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These summaries are intended to be representative of what was observed to have transpired at the meeting. They have not been reviewed for consistency with NAIC meeting minutes. Positions taken by various NAIC working groups and committees at their respective meetings do not become final NAIC positions until they have passed through the appropriate public exposure and parent committee approval process as specified by the NAIC.

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MEMORANDUM

FROM: Ted Schlude
DATE: October 3, 2006
RE: *NAIC Fall Meeting – September 7-11, 2006*

I attended the NAIC Fall meeting held September 7-11, 2006 in St. Louis, Missouri including meetings of the Life and Health Actuarial Task Force (“LHATF”) and selected meetings of the NAIC. Summarized below are the activities which took place at these meetings. Any American Academy of Actuaries documents which are referenced in this report should also be available directly from the Academy website. NAIC meeting documents are also available from the NAIC Publications Department.

LIFE AND HEALTH ACTUARIAL TASK FORCE

The LHATF met on Thursday and Friday and discussed the following topics. Attachments referred to in the LHATF Monthly Actuarial Mailings (with numerical references) are available from the NAIC Publications Department.

1. **Report of AAA Life Reserve Work Group (LRWG):** David Neve, Co-chair of the LRWG provided a status report including a summary of recent changes to the Life PBR Model Regulation, as well as the associated Actuarial Guidelines. The following recent changes were made to the Life PBR Model Regulation:
 - 1) Greatest PV of Accumulated Deficiencies (GPVAD) is now required for Stochastic Reserve calculations per LHATF’s decision in June, 2006.
 - 2) Prudent Best Estimate and Margins: Guidance was added to be considered in setting margins, requires disclosure of impact of each margin and the aggregate impact of margins (Margin Ratio or “Z” – value).
 - 3) Expanded Discussion of Reinsurance
 - 4) Dropped NAIC predetermined scenario set and added option for company to use a “Proprietary Scenario Set” determined to be appropriate by the actuary for the Stochastic Reserve calculation.
 - 5) Incorporated changes to accommodate equity indexed life products.



- 6) **Small Company Items:** allows optional exemption provided by state from PBR (by form/product), allows company to increase the required minimum deterministic reserve to meet the stochastic modeling exclusion.
- 7) **Other Items:** excludes group life, Qualified Actuary must provide reserve certification, Actuarial Report must include discussion of controls on actuarial judgment, reserve computations must be done within six months of valuation date (some regulators prefer a three-month limit).

Refinements to actuarial guideline AG PBR-VAL are provided below.

- 1) Added requirements for setting best estimate assumptions. It was noted that the Canadian normalized method for setting best estimate assumptions was the intent.
- 2) Provides guidance for setting assumption margins including considerations that must be addressed, required sensitivity testing and the rationale and documentation for any adjustment made to individual margins because of the aggregate effect of all margins must be provided.

It was noted that the ACLI has initiated discussions with the Treasury Department to begin to familiarize the Treasury with the PBR methodology being contemplated. The ACLI will provide feedback to the Academy on these discussions. Currently, the work of the LRWG would apply to new products sold, not to inforce business. Given that the Treasury currently requires a seriatim reserve calculation, discussion related to deterministic vs. stochastic reserve computations will be key.

Key issues still in need of resolution include:

- Individual Assumption Margins: balancing individual assumption margins with the goal that in the aggregate the margins produce a level of conservatism in reserves consistent with the solvency objective of statutory reporting (taking into account covariance and diversification effects).
- Aggregation of Risks: The AAA position is that risk offsets or mitigation between blocks should be recognized in the reserve analysis. Some regulators did not feel comfortable using margins in certain blocks to offset deficiencies in others, noting that if the profitable block was sold, it might leave the company with inadequate reserves. The Academy noted that such a situation would require an immediate increase in reserves for the retained block so it should not be a concern to regulators. Other regulators suggested that a deterministic reserve floor be set by block at which point no more reduction due to aggregation benefit would be allowed.
- Discount Rates: The Academy continues to believe that the proper theoretical discount rate for reserves should be the net investment earnings rate on assets. Regulators (particularly New York) are uncomfortable with the possibility that the riskier the asset portfolio, the higher the discount rate that might be used and would



prefer if a more simplified approach such as Treasuries plus 50 bps were used. Their proposal, however, is complicated in that the actual asset distribution would need to be simulated based on original acquisition date and maturity date of assets substituted by Treasuries which is not appealing to the Academy.

Finally, LHATF exposed for comment the following documents of the LRWG:

- Academy September 2006 Principles-Based Reserves for Life Products Model Regulation (Attachment 6, page 11 of August 2006 mailing).
- AG PBR-VAL (Attachment 7, page 37 of August 2006 mailing).
- AG-DIS (Attachment 8, page 66 of August 2006 mailing).

2. **SVL II/PBA:** LHATF heard various Academy reports related to the SVL II/PBA initiative. Donna Claire began the presentation by highlighting the various work groups involved and stated that the Academy is still on target to have a PBA approach for life products ready for adoption in December 2006. She also noted that there are at least two other NAIC meetings scheduled to discuss PBA: 1) discussion by Academy members with regulators (informal) and 2) EX Committee PBR Working Group made up of Commissioners. Reports of various Academy work groups follow:

- Consistency: Principles, Summary, Definitions and Report Format Work Group: Bob DiRico, Chair, noted that refinements to Principle #1 (See Attachment 9, page 74 of August 2006 mailing) and a precise set of definitions have been developed for use in Principles-Based documents (See Attachment 10, page 76 of August 2006 mailing). Definitions include prudent best estimate, best estimate, margin for uncertainty, tail risk, degree of control or influence, stated level of conservatism, solvency objective for statutory reporting, cash surrender value, scenario, clearly defined hedging strategy, conditional tail expectation (CTE), accumulated deficiency and greatest present value of accumulated deficiencies (GPVAD). Next steps include development of standard reporting formats for experience in a PBR framework including mortality, lapse, expenses, premium persistency, etc.
- Annuity Reserve Work Group (ARWG): Jim Lamson, Chair, gave a report on Principles-Based Valuation for Non-Variable Annuities (See Attachment 12, page 83 of August 2006 mailing). The discussion focused on trying to resolve three issues:
 - 1) Application to In Force Business or New Business Only: It was previously decided that LRWG should apply to new business only, but some areas, such as payout annuities, have been identified by regulators as needing attention because formula reserves appear to be inadequate. Regulators are leaning toward a new business only application for annuities to begin with and possibly developing a separate solution to the payout annuity problem.



- 2) Small and Low Risk Annuity Blocks: ARWG is recommending a simplified calculation (AG 33) which would avoid stochastic valuation methodology for small, well-matched blocks of annuities.
- 3) Form of New Requirements: Regulators prefer an approach similar to that used by the LRWG where a model regulation and actuarial guidelines are used to implement the new reserve requirements.

Tentative conclusions by ARWG were reviewed which include.

- 1) Alternative Reserve Option for Small Companies: ARWG will pursue an option for a company to develop its own proprietary predetermined scenario set and weights intended to conservatively simulate CTE with a certification from the valuation actuary.
- 2) Discount Rates for GPVAD: The actual yields on the asset base would determine reserve discount rates similar to the LRWG approach.
- 3) Working Reserve: Equal to cash value if a cash value exists, otherwise zero.
- 4) Projected Credited Rates: The valuation would not be required to consider policy loan interest and investment income from hedge assets.
- 5) Assumed Competitive Environment: has been included as one of the Prudent Best Estimate assumptions.

Five separate modeling software systems are being used to project results for an SPDA business model to begin evaluating the results of such a reserve approach.

- Reinsurance Work Group: Sheldon Summers, Chair of the Reinsurance Work Group, updated LHATF on its progress. The first issue discussed was the concept and importance of a notional gross reserve and the rigor to be required in its computation, particularly when stochastic risk has been completely ceded off by the direct writing company. The calculated notional gross reserve and the reserve held (net of reinsurance) would determine the reserve credit. AG PBR-VAL has been modified to include comment from the Reinsurance Work Group in the area of non-guaranteed elements, recapture, changes to current scale premiums, termination options, modeling of assets not in possession of the insurer or reinsurer and recognition of reinsurer default risk. A subgroup of the Reinsurance Work Group is focusing on reinsurance accounting rules and whether any modifications are required in a principles-based structure. Other areas of work include work on AG PBR-VAL with respect to IMR and the CV Floor, to review a referral from the Life Capital Adequacy Subgroup regarding security for unauthorized reinsurance RBC credit, to review other reinsurance laws and regulations for consistency with a PBR approach and to consider whether reinsurer default risk should be reflected in modeling.



- Standards for Stochastic Methods Work Group (SSMWG): Nancy Bennett, Chair, provided a brief update of activities of this work group which would give the actuary two alternatives: 1) use a prescribed generator developed by the Academy and 2) use a proprietary generator developed by the company that meets calibration criteria. The actuary would be responsible for providing the rationale for the approach taken in arriving at the stochastic scenarios used in their analysis.
- LCAS Economic Scenario Work Group: LHATF heard a detailed report from Larry Gorski related to much of the work involved in developing an updated interest rate model generator. Various iterations of the model parameters have been considered during this process. Particular focus was placed on the long term interest rates generated over time and on the first year interest rate spike to appropriately address regulator concerns under the existing deterministic framework where the focus is on spikes up or down and on long term sustained increases or decreases in the interest environment. It was noted that the long term mean reversion rate was modified from 6.55% in the existing generator to 5.4% based on historical interest rates from April 1953 to April 2006. Maximum interest rates were capped at 17.7% plus a soft add-on. Next steps for this work group include developing an automatic mean reversion point adjustment mechanism, developing calibration criteria, and coordinating the equity scenarios with the interest rate scenarios.
- C-3 Phase II Project: Larry Gorski also provided an update of the work of the Life Capital Work Group in the area of C-3 Phase III which deals with interest rate risk and market risk for life products in a principles-based environment. The time line is to have RBC structural changes ready for December 2006 adoption so that this could be in place for December 31, 2007 RBC calculations. Concepts are similar in nature to C-3 Phase II for variable annuities and would apply to inforce business and allow the actuary to choose from an Academy supplied generator or to use a proprietary company generator subject to calibration criteria.

Various other presentations to LHATF on Principles-Based Valuation were also received as highlighted below.

- ASOP PBR Discussion Draft: Bob Meilander, Chair of the Life Operating Committee of the ASB, gave a presentation on the progress of the ASOP PBR being developed by the PBR Task Force. It was noted that the ASOP will simply provide guidance to actuaries doing principles-based valuation which will dovetail with a regulation, actuarial guidelines and practice notes, if necessary. It will not be a substitute for a regulation on PBR, simply provide guidance. Next steps will be to develop the ASOP exposure draft and receive comments from regulators and the industry.
- Other Governance and Regulatory Interface Issues: Donna Claire discussed various other governance and regulatory issues.



- 1) Valuation Law and Valuation Manual Team: This team headed by Mike Boerner (Texas) is working on changes to the valuation law necessary for Principles-Based Valuation. Work will also begin on a Valuation Manual which will provide reserve guidance similar to the NAIC Accounting Practices and Procedures Manual or RBC instructions. For a period of time, both the AAA Valuation Manual and the NAIC Valuation Manual (it still remains to be seen whether this will be an NAIC document) will coexist as transition to PBR takes place.
 - 2) Central Actuarial Examiner Team: This group headed by Larry Bruning (Kansas) is working on how a centralized examination team might work in practice.
 - 3) Other Governance Issues: This team is dealing with a variety of issues including internal governance, involvement of key management in the process, interface with the actuaries and disclosure in financial reports. The goal is to ensure that PBR will work for actuaries, accountants, lawyers and will involve other groups within the NAIC and the industry, besides LHATF to ensure this goal.
- Implications of PBR on Regulatory Framework: Next, Larry Bruning (Kansas) gave a presentation on Modernization in Insurance Regulation and some of the implications of PBR on the examination process, blanks, AP&P manual, laws and regulations. The financial examination would involve confirming that all material risks are considered, modeled appropriately, using valid assumptions with appropriate margins, proper sensitivity analysis and that sufficient documentation is prepared. Experience data will need to be collected to establish industry benchmarks when credible company experience is not available. There will also be changes to the Annual Statement Blanks, AP&P Manual, Standard Valuation Law, etc. The roles of company management, the valuation actuary, the PBR reviewing actuary, the auditor and the examiner will need to be defined, keeping in mind the overall objective of solvency, consistency between reserves and capital, allowing flexibility for new products/risks, etc. It was noted that the major hurdle will be convincing the Commissioners and state legislatures of the benefits of this process which will require the state to give up some of its power to a centralized authority.
- PBA Review and Governance Work Group: Finally, Shirley Shao, Chair, gave a presentation on PBA Review. Three documents formed the basis for the discussion:
- Document Prepared by the Academy's Life Financial Soundness/Risk Management Committee for LHATF's August 4, 2006 Conference Call (Attachment 52, page 490 of August, 2006 mailing).
 - Academy's Principles-Based Valuation Review Opinion Draft Model Regulation (Attachment 53, page 494 of August 2006 mailing).



- AAA Report on PBA Review and Other Governance Issues September, 2006 (Attachment 54, page 502 of August 2006 mailing).

The Academy has recommended the following:

- a) PBA review opinion would be due one month after financial statement due date, filed with all states, but state of domicile may grant extension.
- b) PBA reviewer should be hired by company (board of directors) with state notification.
- c) Independent PBA reviewer could be a consulting actuary or auditing firm's actuary.
- d) Qualifications – same requirements as for appointed actuary.
- e) Independence requirement would apply (not a recent employee, not the company doing PBA work, no financial interests, five year rotation rule, etc.).
- f) Confidentiality (PBA review opinion, report and workpapers and documentation should be confidential) to balance the legal exposure to the PBA reviewer.
- g) PBA Opinion Requirements would include language similar to traditional reserve opinions and would confirm that all risks were considered, appropriate methods, models, assumptions and margins were used, laws and regulations were complied with, etc.
- h) Material differences of opinion between the valuation actuary and the PBA reviewer would require immediate disclosure and notification to the state.
- i) PBA report would be provided to the Board, and would be available to regulators on request.
- j) PBA Review is a review of the valuation actuary's judgment, not a reserve opinion per se.

Some regulators are still undecided or disagree with the Academy approach on some of these issues such as: 1) many feel that the PBA opinion must be a public document, 2) that the regulator should hire the PBA reviewer rather than the company, and 3) some are still deciding who can do the review.

It was noted that this process takes place every three years in Canada, but U.S. regulators are expecting such a review annually.



Finally, LHATF exposed the PBA Review Model Regulation for comment (Attachment 53 of the August 2006 mailing) and the Academy noted that the ASB is working on three ASOPs (revisions to two existing ones and one new ASOP on PBR).

- 2007 GRET Tables:** LHATF adopted the 2007 GRET factors which are based on SOA life company expense data from 2004 and 2005. These factors will be effective for policy illustrations as of January 1, 2007. The factors and SOA report are included in Attachment 6, page 16 of the July 2006 mailing. A major hurdle continues to be expense classification by type of business into branch office, direct marketing, home service and all other. A summary of the 2006/2007 GRET is provided below.

Type of Business	Acquisition			Maintenance Per Policy
	Per Policy	Per Unit	Percent of Premium	
2006 GRET				
Branch Office	\$76	\$1.35	84%	\$38
Direct Marketing	111	2.00	61	56
Home Service	72	1.30	40	36
Other	78	1.40	43	39
2007 GRET				
Branch Office	\$62	\$1.10	69%	\$31
Direct Marketing	130	2.30	72	65
Home Service	64	1.15	35	32
Other	79	1.40	44	40

- AG VACARVM:** The New York version of AG VACARVM has been in exposure since the June, 2006 NAIC meeting. LHATF reviewed briefly a series of industry comment letters which continued to voice the same concerns expressed earlier regarding the New York draft, including use of CTE 75 for reserves, recognition of revenue sharing, reflection of contractholder behavior, Standard Scenario requirements, aggregation, option value floor, etc. These letters also indicate support for the Hartford proposal which was described as intending to be a compromise document by Hartford (CTE 70, no option value floor, closer to C-3 Phase II construct,...).

Despite objections from New York, LHATF voted to expose the Hartford proposal for comment (See Attachment 8, page 22 of July, 2006 mailing) and will begin to evaluate the impact of the Hartford proposal using existing software available from C-3 Phase II.

- Report on SOA Mortality Experience Studies:** Larry Gorski reported that the work related to development of a scoring algorithm for merging mortality experience data into the various preferred mortality classes is now complete. The biggest challenge was merging three class and four class nonsmoker structures. The SOA has been using 2002-2004 data, but has also sent out a recent call for 2004/2005 experience. This project is necessary to support the Principles-Based Reserves and Capital approach.



- The project is slightly behind schedule, but they expect to have a basic table and tables with margins by the March 2007 NAIC meeting. Given that the Executive/Plenary adopted the ACLI Interim Proposal, the SOA will focus its efforts on supporting PBA rather than development of specific interim preferred tables.
6. **Pre-need Mortality Table:** Roger Annin provided an update related to development of a valuation mortality table for pre-need insurance. Ten companies have contributed data with about 148,000 death claims from 2000-2004. A pre-need table is necessary because the 2001 CSO Table is viewed as inadequate, particularly in early policy years. Next steps include development of the experience tables, consideration of mortality improvement and/or other adjustments, and appropriate loads for a valuation table. The committee is still considering whether tables will or should differentiate between standard, aggregate and select or single premium/multipay plans. In March 2007, the plan is to have graduated mortality tables for consideration.
 7. **SOA's Pandemic Research Study:** Bruce Iverson of the SOA provided a brief update related to an SOA research project on the Impact of Pandemic on the U.S. Life Industry (both insured and general population). The goal is a balanced viewpoint on the possible implications of a pandemic. It is expected that a final report will be available in December 2006.
 8. **Credit for Reinsurance (revisions to SSAP No. 61 and Appendix A-791):** It was noted that Sheldon Summers has prepared Form As to be submitted to the Statutory Accounting Principles Working Group (SAPWG) for its consideration so no action will be taken by LHATF on this issue unless they get a referral back from SAPWG.
 9. **Report of CADTF/LHATF Subgroup:** LHATF received an update on the efforts of this subgroup which has been developing a corporate governance structure under PBR led by Dennis Lauzon of New York. A conference call will be scheduled to discuss how to get other parties such as the Financial Condition (E) Committee, and non-actuaries (accountants and lawyers) involved in this process to make sure that the ultimate work product will function well for all involved. Attachment 43, page 456 of the August 2006 mailing provides the most recent of the joint subgroup reports which includes a draft Corporate Governance for Risk Management Act and Model Regulation.
 10. **Report of the LHATF SVL II Subgroup:** This subgroup continues to work on revisions to the Standard Valuation Law necessary to implement Principles-Based Valuation. The most recent material including revisions to the SVL and a Drafting Notes document created by Katy Campbell (Alaska) which highlights the various decisions made with respect to the draft will be included in the September 2006 mailing.
 11. **2007 Charges:** LHATF reviewed a draft of its charges for 2007. A charge to develop implementation guidelines for use of the preferred tables in the ACLI Interim Solution was added. Also, LHATF will be considering the new SOA Group Waiver Table as a valuation table for group disabled life reserves (both New York and Florida have



requested that LHATF develop a replacement table to the Krieger table using the SOA study).

MEETINGS FOR REGULATORS ON PBA

Two meetings were scheduled within the general NAIC meeting itself on Principles-Based Valuation. The first meeting on PBA Governance issues covered many of the same topics discussed by LHATF including: 1) targeted completion by December, 2006, 2) the concept of a valuation manual which would be maintained much like the RBC formula and instructions and 3) the nature of an independent peer review process (review of actuarial judgment not a reserve opinion).

The second meeting was of the recently formed Principles-Based Reserving (EX) Working Group which is made up of Commissioners from the states of North Dakota, Virginia, Alaska, New Mexico, Kansas, Ohio and New York. This group is led by Jim Poolman, Commissioner of North Dakota and a strong proponent of the Principles-Based Approach to reserves and capital. Various Academy and LHATF representatives described aspects of the PBR process including the use of actuarial judgment, interface with company management, centralized valuation manual, etc. It was noted that the key is to be able to agree to a balance and blend of actuarial and regulatory judgment that will satisfy all participants. Jim Poolman indicated that one of the key hurdles will be convincing legislators to give up some power that they currently have to create a centralized authority. In November, the Academy and NAIC are providing a presentation to legislators at NCOIL. In December, 2006 at the NAIC meeting, there will be a Commissioners Roundtable to introduce these concepts. There needs to be uniform support for this process because it requires the states to cede off authority to the NAIC or some other regulatory body.

Other issues include small company carve outs similar to the Model Audit Rule. The Academy noted that in its view, carve outs depend on inherent product risks, not company size. If a product is risky, then a more refined risk analysis is required, regardless of company size. Others noted that consistency in the exercise of judgment will be a key element.

The ACLI noted that it is just beginning to have discussions with the IRS related to the implications of principles-based reserves within the tax structure. Discussions are beginning to take place with other groups such as the NAIC Blanks Working Group, SAPWG, Examination Oversight, Insolvency and Reinsurance Task Force as well as the Valuation of Securities (VOS) Task Force.

CAPITAL ADEQUACY TASK FORCE (“CADTF”)

I attended three meetings of the Capital Adequacy Task Force summarized below.

1. **Life RBC Working Group (“LRBCWG”)**: The LRBCWG discussed the following topics.
 - C-3 Phase II 2007 Changes: This project refers to issues not addressed by the 2006 RBC Instruction Changes and will be addressed in a future conference call.



- Modco Dividend Liability: New York's proposed changes will be discussed in a conference call. The industry asked for confirmation of its understanding that these changes would not apply to closed blocks.
 - C-3 Phase III Presentation: CADTF received a presentation by Nancy Bennett related to C-3 Phase III which is an Academy project of the Life Capital Work Group to develop C-3 capital charges for all life insurance products. Scope would include a C-3 Phase I replacement for SPWL as well as replacement of the C-1 charge for variable life products with a C-3 charge for: 1) interest rate risk and 2) market risk. The methodology will include: 1) Prudent Best Estimate (PBE) assumptions, 2) two alternatives for interest rate scenarios, an Academy supplied generator or a Company Proprietary Generator which satisfies calibration criteria and 3) direct reflection of hedges based on the C-3 Phase II framework. A report will be provided by the end of September with changes to the formula expected by the December 2006 NAIC meeting in order to meet 2007 yearend implementation requirements.
 - C-3 Phase I Update: Nancy Bennett and Larry Gorski provided an update related to Academy activities in two areas related to C-3 Phase I. These presentations were similar to those received by LHATF previously on 1) developing a consistent approach across reserves and capital, and across product types for stochastic methodology and 2) update of the interest rate generator which includes revision to the long term mean reversion rate (from 6.55% to 5.40%) as well as various other refinements to the parameters of the interest rate generator.
 - Hybrid Security RBC Working Group: It was noted that a separate meeting of the Hybrid RBC Working Group will be held to implement a short term solution by December, 2006 and a long term solution hopefully by December, 2007. This project is discussed in detail below.
 - C-3 Phase II Results Subgroup: LRBCWG received a progress report from Larry Bruning indicating that relatively slow progress was being made by this group because many of the other ongoing projects were occupying its members' time. The intent of this project is to review company experiences and results from C-3 Phase II at 2005 yearend and consider what, if any, refinements in the process are justified.
 - Referral from New York on Collateralization of RBC Credit: The Reinsurance Work Group of the Academy is beginning to look at an issue raised by New York related to whether or not collateral requirements should be considered for unauthorized reinsurance RBC credits similar to the collateral requirements for unauthorized reinsurance reserve credits.
2. Hybrid Security RBC Working Group: During 2006, the SVO classified several hybrid securities as equities in its rating process, which caused AVR and RBC charges to increase significantly for these securities which had generally been classified by insurers as bonds in Schedule D. A working group was formed to develop both a short-term



solution (December 2006) and a long term solution (December 2007) to classification of these securities in the annual statement and for purposes of the AVR and RBC charges.

Hybrid securities include Trust Preferreds, Yankee Tier 1s (with and without coupon step ups) and debt-equity hybrids (with and without mandatory triggers). First, the working group adopted a definition of hybrid security (“securities whose proceeds are accorded some degree of equity treatment by one or more of the NRSRO’s or are recognized as regulatory capital by the issuer’s primary regulatory authority...”).

Short Term RBC Solution: The working group adopted a proposal labeled as “2D” which requires all hybrids to be reported as preferred stock. If classified by the SVO as equity, these securities would be notched down one notch in the AVR and RBC requirements. Also, hybrids not reviewed by the SVO would also be notched down one notch. If classed by the SVO as preferred, the security would not be notched down. Insurers will have the opportunity to file the security with the SVO to see if the notch can be removed.

The working group also referred a disclosure footnote to the financial statement on hybrid securities to the SAPWG for its consideration which would require disclosure of each hybrid security by CUSIP number in the notes to the financials given that the securities might appear as bonds, preferreds or equity in the financial statement.

Long Term Solution: A conference call will be held to discuss a charge to be given to a group of Academy members as well as investment professional representatives to develop a long term solution for hybrid securities.

3. Capital Adequacy Task Force: The CADTF received reports from the Hybrid Security RBC Working Group and Life RBC Working Group related to their meetings. Other reports are provided below:

- C-3 Phase II Subgroup: Larry Bruning stated that four two-hour conference calls will be held in the fourth quarter to make significant progress on the five companies to be reviewed regarding the C-3 Phase II process at 2005 yearend. Regulators to date have been occupied with the PBA process. CADTF is anxious to see how the process has gone and whether any refinements or changes to the C-3 Phase II process are needed.
- LHATF/CADTF Joint Subgroup: This subgroup is working on Corporate Governance Issues related to Principles-Based Valuation in the form of a draft model law and regulation. New York indicated its desire to have a conference call to expose the most recent documents for comment. Several other regulators expressed an interest in getting feedback from other, non-actuaries involved in the process and waiting for the Academy proposal for corporate governance under a principles-based approach.



- IAIS Developments: Rob Esson of the NAIC provided a brief update of progress being made at the IAIS to develop a risk focused framework for principles-based reserves and capital.

ACCOUNTING PRACTICES AND PROCEDURES TASK FORCE

I attended several meetings of working groups reporting to the Accounting Practices and Procedures Task Force and related accounting issues highlighted below.

1. **Statutory Accounting Principles Working Group (“SAPWG”)**: Highlights of the SAPWG meeting are provided below.

- Reinsurance Credit (Revisions to SSAP No. 61 and Appendix A-791): Sheldon Summers submitted Form A’s (substantial modifications) for revisions to Appendix A-791 and SSAP No. 61. Life Reinsurance intended to address issues related to reinsurance credits in situations where net premiums exceed gross premiums, base policy mode is other than annual and the reinsurance contract mode is annual in which case he perceives the net reserve credit received by the ceding company to be too high. This issue was directed back to LHATF by the SAPWG for further consideration.
- Hybrid Security Disclosure Footnote: As an interim measure, SAPWG is considering requiring a note in the financial statement related to hybrid securities because they could show up as bonds, preferred stock or equity at December 31, 2006. All hybrids would be listed by CUSIP in this note. The need for this note will be revisited in 2007 as the accounting guidance for hybrid securities, AVR and RBC is clarified.
- Implementation Guide (Q&A) for Model Audit Rule: This document has been completed and will be incorporated as Appendix G of the Accounting Practices and Procedures Manual, but is not a requirement, rather it should be viewed as for informational purposes according to SAPWG.

2. **NAIC/AICPA Working Group**: It was noted that the Model Audit Rule Implementation Guide will be adopted by the Financial Condition (E) Committee at its meeting on Tuesday. The working group discussed maintenance issues, and adoption issues with respect to the Model Audit Rule. Accreditation will begin at the Financial Regulation and Accreditation (F) Committee in March, 2007. When this process is completed, the Audit Rule will no longer be part of the NAIC Annual Statement Instructions as it has been in the past.

3. **International Accounting Standards Working Group (“IASWG”)**: Topics discussed by the IASWG are highlighted below.

- IASB Insurance Contracts Project: Rob Esson provided an update report on the IASB Insurance Contracts Project which included plans for an insurance contracts



discussion paper by December 2006, but which may be delayed until some time in the first quarter 2007. Unit-linked contracts are causing the most difficulty.

- IAIS Insurance Contracts Subcommittee: This group will meet in October in Beijing and will discuss areas identified as in need of further work including diversification, risk margins, discount rates, life/non-life issues and investment linked products.

5. Other International: Two other meetings were held related to international accounting standards.

- International Insurance Relations (G) Committee: This group discussed activities of the International Association of Insurance Supervisors (“IAIS”) among other things. It was noted that its next meeting is in October in Beijing and that the work program over the next six years is to implement the IAIS core principles. It is expected that the IAIS will be drafting up to ten separate standards over the next two years and the ACLI would like to have a codified U.S. response to these drafts, given the IAIS process does not line up well with the NAIC quarterly meeting schedule. NAIC representatives feel that the process currently in place to respond and comment to the IAIS is satisfactory.
- International Solvency Initiatives Working Group: This working group discussed the following topics: 1) IAIS Solvency Subcommittee Meeting in Quebec City: Rob Curtis from the FSA in the UK will be the new Chair. The plan is to reformulate the Structure Paper with additional discussion to clarify the paper’s conclusions. A new draft will be exposed at Rotterdam (November 13-15) similar in format to CFO Forum documents. The new chair has a goal of an open meeting format; and 2) IAIS ALM Papers (Standards and Issues Papers) will be adopted in Beijing in October by the Technical Committee. Also, the IAIS Solvency Glossary Paper is in progress which is intended to develop common core language.

JOINT EXECUTIVE (EX) / PLENARY COMMITTEE

The Joint Executive (EX) / Plenary Committee adopted the ACLI Interim Solution which included a Model Regulation that allows use of 2001 CSO preferred mortality tables in valuation as well as revisions to Actuarial Guideline 38 to allow use of lapse rates in valuing UL contract secondary guarantees. This proposal splits the 2001 CSO into three nonsmoker tables and two smoker tables to be used in valuing preferred underwriting classes. There is a December 31, 2010 sunset date for AG 38 and an asset adequacy requirement for policies valued under the revised AG 38 was added when lapse rates are used in valuation. California abstained from the vote.



OTHER MATTERS

I attended several other meetings that may be of interest.

1. **Reinsurance Task Force:** The Reinsurance Task Force continues to discuss alternatives to the 100% collateralization requirement for unauthorized reinsurers. The Task Force is focusing on a rating agency approach where the amount of collateral would be set based on the quality of the rating agency rating. This approach could result in U.S. reinsurers having to post collateral in situations where ratings are low or have deteriorated. As part of these deliberations, the Task Force received a presentation from S&P on its Financial Strength Rating Process. The Task Force has previously received presentations related to the regulatory structures in the UK, Germany, Switzerland and Bermuda.

It was also noted that the Interested Parties cannot reach any agreement on a solution to the 100% collateralization requirement. The Reinsurance Task Force has therefore taken over drafting a regulation in an attempt at a solution to the 100% collateralization issue.

Several U.S. groups of cedants and reinsurers are against relaxing the 100% collateralization requirements for unauthorized reinsurance.

2. **Risk Assessment Working Group:** The Handbook Revisions Subgroup discussed efforts related to revisions to distinguish between enterprise-wide risk and financial reporting risk. The Prioritization Subgroup continues to work on a CARRMEL tool. The Implementation Subgroup is working on training programs and review team guidelines for a risk focused approach to examination. About twelve to fourteen programs will be conducted for examiners and analysts during 2007.

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The next NAIC meeting will be held December 7-12, 2006 in San Antonio, Texas. Please contact me if there are any questions related to this summary.

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