion for certain life insurance and annuity products, in part because these policyholders were not harmed during the Great Depression. Ms. Wilson discussed how a decision by the U.S. Supreme Court in 1959 determined that variable annuities are securities because they pass the investment risk to the contract owner, and the value of the contract varies with the value of the asset. She discussed that shortly after this ruling, separate accounts were created as a means to avoid registering the financial statements of general accounts with the SEC.

Ms. Wilson discussed a safe harbor that was created in 1985 called Rule 151, which was intended to address questions that arose regarding fixed annuities that had a guaranteed minimum interest rate. She described how Rule 151 has three conditions to be met in order to be eligible for the exclusion within Section 3(a)(8): 1) the contract must not vary with the investment experience of the separate account; 2) the contract must guarantee all premium and previously credited interest and 3) the contract must credit interest at a rate equal to the NAIC minimum nonforfeiture law.

Mr. Bellamy discussed that with the Harkin Amendment, there are now three ways that insurance products can be exempt from SEC registration requirements: 1) traditional Section 3(a)(8) exemption analysis; 2) Rule 151; 3) the Harkin Amendment. The Harkin Amendment provides three contract requirements for exception: 1) the cash value of the contract does not vary according the investment performance under separate accounts; 2) the contract must meet nonforfeiture law standards based on state law; and 3) the contract must meet suitability standards based on state law. It is important to recognize that those are the three requirements, and the Harkin Amendment and those three requirements apply to any life insurance or annuity product.

Mr. Bellamy discussed the first requirement in more detail. He stated the first requirement is often called the separate account requirement. He stated this concept was included in Section 3(a)(8) and Rule 151, but it includes language that provides a better interpretation of that requirement. He indicated that with this language, an insurer can use, for example, a non-unitized separate account, for accounting purposes to match assets and liabilities for purposes of valuing the assets in the account, but the insurer cannot pass through the investment performance of those assets directly to the contract cash value. He pointed out that the Harkin Amendment does not have any reference to the insulation of assets in separate accounts. The insulation of the assets in the separate account is not determinative of whether it qualifies under the Harkin Amendment. The plain language

of the amendment is that the investment performance cannot be passed through. Insulation of a separate account might be a factor in interpreting whether that requirement is met.

Mr. Hippen asked the presenters how the Harkin Amendment treatment deals with those states that have not adopted the NAIC nonforfeiture law. Mr. Bellamy responded that, if there are no applicable standard nonforfeiture laws or similar requirements of the applicable state, then the contract has to satisfy the model standard nonforfeiture law for either life insurance or annuity products as adopted by the NAIC.

Mr. Hippen asked how the Harkin Amendment treats those situations where the state has no version of the nonforfeiture law for individual deferred annuities and if that requires such contracts to be treated the same as group annuities. Mr. Bellamy responded that, for example, for an individual deferred annuity with no applicable state nonforfeiture law, the NAIC model must be satisfied.

Mr. Hippen discussed that the Interstate Insurance Product Regulation Commission (IIPRC) has adopted a standard for market value adjusted annuities that exempts those annuities from a piece of the NAIC's *Standard Nonforfeiture Law for Individual Deferred Annuities* (#805). He asked how that would be treated because it explicitly excludes a piece of the standard nonforfeiture law. Ms. Wilson replied that it might still be exempt if it complies with Rule 151 or Section 3(a)(8). Mr. Bellamy added that the SEC view is that a market value adjusted annuity that results in the forfeiture of a small amount of excess interest is less problematic than a market value adjusted annuity that invades principal. He discussed how most such products end up being designed somewhere in the middle, unless the company opts for SEC registration. One of the big uncertainties of the Harkin Amendment is that, once a product is outside the clear realm of an individual deferred indexed annuity, there are a lot of opinions on what is meant by the Harkin Amendment when it states that those other types of contracts have to satisfy these nonforfeiture standards. He noted that one school of thought is that if there is no nonforfeiture standard that applies, then everything that is applicable under all three of the requirements must be satisfied. The other school of thought is that products that do not shift investment risks to the contract owner are exempt under Section 3(a)(8). Mr. Bellamy stated that if the nonforfeiture requirement is interpreted in ways that put absolutely no limit on the amount of investment risk that can be shifted to the policy owner, then it would be a problematic interpretation of the Harkin Amendment.

Mr. Hippen stated there were some differences in interpretation as to compliance with either state or standard nonforfeiture laws with some indexed products. He indicated that Missouri has disapproved some indexed products when they did not have sufficient caps and guarantees to prevent violation of the smoothness tests. In response, some companies have imposed caps and reduced their guarantees in order to avoid fluctuations that made it impossible to demonstrate that compliance. Mr. Hippen said some companies have commented that some states are not viewing those requirements the same way and, as such, it is difficult to know whether the SEC will pursue this further. Mr. Bellamy responded by referring to the unprecedented aspects of the Harkin Amendment, wherein it does not change law, but directs the SEC as to what is exempt under the Securities Exchange Act of 1933. He noted that as a result of the Harkin Amendment, two of the three principle requirements are based on state law, which could differ between states. He noted that this could present a big problem because the same product could be exempt in one state, but not in another. He added that this was not logical, but that is the way the Harkin Amendment is drafted. Mr. Hippen asked if any rulemaking were being drafted to address this issue. Mr. Bellamy responded that he did not believe any such rulemaking would be drafted by the SEC on this topic due to other priorities.

Mr. Mumford stated that he did not see how the Harkin Amendment changed anything in state law. He noted that variable annuities are still considered insurance products regulated by the insurance department, even though they are federal securities. An indexed annuity might or might not be a security, but as long as the SEC has no rule that says it is a security and the Harkin Amendment will exempt most of them, they are still going to be insurance products for state regulatory purposes. As such, nothing has changed unless there is a state law that defines indexed products as securities.

Mr. Hippen discussed how there are a number of products being placed in separate accounts that are not registered with the SEC. He noted, as an example, that he has seen products that look more like participating annuities placed in separate accounts, but they are filed as fixed annuities and the companies have somewhat vigorously asserted the right to not call them variable when they have them in separate accounts. He stated that, from the way that the arguments are made and the strength with which they are made, there must be some states that are accepting these kinds of products, letting the companies set up separate accounts and placing what otherwise would be fixed annuities in those separate accounts. Mr. Carmello indicated that New York allows that under their law. Mr. Bellamy responded that should not affect whether it is a security. The question comes down to the contract, and, in particular, whether the value of the contract varies according to the performance

of that separate account. He said that requirement was not dependent on whether the state allows that treatment; it is dependent by its terms on whether that separate account is insulated, and that is really a state law question. Mr. Hippen asked if the issue was more likely to be if a policyholder of a separate account policy becomes dissatisfied with the notion that they see the nonguaranteed elements varying with the separate account, that they might within their rights think they had a cause to file suit, that this should have been sold to them as not being an exempt security and they should have had more disclosure, at least. Mr. Bellamy responded that this was correct; however, while he could certainly make that argument, he would also recognize that if he did, he would lose all of his insurance company clients. Even though a state might permit that arrangement, it is not determinative of whether it should or should not have been registered as a security. Mr. Bellamy said this is no different than a state permitting variable products to be in separate accounts and to pass through investment performance. The SEC says that makes it a security; i.e., it is not the fact of state approval or state permissibility that affects whether the SEC considers it a security.

Mr. Hippen asked whether insurers might be trying to place some of the questioned products into the separate accounts, but not consider them variable so that they do not have to have their variable licensed agents be the only ones that sell them. He asked if the presenters thought it was reasonable to presume everybody will just look the other way in terms of the suitability aspect of the Harkin Amendment. Mr. Mumford responded that Minnesota and Iowa have broad suitability requirements, but they are not in a model. He stated he did not believe the annuity model could be applied to life insurance, because as it was drafted they did not even consider life insurance, it was strictly annuities. Mr. Bellamy stated he believed that would require the determination on life insurance to go back to the primary test of Section 3(a)(8).

Having no further business, the Separate Account Risk Charge (E) Working Group adjourned.

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## 2011 CHARGES

Draft: 10/19/10

### FINANCIAL CONDITION (E) COMMITTEE

The mission of the Financial Condition (E) Committee is to be the central forum and coordinator of solvency-related considerations of the NAIC relating to accounting practices and procedures; blanks; valuation of securities; the Insurance Regulatory Information System (IRIS); financial analysis and solvency; ~~multi-statezone~~ examinations and examiner training; and issues concerning insurer insolvencies and insolvency guarantees. In addition, the Committee interacts with the technical task forces.

#### **Ongoing Maintenance of NAIC Programs, Products or Services:**

1. The Financial Condition (E) Committee will monitor all of the changes to the *Annual/Quarterly Statement Blanks and Instructions*, risk-based capital formulas, *Financial Condition Examiners Handbook*, *Accounting Practices and Procedures Manual*, *Financial Analysis Handbook*, *Purposes and Procedures Manual of the NAIC Securities Valuation Office*, NAIC model laws, NAIC accreditation standards and other NAIC publications. This charge is ongoing.—*Essential*
- ~~2. The Capital and Surplus Relief Working Group will:
  - ~~Consider an implementation schedule for the Capital and Surplus Relief WG recommendations.—*Important*~~
  - ~~As assigned, consider any process changes or other related issues brought to light when developing the Capital and Surplus Relief WG recommendations.—*Important*~~~~
- ~~3. The Credit Default Swap Working Group will:
  - ~~Assist the membership with any policy issues related to credit default swaps, if a holistic approach is not taken by the U.S. Congress to address the issues previously identified by the NAIC.—*Essential*~~
  - ~~Consider, as necessary, the recommended courses of action suggested by the technical committees in addressing the potential areas where financial regulation can be fortified; assist with summarizing this information to the membership on a periodic basis.—*Important*~~~~
2. The Financial Analysis Working Group will:
  - Analyze nationally significant insurers and groups that exhibit characteristics of trending toward or being financially troubled; determine if appropriate action is being taken.—*Essential*
  - Interact with domiciliary regulators and lead states to assist and advise as to what might be the most appropriate regulatory strategies, methods and action(s).—*Essential*
  - Support, encourage, promote and coordinate multi-state efforts in addressing solvency problems, including identifying adverse industry trends.—*Essential*
  - Increase information-sharing and coordination between state regulators and federal authorities, including through representation of state regulators in national bodies with responsibilities for system-wide oversight.—*Essential*
  - Review and make appropriate updates and enhancements to the *Troubled Insurance Company Handbook*.—*Essential*
  - Upon notice that ~~a security~~ a class of securities has been placed under regulatory review, the chair of Financial Analysis Working Group, or his or her representative, will be deemed a member of the Invested Asset (E) Working Group of the Valuation of Securities (E) Task Force. The chair, or his or her representative, is charged with contributing the perspective and expertise of the regulatory group to the development of NAIC regulatory guidance for the security under review.—*Essential*



## 2011 CHARGES

3. The Financial Guaranty Insurance Guideline Working Group will:
  - Consider plans to strengthen the regulation of bond insurance and modernize the solvency requirements for such insurers.
  - ~~, after action is taken by the New York State Insurance Department or other states,~~ Consider the need to modify the Financial Guaranty Insurance Guideline (#1626) after action is taken by the New York State Insurance Department or other states. Provide a recommendation to the Financial Condition Committee on what, if any, changes should be made to this NAIC guideline.—*Essential*
4. Health Reform Solvency Impact Subgroup will assess the solvency impacts/concerns for health insurers as a result of the recently passed Affordable Health Care for America Act (H.R. 3590) and recommend charges for the appropriate Financial Condition Committee groups to address these impacts/concerns.—*Essential*
5. Investment of Insurers Model Act Revisions Working Group will study the need to modify the Investments of Insurers Model Act (#280 and #283) by gathering input from all states regarding the use of the existing models and their effectiveness in addressing the issues that exist within insurers' portfolios, particularly during this most recent economic downturn. The Working Group should consider in this study the International Association of Insurance Supervisors standards on the same general topic as well as any issues that could arise from the recently adopted Financial Regulatory Reform. At the conclusion of such study, provide a recommendation to the Financial Condition Committee, including a request for model law development/change, if the recommendation is for the NAIC to devote its resources to such an effort.—*Essential*
6. The NAIC/AICPA Working Group will:
  - Continually review the Annual Financial Reporting Model Regulation (#205) and its corresponding implementation guide; revise as appropriate.—*Essential*
  - Address financial solvency issues by working with the AICPA and responding to the AICPA exposure drafts. This charge is ongoing.—*Essential*
  - Monitor the federal Sarbanes-Oxley Act, as well as rules and regulations promulgated by the U.S. Securities and Exchange Commission, the Public Company Accounting Oversight Board and other financial services regulatory entities.—*Essential*
  - Review annually the premium threshold amount included in Section 16 of the Annual Financial Reporting Model Regulation (#205), with the general intent that those insurers subject to the Section 16 requirements would capture at least approximately 90% of industry premium and/or in response to any future regulatory or market developments.—*Essential*
7. The National Treatment and Coordination Working Group will:
  - Increase utilization and implementation of the *Company Licensing Best Practices Handbook* by regulators.—*Essential*
  - Continue to reduce state-specific requirements, including the need for hardcopies, for the forms and supplemental information involved in Uniform Certificate of Authority Application (UCAA) and to streamline the application process.—*Essential*
  - Continue to enhance all electronic tools relating to UCAA to increase user-friendliness, accuracy and utility, and to increase its usage by the industry and regulators.—*Essential*

## 2011 CHARGES

- Address the future work items identified in the completion of the *Company Licensing Best Practices Handbook* project.—*Important*
  - In collaboration with the Speed to Market (EX) Task Force, encourage synergies between corporate changes/amendments and rate and form filing review and approval to improve efficiency.—*Important*
  - Analyze Federal Law development and Solvency Modernization Initiative (SMI) for any needed modifications or revisions to the work of the National Treatment and Coordination (E) Working Group
8. The Rating Agency Working Group will:
- Monitor the implementation of recommendations resulting from the NAIC's evaluation of the reliance on nationally recognized statistical rating organization (NRSRO) ratings. Provide a status of the recommendations to the Financial Condition (E) Committee at each NAIC national meeting until the majority of the recommendations have been implemented or disposed. —*Important*
  - Evaluate whether states', municipalities' and other public entities' creditworthiness should take into account the unprecedented financial burdens many public sector issuers face from aging populations, public pension liabilities, infrastructure needs, and revenue instability caused by financial and economic dislocations.
    - The diminished market share of monoline bond insurers (less than 10% of new issues are guaranteed - down from about 50% before the 2008 financial crisis), renders the valuation and credit risk assessment of many municipal bonds more difficult. As a result, the credit quality of insurers' municipal bond portfolio is more opaque, and may require a more frequent and detailed reporting. Heightened reporting levels will enhance transparency and provide regulators information sufficient to assess creditworthiness of the issuer. Many municipal bonds without the guarantee are not actively traded, which also reduces if not eliminates any pricing discovery, and accuracy, the bonds might have had when insured and more liquid. An alternative valuation method may need to be developed, as the NAIC methodology of matrix pricing using comparable bonds may have limitations due to the difficulty of establishing benchmarks, in particular for small municipal issuers.—*Important*
    - Given the impact on municipal finances from the possible protracted equity market downturn, from expected losses in the commercial real estate market, and from the continuing foreclosures in residential real estate market, the credit assessment of municipal bond portfolios should assess the risk of unfunded pension and employee/retiree healthcare liabilities, the growth rate of many government programs (e.g. healthcare, childcare, aged home care) which generally exceeds the growth of government revenues. Continuing municipal fiscal burdens and pressures, and unprecedented burdens resulting from the "baby boomer" generation, may necessitate alternative views and assessments of municipal creditworthiness. Recent municipal defaults in South Carolina, Pennsylvania and Nevada illustrate the sensitivity of this time. —*Important*
    - Regulators should evaluate development of a series of indicators/scales prepared for regulators as warning signs in municipal issues (especially those without strong general obligation support). These indicators could include: i) Liquidity -given the thin secondary market and overall reduced quality of many issues, liquidity is an increasing concern, ii) Sustainability - (as CALPERS and others have raised) on long portfolios given pension, OPEB and social service programs, iii) Municipal Tax Capacity - whether the government has sufficient taxing capacity and authority to satisfy current and prospective obligations, as opposed to neighboring or "competitive" taxing authorities, iv) scrutinize the risk among variant life terms of debt, and v) establishment of thresholds or milestones for reserve adjustments. —*Important*
  - Establish a process to monitor and evaluate ARO activities—*Important*. A monitoring function would:
    - Provide information about product offerings and the direction of financial innovation.
    - Permit timely regulatory intervention to set regulatory treatment for risky securities differently than that suggested by their credit quality.
    - Promote, if not require, rating agency transparency of process, compensation, staff participation, and collateral underlying the security.
    - Determine the materiality of risks other than credit to financial solvency.

## 2011 CHARGES

- Monitor and assess the changes that the rating agencies are implementing, and whether ratings continue to correctly complement regulatory purposes.
- Examine the extent to which insurers rely on ratings instead of performing their own due diligence.

~~10. The Restructuring Mechanisms for Troubled Companies Subgroup will undertake a study of solvent schemes of arrangement (solvent run-offs) and Part VII portfolio transfers (a transfer leaving no recourse to original contractual obligor/insurer) and any other similar alternative mechanisms to handle troubled insurers (other than receivership proceedings) to gain an understanding of (a) how these mechanisms are utilized and implemented; (b) the potential affect on claims of domestic companies, including the consideration of preferential treatment within current laws; (c) how alien insurers (including off shore reinsurers) who have utilized these mechanisms might affect the solvency of domestic companies; and (d) best practices for state insurance departments to consider if utilizing similar mechanisms in the United States and/or interacting with aliens who have implemented these mechanisms.—*Important*~~

9. Separate Accounting Risk Charge Working Group will study the need to develop new regulatory guidance requiring the establishment of risk charges for the risk assumed by the general account in support of individual separate account products guaranteed by the general account. At the conclusion of such study, provide a recommendation to the Financial Condition (E) Committee, including a request for Model Law Development/Change if the recommendation is for the NAIC to devote its resources to such an effort.—*Important*

***Sponsors for 2011 Charges***  
*(Except as noted, I support all charges)*

Staff Support: Todd Sells/Dan Daveline

10. Accounting Practices and Procedures Task Force

The Emerging Accounting Issues Working Group will:

- Provide authoritative guidance on current statutory accounting issues, generally relating to application, interpretation and clarification of existing statutory accounting principles, by conducting meetings at NAIC national meeting sites and other meetings and conference calls when necessary.—*Essential*
- Evaluate individual statutory accounting issues based on its established two-meeting timeline and report its findings to the Accounting Practices and Procedures Task Force.—*Essential*

The Statutory Accounting Principles Working Group will:

- Maintain codified statutory accounting principles by providing periodic updates to the guidance that address new statutory issues and new GAAP pronouncements as they develop.—*Essential*
- At the discretion of the chair, comment on exposed GAAP pronouncements affecting financial accounting and reporting.—*Essential*
- Report its findings relative to these developing issues to the Accounting Practices and Procedures Task Force.—*Essential*

## 2011 CHARGES

- ~~• Accumulate and summarize information from regulators, the industry, auditors and others, on implementation issues related to transitioning to International Financial Reporting Standards (IFRS) for statutory reporting, as well as some of the more significant issues that would need to be considered in implementing such a change.—Important~~
- Upon notice that ~~a security~~ a class of securities has been placed under regulatory review, the chair of Statutory Accounting Principles Working Group, or his or her representative, will be deemed a member of the Invested Asset (E) Working Group of the Valuation of Securities (E) Task Force. The chair, or his or her representative, is charged with contributing the perspective and expertise of the regulatory group to the development of NAIC regulatory guidance for the security under review.—*Essential*
- Provide comments on issues related to evaluating and or implementing to International Financial Reporting Standards (IFRS) for possible U.S. statutory accounting use and provide input on the solvency modernization project as it relates to accounting and reporting issues. —Important

The Blanks Working Group will:

- Consider improvements and revisions to the various annual/quarterly statement blanks and to conform these blanks to changes made in other areas of the NAIC to promote uniformity in reporting of financial information by insurers; to develop reporting formats for other entities subject to the jurisdiction of state insurance departments; to conform the various NAIC blanks and instructions to adopted NAIC policy; and to oversee the development of additional reporting formats within the existing annual statements as needs are identified.—*Essential*
- Continue to monitor state filing checklists to maintain current filing requirements.—*Essential*
- Continue to monitor the quality of financial data filed by insurance companies and recommend improved or additional languages for the *Annual Statement Instructions* to improve the quality of these filings.—*Essential*
- Continue to monitor and review all proposals necessary for the implementation of statutory accounting guidance to ensure proper implementation of any action taken by the Accounting Practices and Procedures Task Force affecting annual statements and/or instructions.—*Essential*
- Continue to coordinate with other task forces of the NAIC to ensure proper implementation of reporting and instructions changes as proposed by these task forces.—*Essential*
- Upon notice that ~~a security~~ a class of securities has been placed under regulatory review, the chair of Blanks Working Group, or his or her representative, will be deemed a member of the Invested Asset (E) Working Group of the Valuation of Securities (E) Task Force. The chair, or his or her representative, is charged with contributing the perspective and expertise of the regulatory group to the development of NAIC regulatory guidance for the security under review.—*Essential*

The Property and Casualty Reinsurance Study Group will:

- Evaluate, on an ongoing basis, all issues and questions related to the accounting for or annual statement reporting of reinsurance transactions that might affect SSAP No. 62, SSAP No. 75 or other portions of the *Accounting Practices and Procedures Manual*, and make appropriate recommendations to the Accounting Practices and Procedures Task Force.—*Essential*
- Monitor, on an ongoing basis, the development of “alternative risk transfer mechanisms” and consider whether broader annual statement disclosure might be appropriate.—*Essential*

13. The Capital Adequacy Task Force will:

- Evaluate refinements to the existing NAIC risk-based capital formulas implemented in 2010~~09~~. Forward final version of the structure of the 2011~~10~~ life, P&C, ~~and~~ health and fraternal RBC formulas to Financial Condition (E) Committee by June 2011~~10~~.—*Essential*

## 2011 CHARGES

- Consider proposals for structural changes to the RBC formulas (including proposals related the NAIC solvency modernization initiative to a principle-based RBC approach) submitted by the working groups/subgroups. Proposed structural changes to the 20~~12~~<sup>11</sup> formulas that are received by the 20~~11~~<sup>10</sup> Fall National Meeting will be considered for adoption by the Task Force, and adopted changes will be forwarded to Financial Condition (E) Committee by March 20~~12~~<sup>11</sup>.—*Essential*
- Review the effectiveness of the NAIC's RBC policies and procedures as they affect the accuracy, audit ability, timeliness of reporting access to RBC results, and comparability between the RBC formulas. Report on data quality problems in the 20~~10~~<sup>09</sup> RBC filings at the summer and fall meetings.—*Essential*
- Monitor changes in accounting and reporting requirements resulting from the adoption and continuing maintenance of the revised *Accounting Practices and Procedures Manual* to ensure that model laws, publications, formulas, analysis tools, etc., supported by the Task Force continue to meet regulatory objectives.—*Essential*
- Evaluate emerging “risk” issues for referral to the risk-based capital working groups/subgroups for certain issues involving more than one RBC formula. Monitor emerging and existing risks relative to their consistent or divergent treatment in the three RBC formulas.—*Essential*
- Conduct a regulatory review of the 200~~7~~<sup>8</sup>, 200~~8~~<sup>9</sup> and 20~~10~~<sup>09</sup> RBC filings and associated company records in order to assess the impact resulting from implementation of the principle-based changes to the life RBC formula. Monitor implementation and impact of the adopted changes, as well as provide responses to the Principles-Based Reserving (EX) Working Group, regarding how the proposed expansion to the principle-based approach affects all of the RBC formulas. Also develop and review disclosure-documentation and governance protocols to be used by regulators and companies.—*Essential*
- Upon notice that a security a class of securities has been placed under regulatory review, the chair of Capital Adequacy Task Force, or his or her representative, will be deemed a member of the Invested Asset (E) Working Group of the Valuation of Securities (E) Task Force. The chair, or his or her representative, is charged with contributing the perspective and expertise of the regulatory group to the development of NAIC regulatory guidance for the security under review.— *Essential*

#### 14. The Examination Oversight Task Force will:

- Provide ongoing maintenance and enhancements to the Form A Database, monitor the usage and encourage state participation.—*Essential*
- Provide input and comments to the International Association of Insurance Supervisors (IAIS) or other related groups on issues regarding international risk-management concepts; coordinate such comments with the International Solvency (EX) Working Group.—*Important*
- Recommend salary rate adjustments for examiners.—*Essential*
- Provide ongoing maintenance and enhancements to the NAIC Lead State Summary Report tool and encourage coordination with solvency matters.—*Essential*

#### The Analyst Team System Oversight Working Group will:

- Monitor the work performed by the Analyst Team and the progress of any changes made to the Analyst Team Project.—*Essential*

## 2011 CHARGES

The IT Examination Working Group will:

- Monitor state usage of automated examination tools (ACL and TeamMate), technology changes and emerging issues in order to re-evaluate examination processes and keep states abreast of the latest tools, techniques and training.—*Essential*
- Enhance current training opportunities for auditing tools and techniques: IT Examination, Introductory ACL, Advanced ACL and TeamMate. Continue offering on-site training programs that are available to states upon request.—*Essential*
- Continually review and revise, as needed, the “Examination of Computer Based Operations” “General Information Technology Review” and “Exhibit C—Evaluation of Controls in Information Systems” sections of the Financial Condition Examiners Handbook.—*Essential*
- Develop and maintain tools that will be part of a more complete IT examination process.—*Important*

The Financial Analysis Research and Development Working Group will:

- Provide ongoing maintenance and enhancements to the automated financial solvency tools developed to assist in monitoring the financial condition of insurance companies. Prioritize analysis and examination efforts to ensure the tools remain reliable and accurate.—*Essential*
- Review current financial analysis solvency tools for life insurance companies for consideration of risk with reserve liabilities as affected by principles-based reserving standards; make appropriate enhancements as necessary.—*Important*

The Financial Analysis Handbook Working Group will:

- Provide ongoing maintenance and enhancements to the Financial Analysis Handbook and related applications for changes to the NAIC annual/quarterly statement blanks, as well as coordinate and analyze input received from other state regulators.—*Essential*
- Continue to incorporate the assessment of risk and risk management into the financial analysis oversight role.—*Essential*
- Review current guidance in the Financial Analysis Handbook regarding the analysis of reserve liabilities for life insurance companies and make appropriate revisions based on the finalized principles-based reserving standards.—*Important*
- Continue incorporating ~~Develop~~ enhancements that encourage coordination of analysis activities within holding company groups.—*Essential*

The Financial Examiners Coordination Working Group will:

- Develop enhancements that encourage coordination of examination activities with regard to holding company groups.—*Essential*
- Promote coordination by assisting and advising domiciliary regulators and exam coordinating states as to what might be the most appropriate regulatory strategies, methods and actions regarding financial examinations of holding company groups.—*Essential*
- Provide ongoing maintenance and enhancements to the Examination Tracking System (ETS). The Working Group also will provide reports to the Examination Oversight Task Force regarding usage of ETS, including examination and coordination statistics.—*Essential*

## 2011 CHARGES

The Financial Examiners Handbook Technical Group will:

- Continue incorporating the assessment of risk and risk management into the financial solvency oversight role.—*Essential*
- Continually review the *Financial Condition Examiners Handbook* and revise, as appropriate.—*Essential*
- Review annually the examination procedures included within the *Financial Condition Examiners Handbook* for updates in response to revisions to the *Accounting Practices and Procedures Manual*.—*Essential*
- Continually review the Annual Financial Reporting Model Regulation (#205) and its related Implementation Guide and revise the *Financial Condition Examiners Handbook*, as appropriate.—*Essential*
- Monitor the implementation of the revised risk-assessment process by receiving feedback, conducting training courses and performing ongoing maintenance—as well as developing additional guidance and exhibits within the *Financial Condition Examiners Handbook* as needed to assist examiners in completing financial condition examinations.—*Important*
- Review current guidance in the *Financial Condition Examiners Handbook* regarding the examination of reserve liabilities for life insurance companies and recommend appropriate revisions based on the finalized principles-based reserving standards.—*Important*
- Upon notice that a security a class of securities has been placed under regulatory review, the Chair of Financial Examiners Handbook (E) Working Group or his or her representative will be deemed a member of the Invested Asset (E) Working Group of the Valuation of Securities (E) Task Force. The Chair or his or her representative is charged with contributing the perspective and expertise of the regulatory group to the development of NAIC regulatory guidance for the security under review.—*Essential*

15. The Receivership and Insolvency Task Force will:

- Promote and mMonitor the adoption activity related to the progress of Insurer Receivership Model Act (#555), Property and Casualty Guaranty Association Model Act (#540), Life & Health Insurance Guaranty Association Model Act (#520), and Guideline for Notice of Protection by [State] Life and Health Insurance Guaranty Association; adoption by the states (and/or components of the model); provide assistance with the models or guidelines as requested; monitor the frequency of situations where policies exceed the guaranty fund coverage limits; and perform additional work as directed by the Financial Condition (E) Committee and/or received through referral by other parties.—*Essential*
- Promote receivership best practices through (a) technical assistance with NAIC training programs, accreditation standards and the judicial training project; (b) updates to the *Receiver's Handbook for Insurance Company Insolvencies* and the Uniform Data Standards, when needed; (c) maintenance and enhancement of existing receivership technology applications, including the Global Receivership Information Database (GRID) and ClaimNet; (d) in coordination with stakeholders.—*Essential*
- Identify and recommend possible solutions to address timing and collection concerns with reinsurance recoverables held by insurers in receivership. —*Essential*
- Study receivership issues related to separate accounts, including the referral from the Separate Accounts Risk Charge Working Group and report on possible solutions. —*Essential*
- Review and consider portions of the recently adopted Dodd-Frank Wall Street Reform and Consumer Protection Act to determine what, if any state laws, regulations or procedures are necessary for state receivers and the NAIC to be prepared for its requirements related to receivership activities, as well as, monitor, review and provide input on federal rulemaking and studies related to insurance receivership. —*Essential*

## 2011 CHARGES

- Monitor nationally significant insurers/groups within receivership to support, encourage, promote and coordinate multi-state efforts in addressing problems. This will include interacting with the Financial Analysis Working Group, domiciliary regulators and lead states to assist and advise as to what might be the most appropriate regulatory strategies, methods and action(s) with regard to the receiverships. —Essential

### 16. The Reinsurance Task Force will:

- Monitor and coordinate activities and areas of interest that overlap to some extent with the charges of other NAIC groups, specifically the International Insurance Relations (G) Committee.—*Essential*
- Provide a forum for the consideration of reinsurance-related issues of public policy.—*Essential*
- Promote and facilitate the implementation of the adopted reinsurance regulatory modernization framework. Provide guidance to the Financial Regulation Standards and Accreditation (F) Committee with respect to key elements of the Reinsurance Regulatory Modernization Framework to be considered for the purposes of the NAIC Financial Regulation Standards and Accreditation Program—Essential
- Consider amendments to the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) to incorporate key elements of the Reinsurance Regulatory Modernization Framework—Essential
- In coordination with the Accident and Health Working Group of the Life and Health Actuarial Task Force, provide support in developing provisions that enable States to establish and maintain a transitional reinsurance program with respect to the Patient Protection and Affordable Care Act—Essential
- Monitor the activities of the Property and Casualty Reinsurance (E) Study Group for matters that should be considered by the Task Force.—*Important*
- Monitor the development of international reinsurance principles, standards and guidance with respect to reinsurance. This includes but is not limited to monitoring the activities of various groups within the International Association of Insurance Supervisors, including the Reinsurance and Other Forms of Risk Transfer Subcommittee, Reinsurance Mutual Recognition Subgroup and Reinsurance Transparency Group.—Important
- Consider the impact of reinsurance-related federal legislation, including but not limited to the Nonadmitted and Reinsurance Reform Act and the Federal Insurance Office Act, and coordinate any appropriate NAIC action—Important

### 17. The Risk Retention Group Task Force will:

- Monitor and evaluate the work of other NAIC committees, task forces and working groups related to risk-retention groups (RRGs) ~~and other types of captive insurers~~. Specifically, if any of these changes affect the NAIC Financial Regulation and Accreditation Standards program, assess whether and/or how the changes should apply to risk-retention groups.—*Important*
- Consider the referral received from the RRG (E) Subgroup of the Financial Examiners Handbook Technical Group regarding risk-focused examinations of RRG. Develop a recommendation regarding whether certain RRGs may be exempt from certain parts or phrases of the risk-focused examination approach and send this recommendation to the Financial Regulation Standards and Accreditation (F) Committee. —Important
- Develop proposed guidance regarding how, and to what extent, the Risk-Based Capital for Insurers Model Act (#312) should be adopted for use with RRGs. —Important

### 18. The Valuation of Securities Task Force will:



## 2011 CHARGES

- Review insurers' existing and/or anticipated investments and determine the appropriate credit assessment, valuation or other procedures that should be applied in such analysis. Coordinate the process by which statutory accounting, annual statement instructions, blanks reporting, asset and interest maintenance reserving, risk-based capital and other applicable guidance is formulated.—*Essential*
- As necessary, consider improvements to the process by which risks in invested assets are evaluated, communicated and monitored, and how the annual statement investment schedules could be made to better reflect risks embedded in securities.—*Essential*
- ~~Evaluate and resolve issues raised by~~ Provide assistance to state insurance regulators ~~on issues~~ involving investments made by the insurance industry.—*Essential*
- Serve as the primary NAIC contact point into the regulator process for insurance companies, their investment advisors and other market participants. *Essential*
- Consider and determine proposals to amend the *Purposes and Procedures Manual*.—*Essential*
- Provide interpretations of the instructions contained in the *Purposes and Procedures Manual*, ~~as the Task Force deems necessary and appropriate.~~—*Essential*
- Monitor changes in accounting and reporting requirements resulting from continuing maintenance of the *Accounting Practices and Procedures Manual* to ensure that the *Purposes and Procedures Manual* continues to reflect regulatory objectives.—*Essential*
- Review and monitor ongoing operations of the SVO. From time to time, the Task Force may review any instruction, procedure or methodology in the *Purposes and Procedures Manual* to ensure it continues to reflect regulatory objectives. In this review and monitoring function, the Task Force shall coordinate administrative issues with the Internal Administration (EX1) Subcommittee and other issues with the appropriate NAIC committee.—*Essential*
- Develop, adopt, monitor and revise, as necessary, an annual agenda for the SVO Research Unit.—*Essential*
- ~~Conclude the study begun in 2006 of the derivatives marketplace, to determine whether any changes to the current regulatory regime is appropriate.~~—*Essential*

### The Invested Asset Working Group will:

- ~~From time to time, the Valuation of Securities Task Force may determine that the technical nature of some matter before it would be best advanced by convening the Invested Asset Working Group and transferring to it a specific regulatory assignment or assignments. The assignment or assignments thus transferred to the Invested Asset Working Group by the Valuation of Securities Task Force shall be within that charge of the Task Force related to development of a regulatory framework for new or evolving investments or the consideration of refinements for an existing regulatory framework applicable to an existing class of securities. The phrase "regulatory framework" refers collectively to and means the following regulatory mechanisms or processes: statutory accounting guidance; annual statement instructions; blanks reporting instructions; asset valuation reserves; interest maintenance reserves; risk-based capital charges; valuation procedures for invested assets; credit assessment procedures for invested assets; or any other aspect of the NAIC financial solvency framework within the scope of the charge of the Task Force. The Invested Asset Working Group is charged with the review of matters in the priority established by the Task Force.~~—*Essential*

## 2011 CHARGES

- The Invested Asset Working Group is charged with considering improvements to the process by which risks in new invested assets are evaluated, communicated and monitored, and how the annual statement investment schedules could be made more transparent to better reflect non-credit risks, such as various structural risks embedded in new and existing securities.—*Essential*
- The Invested Asset (E) Working Group (IAWG) is established as a standing NAIC working group. The mission of the IAWG is to provide continuity in and manage NAIC processes related to the development of regulatory rules to address new investment structures. The IAWG shall fulfill this charge by:
  - Serving as the primary NAIC contact point into the regulatory process for insurance companies, their investment advisors and other market participants;
  - Creating and maintaining a framework and the necessary procedures and processes to conduct technical assessments of investment risks in investment products eligible for purchase by insurance companies;
  - Developing and maintaining knowledge and expertise about investment risks and issues as well as SVO operations and capabilities;
  - Guiding the development of the technology platform of the SVO to ensure the development, implementation and evolution of systems and tools that adequately support NAIC financial solvency objectives;
  - Serving as the primary NAIC regulatory resource to alert the NAIC regulatory community of the identification of regulatory issues and concerns in specific investments or in investments generally;
  - Ensuring that the process by which risks in invested assets are evaluated, communicated and monitored is updated as necessary to permit a timely and comprehensive response to requests for regulatory guidance;
  - Ensuring that the NAIC framework for investment risks in all annual statement investment schedules and reporting instructions captures relevant information of investment risks in insurer-owned securities; and
  - Performing or conducting such other ancillary or related activities that are consistent with its mission and charge.

In its fulfillment of this charge, the IAWG shall meet with the SVO on a regular basis in sessions which are either open or closed to the public, in accordance with, and within the parameters of, the requirements of the NAIC Open Meetings Policy. During these sessions the IAWG shall consult on:

- SVO operations;
- Risks in investment or investment trends identified by the SVO;
- Regulatory practices and regulatory sensitivities that should serve as inputs in the conduct of SVO analytical responsibilities; and
- Market signals and information that warrant scrutiny for possible regulatory relevance.



## Reinsurance Collateral Reduction & Accreditation Recommendations

On September 23, 2009, the NAIC Government Relations Leadership Council adopted the Reinsurance Regulatory Modernization Act of 2009 (RRMA), and agreed to submit the draft legislation to Congress for its further action. This proposed federal legislation was based on the Reinsurance Regulatory Modernization Framework Proposal (Reinsurance Framework), which the NAIC adopted during the Winter 2008 National Meeting. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which was signed into law on July 21<sup>st</sup>. This act includes the Nonadmitted and Reinsurance Reform Act (NRRA), which becomes effective 1-year after its enactment, as well as creates the Federal Insurance Office (FIO). The NRRA prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes such credit and is either (1) an NAIC-accredited state; or (2) has financial solvency requirements substantially similar to NAIC accreditation requirements.

Some states are now expressing an interest in moving forward with individual state-based reinsurance collateral reduction reforms. We have been advised that the changes being considered are generally intended to conform to key elements of the NAIC Reinsurance Framework. The Financial Regulation Standards and Accreditation (F) Committee has made an informal request to the Reinsurance (E) Task Force to consider which key elements of the Reinsurance Framework should be considered in reviewing any individual state initiatives, and whether these key elements should be incorporated into the Credit for Reinsurance Model Law and Regulation. The initial draft recommendations were exposed at the Summer National Meeting for a comment period ending on September 16, 2010. After reviewing all comments, the Task Force has prepared the attached revised draft for consideration. In light of these developments, the Task Force proposes to begin the process of revising the credit for reinsurance models to make them consistent with key elements of the Reinsurance Framework, and will provide guidance to the F Committee with respect to its evaluation and possible revision of the accreditation requirements. The following steps are recommended with respect to state-based reinsurance regulatory modernization efforts:

- **Amend the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation.** The Task Force will consider amendments to Model #785 and Model #786 in order to incorporate key elements of the Framework Proposal.
- **Provide Guidance to the F Committee on Key Elements of Reinsurance Framework for Accreditation Purposes.** Once the key elements have been agreed upon by the Task force, it will submit the information to the F Committee as guidance it may use when reviewing any individual state reforms to reduce collateral. These key elements would not be required of all states; rather, they would be applicable to any state choosing to implement related reinsurance regulatory reforms.<sup>1</sup>

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<sup>1</sup> It should be noted that any proposed changes to the accreditation standards would not require a state to reduce its reinsurance collateral requirements. Under the Accreditation Interlineations, it is only required that a state demonstrate that its laws and administrative practices result in solvency regulation that is similar in force and no less effective than the standard. This has been interpreted to mean that a state may comply by demonstrating that its laws result in solvency regulation that is more effective than the standard.

▪ **Attachment:**

**Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation Purposes**

Laws and Regulations:

The Reinsurance Framework provides that reinsurers may continue to operate under the current Credit for Reinsurance Model Law. Therefore, states would not be required to adopt the new reinsurance collateral reduction framework. However, for those states choosing to reduce collateral for nonadmitted reinsurers, the following elements should be required to be evident in a state’s laws and/or regulations. Further, states should be required to disclose publically a listing of approved reinsurers and approved non-U.S. jurisdictions on a periodic basis.

1. Requirements for Eligible Assuming Insurers

- a. Applicable Reinsurance Contracts. The provisions of this standard shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the implementing statute or regulation. Affiliated reinsurance transactions may receive the same opportunity for reduced collateral requirements as all other reinsurance transactions.
- b. Eligible assuming insurer (as determined by order of the commissioner) maintains capital and surplus of no less than \$250 million. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least \$250 million and a central fund containing a balance of at least \$250 million.
- c. Eligible assuming insurer maintains a secure financial strength rating from at least two approved rating agencies. The maximum collateral reduction allowed for an eligible assuming insurer is consistent with the following table. The lowest financial strength rating shall be used in establishing the maximum amount of the collateral reduction. The commissioner may in his or her discretion require additional collateral, if deemed appropriate.

<u>Collateral</u>	<u>A.M. Best</u>	<u>Standard &amp; Poor’s</u>	<u>Moody’s</u>	<u>Fitch</u>
0%	A++	AAA	Aaa	AAA
10%	A+	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
20%	A, A-	A+, A, A-	A1, A2, A3	A+, A, A-
75%	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
100%	B, B-, C++, C+, C, C-, D, E, F	BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD

- d. Eligible assuming insurer submits to the commissioner a properly executed Form AR-1, or equivalent document deemed acceptable to the commissioner, stipulating that the reinsurer submits to the jurisdiction of U.S. courts, appoints an agent for service of process in the United States, and agrees to post 100% collateral for its United States liabilities if it resists enforcement of a final U.S. judgment.
- e. Eligible assuming insurer must file with the commissioner, both upon initial application and annually thereafter, copies of (1) audited financial statements, regulatory filings and actuarial opinions filed with its domiciliary supervisor; (2) a report in a form substantially similar to the applicable NAIC Annual Filing Blank, either Schedule F or Schedule S; (3) a report of recoverables in dispute or more than 90 days past due; (4) the report of an independent auditor on the financial statements of the insurance enterprise; and (5) a certification from the domiciliary supervisor that the eligible assuming insurer is in good standing, and a list of any regulatory actions against the reinsurer.

f. In order to facilitate the prompt payment of claims, an eligible assuming insurer would not have to post collateral for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a defined catastrophic occurrence as recognized by the commissioner. The one year deferral period is contingent upon the respective eligible assuming insurer continuing to pay claims in a timely manner. Reinsurance recoverables for only the following lines of business as reported on the NAIC annual financial statement related specifically to the catastrophic occurrence will be included in the deferral:

- Line 1: Fire
- Line 2: Allied Lines
- Line 3: Farmowners multiple peril
- Line 4: Homeowners multiple peril
- Line 5: Commercial multiple peril
- Line 9: Inland Marine
- Line 12: Earthquake
- Line 21: Auto physical damage

## 2. Evaluation of Non-U.S. Jurisdictions

a. The commissioner shall evaluate the reinsurance supervisory systems of non-U.S. jurisdictions, both initially and on an ongoing basis, consider the rights, benefits and the extent of reciprocal recognition afforded by non-U.S. jurisdictions to reinsurers licensed and domiciled in the U.S., determine the appropriate supervisory recognition approach for such jurisdictions, and create and publish a list of jurisdictions whose reinsurers may be approved by the commissioner as eligible assuming insurers. Factors to be considered in the determination of the eligibility of the non-U.S. jurisdiction include, but are not limited, to the following:

- Reciprocal treatment of U.S. reinsurers.
- Any solvent scheme of arrangement, or similar procedure, which involves U.S. ceding insurers.
- The jurisdiction adequately and promptly enforces final U.S. judgments or arbitration awards.
- Relevant international standards with respect to mutual recognition of reinsurance supervision; e.g., IAIS guidance papers on mutual recognition of reinsurance supervision or other related documents.

b. If the NAIC issues advisory findings or recommendations that certain jurisdictions should be considered eligible jurisdictions, the commissioner may adopt this list.

c. The non-U.S. jurisdiction agrees to share information and cooperate with the commissioner with respect to the applicable assuming insurer.

### Regulatory Practices and Procedures:

***[Staff Note: The F Committee will review this section and determine any applicable standards as deemed appropriate]***

Oct. 1. 2010 10:04AM State Corporation Commission

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04:11:39 p.m. 09-30-2010 2/3



**State of New Jersey**  
DEPARTMENT OF BANKING AND INSURANCE  
OFFICE OF THE COMMISSIONER  
PO BOX 325  
TRENTON, NJ 08625-0325  
TEL (609) 292-7272

CHRIS CHRISTIE  
*Governor*

KIM GUADAGNO  
*Lt. Governor*

THOMAS B. CONSIDINE  
*Commissioner*

September 30, 2010

The Honorable Alfred W. Gross  
Commissioner  
P.O. Box 1157  
Richmond, VA 23218

Re: E Committee's Proposed Annual Statement Disclosure for RAAs

Dear Commissioner Gross:

We believe RAAs are a very reliable and beneficial option for consumers. However, given the biased and inaccurate media stories surrounding retained asset accounts, the New Jersey Department of Banking and Insurance is moving quickly to implement reforms that will help set the record straight and make a good product even better.

Last week, I signed Order No. A10-109 (copy attached). As a result of the Order, documents establishing new retained asset accounts will be subject to regulatory review and approval. The Order also requires added consumer disclosure about guarantees -- specifically the presence of \$500,000 of NJ state guaranty fund protection and the absence of FDIC protection.

While we support your efforts to require new Annual Statement disclosures about RAAs, we wanted to share with you our concerns with the current draft E Committee proposal.

In our view, the information requested in paragraphs 19a through 19j should be deleted as it may actually spread the fiction that the return on long-term assets in an insurer's general account is somehow "matched" against the short-term liability rates credited to RAAs -- and that the difference represents a profit to the insurer. That is not the case. In fact, all general account assets must stand behind all general account obligations, not just RAA liabilities.

We would suggest that the E Committee remove these requirements and replace them with a request for the following RAA data:

1. the total dollar amount in RAA liability at the beginning and end of the reporting year,
2. the interest paid during the reporting year, and
3. have this information shown by RAA "age" category (for example, up to 12 months, 13 to 24 months, 25 to 36 months, 37 to 48 months, 49 to 60 months, and over 60 months).

Oct. 1. 2010 10:04AM State Corporation Commission  
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04:12:04 p.m. 09-30-2010 3/3

This data would prove useful to regulators in monitoring whether RAAs are operating as expected (i.e., insurers are crediting a fair short term interest rate, and beneficiaries are using the RAA as a short term repository).

Thank you for considering our suggested changes to the E Committee's proposed Annual Statement disclosure for retained asset accounts. We look forward to working with you on these important issues and appreciate the opportunity we had to discuss these issues with you.

*All best!*

Very truly yours



Thomas B. Considine  
Commissioner



October 6, 2010

Commissioner Alfred W. Gross  
Virginia State Corporation Commission  
Bureau of Insurance  
PO Box 1157  
Richmond, Virginia 23218

VIA E-mail

**RE: Proposed Form A relating to Retained Assets Disclosures**

Dear Commissioner Gross:

The American Council of Life Insurers (“ACLI”)<sup>1</sup> appreciates this opportunity to comment on the proposed Form A (Ref #2010-17) that was drafted by the Statutory Accounting Principles Working Group and exposed by the Financial Condition (E) Committee for comments.

The ACLI believes that some of the proposed retained assets disclosures are either unnecessary or inappropriate for purposes of the *Annual Statement*. For example:

- (1) The total count of life insurance claims (19.a) can be determined from the "Exhibit of Life Insurance" or from "Direct Death Benefits and Mature Endowments Incurred" on the Grand Total of the State Page.
- (2) The average interest rate earned by beneficiaries (19.f) can be determined from other suggested reporting information.
- (3) Not all insurers are able to report the amount of interest they earn (and any corresponding interest rates) with regard to retained asset accounts (19.g, 19.h) since not all insurers segregate the related account funds into a separate fund or investment account.
- (4) Assertions or opinions as to whether retained asset accounts are covered under a state's guaranty association law should be made by the guaranty association, not by an insurer on its financial statement (19.k).

Furthermore, similar detailed disclosures are not required for other life insurance or annuity products and we see no compelling reason why retained asset accounts should be treated any differently.

Additionally, the term “retained asset accounts” should be defined within the guidance so it is clear what items are within the scope of these requirements. We suggest a definition that builds off the information used in the “Description of the Issue” section of Form A which was written to introduce the modification to SSAP No. 52. We suggest the following:

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<sup>1</sup> The ACLI is the primary trade association of the life insurance industry, representing more than 300 legal reserve life insurer and fraternal benefit society member companies that account for over 90% of the assets and premiums of the U.S. life insurance and annuity industry.



Retained asset accounts represent settlement of life insurance proceeds which are retained by the insurance entity within their general account for the benefit of the beneficiaries. Amounts held outside of the insurance entity, for example in a non-insurance subsidiary, affiliate or controlled entity accounted for under SSAP 97, *Investments in Subsidiary, Controlled, and Affiliated Entities, A Replacement of SSAP No. 88*, such as a bank or thrift institutions deposit accounts insured by the Federal Deposit Insurance Corporation are not considered retained asset accounts.

In conjunction with this definition, we propose, as an alternative to the proposed list of disclosure requirements in the exposed Form A, that the following disclosures be added to the *Accounting Practices and Procedures Manual* and implemented by the following modifications to the *Annual Statement* beginning in 2011:

(1) Amend the *Exhibit of Number of Policies, Contracts, Certificates, Income Payable and Account Values in Force for Supplementary Contracts, Annuities, Accident & Health and Other Policies* to add another column for Retained Asset Accounts in both the Ordinary and the Group subsections of the Supplementary Contracts section so that the following information can be provided:

- Number of retained asset accounts in force at the beginning of the year.
- Number of retained asset accounts issued during the year.
- Number of retained asset accounts closed out during the year.
- Number of retained asset accounts in force at the end of the year.

(2) Amend *Exhibit 7 – Deposit-Type Contracts* by bifurcating Column 4 – “Supplemental Contracts” into two separate columns – one for “Retained Assets” and one for “Other Supplemental Contracts” so that the following information can be provided:

- Balance of retained asset accounts at the beginning of the year.
- Amount of retained assets accounts added during the year.
- Investment earnings credited to retained asset accounts.
- Amount of retained asset accounts withdrawn during the year.
- Fees and other charges assessed during the year.
- Balance of retained asset accounts at the end of the year.

Because form changes to the above exhibits can not be made in time for filing of the 2010 *Annual Statement*, we suggest that insurers provide the information listed above in the free form *Notes to Financial Statements* section of this year’s *Annual Statement* as follows:

	Ordinary Number	Ordinary Balance/ Amount	Group Number	Group Balance/ Amount
Number/Balance of Retained Asset Accounts at the Beginning of the Year		\$		\$
Number/Amount of Retained Assets Accounts Issued/Added During the Year		\$		\$
Investment Earnings Credited to Retained Asset Accounts During the Year	N/A		N/A	
Fees and Other Charges Assessed to Retained Asset Accounts During the Year	N/A		N/A	
Number/Amount of Retained Asset Accounts Closed/Withdrawn During the Year		\$		\$
Number/Balance of Retained Asset Accounts at the End of the Year		\$		\$

Thank you for your consideration. If you have any questions, please contact Wayne Mehlman at 202-624-2135 or Michael Monahan at 202-624-2324.

Sincerely,



Wayne Mehlman  
Counsel, Insurance Regulation



Michael Monahan  
Director, Accounting Policy

cc: Members of the Financial Condition (E) Committee  
Dan Daveline, NAIC Staff

**Ted Strickland, Governor**  
**Mary Jo Hudson, Director**

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October 8, 2010

Commissioner Alfred W. Gross  
Virginia State Corporation Commission  
Bureau of Insurance  
PO Box 1157  
Richmond, Virginia 23218 VIA E-mail

RE: Proposed Form A relating to Retained Assets Disclosures

Dear Commissioner Gross:

Ohio believes that some of the disclosures for Retained Asset Accounts (RAA) are needed but others are redundant or unnecessary as compared to other disclosures. Since these accounts are similar to banking demand deposit accounts, disclosures should be similar, but incorporate those that are unique to insurance.

Within the new section 19, paragraphs a., c., and e. seem appropriate. Paragraph b. would seem to be 100% of claims for any company that offers RAAs. Paragraphs d. and f. can be calculated using information from a progression (discussed below).

With regards to paragraphs f., g., h., and i., our review of disclosures in bank Securities and Exchange Commission filings did indicate an overall investment spread percentage for the filing entity, but did not indicate an investment spread at a product level, or a product group level. Similar detailed disclosures are not required for other life insurance or annuity products and we see no compelling reason why retained asset accounts should be treated any differently than those insurance products or banking products.

The banking industry does appear to have disclosures (at least for certificates of deposit) related to aging, which may be more appropriate than a weighted average balances. Also, a progression of balances and counts (beginning, added, interest credited, fees, withdrawals, ending) would enable a user to see related amounts and calculate an average earned rate. This can probably be accomplished for this year-end via a table in the notes to financial statements and by adding a column or row specific to Retained Asset Accounts in Exhibit 7 and in the State Page information for longer term solutions.

Thank you for considering our comments and we look forward to discussion on this item.

Sincerely,  
/s/

Dale G. Bruggeman, CPA, FLMI  
Ohio Department of Insurance  
Office of Risk Assessment  
Chief, Policy and Development, Foreign Analysis and Administration

**Accredited by the National Association of Insurance Commissioners (NAIC)**  
Consumer Hotline: 1-800-686-1526    Fraud Hotline: 1-800-686-1527    OSHIIP Hotline: 1-800-686-1578  
TDD Line: (614) 644-3745    (Printed in house)

-----Original Message-----

From: Birny Birnbaum  
Sent: Monday, October 11, 2010 9:57 AM  
To: Daveline, Dan  
Cc: Joe\_Belth; Bob Hunter; Brendan Bridgeland; Gaul, Matt  
Subject: Re: E Committee Exposure-Comments due COB Friday October 8th

Dan,

CEJ submits the following comments on the Form A proposal regarding retained asset accounts.

CEJ supports the proposed information requirements for retained asset accounts and recommends the following addition:

- \* Number of and dollar amount of retained asset accounts in existence for 0 to 11 months, 12 to 23 months, 24 to 35 months, 36 to 59 months and 60 or more months at year end of current year and prior year.
- \* Number of and dollar amount of retained asset accounts with no withdrawal activity for 24 to 35 months, 36 to 59 months and 60 or more months at year end of current year and prior year.
- \* Number of and dollar amount of retained asset accounts transferred to any state unclaimed property funds
- \* Ten-year history of changes in interest rate earned by beneficiaries on retained asset accounts -- a chronological list of the interest rate awarded by the insurer and the effective date of the interest rate change.
- \* Ten-year history of changes in fees charged for retained asset accounts -- a chronological list with the name of the fee, the amount of the fee and the date the fee was implemented, changed or eliminated.
- \* Description of any periodic communication to owners of retained asset accounts regarding the status, earnings or fees of the account, including, for example, periodic statements or tax forms. The description shall include the title of the communication as printed on the communication, the frequency of the communication and a summary of the information contained.

These additional data elements are necessary for reviewing and evaluating how retained asset accounts are utilized by beneficiaries and whether that usage is consistent with insurer assertions about consumer desires and benefits. Insurers claim that retained asset accounts benefit beneficiaries by offering consumers a tool to hold the life insurance benefit during a period of emotional duress, allowing the beneficiary to earn some interest instead of simply receiving a lump sum benefit. The information described above allows an analysis of, among other things,

- \* how often insurers change the interest rate earned on retained asset accounts
- \* the nature and amount of fees charged to beneficiaries for retained asset accounts

- \* the net gain to beneficiaries -- interest earned less fees -- from retained asset accounts
- \* the duration of retained asset accounts and accounts with no withdrawal activity for long periods of time
- \* the amounts of retained asset accounts never withdrawn and turned over to abandoned property funds
- \* the type and frequency of communication with the beneficiary about the retained asset account

The few financial or market conduct examinations we have found which examined retained asset accounts indicate a significant number of these accounts lie dormant for long periods of time. See our attached testimony to NCOIL which cites three market conduct examinations. In one instance, almost one-third of the accounts were dormant for three or more years and 10% were dormant for five or more years. A large number of such dormant accounts raises questions about consumer knowledge and understanding of the accounts because an account dormant for a lengthy period is inconsistent with the contention that retained asset accounts are a short-term option to aid consumers during a period of grief. The information described above will inform regulators, policymakers and the public about how retained asset accounts are used and ensure that legislative or regulatory actions best match any marketplace problems.

Thanks for your consideration,

Birny Birnbaum

**Supplemental Comments of the Center for Economic Justice  
on Retained Asset Accounts**

**To the National Conference of Insurance Legislators and  
the National Association of Insurance Commissioners**

**September 24, 2010**

In the most recent issue of *The Insurance Forum*, Professor Joe Belth writes about retained asset accounts (RAA) and cites two market conduct examinations involving retained asset accounts. CEJ reviewed the market conduct examination reports posted on the New York State Department of Insurance website and found the following:

From the Report on Examination of MONY Life Insurance Company as of December 31, 2001:

The Company indicated that there are approximately 6,890 MONYmarket account holders as of December 31, 2001. A review of the Company's retained asset (MONYmarket) account holder activity as of December 31, 2001 indicated that approximately 1,380 MONYmarket accounts have been dormant (no account holder initiated activity) for 3-5 years and approximately 827 MONYmarket accounts have been dormant over 5 years. The examiner recommends that the Company investigate all MONYmarket accounts that have been dormant a minimum of three years in order to determine if any account(s) should be reported as unclaimed funds and eventually remitted to the appropriate state(s).

The examination found nearly one-third (32%) of RAAs had been dormant for 3 or more years. The examination report of the Phoenix Insurance Company as of December 31, 2002 stated,

The Company uses a retained asset account in the settlement of its claims; the account is named the Preferred Client Account ("PCA"). The PCA is a money market account that a beneficiary can write checks against. The examiner reviewed an inventory of inactive PCA's. During the review, the examiner noted that 1,366 accounts were dormant for periods between three and five years. These accounts totaled \$30,874,265. There were also 110 accounts with a combined balance of \$2,637,797 that had been dormant for more than five years. The Company does not have any procedures in place to contact the owners of such accounts.

The examination report of New York Life Insurance Company dated March 31, 2006 stated

The examiner reviewed a sample of 100 individual life death claims. In reviewing the claims, the examiner noted that in its standard individual life claim form the Company lists only one settlement option for payment of claims – the Continued Interest Account, a type of retained asset account. For further options, the claimant is referred to a Settlement Alternatives sheet. The examiner noted that in none of the claims in the sample did the Company maintain a copy of the Settlement Alternatives sheet. Instead,

upon request to the Company to provide a copy of each sheet that was sent to each beneficiary within the claim sample, the examiner was provided with a copy of a generic Settlement Alternatives sheet. The Company asserted that it does not as a matter of procedure maintain a copy of the sheet sent to each beneficiary, since it deems the sheet to be an informational piece that does not need to be completed or returned by the beneficiary. Without the actual sheet sent to each beneficiary, the examiner could not reconstruct the claim file to determine if the correct settlement options were offered each beneficiary according to the specific policy. Important information, such as the current interest rates being offered under each settlement option, is contained in the missing sheets provided to each claimant.

These examination results are inconsistent with the arguments and claims of the defenders of RAA as the default option for life insurance death benefit settlements. The defenders of RAA as the default option are represented by the comments of Connecticut Insurance Commissioner Tom Sullivan, who wrote to NCOIL:

We need to make sure as regulators and legislators that we are making decisions on the basis of facts surrounding RAAs. We also have an obligation to make sure that we do not frighten grieving survivors into making hurried financial decisions. Death benefits are frequently the largest checks an individual may ever receive and come at a time of numbing pain, when grief counselors generally advise against making immediate major financial decisions. However, a large check will force the recipient into making such a decision. What has been lacking in some of the sensationalized reporting are the facts that an RAA will allow a grieving family member to sort out their debts, make some memorial contributions if they choose, and to make intelligent and gradual investment decisions -while earning an interest rate that was more than they would receive in a bank savings account.

It is noteworthy that there are virtually no complaints about RAAs on a national basis. I can tell you in Connecticut, that the number of complaints on RAAs --going as far back as records are kept --is precisely zero.

The examination results contradict Commissioner Sullivan's defense in three important ways. First, consumers who were misinformed or uninformed about the RAA – with the result that the beneficiary did not understand how to obtain the death benefit – are not going to file a complaint. The examination reports indicate thousands of problems with RAAs among just three insurers – without a consumer complaint. The fact that the Connecticut Department of Insurance received no complaints about RAAs is obviously not evidence of the absence of problems with RAAs, but simply evidence that the absence of consumer complaints is not a relevant indicator of market problems involving poor disclosure to consumers.

Second, the examination reports also indicated that regulators are not providing policymakers with the facts about RAA and that regulators need better market performance data about insurers than consumer complaints. This is a graphic example of the need for more robust collection and publication of market performance data by insurers than the current Market Conduct Annual Statement.

Third, the examination results are inconsistent with the defense that RAAs assist consumers “at a time of numbing pain” and are used, as claimed by the defenders of the default option, as a breathing space to figure out what to do with the funds. The fact that, at least for one insurer, one-third of accounts were dormant for three or more years, is powerful evidence that beneficiaries have forgotten about, or never understood how to access, the settlement funds and are not using the RAA as a short-term holding while use of the funds is considered.

These examination results confirm the concerns with RAAs about which we have written to both NCOIL and the NAIC. While we applaud NCOIL for seeking better disclosure of death benefit options for policyholders and beneficiaries, it is clear that disclosures are not sufficient to protect consumers. We urge NCOIL’s consideration of our September 2, 2010 recommendations for, among other things, affirmative acceptance of RAAs as a settlement option and full payment of the RAA account proceeds within a specified period of time.

We also renew our call to the NAIC to obtain meaningful information about RAAs. As requested in our August 10 and September 15, 2010 letters, the NAIC must obtain information about the duration of RAAs to meaningfully inform the regulators’ review of RAAs.



-----Original Message-----

From: Bob Hunter [<mailto:loonlakeme@aol.com>]

Sent: Monday, October 11, 2010 10:04 AM

To: Daveline, Dan

Cc: belthjmb@aol.com; insuranceresearch@comcast.net; Gaul, Matt;  
birny@sbcglobal.net

Subject: Re: E Committee Exposure-Comments due COB Friday October 8th

Dan,

CFA supports the CEJ position on RAA information requirements.

Bob Hunter  
Director of Insurance  
Consumer Federation of America

W:\National Meetings\2010\Fall\Cmte\E\Attachment Seven.pdf

**Statutory Accounting Principles Working Group  
Maintenance Agenda Submission Form  
Form A**

**Issue: Retained Assets Disclosure**

**Check (applicable entity):**

	P/C	Life	Health
Modification of existing SSAP	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:**

Retained asset accounts represent settlement of life insurance proceeds which are retained by the insurer for the benefit of the beneficiaries. These amounts are typically payable in full on request or payable in separate amounts as drafts or some other form of requests submitted by the beneficiaries.

Recently, there has been an interest in identifying how many insurers utilize retained asset accounts as well as the amount of money involved and interest rates paid to beneficiaries. To easily satisfy these questions, the Financial Condition (E) Committee has been charged with considering creating greater annual statement disclosure regarding these amounts.

**Existing Authoritative Literature:**

*SSAP No. 52—Deposit Type Contracts* (SSAP No. 52) currently requires fund demand disclosures on deposit-type contracts.

**Activity to Date (issues previously addressed by SAPWG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups):**

In August 2010, the Financial Condition (E) committee was charged with developing an annual statement disclosure on retained assets. In addition, other NAIC Working Groups have been charged with developing consumer disclosures.

**Information or issues (included in *Description of Issue*) not previously contemplated by the SAPWG:**

**Recommended Conclusion or Future Action on Issue:**

**Recommending Party:**

Al Gross, Chair of the Financial Condition (E) committee

Disclosures

16. For life and annuity reserves, the financial statements shall disclose the following:
  - a. A description of reserve practices including the amount of any surrender value promised in excess of the reserve as legally computed;
  - b. The method of determination of tabular interest on funds not involving life contingencies; and
  - c. The nature of significant other reserve changes.
  
17. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics as follows:
  - a. Subject to discretionary withdrawal:

Ref # 2010-17

- i. With market value adjustment, where withdrawal of funds is payable at all times, or prior to specified maturity dates where such dates are more than one year after the statement date and:
  - (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the reporting entity; and
  - (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period.
- ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in subparagraph v.(d) below;
- iii. At fair value, where the withdrawal of funds is payable at current fair value of the assets supporting the liabilities, the assets are stated at current fair value, and the liabilities are stated at the current fair value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
- iv. Total with adjustment or at fair value;
- v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:
  - (a) In a lump sum without adjustment;
  - (b) In installments over less than five years, with or without a reduction in interest rate during the installment period;
  - (c) In a lump sum subject to a fixed surrender charge of less than 5%;
  - (d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified "bail out" rate and the "bail out" rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues;
- b. Not subject to discretionary withdrawal;
- c. Total gross;
- d. Reinsurance ceded;
- e. Total net.

18. For federal home loan bank (FHLB) agreements, the following information shall be disclosed for the current and prior year:

- a. General description with information on the nature of the agreement, type of funding (advances, lines of credit, borrowed money, etc.) and intended use of the funding.
- b. Amount of FHLB stock purchased/owned as part of the agreement.
- c. Amount of collateral pledged to the FHLB.
- d. Total borrowing/funding capacity currently available to the reporting entity.
- e. Total reserves related to FHLB funding agreements.
- f. Whether FHLB funding agreement assets and liabilities are classified within the general account or in a separate account; the elements that support this classification and the amounts in each category (i.e., general or separate account).

19. For life insurance claims, disclose the following information regarding the reporting entity's use of retained asset accounts for beneficiaries for the current and prior year:

- a. Total count of life insurance claims;
- b. Total count of life insurance claims offering settlement through retained asset account;
- c. Total count of retained asset option chosen by beneficiary (including if required by reporting entity);
- d. Weighted average daily balance of retained assets;
- e. Interest earned by beneficiaries on retained assets;
- f. Average earned interest rate by beneficiary (e/d);
- g. Interest earned by reporting entity on retained assets;

- h. Average earned interest rate by reporting entity (g/d);
- i. Basis point spread of average earned by insurer over interest earned by beneficiary;
- j. Percentage of weighted average daily balance of retained assets to total admitted assets (before separate accounts)
- k. A narrative description of how the accounts are structured and reported within the reporting entity's financial statements (e.g., as drafts written by the reporting entity and reported within cash and supplemental contracts without life contingencies; as drafts written by an affiliated bank in which the reporting entity has disposed of its liabilities and related assets, etc) and whether the accounts are covered under guaranty funds (with or without limits) or Federal Deposit Insurance Corporation coverage. This description should include all of the different interest rates paid to retained asset account holders. Also indicate if the retained asset account is the default method for satisfying life insurance claims.

20. Refer to the preamble for further discussion regarding disclosure requirements.

**Staff Recommendation:**

NAIC staff recommends the above disclosure be moved to the nonsubstantive active listing and be exposed for comment.

**Staff Review Completed by:**

Robin Marcotte & Dan Daveline  
NAIC staff

**Status**

On September 8, 2010 the Financial Condition E Committee exposed the above language for comment. E committee also ensured that the Statutory Accounting Principles Working Group and its interested parties were aware of this action.

Proposed revisions based on public comments received were distributed prior to the Fall National Meeting. On October 20, 2010 the Financial Condition E committee adopted the following for 2010 reporting:

**Disclosures**

- 16. For life and annuity reserves, the financial statements shall disclose the following:
  - a. A description of reserve practices including the amount of any surrender value promised in excess of the reserve as legally computed;
  - b. The method of determination of tabular interest on funds not involving life contingencies; and
  - c. The nature of significant other reserve changes.
  
- 17. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics as follows:
  - a. Subject to discretionary withdrawal:
    - i. With market value adjustment, where withdrawal of funds is payable at all times, or prior to specified maturity dates where such dates are more than one year after the statement date and;
      - (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the reporting entity; and
      - (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period.
    - ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in subparagraph v.(d) below;

Ref # 2010-17

- iii. At fair value, where the withdrawal of funds is payable at current fair value of the assets supporting the liabilities, the assets are stated at current fair value, and the liabilities are stated at the current fair value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
- iv. Total with adjustment or at fair value;
- v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:
  - (a) In a lump sum without adjustment;
  - (b) In installments over less than five years, with or without a reduction in interest rate during the installment period;
  - (c) In a lump sum subject to a fixed surrender charge of less than 5%;
  - (d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified "bail out" rate and the "bail out" rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues;
- b. Not subject to discretionary withdrawal;
- c. Total gross;
- d. Reinsurance ceded;
- e. Total net.

18. For federal home loan bank (FHLB) agreements, the following information shall be disclosed for the current and prior year:

- a. General description with information on the nature of the agreement, type of funding (advances, lines of credit, borrowed money, etc.) and intended use of the funding.
- b. Amount of FHLB stock purchased/owned as part of the agreement.
- c. Amount of collateral pledged to the FHLB.
- d. Total borrowing/funding capacity currently available to the reporting entity.
- e. Total reserves related to FHLB funding agreements.
- f. Whether FHLB funding agreement assets and liabilities are classified within the general account or in a separate account; the elements that support this classification and the amounts in each category (i.e., general or separate account).

k-19. For life insurance claims, disclose the following information regarding the reporting entity's use of retained asset accounts for beneficiaries. For purposes of this disclosure, retained asset accounts represent settlement of life insurance proceeds which are retained by the insurance entity within their general account for the benefit of the beneficiaries. Amounts held outside of the insurance entity, for example in a non-insurance subsidiary, affiliated or controlled entity accounted for under SSAP No. 97-Investments in Subsidiary, Controlled, and Affiliated Entities, A Replacement of SSAP No. 88, such as an interest bearing account established in the beneficiaries name with a bank or thrift institutions (and subject to applicable Federal Deposit Insurance Corporation coverage) are only required to be described in the context of the structure of the reporting entity's program in accordance with 19a, but quantitative information regarding retained asset accounts transferred outside of the reporting entity are not required.

- a. A narrative description of how the accounts are structured and reported within the reporting entity's financial statements (e.g., as drafts written by the reporting entity and reported within cash and supplemental contracts without life contingencies; as accounts transferred into the beneficiaries name to an affiliated or unaffiliated bank or other financial institution in which the reporting entity has disposed of its liabilities and related assets, etc). This description should include all of the different interest rates paid to retained asset account holders during the reporting year and the number of times

Ref # 2010-17

changes in rates were made during the reporting year. The description should also include a listing of all applicable fees charged by the reporting entity that are directly or indirectly associated with the retained asset accounts. Also indicate if the retained asset account is the default method for satisfying life insurance claims.

- b. Number and balance of retained asset accounts in force at the end of the current year and prior year segregated within "aging categories" of "up to 12 months", "13 to 24 months", "25 to 36 months", "37 to 48 months", "49 to 60 months", "over 60 months";
- c. Number and balance of retained asset accounts in force at the beginning of the year segregated between individual and group contracts;
- d. Number and amount of retained asset accounts issued during the year segregated between individual and group contracts;
- e. Investment earnings credited to retained asset accounts segregated between individual and group contracts;
- f. Fees and other charges assessed to retained asset accounts during the year segregated between individual and group contracts;
- g. Number and amount of retained asset accounts transferred to state unclaimed property funds segregated between individual and group contracts;
- h. Number and amount of retained asset accounts closed/withdrawn during the year segregated between individual and group contracts;
- i. Number and balance of retained asset accounts in force at the end of the year segregated between individual and group contracts;

The following illustrates the required reporting of 19b in tabular format:

	<u>In Force</u>			
	<u>As of End of Current Year</u>		<u>As of End of Prior Year</u>	
	<u>(a) Number</u>	<u>(b) Balance</u>	<u>(c) Number</u>	<u>(d) Balance</u>
<u>Up to and including 12 Months</u>		\$		\$
<u>13 to 24 Months</u>		\$		\$
<u>25 to 37 Months</u>		\$		\$
<u>37 to 48 Months</u>		\$		\$
<u>49 to 60 Months</u>		\$		\$
<u>Over 60 Months</u>		\$		\$
<u>Total</u>		\$		\$

The following illustrates the required reporting of 19c through 19i in tabular format:

	<u>(a) Individual Number</u>	<u>(b) Individual Balance/ Amount</u>	<u>(c) Group Number</u>	<u>(d) Group Balance/ Amount</u>
<u>Number/Balance of Retained Asset Accounts at the Beginning of the Year</u>		\$		\$
<u>Number/Amount of Retained Asset Accounts Issued/Added During the Year</u>		\$		\$
<u>Investment Earnings Credited to Retained Asset Accounts During the Year</u>	<u>N/A</u>		<u>N/A</u>	
<u>Fees and Other Charges Assessed to Retained Asset</u>	<u>NA</u>		<u>NA</u>	

Ref # 2010-17

<u>Accounts During the Year</u>				
<u>Number/Amount of Retained Asset Accounts Transferred to State Unclaimed Property funds During the Year</u>		\$		\$
<u>Number/Amount of Retained Asset Accounts Closed/Withdrawn During the Year</u>		\$		\$
<u>Number/Balance of Retained Asset Accounts at the End of the Year</u>		\$		\$

49-20. The disclosures in paragraph 19 are not required in the annual audited financial statements.  
 Refer to the preamble for further discussion regarding disclosure requirements.

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**To:** Commissioner Gross, Chair of Financial Condition (E) Committee

**From:** Bill Harrington, Chair of the Examination Oversight (E) Task Force

**Date:** October 19, 2010

**Re:** Ongoing Role of the Financial Examiners Coordination (E) Working Group

---

At the 2010 Summer National Meeting in Seattle, a new framework to assist examiners in coordinating group examinations was adopted. Along with this framework, the revisions were adopted to Exhibit Z – Examination Coordination. The Financial Examiners Coordination (E) Working Group’s next step is to inform all states of the new guidance, which will be done via webinar after the Fall National Meeting. To further ensure coordination between states, the Working Group has requested a new charge for 2011 that asks the Working Group to “Promote coordination by assisting and advising domiciliary regulators and exam coordinating states as to what might be the most appropriate regulatory strategies, methods and actions regarding financial examinations of holding company groups.”

The Working Group is currently developing an action plan regarding the execution of this charge. The document outlines the general role of the Working Group in which it will function in an advisory capacity and act as a resource to provide information to regulators to enhance examination coordination. The action plan also provides a list of tasks the Working Group will complete, as necessary, during its future meetings, including:

- Determine the Coordinating State for each group using the factors provided in the coordination framework. The Coordinating State is responsible for, at a minimum, monitoring the examinations of the group.
- Answer questions from and provide suggestions to regulators regarding group examinations.
- Keep up-to-date on and assist with current group coordination efforts.
- Monitor and track overall coordination statistics.
- Revise the guidance in the *Financial Condition Examiners Handbook* related to group exam coordination as deemed necessary.

The Working Group has requested to hold meetings at the NAIC national meetings beginning in 2011 to complete the tasks listed above. These meetings are expected to be held in regulator-to-regulator session, pursuant to paragraph 3 of the NAIC Policy Statement on Open Meetings regarding meetings discussing specific companies, entities or individuals. The Working Group would like to request that the meetings be scheduled for two hours, at least initially, to fully address the new charge mentioned above.

I appreciate the opportunity to present our request for meetings at the national meetings in order to make exam coordination as successful as possible. If you have any questions regarding this request, please feel free to contact me or Dave DelBiondo (PA – Chair of the Financial Examiners Coordination (E) Working Group).

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Draft: 9/16/10

Joint Statutory Accounting Principles (E) Working Group,  
Accounting Practices and Procedures (E) Task Force  
and Financial Condition (E) Committee  
Conference Call  
September 8, 2010

The Statutory Accounting Principles (E) Working Group, Accounting Practices and Procedures (E) Task Force and Financial Condition (E) Committee met via conference call Sept. 8, 2010.

The following Working Group members participated: Jim Armstrong, Chair (IA); Kim Hudson (CA); Linda Sizemore (DE); Jim Hanson (IL); Stewart Guerin (LA); Judith Weaver (MI); Tom Burke (NH); Dennis Fernez (NY); Dale Bruggeman (OH); Alfred W. Gross (VA); and Peter Medley (WI).

The following Task Force members participated: Steve Poizner, Chair, represented by Kim Hudson (CA); Susan E. Voss, Vice Chair, represented by Jim Armstrong (IA); Jay Bradford represented by Mel Anderson (AR); Thomas R. Sullivan represented by Bill Arfanis (CT); Karen Weldin Stewart represented by Linda Sizemore (DE); Kevin M. McCarty represented by Al Willis (FL); Michael T. McRaith represented by Jim Hanson (IL); Carol Cutter represented by Cindy Donovan (IN); Elizabeth Sammis represented by Neil Miller (MD); Joseph G. Murphy represented by John Turchi (MA); Mila Kofman represented by Eric Cioppa (ME); Ken Ross represented by Judith Weaver (MI); John M. Huff represented by Fred Heese (MO); Ann M. Frohman represented by Jim Nixon (NE); Roger A. Sevigny represented by Thomas Burke (NH); Thomas B. Considine represented by Robert Kasinow (NJ); James J. Wrynn represented by Dennis Fernez (NY); Mary Jo Hudson represented by Dale Bruggeman (OH); Kim Holland represented by John McCarter (OK); Teresa D. Miller represented by Russell Latham (OR); Joseph Torti, III, (RI); Leslie A. Newman represented by Larry Knight, Jr. (TN); Neil T. Gooch represented by Don Catmull (UT); Alfred W. Gross (VA); Mike Bertrand represented by Ken McGuckin (VT); Mike Kreidler represented by Patrick McNaughton (WA); Sean Dilweg represented by Peter Medley (WI); and Jane L. Cline represented by Greg Elam (WV).

The following Committee members participated: Alfred W. Gross, Chair (VA); Joseph Torti, III, Vice Chair (RI); Steve Poizner represented by Al Bottalico (CA); Susan E. Voss represented by Jim Armstrong (IA); Ann M. Frohman represented by Jim Nixon (NE); Thomas B. Considine represented by Bob Kasinow (NJ); James J. Wrynn represented by Dennis Fernez (NY); Mary Jo Hudson represented by Bill Harrington (OH); Leslie A. Newman represented by Larry Knight, Jr. (TN); and Sean Dilweg represented by Peter Medley (WI).

1. Opening Comments

Commissioner Gross stated that the purpose of the joint conference call was to consider adoption of a proposed Form A for SSAP No. 10R—*Income Taxes* (SSAP No. 10R), which was exposed by the Statutory Accounting Principles (E) Working Group at the Summer National Meeting.

2. Statement of Statutory Accounting Principles No. 10R—*Income Taxes*

A. Statutory Accounting Principles (E) Working Group

Mr. Armstrong noted the only item on the agenda for the Working Group was the proposed change to SSAP No. 10R. Mr. Armstrong provided a summary of the Form A for SSAP No. 10R. He discussed how the proposed change would allow regulators and the industry an additional year to work on a long-term solution for deferred income taxes. Mr. Bruggeman added that the Form A also contemplates a new disclosure related to tax-planning strategies. Mr. Armstrong noted that the Working Group received no comments on the proposed change. A motion was made by Mr. Hudson to adopt the proposed change to SSAP No. 10R. The motion was seconded by Mr. Bruggeman and passed unanimously. Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

B. Accounting Practices and Procedures Task Force

Mr. Hudson indicated that the only item on the agenda was consideration of the action just taken by the Statutory Accounting Principles (E) Working Group and, more specifically, consideration of the proposed change to SSAP No. 10R. Mr. Hudson asked if there were any questions or comments. Liz Martinez (Ohio National) requested clarification regarding the duplicative nature of the disclosure on tax-planning strategies, because Statement of Financial Accounting Standards No. 109 already requires disclosure on this topic. Mr. Hudson responded that what is being considered is the specific reporting requirement under SSAP No. 10R. Mr. Armstrong added that this would require a specific disclosure in the annual statement to enable regulators to gather more data on the use of such strategies. A motion was made by Mr. Armstrong to adopt the proposed change to SSAP No. 10R. The motion was seconded by Mr. Hanson and passed unanimously. Having no further business, the Accounting Practices and Procedures (E) Task Force adjourned.

C. Financial Condition (E) Committee

Commissioner Gross indicated that the item to be considered by the Financial Condition (E) Committee was the action just taken by the Accounting Practices and Procedures (E) Task Force and, more specifically, consideration of the proposed change to SSAP No. 10R. A motion was made by Mr. Fernez to adopt the proposed change to SSAP No. 10R (Attachment Ten-A). The motion was seconded by Superintendent Torti and passed unanimously.

3. Possible Disclosure Regarding Retained Asset Accounts

Commissioner Gross stated that the other item for the Financial Condition (E) Committee to consider was a possible new disclosure related to retained asset accounts (RAAs), as included in a draft Form A he had sponsored. He noted that there had been significant press coverage and NAIC discussion related to the RAA issue. Commissioner Gross stated the Committee had received the following charge related to that work:

“As directed by the Executive (EX) Committee the Financial Condition (E) Committee will explore the need for enhanced financial reporting by insurance companies to collect information on Retained Asset Accounts (RAAs) including information on the extent of use and length of time the accounts remain open.”

Commissioner Gross stated that he did not believe that RAAs represent a solvency issue; rather, the more important work will be addressed by the Retained Asset Accounts (A/D) Working Group—which is a joint working group of the Life Insurance and Annuities (A) Committee and the Market Regulation and Consumer Affairs (D) Committee—related to the disclosure for beneficiaries. He pointed out that this was an important topic and insurance regulators need certain data on this issue in order to be able to respond to questions from the federal government and others. He added that, at least on a temporary basis, the public might also need transparency on this issue from all life insurers. Commissioner Gross indicated the best alternative for obtaining and providing this was via the financial annual statement. He proposed the exposure of a disclosure that would be included in the “Other Note” for year-end 2010 and perhaps data captured in year-end 2011—and, depending on where developments lead—possibly elimination of the disclosure for year-end 2012. He suggested an exposure of 30 days and a joint conference call between the Committee and the Statutory Accounting Principles (E) Working Group, as a technical advisor to the Committee. A motion was made by Mr. Bottalico to expose the Form A on RAAs for a 30-day comment period. The motion was seconded by Mr. Kasinow and passed unanimously.

Having no further business, the Financial Condition (E) Committee adjourned.

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**Statutory Accounting Principles Working Group  
Maintenance Agenda Submission Form  
Form A**

**Issue:**

*DTA Admission – SSAP No. 10R Analysis*

**Check (applicable entity):**

	P/C	Life	Health
Modification of existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

**Description of Issue:**

In November 2009, the Statutory Accounting Principles Working Group adopted SSAP No. 10R—Income Taxes – A Temporary Replacement of SSAP No. 10 and superseded SSAP No. 10. SSAP No. 10R provides for increased admissibility of deferred tax assets if specific criteria are met. SSAP No. 10R is only effective for 2009 annual financial statements and 2010 interim and annual financial statements:

31. This statement is effective for 2009 annual financial statements, and 2010 interim and annual financial statements only. In the event subsequent deferred tax asset admission guidance is not adopted by the end of this statement's effective period, SSAP No. 10 is reinstated as authoritative guidance for accounting and reporting of income taxes for statutory financial statements.

A subgroup of the Statutory Accounting Principles Working Group has been formed to provide a recommendation on the appropriate determination for admitted deferred tax assets for reporting periods after December 31, 2010.

**Existing Authoritative Literature:**

- *SSAP No. 10R—Income Taxes – A Temporary Replacement of SSAP No. 10*
- *SSAP No. 10—Income Taxes*
- *SSAP No. 10 – Exhibit A – Implementation Questions and Answers* (This exhibit was included within SSAP No. 10, but was not superseded with SSAP No. 10R)

**Activity to Date (issues previously addressed by SAPWG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups):**

The Capital Adequacy Task Force is currently reviewing the risks associated with deferred tax assets in all three RBC formulas.

**Information or issues (included in *Description of Issue*) not previously contemplated by the SAPWG:**

None

**Staff Recommended Conclusion or Future Action on Issue:**

Staff recommends that this issue be included on the Substantive Active Listing, with necessary discussion to determine the appropriate admitted deferred tax assets for reporting periods after December 31, 2010.

**UPDATED August 13, 2010:**

The Working Group noted that they will continue to progress on this issue throughout the remainder of the year, but will expose an intent for a one-year extension of SSAP No. 10R to allow for appropriate deliberation on all necessary elements in determining the admission criteria for DTAs. Items specifically noted that warrant additional time for further analysis include: (1) review of aggregate results from the DTA Data Call, (2) Further assessment of tax planning strategies, (3) FIN 48, (4) AAA final report due in Sept. 2010, (5) Assessment of tax-

sharing agreements, and (6) Impact of admitted DTAs during receivership. Additionally the Working Group noted that receiving year-end 2010 data to analyze along with the data call would be prudent, and also enable consideration of how the economic downturn in 2008 and 2009 have affected the tax carryback levels in steps 10a and 10ei, and any “shifts” to the forward looking steps 10b and 10eii. Timing of Blanks updates and any RBC related changes may need to be considered. Pursuant with this intent, and as noted above, the Working Group will expose proposed revisions to the SSAP No. 10R disclosures to receive additional information regarding the impact tax-planning strategies have on the admittance calculation. The Working Group also noted that guidance for examining the various components of the admittance calculation may be beneficial and will be preparing a referral to the Financial Condition Examiners Handbook Working Group.

To reflect the proposed one-year extension, as well as the additional disclosures for tax-planning strategies, the following revisions are proposed to SSAP No. 10R:

Effective Date: January 1, 2001; Substantive revisions to paragraphs 10, 11, 18, 31 and 32 effective for annual periods ending December 31, 2009 and interim and annual periods of 2010 and 2011. This statement (SSAP No. 10R) shall not be applied or considered effective for interim and annual periods subsequent to 20102011. See paragraph 31 of this statement.

18. The components of the net DTA or DTL recognized in a reporting entity’s financial statements shall be disclosed as follows:
  - a. The total of all DTAs (gross, adjusted gross, admitted and nonadmitted) by tax character;
  - b. The total of all DTLs by tax character;
  - c. Whether the reporting entity has elected to admit DTAs pursuant to paragraph 10.e. and whether the current-period election differs from the prior reporting period;
  - d. The total DTAs nonadmitted as the result of the application of paragraph 10;
  - e. The net change during the year in the total DTAs nonadmitted;
  - f. The increased amount by tax character, and the change in such, of admitted adjusted gross DTAs resulting from the use of paragraph 10.e., if applicable;
  - g. The amount of each result or component of the calculation, by tax character of paragraphs 10.a., 10.b.i., 10.b.ii., 10.c., 10.e.i., 10.e.ii.a., 10.e.ii.b., and 10.e.iii, (see Q&A 4.14 of SSAP No. 10 as an example) and the risk-based capital level (total adjusted capital and authorized control level) used in paragraph 10.d.;
  - h. The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted DTAs, by percentage and by tax character;
  - i. The amount of admitted DTAs, admitted assets, statutory surplus and total adjusted capital in the risk-based capital calculation resulting from the calculation in paragraph 10.a., 10.b., and 10.c., and the increased amount of DTAs, admitted assets and surplus resulting from the use of paragraph 10.e., if applicable.
31. This statement is effective for 2009 annual financial statements, and 2010 and 2011 interim and annual financial statements only<sup>3</sup>. In the event subsequent deferred tax asset admission guidance is not adopted by the end of this statement’s effective period, SSAP No. 10 is reinstated

as authoritative guidance for accounting and reporting of income taxes for statutory financial statements.

Footnote 3 A Subgroup of the Statutory Accounting Principles Working Group has been formed to provide a recommendation on the appropriate determination for admitting deferred tax assets for reporting periods after December 31, ~~2010~~2011.

**Recommending Party:**

John Tittle – NAIC Staff

**Status:**

On August 14, 2010, the Statutory Accounting Principles Working Group moved this agenda item, and the focus of the DTA Subgroup to provide a recommendation on the appropriate determination of admitted deferred tax assets, to the substantive active listing.

Also on August 14, 2010, the Working Group exposed nonsubstantive revisions to SSAP No. 10R, as illustrated above, to reflect a one-year proposed extension to the timeframe for which SSAP No. 10R can be in effect (sunset clause) as well as to incorporate additional disclosures for tax-planning strategies. These nonsubstantive revisions are exposed for a limited two-week exposure period ending **August 27, 2010**. It is anticipated that these SSAP No. 10R nonsubstantive revisions, if adopted by the Working Group, will be effective for 2010 annual reporting. A joint conference call of the Statutory Accounting Principles Working Group, Accounting Practices and Procedures Task Force, and the Financial Condition (E) Committee will be scheduled to hear comments on the exposed nonsubstantive revisions.