

July 2, 2008

The Honorable Sandy Praeger
Kansas Insurance Commissioner and
President,
National Association of Insurance Commissioners
2301 McGee, Suite 800
Kansas City, MO 64108-2604

Via E-mail

SUBJECT: *Process Issues – Proposal to Integrate the Market Conduct
Annual Statement with the Financial Annual Statement*

Dear Commissioner Praeger:

This letter is sent on behalf of a group of *Interested Parties* who regularly monitor financial matters that are under the auspices of NAIC's Financial Condition (E) Committee ("E Committee"). We meet quarterly to review proposals pending before the Statutory Accounting Principles (E) Working Group, the Emerging Accounting Issues (E) Working Group, the Valuation of Securities (E) Task Force, the NAIC/AICPA (E) Working Group, the Blanks (E) Working Group, and other E Committee groups, in order to develop and communicate our consensus positions to the financial regulators who participate on the E Committee groups. *Interested Parties* and the regulators with whom we regularly work have found this type of interaction helps ensure that decisions made are technically sound and can be reasonably implemented. This process has been in place for many years.

Collectively, the *Interested Parties* provide significant industry expertise to the E Committee and its subsidiary groups and, accordingly, there have been times when the financial regulators have sought out our assistance on particularly difficult issues. Both sides have found collaboration to be beneficial. Even in the midst of occasional disagreement between the financial regulators and *Interested Parties*, our mutual respect, candor and commitment to work together have led to the development of important solvency tools. The codification project creating the Accounting Practices and Procedures Manual, the revised Model Audit Rule, and the new Risk-Focused Surveillance Framework are important examples resulting from this collaborative process.

What has occasioned this letter is our concern that, at the next Executive and Plenary conference call, insurance commissioners will be asked to make a decision to change the role and function of the regulators' most important solvency tools – the financial annual statement and the database created from the information contained in the statements – by adding a market conduct supplement to the financial annual statement database. This significant decision is about to be made without first seeking the advice of the regulators and *Interested Parties* who possess the greatest experience and expertise with the financial annual statement. *Interested Parties* are profoundly disappointed by the NAIC's willingness to foreclose meaningful discussion between *Interested Parties* and the financial regulators by circumventing the E Committee vetting process.

Since we, as *Interested Parties*, have not had a fair opportunity to raise our many concerns with the NAIC's efforts to integrate market conduct information into the financial annual statement database, we are submitting this letter to summarize key areas of concern. **We urge NAIC leadership to defer any action on the market conduct proposal until the issues we raise below have been fully considered.**

A. Lack of Adequate Due Process

The NAIC has a history of, and an obligation to, being an organization that respects due process. As state officials, NAIC's members are bound by law to respect due process in their respective states. It follows that an organization of state officials ought to likewise respect the concept of due process when developing model laws or, as in this case, materially changing reporting requirements.

In keeping with its due process principles, the NAIC has created an extensive committee system for identifying issues, developing solutions, and giving affected parties a process by which they can raise concerns and objections. In advancing the market conduct proposal, however, the D Committee members who are committed to a specific result have bypassed the NAIC's regular committee process to minimize objections, not only from the industry that will be subjected to this new requirement, but also from fellow financial regulators who may believe the requirement is ill-advised. We ask the Executive Committee to reaffirm the NAIC's commitment to fairness and due process.

NAIC committees have been given specific subject matter jurisdiction. E Committee has jurisdiction over the financial annual statement blanks. According to NAIC's 2008 charges, the E Committee's mission 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, zone examinations and examiner training and issues concerning insurer insolvencies and insolvency guarantees.

We fail to see how E Committee served as the "central forum and coordinator" of the proposal to add market conduct data to the financial annual statement database, when, in fact, the E Committee was not involved at all. And, as we pointed out earlier, when the NAIC excluded the E Committee from deliberating the issue of adding market conduct data to the financial annual statement databases, *Interested Parties* were also effectively excluded from that deliberation.

References have been made, from time to time, that the E Committee would eventually be involved in the deliberation process. Unfortunately, it now appears that E Committee involvement is to be limited to merely carrying out a directive from the Executive Committee to the Blanks (E) Working Group to implement decisions that will be made by Executive and Plenary. We submit that such a cursory acknowledgement of due process appears disingenuous. This level of involvement on the part of the E Committee is both insufficient and inadequate.

B. Disregard For Established Blanks Procedures

Several years ago, the Blanks (E) Working Group and Interested Parties collaboratively engaged in a series of discussions on improving the process by which blanks proposals are considered. Both sides agreed that the process existing at that time had become unwieldy and difficult to manage. As a result of those discussions, new Blanks procedures were developed and ultimately approved by the E Committee. They have been in effect since 2005. We have attached a copy of those procedures at the end of this letter for your reference.

Please note that section 3 of the procedures provide for considering changes to the annual statement blanks:

The following guidelines apply. Any proposal that affects a quarterly statement must be effective at the beginning of the year and any quarterly proposal must be adopted no later than the NAIC Fall National Meeting for changes effective the following year (change effective 1st quarter 2006 must be adopted no later than the Fall 2005 meeting). Changes that only affect the annual statement must be adopted no later than the NAIC Summer National Meeting in the year of the change (change effective with annual statement for 2005 to be filed March 1, 2006 must be adopted no later than Summer 2005 meeting).

The needs of regulators, annual statement preparers, and annual statement software vendors were carefully considered and balanced in arriving at the above guidelines. The summer NAIC meeting was set as the deadline for annual statement changes because of the extensive testing required to ensure reliable reporting. The annual statement contains voluminous, detailed information, which must be provided to regulators in a very short and unforgiving period of time after year-end. There is little room for software failure, thus extensive testing before year-end is critical. The financial regulators understand those considerations. Had this proposal been put through the E Committee vetting process, those considerations would have come out earlier and the Committee members could have and would have informed leadership on the proper approach for pursuing this proposal.

Some might argue that the above procedures only apply to the March 1st filing deadline, and therefore the time restrictions should not apply to the market conduct data because the proposed filing date for that information would be May 1st. The existing procedures apply to changes related to the annual statement filings for year-end, which include the actual blanks filed by March 1st, the audited statutory statements filed by June 1st and all filings in between. Because the NAIC failed to put the proposal through the normal process, no appropriate guidelines have been put in place for the market conduct data, nor have any other attendant filing issues been considered. The advocates of this proposal appear to be unaware of the conscientious process that was adopted by the E Committee. By ignoring established procedures within the E Committee structure, the NAIC failed to enlist the best annual statement expertise in vetting the many issues that would naturally arise from this sea-change approach to the financial annual statement.

C. Increased Burden on Preparers

Interested Parties encourage NAIC leadership to consider how this proposal will affect annual statement preparers. *Interested Parties* believe that the burden of preparing the annual statement will increase considerably. Currently, preparers must compile the financial annual statement within a two month period in order to meet the statutory March 1st deadline. In

addition, preparers must also file Management's Discussion and Analysis by April 1st. Then, they must spend a considerable amount of time meeting the requirements to file audited financial statements, including the requirements that will be imposed by the newly revised Model Audit Rule. Not only would this market conduct proposal add an incredible amount of new data that must be processed, reviewed, and filed, but it would effectively accelerate by 60 days the time period for supplying the market conduct data to the NAIC: existing laws impose a June 30th filing deadline, while this proposal requires a May 1st filing deadline.

Currently, insurers are required to file a separate market conduct annual statement in the approximately 29 jurisdictions that require it. The NAIC seems intent on extending the collection of data to all 56 NAIC jurisdictions, including states that do not require the data. Because the existing requirements for filing a separate market conduct annual statement are limited to 29 jurisdictions, some companies may not have systems in place to gather the required market conduct information for all the other jurisdictions. Insurers may need to establish new processes and perhaps add personnel in order to accommodate the increased number of jurisdictions. In effect, this proposal will likely increase the amount of work that must be done and decrease the amount of time in which to do that work – with no discernable regulatory benefit.

In addition to the aggressive timetable and the immediate expansion from 29 to 56 jurisdictions, the issue of ambiguous or conflicting definitions of data elements has never been resolved. Also, the NAIC has not developed any procedures for vetting the market conduct data. Clearly, this proposal places an excessive compliance burden upon preparers in meeting their annual statement filing obligations.

D. Confidentiality and Other Substantive Issues Remain Unresolved

We know our colleagues who are experts in the area of market conduct review have raised a number of substantive issues before the Market Regulation and Consumer Affairs (D) Committee and we do not intend to rehash those arguments in detail. However, we believe that, before going forward, the NAC must first resolve some very important substantive questions:

- Blending Annual Statements / Categorization of Data – Removing market conduct data from the protection of the individual state Market Conduct statutes creates a risk that data residing in or reports produced from the market conduct data may not be protected by the state Market Conduct confidentiality provisions. Also, some states may be precluded from participating in the NAIC project because of the confidentiality provisions in their respective statutes.
- Access and Data Security Safeguards – If there will be confidential and open information maintained in the same database, issues must be resolved regarding access to that data. Development of methods for restricting access will be difficult. Because some of the market conduct data will be confidential, the NAIC needs to provide appropriate assurances of safeguards to prevent unauthorized access to confidential data that will reside on the same database as publicly available data. It is our understanding that reasonable counter-proposals have been offered and these proposals should be addressed before the NAIC makes a final decision.

- Authority of NAIC – Because no state legislature has required a fundamental change or expansion in the nature of the insurer annual statement to include market conduct data, the authority of the NAIC to collect market conduct data as part of an annual statement filing is clearly in question.

E. Blanks Changes Can Move Forward Without the Market Conduct Portion

We continue to hear talk of the need to reach a quick decision, with the explanation that the software vendors need a resolution of the reporting changes. Our view, rather, is that instead of truncating its normal deliberative process, the NAIC should use its committee structure to complete the vetting of this proposal. In other words, this proposal should be referred to the E Committee to conduct a thorough review of the proposal and provide advice to NAIC leadership regarding the various hurdles associated with its effective integration into the financial annual statement database.

Only after all the relevant issues have been identified and resolved through the E Committee vetting process can a realistic timetable be established. It is true that the timetable may not allow for implementation of the proposal for the 2008 annual statement, but similarly, it is possible that it might. In either case, there is no reason why the NAIC staff should continue delaying the June release of the specifications and other statement documentation needed by vendors to begin making changes to the various software packages used by industry. We ask that the non-market conduct information be released immediately so the software vendors can do their job. The market conduct specifications can be provided at a later date. The software vendors can let you know if the initial specifications can be added and adequately tested in time for the 2008 annual statement.

Summary

Given the many substantive and process concerns that have been raised, *Interested Parties* believe the most prudent approach is to defer any action at the Executive and Plenary level and allow the E Committee to do its work. The E Committee vetting process will frame the proposal properly and allow the NAIC to address yet another important concern: funding. How will this significant expansion of the financial annual statement database be paid for? Since there are substantial issues surrounding the industry's funding of the original annual statement database, the funding issue alone is reason enough for the NAIC to allow this issue to be fully vetted through the committee process before proceeding.

Rather than hurriedly pursuing an arbitrary deadline, *Interested Parties* request that the NAIC consider if there are other ways to achieve the end objective without violating long established principles on due process and regulatory transparency. These principles are critical in retaining the legitimacy of NAIC processes, particularly in the area of financial regulation. We believe it is possible to achieve the end objectives without creating excessive burden on all the relevant stakeholders. NAIC leadership has a narrow window of opportunity to get its process back on track. That requires allowing the committee structure to work and committing to fully and fairly debating the outstanding issues raised by the annual statement preparers.

(The Interested Parties signing onto this letter are identified in a separate list that follows this letter.)

The Interested Parties, as noted below, agree with the comments contained in this letter:

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America's Health Insurance Plans	Randi Reichel	301-774-2268	rreichel@ahip.org
American Insurance Association (410 members)	Phil Carson	202-828-7170	pcarson@aiadc.org
AXA Financial	Rose Albrizio	212-314-5630	rosemarie.albrizio@axa-financial.com
Blue Cross Blue Shield Association	Joe Zolecki	312-297-5766	Joseph.Zolecki@bcbsa.com
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Fiserv	Connie Woodroof	913-788-8201	connie.woodroof@fiserv.com
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Cc: NAIC Executive Committee

Commissioner Alfred Gross
Chair, Financial Condition (E) Committee

Catherine Weatherford
Executive Vice President and CEO

Addendum

PROCEDURES OF THE FINANCIAL CONDITION (E) COMMITTEE BLANKS WORKING GROUP IN CONNECTION WITH PROPOSED AMENDMENTS TO ANNUAL AND QUARTERLY STATEMENT BLANKS AND INSTRUCTIONS

The following establishes procedures and rules of the Financial Condition (E) Committee Blanks Working Group (Blanks Working Group) with respect to proposed amendments to the annual and quarterly statement blanks and instructions.

1. The Blanks Working Group may consider relevant proposals to change the NAIC Statement Blanks and Instructions at any interim or national meeting as scheduled by the Blanks Working Group.
2. Suggested changes and amendments filed with the NAIC Executive Headquarters shall be considered at the next regularly scheduled meeting of the Blanks Working Group if the proposal is filed at least thirty days prior to the meeting. Items filed less than thirty days prior to a regularly scheduled meeting will be considered at the following regularly scheduled meeting. In rare circumstances, suggested changes and amendments can be considered as an exception to the above stated process and timeframe based on a super majority (two-thirds) consent of the Blanks Working Group members present.
3. All proposals shall be stated in a concise and complete form. The Submission Form and Instructions are available online at http://www.naic.org/committees_e_app_blanks.htm [BlanksAgenda_Form.doc](#)

The following guidelines apply. Any proposal that affects a quarterly statement must be effective at the beginning of the year and any quarterly proposal must be adopted no later than the NAIC Fall National Meeting for changes effective the following year (change effective 1st quarter 2006 must be adopted no later than the Fall 2005 meeting). Changes that only affect the annual statement must be adopted no later than the NAIC Summer National Meeting in the year of the change (change effective with annual statement for 2005 to be filed March 1, 2006 must be adopted no later than Summer 2005 meeting). Changes that do not conform to the time guidelines above are limited to: (a) Disclosures required in the current year by the *Accounting Practices and Procedures Manual* and (b) those items providing instructional clarification of current reporting requirements. These proposals will modify the instructions only, including Notes to Financial Statements, and will not be data captured. If the proposal is to add a Note to Financial Statements that should be data captured, the Note may be added to the instructions in the current year and data captured the first subsequent year-end. The disclosure will not be data captured on a quarterly basis. Any new Note will be added as the last Note to avoid renumbering existing Notes. If necessary, the Note will be renumbered at the first subsequent year-end. If a Note is deleted, the remaining Notes will not be renumbered in the current year but will be renumbered at the first subsequent year-end.

An illustration of the format of any exhibits or schedules should accompany the Submission Form. In addition, if another NAIC Committee, Task Force or Working Group is known to have considered this proposal, that Committee, Task Force or Working Group should provide any relevant information.

The Blanks Working Group will review the proposal and determine whether to receive the proposal for public comment and consideration at its next meeting or whether to reject the proposal. The comment period ends 30 days prior to the next designated National or interim meeting of the Working Group. The Working Group will consider comments received on each proposal at its next meeting. Proposals under consideration may be deferred by the Working Group until the next meeting.

However, the Working Group will limit the number of deferrals to "two" based upon the belief the proposal should be revised and resubmitted if it requires further work or input after two meetings. At the third meeting the proposal cannot be deferred again and must be otherwise acted upon. The Working Group may also refer proposals to other NAIC groups due to their technical expertise or for other review. If a proposal has been referred to another NAIC group, the proposal will come off of the Working Group's agenda and will only be considered again in the form of a new proposal.

4. The NAIC Executive Headquarters shall prepare an agenda of all suggestions. One copy of the agenda shall be sent to each member of the Blanks Working Group, or his/her representative, at least two weeks prior to the next regularly scheduled meeting.

5. a. The agenda shall be divided into two sections. NAIC Staff will complete the initial classification of the submissions into one of the two sections prior to exposure of the agenda. The criteria for classification into one of the two sections is as follows:

i. ITEMS PREVIOUSLY EXPOSED – The first section of the agenda will be limited to items that the Blanks Working Group received for public comment at its prior meeting.

ii. NEW ITEMS – The second section of the agenda will be limited to new items.

b. At each meeting, the Blanks Working Group shall not hold any discussion on any substantive item in the agenda until (1) the chair has briefly stated the agenda item and (2) the chair has called for a motion from the members. If a motion is made and seconded, the item is then discussed and voted upon.

6. At each meeting, the Blanks Working Group will review comments for those proposals that the Blanks Working Group received for comment at a previous meeting.

7. NAIC Staff will present to the Blanks Working Group a list of necessary non-substantive changes discovered in the process of implementing proposals, e.g., reference changes due to new SSAPs or required changes discovered in the process of implementing proposals. The Blanks Working Group will review these changes and may adopt the appropriate items at any regularly scheduled meeting. Such actions will be documented in the minutes of the Blanks Working Group. NAIC staff may also request that the Working Group reconsider items adopted, if these items contain substantial errors.

8. The Working Group may, when deemed necessary, appoint an Ad Hoc group to study and propose resolution of certain issues.

9. The NAIC Executive Headquarters will publish each agenda approximately two weeks prior to each interim or national meeting (including proposals received for comment and comments received) on the NAIC Web site.

10. The NAIC Executive Headquarters will publish the *Blanks* and *Annual Statement Instructions* for the next subsequent year on, or about November 1 each year. NAIC Staff will post to the NAIC Web site any subsequent corrections to these publications.

Adopted Proc. 1982 Vol. I p. 27

Amended Proc. 1987 Vol. I p. 274

Amended Proc. 1988 Vol. I p. 200

Amended Proc. 1995 1st Qtr. p. 299

Amended Proc. 2000 Winter National Meeting - Compilation of Minutes

Amended Proc. 2003 2nd Qtr. p. 681

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