The Financial Regulation Standards and Accreditation (F) Committee met in Washington, DC, Nov. 16, 2014. The following Committee members participated: John M. Huff, Chair (MO); Julia Rathgeber, Vice Chair (TX); Jim L. Ridling represented by Richard Ford (AL); Thomas B. Leonardi represented by Bill Arfanis (CT); Eric A. Cioppa (ME); Annette E. Flood (MI); Mary Taylor represented by Dale Bruggeman and Jillian Froment (OH); Michael F. Consedine represented by Kim Rankin (PA); Joseph Torti III (RI); Raymond G. Farmer (SC); Julie Mix McPeak represented by Michael Humphreys (TN); Todd E. Kiser (UT); and Jacqueline K. Cunningham represented by Doug Stolte (VA). Also participating was: Judy Weaver (MI).

1. **Adopted its Aug. 16 Minutes**

Ms. Froment made a motion, seconded by Mr. Ford, to adopt the minutes of the Committee’s Aug. 16 meeting (see NAIC Proceedings – Summer 2014, Financial Regulation Standards and Accreditation (F) Committee). The motion passed unanimously.

Director Huff said the Committee also met in regulator-to-regulator session Nov. 15 pursuant to paragraph 7 (consideration of individual state insurance department’s compliance with NAIC financial regulation standards by the Financial Regulation Standards and Accreditation (F) Committee or any subgroup appointed thereunder) of the NAIC Policy Statement on Open Meetings. During this meeting, the Committee discussed state-specific accreditation issues and voted to award continued accreditation to the insurance departments of Maryland, New York, Oregon and Washington.

2. **Discussed Revisions to the Accreditation Guidance Related to Captives and Special Purpose Vehicles**

Director Huff said that at the 2013 Fall National Meeting, the Committee began discussions on whether certain captives and special purpose vehicles (SPVs) such as those that assume business written in accordance with the *Valuation of Life Insurance Policies Model Regulation* (#830) (commonly referred to as “Regulation XXX”) and *Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation* (AG 38) (commonly referred to as “Regulation AXXX”) should be included in the scope of the accreditation program. At the 2014 Spring National Meeting, the Committee exposed for a 45-day comment period proposed revisions to the current accreditation guidance to incorporate various types of captive insurers into the scope of the accreditation program. A total of 34 comment letters were received during the exposure period, and the majority of the commenters were in opposition to the proposed revisions. Many of the comment letters indicated that the proposed definition was overly broad and resulted in unintended consequences. Based on those comment letters, Director Huff said he has been working with NAIC staff and others to further explore the direction of this project.

Director Huff said that an initial overall concern with the use of captives to reinsure business from ceding U.S. life insurers resulted in an NAIC white paper on the issue. Captive reinsurance transactions for XXX/AXXX products were highlighted in particular. These products were identified as being subject to potentially significant excess reserve requirements, so some solvency regulators were willing to approve these XXX/AXXX cessions to captives to allow the ceding insurer some surplus relief. The surplus relief was accomplished by establishing a conservative level of economic reserves and backing that with traditional assets, but allowing nontraditional assets to back the remainder of the reserve up to the full formulaic reserve amount within the captive. These facts allowed the NAIC to establish a consistent methodology for states to consider in approving these transactions until principle-based reserving (PBR) is implemented and eliminates the need for this type of reserve financing captive transaction. *Actuarial Guideline XLVIII (AG 48)*, which was recently released for exposure, is being considered for adoption by the Principle-Based Reserving Implementation (EX) Task Force at this national meeting and documents this consistent methodology.

Director Huff noted that the revised definition of multi-state reinsurer initially released for comment by the Committee was an attempt to address the lack of consistency and transparency in the captive transactions referenced in the NAIC white paper, excluding those future transactions that meet the requirements for the XXX/AXXX Reinsurance Framework once adopted and implemented. One of the primary regulator comments related to the initial draft was that the proposed revisions were scoping in too many captive transactions. The original proposed definition of multi-state reinsurer had a broader effect than just with respect to XXX/AXXX reserves ceded to captives. Specifically, it would have recognized that a multi-state reinsurer that assumes business written in any state other than its state of domicile constitutes multi-state business, and it
Draft Pending Adoption

would have subjected such a multi-state reinsurer to the accreditation standards. This was considered important because the federal Dodd-Frank Wall Street Reform and Consumer Protection Act preempts the extraterritorial application of state credit for reinsurance laws so that non-domiciliary regulators of a ceding company selling insurance policies in their state must rely on the state of domicile of the ceding insurer, but only if that state is accredited. However, this created a great amount of opposition from both state regulators and interested parties.

Director Huff said that before discussing the issue further with the Committee, it was important to wait for more of the XXX/AXXX Reinsurance Framework to be developed. Now that the proposed AG 48 has been exposed, it is appropriate for the Committee to begin discussions on this issue once more. To that end, NAIC staff have drafted a memorandum related to this topic (Attachment One).

Director Huff said that to be responsive to the comments received, he believes that the types of captive reinsurance transactions for inclusion in the definition should be scaled back from the original version, but it should also include those captive transactions related to variable annuities and long-term care (LTC) business. He said this refinement should reinforce to regulators that the Committee is not intending to capture pure captive transactions. Rather, it focuses on areas of concern rather than taking perhaps too broad of an approach to address concerns. Given the protracted low interest rate environment and the risks of an interest rate spike, it is appropriate that these two products be the next area of focus. In doing so, the insurance regulators would also be responsive to concerns expressed in the U.S. Department of the Treasury’s Financial Stability Oversight Council’s 2014 Annual Report regarding captive reinsurance transactions for “insurance products with liability valuations that are volatile, cyclically-sensitive, or interest-rate-sensitive.”

Director Huff noted that the memorandum that NAIC staff prepared discusses the general direction of the project, but he also noted that the accreditation preambles have been gradually added upon and revised over the course of the years to the extent that makes it difficult to simply add a section on multi-state reinsurers that both adequately and transparently addresses the proposed revisions. The memorandum includes a recommendation that NAIC staff be directed to prepare new and revised preambles that will clarify the scope of the NAIC accreditation standards, including their proposed applicability to XXX/AXXX, variable annuities and LTC reinsurance.

Superintendent Torti agreed that the initial proposed revisions would have unintentionally included more captives that those reinsuring XXX/AXXX business. He reminded the Committee that with the national system of state-based regulation and reliance on the accreditation program, insurers that have multi-state business should be subject to the accreditation standards.

Commissioner Rathgeber said that she supports the approach included in the NAIC staff memorandum, noting that this is a complex issue and that the approach is reasonable given the work of other NAIC groups.

Paul Graham (American Council of Life Insurers—ACLI) noted that the NAIC has worked diligently on the appropriate framework to address those captives reinsuring XXX/AXXX business, but he said that similar due diligence by the NAIC has not been done on those captives reinsuring variable annuities and LTC products. He said that these two types of reinsurance transactions are quite different. He said that the NAIC should perform similar studies on variable annuity and LTC reinsurance transactions as it has performed for the XXX/AXXX reinsurance transactions.

Superintendent Cioppa made a motion, seconded by Director Farmer, to direct NAIC staff to develop new preambles that will clarify the scope of the NAIC accreditation standards, including their proposed applicability to XXX/AXXX, variable annuities and LTC reinsurance. The motion passed unanimously.

3. Heard a Presentation on the Accreditation Program and Process

Director Huff said that in an effort to provide further information and clarity about the accreditation program, he and other individuals developed a general presentation on the overall accreditation program and process. During the presentation, Director Huff discussed the background and development of the accreditation program. Julie Garber (NAIC) discussed the four parts of the accreditation standards and the different types of accreditation reviews. Dan Schelp (NAIC) presented information on the NAIC Legal Division’s review process during the different types of accreditation reviews, including a description of the different bases for compliance in the Part A: Laws and Regulations standards. Neil Rector (Rector & Associates, Inc.) discussed the role of the accreditation review team and how a full accreditation review is conducted.
Draft Pending Adoption

4. Received an Update on State Adoption of the 2010 Revisions to Model #440 and Model #450

Director Huff said that at the 2013 Summer National Meeting, the Committee adopted the 2010 revisions to the Insurance Holding Company System Regulatory Act (#440) and Insurance Holding Company Systems Model Regulation with Reporting Forms and Instructions (#450) as an update to the Part A: Holding Company Systems accreditation standard. The 2010 revisions to Model #440 and Model #450 are required for accreditation purposes as of Jan. 1, 2016.

Director Huff noted that there are currently 38 jurisdictions that have adopted the revisions to Model #440 in full or in part, and many of these states have also adopted the related revisions to Model #450. As the revisions become required in a little over a year, he urged state insurance departments, as well as members of industry and the trade associations, to work together to ensure that all states have the appropriate laws and regulations in place by Jan. 1, 2016.

Director Huff said that although the Group Solvency Issues (E) Working Group is currently drafting further revisions to the model, states should still proceed with adopting the 2010 revisions next year. When the Group Solvency Issues (E) Working Group adopts additional revisions, those revisions will have a separate exposure and seasoning process for accreditation purposes.

Adam Kerns (American Insurance Association—AIA) said that the AIA continues to have concerns related to states adopting wording that deviates from the confidentiality provisions in Model #440. He said that the AIA is willing to help states adopt the various models, but that support hinges on the states adopting appropriate confidentiality provisions. Director Huff noted that the models have been negotiated in good faith through the NAIC process. He asked that the interested parties help the regulators in the education process with state legislators regarding the importance of confidentiality. He noted that greater confidentiality provisions allow for more information to be shared with the regulators.

5. Voted to Expose a Referral Received from the Financial Analysis Handbook (E) Working Group


Director Flood made a motion, seconded by Ms. Rankin, to release the Financial Analysis Handbook (E) Working Group’s referral for a 20-day public comment period. The motion passed unanimously.

Having no further business, the Financial Regulation Standards and Accreditation (F) Committee adjourned.

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Attachment Two

*Corporate Governance Annual Disclosure Model Act (#305)*

and

*Model Regulation (#306)*
To: Director John M. Huff (MO), Chair of Financial Regulation Standards and Accreditation (F) Committee

From: Commissioner Susan Donegan (VT), Chair of Corporate Governance (E) Working Group

Date: Nov. 18, 2014

Re: Recommendation for Part A Accreditation Standards and Guidelines for the Corporate Governance Annual Disclosure Model Act and the Corporate Governance Annual Disclosure Model Regulation

Executive Summary

On November 18, 2014, the NAIC Executive Committee and Plenary adopted the Corporate Governance Annual Disclosure Model Act (#305) and the Corporate Governance Annual Disclosure Model Regulation (#306). These models were adopted as a result of a multi-year project of the Corporate Governance (E) Working Group to study and compare existing governance requirements for U.S. insurers to established best practices, international standards and U.S. regulatory needs. Upon the conclusion of this study, the Working Group identified a number of proposed enhancements to strengthen corporate governance standards within the U.S. solvency system, including the annual collection of detailed information on an insurer’s corporate governance practices.

Together, Model #305 and Model #306 require an insurer (or group of insurers) to provide a confidential disclosure regarding its corporate governance practices to the lead state and/or domestic regulator annually by June 1. The insurer (or group of insurers) may choose to provide information on governance activities that occur at the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level, based on its determination of the level at which decisions are made, oversight is provided and governance accountability is assessed in relation to the insurance activities of the insurer.

The insurer has discretion regarding the appropriate format for providing the information and is permitted to customize the communication to provide the most relevant information necessary to permit the domiciliary commissioner to gain an understanding of the corporate governance structure, policies and practices utilized by the insurer. However, at a minimum, the disclosure is required to address:

- The insurer’s corporate governance framework and structure;
- The policies and practices of its board of directors and significant committees;
- The policies and practices directing senior management; and
- The processes by which the board of directors, its committees and senior management ensure an appropriate level of oversight to the critical risk areas impacting the insurer’s business activities.

In completing the annual disclosure, the insurer may reference other existing documents (e.g., the Own Risk and Solvency Assessment (ORSA) Summary Report, holding company Form B or Form F filings, U.S. Securities and Exchange Commission (SEC) proxy statements, foreign regulatory reporting requirements, etc.) to the regulator in fulfillment of the information requested in various areas.
All information provided in the annual disclosure is recognized as being proprietary to the insurer and containing trade secrets. Therefore, confidentiality language was included in Model #305 stating that all such information is deemed confidential by law and privileged, is not subject to subpoena and is not subject to discovery or admissible in evidence in any private civil action. However, the domiciliary commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the commissioner’s official duties.

The requirements of the Model Act and Model Regulation are intended to be effective Jan. 1, 2016. The first annual disclosure is scheduled to be due by June 1, 2016.

A statement and explanation of how the potential standard is directly related to solvency surveillance and why the proposal should be included in the standards:

The intent of the models is to provide more information to regulators on insurers’ corporate governance practices on an annual basis. Currently, regulators obtain a significant amount of information on insurers’ corporate governance practices during full-scope examinations, which typically occur once every 3-5 years. However, information on governance practices, including changes that can have a substantial impact on current and prospective solvency, is not widely available to regulators in the period between onsite examinations. Through the adoption of standards in this area, regulators can ensure that sufficient information on governance practices is available to assess the solvency of insurers on an annual basis.

A statement as to why ultimate adoption by every jurisdiction may be desirable:

Ultimate adoption by every jurisdiction will result in uniform application of the disclosure requirements to all U.S. insurers, which results in an even regulatory playing field and provides equivalent information for jurisdictions to utilize in assessing an insurer’s solvency position. Per Model #305, the disclosure requirements can be met by providing the annual disclosure on a group basis to the Lead State regulator and the review of the disclosure should be coordinated across jurisdictions that have domestic states in the group. As such, uniform adoption will provide that the legal framework exists in all states so that this coordinated regulatory effort can be effective.

In addition, uniform adoption across jurisdictions will assist the U.S. in meeting international standards relating to corporate governance and oversight. The IAIS has adopted principles and guidance related to corporate governance in ICP 5 – Suitability of Individuals, ICP 7 – Corporate Governance and ICP 8 – Risk Management and Internal Controls. In addition, the results of the 2009 U.S. FSAP and the 2013 FIO Insurance Modernization Report included recommendations for U.S. regulators in relation to corporate governance matters. The uniform adoption of Model #305 and Model #306 would assist the U.S. in responding to these recommendations and fulfilling international expectations in this area.

A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date:

The Working Group is not yet aware of any states that have adopted Model #305 and Model #306. As these models were recently adopted by the NAIC, the Working Group expects jurisdictions to begin taking action to adopt the models in 2015.

A statement as to the provisions needed to meet the minimum requirements of the standard. That is, whether a state would be required to have “substantially similar” language or rather a regulatory framework. If it is being proposed that “substantially similar” language be required, the referring committee, task force or working group shall recommend those items that should be considered significant elements:

The Working Group recommends the following provisions be adopted to require uniform implementation of the corporate governance annual disclosure requirements:
20. Corporate Governance

State statute and/or regulation should include a requirement for insurers to provide a confidential annual disclosure of their corporate governance practices that is substantially similar to the NAIC’s Corporate Governance Annual Disclosure Model Act (#305) and Corporate Governance Disclosure Model Regulation (#306).

a. Requires the insurer or insurance group to submit a Corporate Governance Annual Disclosure (CGAD) by June 1 of each year, similar to Section 3 of Model #305.
b. Requires the CGAD to contain the material information necessary to permit the Commissioner to gain an understanding of the insurer or group's corporate governance structure, policies, and practices, similar to Section 5a of Model #305.
c. Requires the CGAD to be prepared consistent with the Corporate Governance Annual Disclosure Model Regulation, similar to Section 5b of Model #305.
d. Provides confidentiality protection for the CGAD, including provisions maintaining confidentiality for information shared with state, federal and international regulators, similar to Section 6 of Model #305.
e. Includes an effective date no earlier than Jan. 1, 2016, similar to Section 10 of Model #305.
f. Prescribes filing procedures for the CGAD, including required signatures, rationale for the level at which information is reported, filing with the Lead State, the ability to reference other documents and processes for describing changes from the prior year’s disclosure, similar to Section 5 of Model #306.
g. Prescribes the general content for the CGAD, including a description of corporate governance framework and structure, a description of policies and practices of the board of directors, a description of policies and practices for directing senior management and a description of oversight provided to critical risk areas impacting the insurer’s business activities, similar to Section 6 of Model #306.

An estimate of the cost for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it, if reasonably quantifiable:

It is the understanding of insurance regulators that insurers currently summarize and describe their corporate governance practices to a number of various stakeholders on a regular basis. In addition, the disclosure requirements allow reference to existing documents and filings and provide guidance for filing changes from the prior year to simplify the reporting process. Therefore, the costs for insurance companies to comply with the proposal are not expected to be overly significant.

In addition, the Existing sections of the NAIC’s Financial Analysis Handbook and Financial Condition Examiners Handbook provide guidance to regulators for use in reviewing and assessing the corporate governance practices of insurers, which already composes a significant element of existing analysis and examination processes. The additional information provided to regulators through the CGAD may require some additional time to review and utilize, but is not expected to significantly increase the burden of regulators in this area. A referral has been provided to the Risk-Focused Surveillance (E) Working Group, the Financial Analysis Handbook (E) Working Group and the Financial Examiners Handbook (E) Technical Group to consider updating and revising the existing regulatory guidance in this area once the CGAD begins to be received.

Additional information:
None deemed necessary.
CORPORATE GOVERNANCE ANNUAL DISCLOSURE MODEL ACT

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Section 1. Purpose and Scope.

A. The purpose of this Act is to:

1. Provide the Insurance Commissioner a summary of an insurer or insurance group’s corporate governance structure, policies and practices to permit the Commissioner to gain and maintain an understanding of the insurer’s corporate governance framework.

2. Outline the requirements for completing a corporate governance annual disclosure with the Insurance Commissioner.

3. Provide for the confidential treatment of the corporate governance annual disclosure and related information that will contain confidential and sensitive information related to an insurer or insurance group’s internal operations and proprietary and trade secret information which, if made public, could potentially cause the insurer or insurance group competitive harm or disadvantage.

B. Nothing in this act shall be construed to prescribe or impose corporate governance standards and internal procedures beyond that which is required under applicable state corporate law. Notwithstanding the foregoing, nothing in this act shall be construed to limit the Commissioner’s authority, or the rights or obligations of third parties, under [INSERT EXAMINATION CITATION]

C. The requirements of this Act shall apply to all insurers domiciled in this state.

Drafting Note: The requirements of this Act are intended to apply to all commercial risk bearing entities subject to oversight by state insurance departments. Therefore, modifications may be necessary to ensure that all entities intended to be subject to the Act, but not meeting the state’s legal definition of “insurer,” are appropriately referenced.

Section 2. Definitions.

A. “Commissioner.” The Insurance Commissioner of the State.

B. “Corporate Governance Annual Disclosure (CGAD).” A Corporate Governance Annual Disclosure shall mean a confidential report filed by the insurer or insurance group made in accordance with the requirements of this Act.
C. “Insurance group.” For the purpose of this Act, the term “insurance group” shall mean those insurers and affiliates included within an insurance holding company system as defined in [insert state law equivalent to the model Insurance Holding Company System Regulatory Act.]

D. “Insurer.” The term “insurer” shall have the same meaning as set forth in Section [insert applicable section] of this Chapter, except that it shall not include agencies, authorities or instrumentalities of the United States, its possessions and territories, the Commonwealth of Puerto Rico, the District of Columbia, or a state or political subdivision of a state.

E. “ORSA Summary Report.” The term “ORSA Summary Report” shall mean the report filed in accordance with [insert applicable statutory reference to the Risk Management and Own Risk and Solvency Assessment Model Act.]

Section 3. Disclosure Requirement.

A. An insurer, or the insurance group of which the insurer is a member, shall, no later than June 1 of each calendar year, submit to the Commissioner a Corporate Governance Annual Disclosure (CGAD) that contains the information described in Section 5B below. Notwithstanding any request from the Commissioner made pursuant to Subsection C, if the insurer is a member of an insurance group, the insurer shall submit the report required by this Section to the Commissioner of the lead state for the insurance group, in accordance with the laws of the lead state, as determined by the procedures outlined in the most recent Financial Analysis Handbook adopted by the NAIC.

B. The CGAD must include a signature of the insurer or insurance group’s chief executive officer or corporate secretary attesting to the best of that individual’s belief and knowledge that the insurer has implemented the corporate governance practices and that a copy of the disclosure has been provided to the insurer’s board of directors or the appropriate committee thereof.

C. An insurer not required to submit a CGAD under this section shall do so upon the Commissioner’s request.

D. For purposes of completing the CGAD, the insurer or insurance group may provide information regarding corporate governance at the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level, depending upon how the insurer or insurance group has structured its system of corporate governance. The insurer or insurance group is encouraged to make the CGAD disclosures at the level at which the insurer's or insurance group’s risk appetite is determined, or at which the earnings, capital, liquidity, operations, and reputation of the insurer are overseen collectively and at which the supervision of those factors are coordinated and exercised, or the level at which legal liability for failure of general corporate governance duties would be placed. If the insurer or insurance group determines the level of reporting based on these criteria, it shall indicate which of the three criteria was used to determine the level of reporting and explain any subsequent changes in level of reporting.

E. The review of the CGAD and any additional requests for information shall be made through the lead state as determined by the procedures within the most recent Financial Analysis Handbook referenced in Paragraph A of this section.
F. Insurers providing information substantially similar to the information required by this Act in other documents provided to the Commissioner, including proxy statements filed in conjunction with Form B requirements, or other state or federal filings provided to this Department shall not be required to duplicate that information in the CGAD, but shall only be required to cross reference the document in which the information is included.

Section 4. Rules and Regulations

The Commissioner may, upon notice and opportunity for all interested persons to be heard, issue such rules, regulations and orders as shall be necessary to carry out the provisions of this Act.

Section 5. Contents of Corporate Governance Annual Disclosure.

A. The insurer or insurance group shall have discretion over the responses to the CGAD inquiries, provided the CGAD shall contain the material information necessary to permit the Commissioner to gain an understanding of the insurer's or group's corporate governance structure, policies, and practices. The Commissioner may request additional information that he or she deems material and necessary to provide the Commissioner with a clear understanding of the corporate governance policies, the reporting or information system or controls implementing those policies.

B. Notwithstanding Subsection A of this section, the CGAD shall be prepared consistent with the Corporate Governance Annual Disclosure Model Regulation [INSERT CITATION]. Documentation and supporting information shall be maintained and made available upon examination or upon request of the Commissioner.

Section 6. Confidentiality.

A. Documents, materials or other information including the CGAD, in the possession or control of the Department of Insurance that are obtained by, created by or disclosed to the Commissioner or any other person under this Act, are recognized by this state as being proprietary and to contain trade secrets. All such documents, materials or other information shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information, sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action. However, the Commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the Commissioner's official duties. The Commissioner shall not otherwise make the documents, materials or other information public without the prior written consent of the insurer. Nothing in this section shall be construed to require written consent of the insurer before the Commissioner may share or receive confidential documents, materials or other CGAD-related information pursuant to Subsection C below to assist in the performance of the Commissioner's regular duties.

Drafting Note: States should consider whether to specifically invoke their examination statute as applicable additional confidentiality protection for documents submitted pursuant to this Model Act.

B. Neither the Commissioner nor any person who received documents, materials or other CGAD-related information, through examination or otherwise, while acting under the authority of the Commissioner, or with whom such documents, materials or other information are shared pursuant to this Act shall be permitted or required to testify in any private civil action concerning any confidential documents, materials, or information subject to Subsection A.
C. In order to assist in the performance of the Commissioner’s regulatory duties, the Commissioner:

1. May, upon request, share documents, materials or other CGAD-related information including the confidential and privileged documents, materials or information subject to Subsection A, including proprietary and trade secret documents and materials with other state, federal and international financial regulatory agencies, including members of any supervisory college as defined in the [insert cross-reference to appropriate section of Insurance Holding Company System Regulatory Act, as amended], with the NAIC, and with third party consultants pursuant to Section 7, provided that the recipient agrees in writing to maintain the confidentiality and privileged status of the CGAD-related documents, material or other information and has verified in writing the legal authority to maintain confidentiality; and

2. May receive documents, materials or other CGAD-related information, including otherwise confidential and privileged documents, materials or information, including proprietary and trade-secret information or documents, from regulatory officials of other state, federal and international financial regulatory agencies, including members of any supervisory college as defined in the [insert cross-reference to appropriate section of Insurance Holding Company System Regulatory Act, as amended], and from the NAIC, and shall maintain as confidential or privileged any documents, materials or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information.

D. The sharing of information and documents by the Commissioner pursuant to this Act shall not constitute a delegation of regulatory authority or rulemaking, and the Commissioner is solely responsible for the administration, execution and enforcement of the provisions of this Act.

E. No waiver of any applicable privilege or claim of confidentiality in the documents, proprietary and trade-secret materials or other CGAD-related information shall occur as a result of disclosure of such CGAD-related information or documents to the Commissioner under this section or as a result of sharing as authorized in this Act.

Section 7. NAIC and Third-party Consultants

A. The Commissioner may retain, at the insurer's expense, third-party consultants, including attorneys, actuaries, accountants and other experts not otherwise a part of the Commissioner's staff as may be reasonably necessary to assist the Commissioner in reviewing the CGAD and related information or the insurer's compliance with this Act.

B. Any persons retained under Subsection A shall be under the direction and control of the Commissioner and shall act in a purely advisory capacity.

C. The NAIC and third-party consultants shall be subject to the same confidentiality standards and requirements as the Commissioner.

D. As part of the retention process, a third-party consultant shall verify to the Commissioner, with notice to the insurer, that it is free of a conflict of interest and that it has internal procedures in place to monitor compliance with a conflict and to comply with the confidentiality standards and requirements of this Act.
E. A written agreement with the NAIC and/or a third-party consultant governing sharing and use of information provided pursuant to this Act shall contain the following provisions and expressly require the written consent of the insurer prior to making public information provided under this Act:

1. Specific procedures and protocols for maintaining the confidentiality and security of CGAD-related information shared with the NAIC or a third-party consultant pursuant to this Act.

2. Procedures and protocols for sharing by the NAIC only with other state regulators from states in which the insurance group has domiciled insurers. The agreement shall provide that the recipient agrees in writing to maintain the confidentiality and privileged status of the CGAD-related documents, materials or other information and has verified in writing the legal authority to maintain confidentiality.

3. A provision specifying that ownership of the CGAD-related information shared with the NAIC or a third-party consultant remains with the Department of Insurance and the NAIC’s or third-party consultant’s use of the information is subject to the direction of the Commissioner;

4. A provision that prohibits the NAIC or a third-party consultant from storing the information shared pursuant to this Act in a permanent database after the underlying analysis is completed;

5. A provision requiring the NAIC or third-party consultant to provide prompt notice to the Commissioner and to the insurer or insurance group regarding any subpoena, request for disclosure, or request for production of the insurer’s CGAD-related information; and

6. A requirement that the NAIC or a third-party consultant to consent to intervention by an insurer in any judicial or administrative action in which the NAIC or a third-party consultant may be required to disclose confidential information about the insurer shared with the NAIC or a third-party consultant pursuant to this Act.

Section 8. Sanctions.

Any insurer failing, without just cause, to timely file the CGAD as required in this Act shall be required, after notice and hearing, to pay a penalty of $[insert amount] for each day’s delay, to be recovered by the Commissioner and the penalty so recovered shall be paid into the General Revenue Fund of this state. The maximum penalty under this section is $[insert amount]. The Commissioner may reduce the penalty if the insurer demonstrates to the Commissioner that the imposition of the penalty would constitute a financial hardship to the insurer.

Section 9. Severability Clause.

If any provision of this Act other than Section 6, or the application thereof to any person or circumstance, is held invalid, such determination shall not affect the provisions or applications of this Act which can be given effect without the invalid provision or application, and to that end the provisions of this Act, with the exception of Section 6, are severable.
Section 10. Effective Date.

The requirements of this Act shall become effective on January 1, 2016. The first filing of the CGAD shall be in 2016.

Chronological Summary of Action (all references are to the Proceedings of the NAIC).

Adopted by Executive/Plenary Committee at 2014 Fall National Meeting
CORPORATE GOVERNANCE ANNUAL DISCLOSURE MODEL REGULATION

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Section 1. Authority

These regulations are promulgated pursuant to the authority granted by Sections [insert applicable sections] and [insert applicable section] of the Insurance Law.

Section 2. Purpose

The purpose of these regulations is to set forth the procedures for filing and the required contents of the Corporate Governance Annual Disclosure (CGAD), deemed necessary by the [Commissioner] to carry out the provisions of [insert reference to Corporate Governance Annual Disclosure Model Act].

Section 3. Definitions.

A. “Commissioner.” The Insurance Commissioner of the State.

B. “Insurance group.” For the purpose of this Act, the term “insurance group” shall mean those insurers and affiliates included within an insurance holding company system as defined in [insert state law equivalent to the model Insurance Holding Company System Regulatory Act].

C. “Insurer.” The term “insurer” shall have the same meaning as set forth in Section [insert applicable section] of this Chapter, except that it shall not include agencies, authorities or instrumentalities of the United States, its possessions and territories, the Commonwealth of Puerto Rico, the District of Columbia, or a state or political subdivision of a state.

D. “Senior Management.” The term “senior management” shall mean any corporate officer responsible for reporting information to the board of directors at regular intervals or providing this information to shareholders or regulators and shall include, for example and without limitation, the Chief Executive Officer (“CEO”), Chief Financial Officer (“CFO”), Chief Operations Officer (“COO”), Chief Procurement Officer (“CPO”), Chief Legal Officer (“CLO”), Chief Information Officer (“CIO”), Chief Technology Officer (“CTO”), Chief Revenue Officer (“CRO”), Chief Visionary Officer (“CVO”), or any other “C” level executive.

Section 4. Filing Procedures

A. An insurer, or the insurance group of which the insurer is a member, required to file a CGAD by the [insert reference to Corporate Governance Annual Disclosure Model Act], shall, no later than June 1 of each calendar year, submit to the Commissioner a CGAD that contains the information described in Section 5 of these regulations.
B. The CGAD must include a signature of the insurer’s or insurance group’s chief executive officer or corporate secretary attesting to the best of that individual’s belief and knowledge that the insurer or insurance group has implemented the corporate governance practices and that a copy of the CGAD has been provided to the insurer’s or insurance group’s Board of Directors (hereafter “Board”) or the appropriate committee thereof.

C. The insurer or insurance group shall have discretion regarding the appropriate format for providing the information required by these regulations and is permitted to customize the CGAD to provide the most relevant information necessary to permit the Commissioner to gain an understanding of the corporate governance structure, policies and practices utilized by the insurer or insurance group.

D. For purposes of completing the CGAD, the insurer or insurance group may choose to provide information on governance activities that occur at the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level, depending upon how the insurer or insurance group has structured its system of corporate governance. The insurer or insurance group is encouraged to make the CGAD disclosures at the level at which the insurer’s or insurance group’s risk appetite is determined, or at which the earnings, capital, liquidity, operations, and reputation of the insurer are overseen collectively and at which the supervision of those factors are coordinated and exercised, or the level at which legal liability for failure of general corporate governance duties would be placed. If the insurer or insurance group determines the level of reporting based on these criteria, it shall indicate which of the three criteria was used to determine the level of reporting and explain any subsequent changes in level of reporting.

E. Notwithstanding Subsection A of this Section, and as outlined in Section 3 of the Corporate Governance Annual Disclosure Model Act, if the CGAD is completed at the insurance group level, then it must be filed with the lead state of the group as determined by the procedures outlined in the most recent Financial Analysis Handbook adopted by the NAIC. In these instances, a copy of the CGAD must also be provided to the chief regulatory official of any state in which the insurance group has a domestic insurer, upon request.

F. An insurer or insurance group may comply with this section by referencing other existing documents (e.g., ORSA Summary Report, Holding Company Form B or F Filings, Securities and Exchange Commission (SEC) Proxy Statements, foreign regulatory reporting requirements, etc.) if the documents provide information that is comparable to the information described in Section 5. The insurer or insurance group shall clearly reference the location of the relevant information within the CGAD and attach the referenced document if it is not already filed or available to the regulator.

G. Each year following the initial filing of the CGAD, the insurer or insurance group shall file an amended version of the previously filed CGAD indicating where changes have been made. If no changes were made in the information or activities reported by the insurer or insurance group, the filing should so state.

Section 5. Contents of Corporate Governance Annual Disclosure

A. The insurer or insurance group shall be as descriptive as possible in completing the CGAD, with inclusion of attachments or example documents that are used in the governance process, since these may provide a means to demonstrate the strengths of their governance framework and practices.
B. The CGAD shall describe the insurer's or insurance group's corporate governance framework and structure including consideration of the following.

(1) The Board and various committees thereof ultimately responsible for overseeing the insurer or insurance group and the level(s) at which that oversight occurs (e.g., ultimate control level, intermediate holding company, legal entity, etc.). The insurer or insurance group shall describe and discuss the rationale for the current Board size and structure; and

(2) The duties of the Board and each of its significant committees and how they are governed (e.g., bylaws, charters, informal mandates, etc.), as well as how the Board's leadership is structured, including a discussion of the roles of Chief Executive Officer (CEO) and Chairman of the Board within the organization.

C. The insurer or insurance group shall describe the policies and practices of the most senior governing entity and significant committees thereof, including a discussion of the following factors:

(1) How the qualifications, expertise and experience of each Board member meet the needs of the insurer or insurance group.

(2) How an appropriate amount of independence is maintained on the Board and its significant committees.

(3) The number of meetings held by the Board and its significant committees over the past year as well as information on director attendance.

(4) How the insurer or insurance group identifies, nominates and elects members to the Board and its committees. The discussion should include, for example:

(a) Whether a nomination committee is in place to identify and select individuals for consideration.

(b) Whether term limits are placed on directors.

(c) How the election and re-election processes function.

(d) Whether a Board diversity policy is in place and if so, how it functions.

(5) The processes in place for the Board to evaluate its performance and the performance of its committees, as well as any recent measures taken to improve performance (including any Board or committee training programs that have been put in place).

D. The insurer or insurance group shall describe the policies and practices for directing Senior Management, including a description of the following factors:

(1) Any processes or practices (i.e., suitability standards) to determine whether officers and key persons in control functions have the appropriate background, experience and integrity to fulfill their prospective roles, including:

(a) Identification of the specific positions for which suitability standards have been developed and a description of the standards employed.
(b) Any changes in an officer’s or key person’s suitability as outlined by the insurer’s or insurance group’s standards and procedures to monitor and evaluate such changes.

(2) The insurer’s or insurance group’s code of business conduct and ethics, the discussion of which considers, for example:

(a) compliance with laws, rules, and regulations; and

(b) proactive reporting of any illegal or unethical behavior.

(3) The insurer’s or insurance group’s processes for performance evaluation, compensation and corrective action to ensure effective senior management throughout the organization, including a description of the general objectives of significant compensation programs and what the programs are designed to reward. The description shall include sufficient detail to allow the Commissioner to understand how the organization ensures that compensation programs do not encourage and/or reward excessive risk taking. Elements to be discussed may include, for example:

(a) The Board’s role in overseeing management compensation programs and practices.

(b) The various elements of compensation awarded in the insurer’s or insurance group’s compensation programs and how the insurer or insurance group determines and calculates the amount of each element of compensation paid;

(c) How compensation programs are related to both company and individual performance over time;

(d) Whether compensation programs include risk adjustments and how those adjustments are incorporated into the programs for employees at different levels;

(e) Any clawback provisions built into the programs to recover awards or payments if the performance measures upon which they are based are restated or otherwise adjusted;

(f) Any other factors relevant in understanding how the insurer or insurance group monitors its compensation policies to determine whether its risk management objectives are met by incentivizing its employees.

(4) The insurer’s or insurance group’s plans for CEO and Senior Management succession.

E. The insurer or insurance group shall describe the processes by which the Board, its committees and Senior Management ensure an appropriate amount of oversight to the critical risk areas impacting the insurer’s business activities, including a discussion of:

(1) How oversight and management responsibilities are delegated between the Board, its committees and Senior Management;

(2) How the Board is kept informed of the insurer’s strategic plans, the associated risks, and steps that Senior Management is taking to monitor and manage those risks;
(3) How reporting responsibilities are organized for each critical risk area. The description should allow the Commissioner to understand the frequency at which information on each critical risk area is reported to and reviewed by Senior Management and the Board. This description may include, for example, the following critical risk areas of the insurer:

(a) Risk management processes (An ORSA Summary Report filer may refer to its ORSA Summary Report pursuant to the Risk Management and Own Risk and Solvency Assessment Model Act);

(b) Actuarial function;

(c) Investment decision-making processes;

(d) Reinsurance decision-making processes;

(e) Business strategy/finance decision-making processes;

(f) Compliance function;

(g) Financial reporting/internal auditing; and

(h) Market conduct decision-making processes.

Section 6. Severability Clause

If any provision of these regulations, or the application thereof to any person or circumstance, is held invalid, such determination shall not affect other provisions or applications of these regulations which can be given effect without the invalid provision or application, and to that end the provisions of these regulations are severable.

Chronological Summary of Action (all references are to the Proceedings of the NAIC).

Adopted by Executive/Plenary at 2014 Fall National Meeting
Technical Correction – January 2015
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Attachment Three

2014 Revisions to Annual Financial Reporting Model Regulation (#205)
To: Director John M. Huff (MO), Chair of Financial Regulation Standards and Accreditation (F) Committee  
From: Commissioner Susan Donegan (VT), Chair of Corporate Governance (E) Working Group  
Date: Nov. 17, 2014  
Re: Recommendation for Part A Accreditation Standards and Guidelines for revisions to the Annual Financial Reporting Model Regulation (#205)

Executive Summary

On August 19, 2014, the NAIC Executive Committee and Plenary adopted revisions to the *Annual Financial Reporting Model Regulation* (Model #205) to incorporate an internal audit function requirement for large insurers into the regulation. The revisions require individual insurers writing more than $500 million or insurance groups writing more than $1 billion in annual premium to maintain an internal audit function providing independent, objective and reasonable assurance to the audit committee and insurer management regarding the insurer’s governance, risk management and internal controls. The function is required to be organizationally independent from management and required to report at least annually to the audit committee on the results of internal audit activities.

A statement and explanation of how the potential standard is directly related to solvency surveillance and why the proposal should be included in the standards:

An internal audit function is generally considered to be a key component of an effective internal control framework. International standards recognize the importance of an internal audit function within ICP 8 – Risk Management and Internal Controls. After studying the need for an internal audit function requirement within U.S. insurance regulation, the Corporate Governance (E) Working Group determined that the best way to implement an internal audit requirement would be to place the requirement within the NAIC’s existing Model #205. This model already includes a requirement for insurers to receive an annual financial statement audit, as well as requirements related to audit committees and internal controls over financial reporting. In addition, Model #205 is already recognized as critical to solvency surveillance and required for accreditation through the existing Part A standards.

A statement as to why ultimate adoption by every jurisdiction may be desirable:

As Model #205 is already part of the Part A accreditation requirements and has been adopted in some form by every jurisdiction, the internal audit revisions should also be adopted by every jurisdiction to ensure uniformity and consistency in requirements for U.S. insurers. In addition, uniform adoption across jurisdictions will assist the U.S. in meeting international standards and ensure a standard level of protection to policyholders of large insurers across the U.S.
A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date:

While all states have adopted Model #205 in some format, the Working Group is not yet aware of any states that have adopted the internal audit function revisions. As these revisions were only recently adopted by the NAIC, the Working Group expects jurisdictions to begin taking action to incorporate the revisions beginning in 2015.

A statement as to the provisions needed to meet the minimum requirements of the standard. That is, whether a state would be required to have “substantially similar” language or rather a regulatory framework. If it is being proposed that “substantially similar” language be required, the referring committee, task force or working group shall recommend those items that should be considered significant elements:

The Working Group recommends that the provisions be modified as follows (see tracked changes) to require incorporation of the internal audit function requirement into the existing significant elements:

11. CPA Audits

State statute or regulation should contain a requirement for annual audits of domestic insurance companies by independent certified accountants that is substantially similar to the NAIC’s Annual Financial Reporting Model Regulation (#205).

[No changes proposed to existing elements a – n]

o. Includes requirements for conduct of the insurer in connection with the preparation of certain reports and documents similar to Section 156.

p. Includes requirements related to management’s report of internal control over financial reporting similar to Section 167.

q. Includes requirements related to the establishment and maintenance of an internal audit function similar to Section 15.

An estimate of the cost for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it, if reasonably quantifiable:

The Working Group notes that all publicly-held insurers are already required to maintain an internal audit function through stock exchange listing requirements. In addition, it is a standard industry best practice for large insurers to maintain internal audit functions of their own volition. Therefore, the Working Group has concluded that the costs for companies to meet the new requirements are nominal, given existing practices in this area. As far as the impact on state departments to enforce this requirement, the internal audit functions of insurers are already reviewed as part of each full-scope financial condition examination. Therefore, enforcement of the new requirement would be a simple addition to the existing work plan in this area.

Additional information:

None deemed necessary.
ANNUAL FINANCIAL REPORTING MODEL REGULATION

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Section 1. Authority

This regulation is promulgated by the commissioner of insurance pursuant to Sections [insert applicable sections] of the [insert state] insurance law.

Section 2. Purpose and Scope

The purpose of this regulation is to improve the [insert state] Insurance Department’s surveillance of the financial condition of insurers by requiring (1) an annual audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants, (2) Communication of Internal Control Related Matters Noted in an Audit, and (3) Management’s Report of Internal Control over Financial Reporting.

Every insurer (as defined in Section 3) shall be subject to this regulation. Insurers having direct premiums written in this state of less than $1,000,000 in any calendar year and less than 1,000 policyholders or certificate holders of direct written policies nationwide at the end of the calendar year shall be exempt from this regulation for the year (unless the commissioner makes a specific finding that compliance is necessary for the commissioner to carry out statutory responsibilities) except that insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of $1,000,000 or more will not be so exempt.

Foreign or alien insurers filing the Audited financial report in another state, pursuant to that state’s requirement for filing of Audited financial reports, which has been found by the commissioner to be substantially similar to the requirements herein, are exempt from Sections 4 through 13 of this regulation if:
A. A copy of the Audited financial report, Communication of Internal Control Related Matters Noted in an Audit, and the Accountant’s Letter of Qualifications that are filed with the other state are filed with the commissioner in accordance with the filing dates specified in Sections 4, 11 and 12, respectively (Canadian insurers may submit accountants’ reports as filed with the Office of the Superintendent of Financial Institutions, Canada).

B. A copy of any Notification of Adverse Financial Condition Report filed with the other state is filed with the commissioner within the time specified in Section 10.

Foreign or alien insurers required to file Management’s Report of Internal Control over Financial Reporting in another state are exempt from filing the Report in this state provided the other state has substantially similar reporting requirements and the Report is filed with the commissioner of the other state within the time specified.

This regulation shall not prohibit, preclude or in any way limit the commissioner of insurance from ordering or conducting or performing examinations of insurers under the rules and regulations of the [insert state] Department of Insurance and the practices and procedures of the [insert state] Department of Insurance.

Section 3. Definitions

The terms and definitions contained herein are intended to provide definitional guidance as the terms are used within this regulation.

A. “Accountant” or “independent certified public accountant” means an independent certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants (AICPA) and in all states in which he or she is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.

B. An “affiliate” of, or person “affiliated” with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

C. “Audit committee” means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or Group of insurers, the Internal audit function of an insurer or Group of insurers (if applicable), and external audits of financial statements of the insurer or Group of insurers. The Audit committee of any entity that controls a Group of insurers may be deemed to be the Audit committee for one or more of these controlled insurers solely for the purposes of this regulation at the election of the controlling person. Refer to Section 14E for exercising this election. If an Audit committee is not designated by the insurer, the insurer’s entire board of directors shall constitute the Audit committee.

D. “Audited financial report” means and includes those items specified in Section 5 of this regulation.

E. “Indemnification” means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards,
whether or not resulting in part from knowing of other misrepresentations made by
the insurer or its representatives.

F. “Independent board member” has the same meaning as described in Section 14C.

G. “Insurer” means a licensed insurer as defined in Sections [insert applicable sections]
of the [insert state] insurance law or an authorized insurer as defined in Sections
[insert applicable sections] of the [insert state] insurance law.

H. “Group of insurers” means those licensed insurers included in the reporting
requirements of [insert state law equivalent of the model Insurance Holding
Company System Regulatory Act], or a set of insurers as identified by management,
for the purpose of assessing the effectiveness of Internal control over financial
reporting.

I. “Internal audit function” means a person or persons that provide independent,
objective and reasonable assurance designed to add value and improve an
organization’s operations and accomplish its objectives by bringing a systematic,
disciplined approach to evaluate and improve the effectiveness of risk management,
control and governance processes.

J. “Internal control over financial reporting” means a process effected by an entity’s
board of directors, management and other personnel designed to provide reasonable
assurance regarding the reliability of the financial statements, i.e., those items
specified in Section 5B through 5G of this regulation and includes those policies and
procedures that:

(1) Pertain to the maintenance of records that, in reasonable detail, accurately
and fairly reflect the transactions and dispositions of assets;

(2) Provide reasonable assurance that transactions are recorded as necessary to
permit preparation of the financial statements, i.e., those items specified in
Section 5B through 5G of this regulation and that receipts and expenditures
are being made only in accordance with authorizations of management and
directors; and

(3) Provide reasonable assurance regarding prevention or timely detection of
unauthorized acquisition, use or disposition of assets that could have a
material effect on the financial statements, i.e., those items specified in
Section 5B through 5G of this regulation.


L. “Section 404” means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC’s
rules and regulations promulgated thereunder.

M. “Section 404 Report” means management’s report on “internal control over financial
reporting” as defined by the SEC and the related attestation report of the
independent certified public accountant as described in Section 3A.

N. “SOX Compliant Entity” means an entity that either is required to be compliant
with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-
Oxley Act of 2002: (i) the preapproval requirements of Section 201 (Section 10A(i) of
the Securities Exchange Act of 1934); (ii) the Audit committee independence
requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

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Section 14. Requirements for Audit Committees

This section shall not apply to foreign or alien insurers licensed in this state or an insurer that is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity.

A. The Audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any accountant (including resolution of disagreements between management and the accountant regarding financial reporting) for the purpose of preparing or issuing the Audited financial report or related work pursuant to this regulation. Each accountant shall report directly to the Audit committee.

B. The Audit committee of an insurer or Group of insurers shall be responsible for overseeing the insurer’s Internal audit function and granting the person or persons performing the function suitable authority and resources to fulfill their responsibilities if required by Section 15 of this Regulation.

C. Each member of the Audit committee shall be a member of the board of directors of the insurer or a member of the board of directors of an entity elected pursuant to Subsection E-F and Section 3C.

D. In order to be considered independent for purposes of this section, a member of the Audit committee may not, other than in his or her capacity as a member of the Audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary thereof. However, if law requires board participation by otherwise non-independent members, that law shall prevail and such members may participate in the Audit committee and be designated as independent for Audit committee purposes, unless they are an officer or employee of the insurer or one of its affiliates.

D-E. If a member of the Audit committee ceases to be independent for reasons outside the member’s reasonable control, that person, with notice by the responsible entity to the state, may remain an Audit committee member of the responsible entity until the earlier of the next annual meeting of the responsible entity or one year from the occurrence of the event that caused the member to be no longer independent.

Drafting Note: In determining independence, the commissioner shall consider utilizing guidance provided in the SEC’s Final Rule No. 33-8220, Standards Relating to Listed Company Audit Committees adopted April 9, 2003.

E-F. To exercise the election of the controlling person to designate the Audit committee for purposes of this regulation, the ultimate controlling person shall provide written notice to the commissioners of the affected insurers. Notification shall be made timely prior to the issuance of the statutory audit report and include a description of the basis for the election. The election can be changed through notice to the...
commissioner by the insurer, which shall include a description of the basis for the change. The election shall remain in effect for perpetuity, until rescinded.

GF. (1) The Audit committee shall require the accountant that performs for an insurer any audit required by this regulation to timely report to the Audit committee in accordance with the requirements of SAS 61, Communication with Audit Committees, or its replacement, including:

(a) All significant accounting policies and material permitted practices;

(b) All material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and

(c) Other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.

(2) If an insurer is a member of an insurance holding company system, the reports required by Subsection GF(1) may be provided to the Audit committee on an aggregate basis for insurers in the holding company system, provided that any substantial differences among insurers in the system are identified to the Audit committee.

GH. The proportion of independent Audit committee members shall meet or exceed the following criteria:

<table>
<thead>
<tr>
<th>Prior Calendar Year Direct Written and Assumed Premiums</th>
<th>Over $300,000,000 - $500,000,000</th>
<th>Over $500,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $300,000,000</td>
<td>Majority (50% or more) of members shall be independent. See also Note A and B.</td>
<td>Supermajority of members (75% or more) shall be independent. See also Note A.</td>
</tr>
<tr>
<td>No minimum requirements. See also Note A and B.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note A: The commissioner has authority afforded by state law to require the entity’s board to enact improvements to the independence of the Audit committee membership if the insurer is in a RBC action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer.

Note B: All insurers with less than $500,000,000 in prior year direct written and assumed premiums are encouraged to structure their Audit committees with at least a supermajority of independent Audit committee members.

Note C: Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from non-affiliates for the reporting entities.

HI. An insurer with direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than $500,000,000 may make application to the commissioner for a waiver from
the Section 14 requirements based upon hardship. The insurer shall file, with its annual statement filing, the approval for relief from Section 14 with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

Section 15. **Internal Audit Function Requirements**

A. Exemption – An insurer is exempt from the requirements of this section if:

(1) The insurer has annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than $500,000,000; or,

(2) If the insurer is a member of a Group of insurers that has annual direct written and unaffiliated assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than $1,000,000,000.

Note: An insurer or Group of insurers exempt from the requirements of this section is encouraged, but not required, to conduct a review of the insurer business type, sources of capital, and other risk factors to determine whether an Internal audit function is warranted. The potential benefits of an Internal audit function should be assessed and compared against the estimated costs.

B. Function – The insurer or Group of insurers shall establish an Internal audit function providing independent, objective and reasonable assurance to the Audit committee and insurer management regarding the insurer’s governance, risk management and internal controls. This assurance shall be provided by performing general and specific audits, reviews and tests and by employing other techniques deemed necessary to protect assets, evaluate control effectiveness and efficiency, and evaluate compliance with policies and regulations.

C. Independence – In order to ensure that internal auditors remain objective, the Internal audit function must be organizationally independent. Specifically, the Internal audit function will not defer ultimate judgment on audit matters to others, and shall appoint an individual to head the Internal audit function who will have direct and unrestricted access to the board of directors. Organizational independence does not preclude dual-reporting relationships.

D. Reporting – The head of the Internal audit function shall report to the Audit committee regularly, but no less than annually, on the periodic audit plan, factors that may adversely impact the Internal audit function’s independence or effectiveness, material findings from completed audits and the appropriateness of corrective actions implemented by management as a result of audit findings.

E. Additional Requirements – If an insurer is a member of an insurance holding company system or included in a Group of insurers, the insurer may satisfy the Internal audit function requirements set forth in this section at the ultimate controlling parent level, an intermediate holding company level or the individual legal entity level.
Section 16. Conduct of Insurer in Connection with the Preparation of Required Reports and Documents

A. No director or officer of an insurer shall, directly or indirectly:

(1) Make or cause to be made a materially false or misleading statement to an accountant in connection with any audit, review or communication required under this regulation; or

(2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which the statements were made, not misleading to an accountant in connection with any audit, review or communication required under this regulation.

B. No officer or director of an insurer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence any accountant engaged in the performance of an audit pursuant to this regulation if that person knew or should have known that the action, if successful, could result in rendering the insurer’s financial statements materially misleading.

C. For purposes of Subsection B of this section, actions that, “if successful, could result in rendering the insurer’s financial statements materially misleading” include, but are not limited to, actions taken at any time with respect to the professional engagement period to coerce, manipulate, mislead or fraudulently influence an accountant:

(1) To issue or reissue a report on an insurer’s financial statements that is not warranted in the circumstances (due to material violations of statutory accounting principles prescribed by the commissioner, generally accepted auditing standards, or other professional or regulatory standards);

(2) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;

(3) Not to withdraw an issued report; or

(4) Not to communicate matters to an insurer’s Audit committee.

Drafting Note: In determining what types of sanctions or penalties could be assessed for violations of items included in Subsections A through C, each state should refer to its individual authority provided by state statutes.

Section 1617. Management’s Report of Internal Control over Financial Reporting

A. Every insurer required to file an Audited financial report pursuant to this regulation that has annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of $500,000,000 or more shall prepare a report of the insurer’s or Group of insurers’ Internal control over financial reporting, as these terms are defined in Section 3. The report shall be filed with the commissioner along with the Communication of Internal Control Related Matters Noted in an Audit described under Section 11. Management’s Report of Internal Control over Financial Reporting shall be as of December 31 immediately preceding.
B. Notwithstanding the premium threshold in Subsection A, the commissioner may require an insurer to file Management’s Report of Internal Control over Financial Reporting if the insurer is in any RBC level event, or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in (include reference to Corrective Action statute).

C. An insurer or a Group of insurers that is

1. directly subject to Section 404;
2. part of a holding company system whose parent is directly subject to Section 404;
3. not directly subject to Section 404 but is a SOX Compliant Entity; or
4. a member of a holding company system whose parent is not directly subject to Section 404 but is a SOX Compliant Entity;

may file its or its parent’s Section 404 Report and an addendum in satisfaction of this Section 16-17 requirement provided that those internal controls of the insurer or Group of insurers having a material impact on the preparation of the insurer’s or Group of insurers’ audited statutory financial statements (those items included in Section 5B through 5G of this regulation) were included in the scope of the Section 404 Report. The addendum shall be a positive statement by management that there are no material processes with respect to the preparation of the insurer’s or Group of insurers’ audited statutory financial statements (those items included in Section 5B through 5G of this regulation) excluded from the Section 404 Report. If there are internal controls of the insurer or Group of insurers that have a material impact on the preparation of the insurer’s or Group of insurers’ audited statutory financial statements and those internal controls were not included in the scope of the Section 404 Report, the insurer or Group of insurers may either file (i) a Section 16-17 report, or (ii) the Section 404 Report and a Section 16-17 report for those internal controls that have a material impact on the preparation of the insurer’s or Group of insurers’ audited statutory financial statements not covered by the Section 404 Report.

D. Management’s Report of Internal Control over Financial Reporting shall include:

1. A statement that management is responsible for establishing and maintaining adequate Internal control over financial reporting;
2. A statement that management has established Internal control over financial reporting and an assertion, to the best of management’s knowledge and belief, after diligent inquiry, as to whether its Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles;
3. A statement that briefly describes the approach or processes by which management evaluated the effectiveness of its Internal control over financial reporting; and
(4) A statement that briefly describes the scope of work that is included and whether any internal controls were excluded;

(5) Disclosure of any unremediated material weaknesses in the Internal control over financial reporting identified by management as of December 31 immediately preceding. Management is not permitted to conclude that the Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles if there is one or more unremediated material weaknesses in its Internal control over financial reporting;

(6) A statement regarding the inherent limitations of internal control systems; and

(7) Signatures of the chief executive officer and the chief financial officer (or equivalent position/title).

E. Management shall document and make available upon financial condition examination the basis upon which its assertions, required in Subsection D above, are made. Management may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

(1) Management shall have discretion as to the nature of the internal control framework used, and the nature and extent of documentation, in order to make its assertion in a cost effective manner and, as such, may include assembly of or reference to existing documentation.

(2) Management’s Report on Internal Control over Financial Reporting, required by Subsection A above, and any documentation provided in support thereof during the course of a financial condition examination, shall be kept confidential by the state insurance department.

Drafting Note: It is the recommendation that the company officer responsible for financial reporting would not be a member of the Audit committee and that the independent committee members would meet periodically, with no management present, with the independent certified public accountant to discuss the strengths and weaknesses of the insurer’s or Group of insurers’ internal control environments.

Section 1718. Exemptions and Effective Dates

A. Upon written application of any insurer, the commissioner may grant an exemption from compliance with any and all provisions of this regulation if the commissioner finds, upon review of the application, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for a specified period or periods. Within ten (10) days from a denial of an insurer’s written request for an exemption from this regulation, the insurer may request in writing a hearing on its application for an exemption. The hearing shall be held in accordance with the regulations of the [insert state] Department of Insurance pertaining to administrative hearing procedures.

B. Domestic insurers retaining a certified public accountant on the effective date of this regulation who qualify as independent shall comply with this regulation for the year ending December 31, 2011 and each year thereafter unless the commissioner permits otherwise.
C. Domestic insurers not retaining a certified public accountant on the effective date of this regulation who qualifies as independent may meet the following schedule for compliance unless the commissioner permits otherwise.

1. As of December 31, 20\[\] , file with the commissioner an Audited financial report.

2. For the year ending December 31, 20\[\] and each year thereafter, such insurers shall file with the commissioner all reports and communication required by this regulation.

D. Foreign insurers shall comply with this regulation for the year ending December 31, 20\[\] and each year thereafter, unless the commissioner permits otherwise.

E. The requirements of Section 7D shall be in effect for audits of the year beginning January 1, 2010 and thereafter.

F. The requirements of Section 14 are to be in effect January 1, 2010. An insurer or Group of insurers that is not required to have independent Audit committee members or only a majority of independent Audit committee members (as opposed to a supermajority) because the total written and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to changes in premium shall have one (1) year following the year the threshold is exceeded (but not earlier than January 1, 2010) to comply with the independence requirements. Likewise, an insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one (1) calendar year following the date of acquisition or combination to comply with the independence requirements.

Drafting Note: Adoption of Section 14 is assumed to occur one year prior to the effective date of Section 16\[\]7.

G. The requirements of Section 16\[\]7 and other modified sections [identify modified sections], except for Section 14 covered above, are effective beginning with the reporting period ending December 31, 2010 and each year thereafter. An insurer or Group of insurers that is not required to file a report because the total written premium is below the threshold and subsequently becomes subject to the reporting requirements shall have two (2) years following the year the threshold is exceeded (but not earlier than December 31, 2010) to file a report. Likewise, an insurer acquired in a business combination shall have two (2) calendar years following the date of acquisition or combination to comply with the reporting requirements.

H. The requirements of Section 15 are to be in effect January 1, 2016. If an insurer or Group of insurers that is exempt from the Section 15 requirements no longer qualifies for that exemption, it shall have one year after the year the threshold is exceeded to comply with the requirements of this article.

Section 18\[\]9. Canadian and British Companies

A. In the case of Canadian and British insurers, the annual Audited financial report shall be defined as the annual statement of total business on the form filed by such companies with their supervision authority duly audited by an independent chartered accountant.
B. For such insurers, the letter required in Section 6B shall state that the accountant is aware of the requirements relating to the annual Audited financial report filed with the commissioner pursuant to Section 4 and shall affirm that the opinion expressed is in conformity with those requirements.

Section 1920. Severability Provision

If any section or portion of a section of this regulation or its applicability to any person or circumstance is held invalid by a court, the remainder of the regulation or the applicability of the provision to other persons or circumstances shall not be affected.

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

2003 Proc. 2nd Quarter 473, 489, 491 (amended and adopted by parent committee).
Attachment Four

2014 Revisions to the
*Insurance Holding Company System Regulatory Act* (#440)
MEMORANDUM

TO: Director John Huff, Chair, Financial Regulation Standards and Accreditation (F) Committee

FROM: Danny Saenz, Chair, Group Solvency Issues (E) Working Group

DATE: March 27, 2015

RE: 2014 Changes to the Insurance Holding Company System Regulatory Act (Model #440)

In December 2015, the Group Solvency Issues (E) Working Group, the Financial Condition (E) Committee and the NAIC Plenary adopted changes to the Insurance Holding Company System Regulatory Act (Model #440). The changes to the model provide authority to a designated state to act as a group-wide supervisor for an internationally active insurance group. Such groups are defined in #440 as U.S. based groups with a) premiums written in at least three countries; b) the percentage of gross premiums written outside the United States is at least ten percent (10%) of the insurance holding company system’s total gross written premiums; and c) groups with total assets of the insurance holding company system are at least $50 billion or total gross written premiums of the insurance holding company of at least $10 billion.

During the development of the model for adoption by the Plenary, it was noted that there may be some question whether this language is necessary for the states that would not be considered the lead state for such a group. However, it was further noted that because the groups that do meet the above criteria tend to operate in the vast majority of the states, and the proposed changes to #440 discuss the authority of domestic regulators to cooperate together to require certain action by the insurance holding company, it was recommended that all states consider enacting this statutory language. However, the Working Group did not develop a recommendation regarding whether the changes should be required for accreditation purposes. The Working Group plans to discuss each member’s plans for proposing the introduction of such changes into their legislative docket, however it’s likely that the Working Group may not be prepared to make a recommendation even after that discussion.
INSURANCE HOLDING COMPANY SYSTEM REGULATORY ACT

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Section 1. Definitions

As used in this Act, the following terms shall have these meanings unless the context shall otherwise require:

A. “Affiliate.” An “affiliate” of, or person “affiliated” with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

B. “Commissioner.” The term “commissioner” shall mean the insurance commissioner, the commissioner’s deputies, or the Insurance Department, as appropriate.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the word “commissioner” appears.

C. “Control.” The term “control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person. This presumption may be rebutted by a showing made in the manner provided by Section 4K that control does not exist in fact. The commissioner may determine, after furnishing all persons in interest notice

and opportunity to be heard and making specific findings of fact to support the determination, that control exists in fact, notwithstanding the absence of a presumption to that effect.

D. “Group-wide supervisor.” The regulatory official authorized to engage in conducting and coordinating group-wide supervision activities who is determined or acknowledged by the commissioner under Section 7.1 to have sufficient significant contacts with the internationally active insurance group.

E. “Insurance Holding Company System.” An “insurance holding company system” consists of two (2) or more affiliated persons, one or more of which is an insurer.
“Insurer.” The term “insurer” shall have the same meaning as set forth in Section [insert applicable section] of this Chapter, except that it shall not include agencies, authorities or instrumentalities of the United States, its possessions and territories, the Commonwealth of Puerto Rico, the District of Columbia, or a state or political subdivision of a state.

Drafting Note: References in this model act to “Chapter” are references to the entire state insurance code.

Drafting Note: States should consider applicability of this model act to fraternal societies and captives.

G. “Internationally active insurance group.” An insurance holding company system that (1) includes an insurer registered under Section 4; and (2) meets the following criteria: (a) premiums written in at least three countries, (b) the percentage of gross premiums written outside the United States is at least ten percent (10%) of the insurance holding company system’s total gross written premiums, and (c) based on a three-year rolling average, the total assets of the insurance holding company system are at least fifty billion dollars ($50,000,000,000) or the total gross written premiums of the insurance holding company system are at least ten billion dollars ($10,000,000,000).

H. “Enterprise Risk.” “Enterprise risk” shall mean any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole, including, but not limited to, anything that would cause the insurer’s Risk-Based Capital to fall into company action level as set forth in [insert cross reference to appropriate section of Risk-Based Capital (RBC) Model Act] or would cause the insurer to be in hazardous financial condition [insert cross reference to appropriate section of Model Regulation to define standards and commissioner’s authority over companies deemed to be in hazardous financial condition].

I. “Person.” A “person” is an individual, a corporation, a limited liability company, a partnership, an association, a joint stock company, a trust, an unincorporated organization, any similar entity or any combination of the foregoing acting in concert, but shall not include any joint venture partnership exclusively engaged in owning, managing, leasing or developing real or tangible personal property.

J. “Securityholder.” A “securityholder” of a specified person is one who owns any security of such person, including common stock, preferred stock, debt obligations and any other security convertible into or evidencing the right to acquire any of the foregoing.

K. “Subsidiary.” A “subsidiary” of a specified person is an affiliate controlled by such person directly or indirectly through one or more intermediaries.

L. “Voting Security.” The term “voting security” shall include any security convertible into or evidencing a right to acquire a voting security.

Section 7. Supervisory Colleges

A. Power of Commissioner. With respect to any insurer registered under Section 4, and in accordance with Subsection C below, the commissioner shall also have the power to participate in a supervisory college for any domestic insurer that is part of an insurance holding company system with international operations in order to determine compliance by the insurer with this Chapter. The powers of the commissioner with respect to supervisory colleges include, but are not limited to, the following:

1. Initiating the establishment of a supervisory college;

2. Clarifying the membership and participation of other supervisors in the supervisory college;

3. Clarifying the functions of the supervisory college and the role of other regulators, including the establishment of a group-wide supervisor;
Coordinating the ongoing activities of the supervisory college, including planning meetings, supervisory activities, and processes for information sharing; and

Establishing a crisis management plan.

B. Expenses. Each registered insurer subject to this section shall be liable for and shall pay the reasonable expenses of the commissioner’s participation in a ultimatey college in accordance with Subsection C below, including reasonable travel expenses. For purposes of this section, a supervisory college may be convened as either a temporary or permanent forum for communication and cooperation between the regulators charged with the supervision of the insurer or its affiliates, and the commissioner may establish a regular assessment to the insurer for the payment of these expenses.

C. Supervisory College. In order to assess the business strategy, financial position, legal and regulatory position, risk exposure, risk management and governance processes, and as part of the examination of individual insurers in accordance with Section 6, the commissioner may participate in a supervisory college with other regulators charged with supervision of the insurer or its affiliates, including other state, federal and international regulatory agencies. The commissioner may enter into agreements in accordance with Section 8C providing the basis for cooperation between the commissioner and the other regulatory agencies, and the activities of the supervisory college. Nothing in this section shall delegate to the supervisory college the authority of the commissioner to regulate or supervise the insurer or its affiliates within its jurisdiction.

Section 7.1. Group-wide Supervision of Internationally Active Insurance Groups.

A. The commissioner is authorized to act as the group-wide supervisor for any internationally active insurance group in accordance with the provisions of this section. However, the commissioner may otherwise acknowledge another regulatory official as the group-wide supervisor where the internationally active insurance group:

1. Does not have substantial insurance operations in the United States;

2. Has substantial insurance operations in the United States, but not in this state; or

3. Has substantial insurance operations in the United States and this state, but the commissioner has determined pursuant to the factors set forth in Subsections B and F that the other regulatory official is the appropriate group-wide supervisor.

An insurance holding company system that does not otherwise qualify as an internationally active insurance group may request that the commissioner make a determination or acknowledgment as to a group-wide supervisor pursuant to this section.

B. In cooperation with other state, federal and international regulatory agencies, the commissioner will identify a single group-wide supervisor for an internationally active insurance group. The commissioner may determine that the commissioner is the appropriate group-wide supervisor for an internationally active insurance group that conducts substantial insurance operations concentrated in this state. However, the commissioner may acknowledge that a regulatory official from another jurisdiction is the appropriate group-wide supervisor for the internationally active insurance group. The commissioner shall consider the following factors when making a determination or acknowledgment under this subsection:

1. The place of domicile of the insurers within the internationally active insurance group that hold the largest share of the group’s written premiums, assets or liabilities;

2. The place of domicile of the top-tiered insurer(s) in the insurance holding company system of the internationally active insurance group;

3. The location of the executive offices or largest operational offices of the internationally active insurance group;

4. Whether another regulatory official is acting or is seeking to act as the group-wide supervisor.
under a regulatory system that the commissioner determines to be:

(a) Substantially similar to the system of regulation provided under the laws of this state, or

(b) Otherwise sufficient in terms of providing for group-wide supervision, enterprise risk analysis, and cooperation with other regulatory officials; and

(5) Whether another regulatory official acting or seeking to act as the group-wide supervisor provides the commissioner with reasonably reciprocal recognition and cooperation.

However, a commissioner identified under this section as the group-wide supervisor may determine that it is appropriate to acknowledge another supervisor to serve as the group-wide supervisor. The acknowledgment of the group-wide supervisor shall be made after consideration of the factors listed in Paragraphs (1) through (5) above, and shall be made in cooperation with and subject to the acknowledgment of other regulatory officials involved with supervision of members of the internationally active insurance group, and in consultation with the internationally active insurance group.

C. Notwithstanding any other provision of law, when another regulatory official is acting as the group-wide supervisor of an internationally active insurance group, the commissioner shall acknowledge that regulatory official as the group-wide supervisor. However, in the event of a material change in the internationally active insurance group that results in:

(1) The internationally active insurance group’s insurers domiciled in this state holding the largest share of the group’s premiums, assets or liabilities; or

(2) This state being the place of domicile of the top-tiered insurer(s) in the insurance holding company system of the internationally active insurance group,

the commissioner shall make a determination or acknowledgment as to the appropriate group-wide supervisor for such an internationally active insurance group pursuant to Subsection B.

D. Pursuant to Section 6, the commissioner is authorized to collect from any insurer registered pursuant to Section 4 all information necessary to determine whether the commissioner may act as the group-wide supervisor of an internationally active insurance group or if the commissioner may acknowledge another regulatory official to act as the group-wide supervisor. Prior to issuing a determination that an internationally active insurance group is subject to group-wide supervision by the commissioner, the commissioner shall notify the insurer registered pursuant to Section 4 and the ultimate controlling person within the internationally active insurance group. The internationally active insurance group shall have not less than thirty (30) days to provide the commissioner with additional information pertinent to the pending determination. The commissioner shall publish in the [insert name of state administrative record] and on its Internet website the identity of internationally active insurance groups that the commissioner has determined are subject to group-wide supervision by the commissioner.

E. If the commissioner is the group-wide supervisor for an internationally active insurance group, the commissioner is authorized to engage in any of the following group-wide supervision activities:

(1) Assess the enterprise risks within the internationally active insurance group to ensure that:

   (a) The material financial condition and liquidity risks to the members of the internationally active insurance group that are engaged in the business of insurance are identified by management, and

   (b) Reasonable and effective mitigation measures are in place;

(2) Request, from any member of an internationally active insurance group subject to the commissioner’s supervision, information necessary and appropriate to assess enterprise risk, including, but not limited to, information about the members of the internationally active insurance group regarding:
(a) Governance, risk assessment and management; 
(b) Capital adequacy; and
(c) Material intercompany transactions;

(3) Coordinate and, through the authority of the regulatory officials of the jurisdictions where members of the internationally active insurance group are domiciled, compel development and implementation of reasonable measures designed to ensure that the internationally active insurance group is able to timely recognize and mitigate enterprise risks to members of such internationally active insurance group that are engaged in the business of insurance;

(4) Communicate with other state, federal and international regulatory agencies for members within the internationally active insurance group and share relevant information subject to the confidentiality provisions of Section 8, through supervisory colleges as set forth in Section 7 or otherwise;

(5) Enter into agreements with or obtain documentation from any insurer registered under Section 4, any member of the internationally active insurance group, and any other state, federal and international regulatory agencies for members of the internationally active insurance group, providing the basis for or otherwise clarifying the commissioner's role as group-wide supervisor, including provisions for resolving disputes with other regulatory officials. Such agreements or documentation shall not serve as evidence in any proceeding that any insurer or person within an insurance holding company system not domiciled or incorporated in this state is doing business in this state or is otherwise subject to jurisdiction in this state; and

(6) Other group-wide supervision activities, consistent with the authorities and purposes enumerated above, as considered necessary by the commissioner.

F. If the commissioner acknowledges that another regulatory official from a jurisdiction that is not accredited by the NAIC is the group-wide supervisor, the commissioner is authorized to reasonably cooperate, through supervisory colleges or otherwise, with group-wide supervision undertaken by the group-wide supervisor, provided that:

(1) The commissioner's cooperation is in compliance with the laws of this state; and

(2) The regulatory official acknowledged as the group-wide supervisor also recognizes and cooperates with the commissioner's activities as a group-wide supervisor for other internationally active insurance groups where applicable. Where such recognition and cooperation is not reasonably reciprocal, the commissioner is authorized to refuse recognition and cooperation.

G. The commissioner is authorized to enter into agreements with or obtain documentation from any insurer registered under Section 4, any affiliate of the insurer, and other state, federal and international regulatory agencies for members of the internationally active insurance group, that provide the basis for or otherwise clarify a regulatory official's role as group-wide supervisor.

H. The commissioner may promulgate regulations necessary for the administration of this section.

I. A registered insurer subject to this section shall be liable for and shall pay the reasonable expenses of the commissioner's participation in the administration of this section, including the engagement of attorneys, actuaries and any other professionals and all reasonable travel expenses.

Section 8. Confidential Treatment

A. Documents, materials or other information in the possession or control of the Department of Insurance that are obtained by or disclosed to the commissioner or any other person in the course of an examination or investigation made pursuant to Section 6 and all information reported or provided to the Department of Insurance pursuant to Section 3B(12) and (13), Section 4, and Section 5 and Section 7.1 shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information,
sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action. However, the commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the commissioner’s official duties. The commissioner shall not otherwise make the documents, materials or other information public without the prior written consent of the insurer to which it pertains unless the commissioner, after giving the insurer and its affiliates who would be affected thereby notice and opportunity to be heard, determines that the interest of policyholders, shareholders or the public will be served by the publication thereof, in which event the commissioner may publish all or any part in such manner as may be deemed appropriate.

B. Neither the commissioner nor any person who received documents, materials or other information while acting under the authority of the commissioner or with whom such documents, materials or other information are shared pursuant to this Act shall be permitted or required to testify in any private civil action concerning any confidential documents, materials, or information subject to Subsection A.

C. In order to assist in the performance of the commissioner’s duties, the commissioner:

(1) May share documents, materials or other information, including the confidential and privileged documents, materials or information subject to Subsection A, with other state, federal and international regulatory agencies, with the NAIC and its affiliates and subsidiaries, and with state, federal, and international law enforcement authorities, including members of any supervisory college described in Section 7, provided that the recipient agrees in writing to maintain the confidentiality and privileged status of the document, material or other information, and has verified in writing the legal authority to maintain confidentiality.

(2) Notwithstanding paragraph (1) above, the commissioner may only share confidential and privileged documents, material, or information reported pursuant to Section 4L with commissioners of states having statutes or regulations substantially similar to Subsection A and who have agreed in writing not to disclose such information.

(3) May receive documents, materials or information, including otherwise confidential and privileged documents, materials or information from the NAIC and its affiliates and subsidiaries and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and shall maintain as confidential or privileged any document, material or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information; and

(4) Shall enter into written agreements with the NAIC governing sharing and use of information provided pursuant to this Act consistent with this subsection that shall:

(i) specify procedures and protocols regarding the confidentiality and security of information shared with the NAIC and its affiliates and subsidiaries pursuant to this Act, including procedures and protocols for sharing by the NAIC with other state, federal or international regulators;

(ii) specify that ownership of information shared with the NAIC and its affiliates and subsidiaries pursuant to this Act remains with the commissioner and the NAIC’s use of the information is subject to the direction of the commissioner:

(iii) require prompt notice to be given to an insurer whose confidential information in the possession of the NAIC pursuant to this Act is subject to a request or subpoena to the NAIC for disclosure or production; and

(iv) require the NAIC and its affiliates and subsidiaries to consent to intervention by an insurer in any judicial or administrative action in which the NAIC and its affiliates and subsidiaries may be required to disclose confidential information about the insurer shared with the NAIC and its affiliates and subsidiaries pursuant to this Act.
D. The sharing of information by the commissioner pursuant to this Act shall not constitute a delegation of regulatory authority or rulemaking, and the commissioner is solely responsible for the administration, execution and enforcement of the provisions of this Act.

E. No waiver of any applicable privilege or claim of confidentiality in the documents, materials or information shall occur as a result of disclosure to the commissioner under this section or as a result of sharing as authorized in Subsection C.

F. Documents, materials or other information in the possession or control of the NAIC pursuant to this Act shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information, sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action.
Attachment Five

Memos on Revisions Adopted in 2014 to NAIC Publications
To: Director John M. Huff (MO), Chair of Financial Regulations Standards and Accreditation (F) Committee
Commissioner David Mattax (TX), Vice Chair of Financial Regulations Standards and Accreditation (F) Committee

From: Dale Bruggeman (OH), Chair of Statutory Accounting Principles (E) Working Group
Jim Armstrong (IA), Vice Chair of Statutory Accounting Principles (E) Working Group

Date: February 11, 2015


Attachment A to this memo includes a detailed listing of all the material changes made to the Manual in 2012. On behalf of the Statutory Accounting Principles (E) Working Group, it is our opinion that none of these items either individually or collectively should be considered “significant” as defined by the Financial Solvency Accreditation Standards. Although some of the changes have been categorized as “substantive” by the SAPWG, this is not meant to suggest the modifications are synonymous with the term “significant” within the FRSAC context.

As outlined in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles (SAP Policy Statement), modifications will be made to the Accounting Practices and Procedures Manual each and every year. As such, it will be reprinted with an “as of” date associated with it. For example, the next printing of the manual, which encompasses the attached modifications, will be titled Accounting Practices and Procedures Manual – as of March 2015. This process allows for an efficient way to update the manual and virtually guarantees that users have the latest version. Reprints and updates are necessary because of the evolutionary nature of accounting (both in the Statutory and Generally Accepted Accounting Principles arenas), and are positive for users of the manual.

The SAPWG sincerely requests that the FRSAC consider the items listed in Attachment A as “insignificant” changes to the Manual. We will continue to notify the FRSAC of any changes to the Manual and also to advise if, in our opinion, those changes are “significant” by Financial Solvency Accreditation Standards.

cc: Julie Garber, Sara Franson, Sherry Shull, Julie Gann, Robin Marcotte
The following represents a summary of the changes that were made to the As of March 2014 version of the Accounting Practices and Procedures Manual (Manual) to create the As of March 2015 version.

The first section summarizes substantive revisions to statutory accounting principles. Substantive revisions introduce original or modified accounting principles. Substantive revisions can be reflected in an existing SSAP or a new SSAP. When substantive revisions are made to an existing SSAP, the front of the SSAP identifies the substantive changes and effective date of the substantive revisions. If substantive revisions in an existing SSAP are depicted by underlines (new language) and strikethroughs (removed language) this tracking will not be shown in subsequent manuals. Substantively revised SSAPs and new SSAPs usually refer to a corresponding issue paper that will reflect the substantive revisions for historical purposes. If language in an existing SSAP is superseded, the superseded language is shaded, with the reader referred to the new or substantively revised SSAP. SSAPs that are completely superseded and interpretations that are nullified are included in Appendix H.

The second section summarizes the nonsubstantive revisions to statutory accounting principles. Nonsubstantive changes are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. Nonsubstantive changes are depicted by underlines (new language) and strikethroughs (removed language) and will not be shown as marked in subsequent manuals.

The third section summarizes any revisions to the appendices in the Manual.

### 1. Substantive Revisions – Statutory Accounting Principles

<table>
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<tr>
<th>Section</th>
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<tr>
<td>SSAP No. 40R SSAP No. 48</td>
<td>2013-17</td>
<td>Revisions related to wholly-owned single real estate held in an LLC, which meets specific conditions, with an effective date of Jan. 1, 2015.</td>
</tr>
<tr>
<td>SSAP No. 106 SSAP No. 35R</td>
<td>2014-01</td>
<td>New SSAP moves guidance on the Affordable Care Act Section 9010 from SSAP No. 35R and includes nonsubstantive edits to the disclosures.</td>
</tr>
<tr>
<td>SSAP No. 107 SSAP No. 35R</td>
<td>2014-12</td>
<td>New SSAP addresses the risk-sharing provisions of the Affordable Care Act known as risk adjustment, reinsurance and risk corridors. With this adoption, the disclosures previously located within SSAP No. 35R are moved to this SSAP and INT 13-04 is nullified.</td>
</tr>
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### 2. Nonsubstantive Revisions – Statutory Accounting Principles

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<tr>
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<tr>
<td>Preamble</td>
<td>2013-35</td>
<td>Revisions clarify that as of Sept. 15, 2009, AICPA SOPs will no longer be reviewed for statutory accounting.</td>
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<tr>
<td>SSAP No. 1 SSAP No. 4</td>
<td>2014-16</td>
<td>Revisions clarify the guidance for restricted assets.</td>
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<td>SSAP No. 3 SSAP No. 68</td>
<td>2013-29</td>
<td>Revisions clarify that the disclosure exemption for mergers with shell entities does not change the Jan. 1 date to determine the cumulative effect in accounting principle.</td>
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<tr>
<td>SSAP No. 11</td>
<td>2014-07</td>
<td>Revisions identify the adoption of specific paragraphs from Accounting Principles Board Opinion (APB) 12, Omnibus Opinion – 1967 and add guidance to reflect previously adopted GAAP, with minor technical edits.</td>
</tr>
<tr>
<td>SSAP No. 16R</td>
<td>2014-04</td>
<td>Revisions make the capitalization policy disclosure consistent with other SSAPs.</td>
</tr>
<tr>
<td>SSAP No. 19 SSAP No. 22</td>
<td>2014-05</td>
<td>Revisions adopt with modification ASU 2014-05–Service Concession Arrangements to clarify that service concession arrangements are not within the scope of SSAP No. 22 and shall not be recognized as property, plant or equipment in SSAP No. 19.</td>
</tr>
<tr>
<td>SSAP No. 26 SSAP No. 43R</td>
<td>2014-02</td>
<td>Revisions incorporate a new “structured note” disclosure and clarify that the guidance in SSAP No. 43R pertains to structured securities, not structured notes.</td>
</tr>
<tr>
<td>SSAP No.</td>
<td>Year(s)</td>
<td>Description</td>
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<tr>
<td>35R</td>
<td>2013-28</td>
<td>Revisions include disclosures pertaining to the risk-sharing provisions of the Affordable Care Act programs (risk adjustment, reinsurance and risk corridors). These disclosures were subsequently moved to SSAP No. 107.</td>
</tr>
<tr>
<td>55</td>
<td>2014-19</td>
<td>Revisions clarify that claims-related losses for extra contractual obligations and bad faith lawsuits are to be included in losses. Also, technical revisions related to prepaid adjustment expenses.</td>
</tr>
<tr>
<td>56</td>
<td>2014-18</td>
<td>Revisions clarify the reporting of separate accounts disclosures.</td>
</tr>
<tr>
<td>57</td>
<td>2014-06</td>
<td>Revisions to the disclosure requirements, with corresponding terminology revisions.</td>
</tr>
<tr>
<td>86</td>
<td>2013-32</td>
<td>Revisions adopt ASU 2013-10–Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. This ASU defines a benchmark interest rate and eliminates the restriction on different rates for similar hedges.</td>
</tr>
<tr>
<td>86</td>
<td>2014-09</td>
<td>Revisions reject ASU 2014-03–Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach (PCC) as not applicable.</td>
</tr>
<tr>
<td>86</td>
<td>2014-11</td>
<td>Revisions clarify the reporting of derivatives between Schedule DB and the balance sheet.</td>
</tr>
<tr>
<td>92</td>
<td>2013-37</td>
<td>Revisions adopt by reference ASU 2011-09–Disclosures about an Employer’s Participation in a Multiemployer Plan and incorporate limited additional disclosures for multiemployer plans.</td>
</tr>
<tr>
<td>102</td>
<td>2013-37</td>
<td>Revisions add reference in Appendix B – Determining the Valuation Method, to the SSAP’s downstream holding company guidance.</td>
</tr>
<tr>
<td>97</td>
<td>2013-31</td>
<td>Revisions clarify the RBC authorized control level used in the DTA calculation.</td>
</tr>
<tr>
<td>101</td>
<td>2014-20</td>
<td>Revisions adopt ASU 2014-12–Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period with an effective date of Jan. 1, 2016, with early adoption permitted.</td>
</tr>
<tr>
<td>104R</td>
<td>2014-17</td>
<td>Revisions adopt ASU 2014-12–Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period with an effective date of Jan. 1, 2016, with early adoption permitted.</td>
</tr>
</tbody>
</table>

### 3. Revisions to the Appendices

<table>
<thead>
<tr>
<th>Section</th>
<th>Reference</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appendix A</td>
<td>2014-21</td>
<td>Revisions incorporate changes to Appendix A-010: Minimum Reserve Standards for Individual and Group Health Insurance Contracts to allow the 2012 Group Long-Term Disability Table adopted by the Health Actuarial (B) Task Force with a Jan. 1, 2017, effective date and early adoption permitted.</td>
</tr>
<tr>
<td>Appendix B</td>
<td>2013-04 (EAIWG)</td>
<td>INT 13-04: Accounting for the Risk-Sharing Provisions of the Affordable Care Act was adopted to provide temporary guidance on the risk-sharing provisions. This INT was subsequently nullified by SSAP No. 107 and moved to Appendix H. Placement revisions move GAAP guidance identified as rejected from INT 99-00 into Issue Paper No. 99. INT 99-00 was nullified and moved to Appendix H.</td>
</tr>
<tr>
<td>Appendix B</td>
<td>2014-12 (SAPWG)</td>
<td></td>
</tr>
<tr>
<td>Appendix B</td>
<td>2014-26 (SAPWG)</td>
<td></td>
</tr>
</tbody>
</table>
### Appendix C

**2014-22**

*Actuarial Guideline XLVII: Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table* has been added.

*Actuarial Guideline XLVIII: Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued Under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model 830)* has been added.

Actuarial Interpretations 38 through 41 have been added to Appendix C2.

### Appendix D

**2013-35**

Revisions update the appendix based on the consideration of GAAP through the statutory review process. These revisions are not tracked as changes. Additionally, revisions clarify that as of Sept. 15, 2009, AICPA SOPs will no longer be reviewed for statutory accounting.

### Appendix E


Revisions reflect the rejection of the following GAAP guidance as not applicable to statutory accounting in *Issue Paper No. 99—Nonapplicable GAAP Pronouncements* (Issue Paper No. 99):

- **ASU 2012-04—Technical Corrections and Improvements**
- **ASU 2013-12—Definition of a Public Business Entity, An Addition to the Master Glossary**
- **ASU 2014-10—Development Stage Entities**
- **SOP 09-1—Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data Placement**

Revisions move GAAP guidance identified as rejected from INT 99-00 into Issue Paper No. 99. Additionally, revisions add reference of the original SSAP that corresponds with each issue paper, as well as the current authoritative SSAP guidance.

The following Issue Papers were adopted or amended:

- **Issue Paper No. 148—Affordable Care Act Section 9010 Assessment**
- **Issue Paper No. 149—Wholly-Owned Single Real Estate Property in an LLC**
- **Issue Paper No. 150—Accounting for the Risk-Sharing Provisions of the Affordable Care Act**

### Appendix F

**N/A**

No revisions have been made to this appendix.

### Appendix G

**N/A**

No revisions have been made to this appendix.

### Appendix H

**2014-26, 2013-04 (EAIWG), 2014-12 (SAPWG)**

Revisions add nullified INTs:

- **INT 99-00: Compilation of Rejected EITFs**
- **INT 13-04: Accounting for the Risk-Sharing Provisions of the Affordable Care Act**

G:\DATA\Stat Acctg\6. Memos\A. MEMOS\2014 Accreditation Memo.doc
TO: Honorable John Huff, Chair
Financial Regulation Standards & Accreditation (F) Committee

FROM: Jake Garn, Utah Chief Financial Examiner, Chair
Blanks (E) Working Group

DATE: January 13, 2015

RE: Items Impacting Current Accreditation Standard

Please find attached a list of items adopted by the Blanks (E) Working Group during 2014. The Blanks Working Group adopts numerous changes to the Annual Statement Blanks and Instructions each year. Most of the changes are made to clarify current requirements or are considered enhancements to existing reporting. The changes adopted in 2014 do not represent a substantive change to any reporting requirements.

I am planning to be present when the Financial Regulation Standards & Accreditation (F) Committee meets in Phoenix, AZ in the event any member of the committee wishes to discuss these issues.
Changes to blanks and instructions adopted during 2014

1. Modify the supplemental compensation exhibit and add instructions to facilitate the collection of additional detail on the nature of compensation paid to top executives and directors (2013-20BWG) effective 12/31/2014.
2. Change the column description for the Federal ID Number Column on Schedule Y, Part 1A and Part 2 to read only ID Number. Add instruction similar to the ID Number Column instruction included in the reinsurance exhibits Schedule F and Schedule S (2013-24BWG) effective 12/31/2014.
3. Add questions related to the Actuarial Memorandum required by Actuarial Guideline XXXVIII 8D and Regulatory Asset Adequacy Issues Summary (RAAIS) required by the Actuarial Opinion and Memorandum Regulation (# 822), Section 7A(5) to the Supplemental Exhibits and Schedules Interrogatories (2013-25BWG) effective 12/31/2014.
4. Move from Note 21, Other Items the disclosure for Offsetting and Netting of Assets and Liabilities to Note 5, Investments with an illustration to be data captured (2013-26BWG) effective 12/31/2014.
5. Add additional lines to the AVR Default Component and Equity and Other Invested Assets Component blank pages for mortgage loans. Update line and page number reference impacted (2013-27BWG) effective 12/31/2014.
6. Modify the Schedule P instructions to clarify when restatement is needed as a result of a change in pooling percentage (2014-01BWG) effective 1/1/2015.
10. Modify the instructions for NAIC Company Code, Alien Insurer Identification Number, Pool/Association Number and Certified Reinsurer Number to clarify the party assigned a Company Code or Pool/Association number. Replace application requirements with contact information for obtaining numbers assigned since the last publication of the NAIC Listing of Companies or to have a number assigned (2014-05BWG) effective 12/31/2014.
11. Add a disclosure to Note 5, Investments for Structured Notes and data capture the illustration (2014-06BWG) effective 12/31/2014.
12. Modify the instruction and illustration in Note 22, Events Subsequent to reflect additional disclosures related to the ACA assessment (2014-07BWG) effective 12/31/2014.
13. Add an additional line of business in the Property/Casualty Exhibit of Premiums and Losses (Statutory Page 14) and Insurance Expense Exhibit, Parts II and III of the NAIC Annual Statement Blank, and the corresponding instructions. Label the new line as “Line 2.4 Private crop” for writers of the private market coverages (2014-08BWG) effective 12/31/2014.
16. For Schedules A, B and BA, add electronic only columns for postal code and property type. For Schedules B and BA, add an electronic only column for maturity date. Change the state column to accept the three-character country code when reporting a country (2014-11BWG) effective 12/31/2014.
17. Add a new disclosure to Note 24 related to the risk sharing provision of the Affordable Care Act. The amounts will be data captured (2014-12BWG) effective 12/31/2014.
18. Changes to the Actuarial Opinion annual statement blanks instructions for the Life and Fraternal annual statements. These changes result in requirements for such appointed actuary reporting that is similar to that currently in the Health and P/C Actuarial Opinion instructions, which stipulate that the appointed actuary report to the Board of Directors or Audit Committee. Eliminate the instructions no longer needed (2014-13BWG) effective 12/31/2014.
19. Proposed modifications to the Actuarial Opinion Instructions for P&C and Title as well as the Actuarial Opinion Summary Supplement are included in the attached document (2014-14BWG) effective 12/31/2014.
20. Add disclosures to the General Interrogatories Part 2 – Life Interrogatories Section 1.6 - most current year (Ordinary Life Insurance; US business only) for direct premiums written, incurred claims, and number of covered lives (2014-16BWG) effective 12/31/2014.
21. Add two footnote lines to Schedule DB, Part D, Section 1, add a crosscheck to the instructions for the derivatives lines on the asset and liability pages and add a reference for the illustration for 5J (2014-17BWG) effective 1/1/2015.

22. Add a new Principles Based Reserve Supplemental XXX/AXXX Reinsurance Exhibit (Parts 1, 2 and 3) to the Life and Fraternal blank (2014-18BWG) effective 12/31/2014.
TO: John M. Huff (MO), Chair  
Financial Regulation Standards and Accreditation (F) Committee
FROM: Doug Slape (TX), Chair  
Capital Adequacy (E) Task Force
Date: February 25, 2015
RE: Accreditation Standards – Changes to the Risk-Based Capital Formulas and Instructions for Life and Property/Casualty

Attached please find a brief description of changes to the 2014 Risk-Based Capital Report Including Overview and Instructions for health, life and property/casualty. These changes were adopted by the Capital Adequacy (E) Task Force and Jt. Executive (EX) Committee/Plenary in 2014. Significance of these changes was viewed as it relates to the overall RBC standard.

No changes to the RBC formulas or instructions were deemed to be significant for health, life or property/casualty.

Any questions can be directed to NAIC staff:
Property/Casualty – Eva Yeung (NAIC)  
Life – Dave Fleming (NAIC)  
Health — Crystal Brown (NAIC)

Health Risk-Based Capital Formula

Not Significant Revisions were made and new lines were added to XR005 for Federal Home Loan Bank stock.
Not Significant The instructions and annual statement source was updated for Working Capital Finance Investments on XR007.
Not Significant Low Income Housing Tax Credit Lines were added to the Asset Concentration on XR011.
Not Significant Working Capital Finance Investment Class 1 and Class 2 were added in XR007.
Not Significant The factor for Receivables for Securities was updated.
Not Significant A new page was added for the Operational Risk on page XR022 for informational purposes only.
Not Significant A new page was added for the Underwriting Risk Experience Fluctuation Risk page XR012A for the Affordable Care Act (ACA).
Not Significant Credit Risk, updates were made to page XR019, as a result of the adoption of 2014-05-H for the ACA reinsurance.
Not Significant A sensitivity test was added to page XR025 for the ACA Fee for information purposes only.
Not Significant A sensitivity test was added to page XR025 for the ACA Risk Adjustment and Risk Corridor on page XR025.

Life Risk-Based Capital Formula

Not Significant New lines added to LR017 for expanded treatment of Federal Home Loan Bank items
Not Significant A new section was added following line (37) of LR027 Interest Rate Risk and Market Risk to provide for the presentation of information-only, alternative calculations of the C-3 RBC cash flow testing.
Not Significant LR029-A Operational Risk was added to the formula for informational purposes only.
Not Significant A new footnote was added to LR033 to limit the amount of the asset valuation reserve that can be added to total adjusted capital to that amount not used in asset adequacy testing.
Not Significant An ACA fee sensitivity test was added to LR033.
Not Significant The factor for Receivable for Securities was updated on LR012.
Property/Casualty Risk-Based Capital Formula

Not Significant  New Catastrophe Risk Attestation (PR002) was implemented for informational purposes only.
Not Significant  PR003A, PR004A, PR030A and PR031A pages were added for informational purposes only as a result of
the adoption of 2014-04-CR to address the issue that the R0 component in the current RBC formula was
not updated to reflect the insurance subsidiary RBC charge including Catastrophe Risk.
Not Significant  Reserve and premium underwriting risk line 1 industry average development factors were updated.
Not Significant  Premium underwriting risk line 4 industry loss and loss adjustment expense factors for Homeowners and
Fire, Commercial Multiple Peril, Surety, Special Property, Auto Physical Damage, International, and
Reinsurance lines were updated.
Not Significant  Operational Risk PR027 formula and instructions were added for informational purposes only.
Not Significant  A sensitivity test was added to the Calculation of Total Adjusted Capital PR029 page to provide a “what if”
scenario to eliminate the ACA fee from PR029.
MEMORANDUM

TO:             Financial Regulation Standards and Accreditation (F) Committee

FROM: Stewart Guerin (LA), Chair of the Valuation of Securities (E) Task Force
       Bob Carcano, Senior Counsel, SVO

CC: Todd, Sells, Director, Financial Regulatory Services, NAIC

DATE: February 3, 2015

RE: Report of the Valuation of Securities (E) Task Force

A. **Purpose** – This report is presented to assist the Financial Regulation Standards and Accreditation (F) Committee in determining if amendments to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* adopted by the Valuation of Securities (E) Task Force in 2014 require corresponding changes in either the Financial Regulation Standards (defined below) or state laws or regulations adopted in conformity with Part A: Laws and Regulations of the Financial Regulation Standards.

B. **Financial Regulation Standards** – The NAIC Policy Statement on Financial Regulation Standards (SFRS) in the 2014 Accreditation Program Manual consists of four parts: Part A identifies laws and regulations deemed necessary to financial solvency regulation;¹ Part B identifies regulatory practices and procedures that supplement and support enforcement of the financial solvency laws and regulations discussed in Part A;² Part C contains three standards related to an insurance department’s organizational and personnel policies; and Part D focuses on Organization, licensing and change of control of domestic insurers.

**Part A** - This report is concerned with the financial solvency standards in Part A. Those standards relevant to this report are shown immediately below and can be characterized as NAIC model legislation, codified NAIC guidance (i.e., the *Accounting Practices and Procedures Manual*): analytical work product of the NAIC staff (including the NAIC Investment Analysis Office) and state laws and regulations that contain substantially the same standards as NAIC model legislation or guidance. A review indicates that the work product of the NAIC Investment Analysis Office is directly or indirectly incorporated into the following Part A standards. For example:

- **Standard 5** requires that insurer owned securities be valued in accordance with the standards promulgated by the NAIC Investment Analysis Office;
- **Standard 2**, the *Risk-Based Capital (RBC) for Insurers Model Act (#312)*⁴ assigns RBC factors for securities based on their credit risk as measured by NAIC Designations;
- **Standard 3**, the *Accounting Practices and Procedures Manual*⁵ uses NAIC Designations produced by the SVO and or Price Grids produced by the SSG to identify valuation rules applicable to an investment and the reserved capital amount the insurer must report;
- **Standard 6**, the *Insurance Holding Company System Regulatory Act (#440)*⁶ defines subsidiary, controlled and affiliated (SCA) investments for which the SVO assigns valuation assessments;
- **Standard 8**, pertaining to state investment regulations often incorporate NAIC mechanisms that relate asset allocations by reference to credit risk expressed in the form of NAIC Designations;⁷ and

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² naic.org
³ Standard 5 requires that insurer owned securities be valued in accordance with the standards promulgated by the NAIC Investment Analysis Office;
⁴ Risk-Based Capital (RBC) for Insurers Model Act (S.Cap. Act. 2013.511135)
⁷ Standard 8, pertaining to state investment regulations often incorporate NAIC mechanisms that relate asset allocations by reference to credit risk expressed in the form of NAIC Designations;
Standard 10, the Credit for Reinsurance Model Act (#785) identifies securities compiled by the SVO, and letters of credits issued by the banks on the NAIC Bank List administered by the SVO, as eligible for use as collateral in reinsurance transactions.

C. Investment Analysis Office Standards Identified in the Purposes and Procedures Manual – All SVO and SSG standards related to the assessment of credit risk in insurer owned securities, identification of additional non-payment risk in securities, classification of certain assets as bonds or as bond-like for reporting purposes, the valuation of insurer owned securities, and other activities conducted by the SVO or the SSG in support of state insurance regulatory objectives, are published in the Purposes and Procedures Manual. In 2014, the Purposes and Procedures Manual was revised in June and December, with all policies, analytical procedures and instructions adopted during 2014 effective for year-end financial reporting.

Amendments to the Purposes and Procedures Manual would automatically be reflected in the SFRS if any or all of the SFRS Standards identified in paragraph A of this memorandum have been adopted by an accredited state or incorporated by reference into the laws or regulations of an accredited state. For example, amendments to the Purposes and Procedures Manual would be directly incorporated by reference if the laws or regulations of an accredited state refer to or incorporate Standard 5 on valuation. Amendments to the Purposes and Procedures Manual would be indirectly incorporated by reference if the law or regulations of a state refers to or incorporates any other Standard that itself uses NAIC Designations or other analytical products of the Investment Analysis Office as a component; for example, Standard 2 in the case of RBC and/or Standard 3 in the case of statutory accounting.

D. Conclusion – In our opinion, reasoning as discussed above, amendments to the Purposes and Procedures Manual adopted by the Valuation of Securities (E) Task Force in 2014 can be characterized as maintenance items consistent with the existing regulatory framework and automatically incorporated into the Part A Standards identified above. In addition the amendments identified in Attachments One and Two did not create processes or practices external to the Purposes and Procedures Manual or other NAIC model legislation, guidance or analysis of NAIC staff that would suggest the need to consider an amendment to NAIC model legislation or guidance or legislative action on the part of an accredited state.

We hope this is responsive to the issues and concerns before the Committee.
Attachment One

RECENT CHANGES TO THE SVO PURPOSES AND PROCEDURES MANUAL
Published in the July 1, 2014 Publication

- **Working Capital Finance Investments** – Reporting instructions and analytical methodologies were added to permit the SVO to assign NAIC Designations to Working Capital Finance Investment (WCFIs). A new Part Two, Section 9 (o) was added to provide instructions on how to file a WCFI with the SVO. A new subparagraph (G) was added to Part Two, Section 10 (c) (i) to identify documents that have to be filed with the SVO for assessment of a WCFI. Similarly, a new subparagraph (D) was added to Part Two, Section 11 (e) (i) to identify documentation required to be filed with the SVO for an annual update of an NAIC Designation assigned to a WCFI. A new Part Three, Section 6 was added to describe the analytical methodologies to be followed by the SVO when assessing a proposed WCFI for assignment of an NAIC Designation.

*The Valuation of Securities (E) Task Force adopted this amendment on December 16, 2013, to be effective on January 1, 2014.*

- **Expedited Review Text Eliminated from RTAS Text** – Part Four, Section 3 (a) was amended to delete subparagraph (vii); the “expedited review” clause. The clause described a procedure when an RTAS Application involved the issuance of a security identical to one previously reviewed by the SVO. In practice, the procedure was rarely utilized and the phrase is often misinterpreted.

*The Valuation of Securities (E) Task Force adopted this amendment on March 30, 2014.*

- **Clarifying Instruction for Debt-Equity Hybrid Adopted** – Part One, Section 2 (c) was amended to add a new subparagraph (v) to clarify that an unrated hybrid security is filed with the SVO for an NAIC Designation but the insurance company reports the hybrid security as a bond pursuant to NAIC Annual Statement Instructions using the NAIC Designation assigned by the SVO.

*The Valuation of Securities (E) Task Force adopted this amendment on March 30, 2014.*

- **Catastrophe-Linked Bonds were made subject to the Filing Exempt Process** – Part Four, Section 4 (a) was amended to delete an instruction that requires the SVO to classify certain Catastrophe-Linked Bonds as equity for reporting purposes which is inconsistent with more recent instructions and to instead make these securities subject to the filing exemption specified in Part Two, Section 4 (d) of this Manual. A corresponding amendment was made to Part Two, Section 4 (d).

*The Valuation of Securities (E) Task Force adopted this amendment on March 30, 2014.*

- **Short-Dated Non-Principal Protected Securities Instruction Deleted** – Part One, Section 2 (c) (iii), the Short-Dated Non-Principal Protected Securities instruction, was deleted because it required the SVO to classify certain securities as equity for reporting purposes, which is inconsistent with a recently adopted methodology. Similar text was deleted in Part Two, Section 1 (the definition of Unconfirmed FE) and Part Three, Section 1(b) which describes a procedure applicable to preferred stock.

*The Valuation of Securities (E) Task Force adopted this amendment on March 30, 2014.*

- **Reference to Morningstar Credit Rating, LLC in the NAIC CRP List was Corrected** - Part One, Section 7 (d) (i) was amended to reflect that Morningstar Credit Ratings, LLC is an NAIC CRP for “all structured finance securities.” However, because a reference to RealPoint, LLC was inadvertently reinserted in the December 31, 2013 publication of the *Purposes and Procedures* after previous publications had reflected the name change of this NAIC CRP to Morningstar Credit Rating, LLC, the change in the text in this publication may cause some confusion. To avoid confusion we clarify that this publication: 1) reinserts the correct name of the this NAIC CRP (by deleting RealPoint, LLC and replacing it with Morningstar Credit Ratings, LLC); and 2) corrects the scope of their NAIC CRP activity (by...
deleting the qualifier “CMBS only” and inserting instead “All Structured Finance Securities”), so the reference now reads: Morningstar Credit Ratings, LLC (All Structured Finance Securities).

The Valuation of Securities (E) Task Force adopted this amendment on June 19, 2014.

- **A New Part Seven of the Purposes and Procedures Manual is Adopted** – Part Seven consists of text previously adopted by the Task Force that pertains to the recently created NAIC Structured Securities Group (SSG). Part Seven collects all instructions pertaining to the SSG in one location. For example, the annual surveillance of insurer owned RMBS and CMBS formerly contained in Part Three, Section 3 (c) – which describes the financial modeling methodology –, can now be found in Part Seven. In the process of organizing the disparate portions of text into a coherent whole, some new text was added and minor changes were made to existing text.

The Valuation of Securities (E) Task Force adopted this amendment on June 19, 2014.

- **Description of Methodology for Principal Protected Notes is Deleted** – Text in Part Three, Section 3 (b) (viii) was deleted. The Task Force had previously considered replacing an instruction that the SVO reclassify PPNs as equity and other text with a description of weighted average methodology which is often used by the SVO to assess this asset class. After discussion, the Task Force instructed the SVO to delete the reclassification instruction and not add any other text to the section.

The Valuation of Securities (E) Task Force adopted this amendment on June 19, 2014.
Attachment Two

RECENT CHANGES TO THE SVO PURPOSES AND PROCEDURES MANUAL
Published in the December 31, 2014 Publication

- **RMBS and CMBS Documentation Standards** - Part Seven, Sections 2 and 5 of the *Purposes and Procedures Manual* were amended to add documentation standards that would enable the SSG to evaluate whether an RMBS or CMBS is eligible for financial modeling at year-end. Documentation standards address both a first time assessment which would include an assessment of SPV and Trust formation, structure and insolvency remoteness and the information and data necessary on an annual basis for financial modeling.

  The Valuation of Securities (E) Task Force adopted this amendment on August 17, 2014.

- **Time Period to Address Filing Deficiency Reduced** – Part Two, Section 10 (b) of the *Purposes and Procedures Manual* was amended to reduce the time period an insurer has to correct an InfoReq deficiency. The time period which was 90 days has been shortened to 45 days.

  The Valuation of Securities (E) Task Force adopted this amendment on August 17, 2014.

- **Catastrophe Linked Bonds** – Part Four, Section 4 (a) of the *Purposes and Procedures Manual* was amended to provide that catastrophe-linked bonds not assigned credit ratings by an NAIC credit rating provider (CRP) and those assigned a credit rating by an NAIC CRP but on the basis of a methodology other than the one specified in the *Purposes and Procedures Manual* are filed under the special reporting instruction referred to as the 5*/6* process.

  The Valuation of Securities (E) Task Force adopted this amendment on October 2, 2014.

- **Definition of NAIC Designations Amended** - Part One, Section 3 (b) (i) of the *Purposes and Procedures Manual* was amended to clarify that NAIC Designations are notched to reflect the credit risk of the specific issuer obligations, its relative position in the issuer’s capital structure and priority of payment.

  The Valuation of Securities (E) Task Force adopted this amendment on October 2, 2014.

- **Documentation Standard for Re-REMICs** - Part Seven, Sections 2 and 5 of the *Purposes and Procedures Manual* was amended to add a definition of Re-REMICs and to add documentation standards for them.

  The Valuation of Securities (E) Task Force adopted this amendment on November 17, 2014.

- **Canadian ASPE and French GAAP added National Financial Presentation Standards** - Part Two, Sections 10 (c) (i) (D) 4 and 5 of the *Purposes and Procedures Manual* was amended to replace the reference to Canadian GAAP with a reference to Canadian Accounting Standards for Private Enterprises (ASPE) but only for non-financial institutions and to add French GAAP subject to the requirement that additional information be filed with Audited Financial Statements presented in accordance with French GAAP.

  The Valuation of Securities (E) Task Force adopted this amendment on November 17, 2014.

- **Credit Rating Standard for Foreign Bank on the NAIC Bank List is Equalized with that for Domestic Banks** - Part Six, Sections 1 (b) (ii) of the *Purposes and Procedures Manual* was amended to equalize the credit rating standard foreign banks who wish to be placed on the list of issuers of letters of credit must obtain with that of domestic banks.

  The Valuation of Securities (E) Task Force adopted this amendment on November 17, 2014.
Characteristics of CRP Credit Ratings under the Filing Exempt Rule Clarified - Part One, Section 4(ii) (B) of the Purposes and Procedures Manual was revised to break out, rearrange and number the concepts in the original text in order to create a definition of “Eligible NAIC CRP Rating” for use in Part Two Section 4 (d), the filing exempt rule. Part Two, Section 4 (d) of the Purposes and Procedures Manual was amended to delete the discussion of characteristics of credit ratings eligible for filing exemption which is addressed in Part Two Section 4 (ii) (B). And Part One, Section 3 (c) (iv) of the Purposes and Procedures Manual was amended to delete the discussion of the FE Rule which is addressed in Part Two, Section 4 (d) and the discussion of characteristics of credit ratings eligible for filing exemption which is addressed in Part One, Section 4 (ii) (B).

The Valuation of Securities (E) Task Force adopted this amendment on November 17, 2014.

List of Fees for Services and Publications Moved to the NAIC Web-Site – Effective with this publication of the Purposes and Procedures Manual, the List of Fees for Services will no longer be published in Part One, Section 7 (c) of the Purposes and Procedures Manual but will instead be published on the NAIC web-site at this location: http://www.naic.org/

The Annual Fee Assessment Has Been Removed – During the NAIC 2014 Fall National Meeting, the NAIC agreed to remove the SVO Assessment: a revenue measure introduced in 2004 in response to the adoption of the Filing Exempt Rule published as part of the List of Fees for Services in Part One, Section 7 (c) of the Purposes and Procedures Manual. This information will no longer be published reflecting the decision of the NAIC to remove the fee assessment.

END NOTES

1 “…The purpose of the Part A: Laws and Regulations standards are to assure that an accredited state has sufficient authority to regulate the solvency of its multi-state domestic insurance industry in an effective manner. … A state may demonstrate compliance with a Part A standard through a law, a regulation, an established practice, which implements the general authority granted to the state or any combination of laws, regulations or practices, which achieves the objective of the standard …” 2014 Accreditation Program Manual. “…For those standards included in the Part A … where the term “substantially similar” is included, a state must have a law, regulation, administrative practice or a combination of the above that addresses the significant elements included in the NAIC model laws or regulations… Accreditation Interlineations (Substantially Similar)

2v …Part B sets out standards required to ensure adequate solvency regulation of multi-state insurers … In addition to a domestic state’s examination and analysis activities, other checks and balances exist in the regulatory environment. These include … analyses by NAIC’s staff, … and to some extent the evaluation by private rating agencies. …” 2014 Accreditation Program Manual

3 The SFRS requires that securities owned by insurance companies be valued in accordance with standards promulgated by the NAIC’s Capital Markets and Investment Analysis Office approved by VOS TF while other invested assets should be valued in accordance with procedures promulgated by the Financial Condition (E) Committee. The Investment Analysis Office refers to two independent staff functions: i.e., that of the SVO and that of the NAIC Structured Securities Group (SSG). The SSG was formally established as an NAIC staff function in 2013 and assumes responsibility for the conduct of the year-end financial surveillance of insurer owned residential mortgage backed securities (RMBS) and commercial mortgage backed securities (CMBS), conducted by the SVO since 2009. The SSG is also presumptively the segment of NAIC professional staff that would lead assessment of structured finance products generally.

(Would eliminate this statement at this time even though we know it is true)

NAIC valuation procedures, applicable to corporate, municipal and asset backed securities (ABS) are contained in Part Five of the Purposes and Procedures Manual of the NAIC Investment Analysis Office (Purposes and Procedures Manual). These procedures seek to identify a market value and in certain circumstances to require the use of a market value. Insurance companies either report the fair value determined by the SVO for a security or determine a fair value in accordance with one of the valuation methodologies described in the Purposes and Procedures Manual. The fair value determined in accordance with the Purposes and Procedures Manual is reported in the fair value column and the book/adjusted carrying value column of the NAIC financial annual statement blank. In addition, the Annual Statement Instructions require insurers to report a fair value, so that even an insurer entitled to use amortized value in the “Book/Adjusted Carrying Value” column, must use fair value in the “Rate Used to Report Fair Value” column.

The financial modeling process administered by the SSG generates intrinsic price values (referred to Price Grids) for RMBS and CMBS instead of an NAIC Designation. These standards are contained in Part Seven of the Purposes and Procedures Manual. Price Grids are used by insurers to generate NAIC Designations in accordance with procedures specified in paragraph 25 of Statement of Statutory Accounting Principles (SSAP) No. 43R Loan Backed and Structured Securities of the NAIC Accounting Practices and Procedures Manual. Accordingly, to the extent that the NAIC Accounting Practices and Procedures Manual is incorporated by reference in any standard, Price Grids and NAIC Designations derived by reference to them, would also be incorporated.

4 The SFRS requires the adoption of the Risk Based Capital (RBC) for Insurers Model Act (#312) or a substantially similar law or regulation. RBC factors are tied to NAIC designations assigned by the SVO or in certain cases, for example in the case of Mortgage Referenced Securities, by the SSG; NAIC Designations assigned by insurance companies pursuant to the filing exempt rule contained in the Purposes and Procedures Manual or NAIC Designations derived by insurance companies for RMBS and CMBS from Price Grids produced by the SSG pursuant to paragraph 25 of SSAP No. 43R. “…This standard
does not articulate a threshold level for minimum capital and surplus required for insurers to transact business ... Risk-based capital will, however, effectively require minimums when adopted by states.” Accreditation Interlineations - Financial Regulation Standards

5 The SFRS requires the use of the codified version of the Accounting Practices and Procedures Manual. Valuation procedures applicable to long-term invested assets are determined by the nature of the insurer (life or property/casualty) and the NAIC designation assigned to the security by the SVO or SSG; NAIC Designations assigned by insurance companies pursuant to the filing exempt rule contained in the Purposes and Procedures Manual or NAIC Designations derived by insurance companies for RMBS and CMBS from Price Grids produced by the SSG pursuant to paragraph 25 of SSAP No. 43R. “ ...To satisfy this standard, ... specific adoption of the NAIC Annual Statement Blank, NAIC Annual Statement Instructions, and the NAIC Accounting Practices and Procedures Manual [is required].” Accreditation Interlineations - Financial Regulation Standards

6 The SFRS requires the adoption of the Insurance Holding Company System Regulatory Act (#440) or a substantially similar act. For the time period relevant in this report, the SVO reviews and approves the values the insurer reports for subsidiary, controlled and affiliated investments under this act. Beginning in 2015, this function will be transferred to the NAIC Financial Regulatory Services. “ ... One of the significant elements of this standard pertains to limitations on investments in subsidiaries.” Accreditation Interlineations - Financial Regulation Standards

7 The SFRS requires a diversified investment portfolio. Although the Investment of Insurers Model Act (Defined Limits or Defined Standards) is not specifically identified, portions of one or the other model acts have been adopted by many of the states and these relate specific asset allocations to NAIC Designations provided by the SVO or in some cases by the SSG; NAIC Designations assigned by insurance companies pursuant to the filing exempt rule contained in the Purposes and Procedures Manual or NAIC Designations derived by insurance companies for RMBS and CMBS from Price Grids produced by the SSG pursuant to paragraph 25 of SSAP No., 43R. “ ... This standard ... [will require] that statutes, together with related regulations and administrative practices, provide adequate basis ... to prevent, or correct, undue concentration of investment by type and issue and unreasonable mismatching of maturities of assets and liabilities. The standard is not interpreted to require an investment statute that automatically leads to a fully diversified portfolio of investments.” Accreditation Interlineations - Financial Regulation Standards

The NAIC Investment of Insurers Model Act (Defined Limits Version) (# 280) imposes a 3% limit on the amount an insurer can invest in a single person (the threshold diversification limit) and also imposes a percentage limit on total investments of a defined credit quality, expressed by reference to NAIC Designation categories (the threshold credit quality limit). An additional percentage limit is then assigned to specific asset categories, which may or may not be subject to adjustment with the two threshold requirements. The limits identified in the Model Act are what would guide portfolio allocation decisions. Once made the insurer would shift to monitoring changes in the portfolio and rebalancing the allocations accordingly. Assuming a process for the identification of concentrations caused by indirect exposures, the insurer would aggregate such exposures with similar risks across all activities.

8 The SFRS requires the adoption of the Credit for Reinsurance Model Act (#785), Credit for Reinsurance Model Regulation (#786) and Life and Health Reinsurance Agreement Model Regulation (#791) or substantially similar laws. The SVO maintains a list of banks that meet defined eligibility criteria to issue letters of credit in support of reinsurance obligations or that are eligible to serve as trustees under various arrangements required by state insurance law.
To: The Financial Regulation Standards and Accreditation (F) Committee

From: Al Bottalico, Chair
Financial Examiners Handbook Technical Group

Date: February 27, 2015

Subject: Consideration for Financial Accreditation Standards
2015 Financial Condition Examiners Handbook

The Accreditation Program Manual includes Review Team Guidelines to be used for financial examinations performed using the risk-focused surveillance approach that is found in the NAIC Financial Condition Examiners Handbook (the Handbook). This memorandum is to update the FRSAC on changes that the Financial Examiners Handbook Technical Group (FEHTG) has made to the Handbook during 2014.

Modifications are made to the Handbook each year, and a new edition is printed annually. This process allows for an efficient way to update the Handbook and ensures that users have the latest version. The FEHTG made several changes to the Handbook in 2014. It is the FEHTG’s opinion that several of these changes should be considered “significant” for accreditation purposes. FEHTG defined “significant” as a change that may immediately warrant a change to at least one accreditation standard or the Review Team Guideline(s) for said standard. These changes are segregated in the list below.

Although some changes have been categorized as “significant” by the FEHTG, this is not meant to suggest the modifications are synonymous with the term “significant” within the FRSAC context. During 2014, the FEHTG made the following changes:

Significant Changes to the Handbook Impacting Accreditation Standards and/or Review Team Guidelines:

- The Coordination Framework was completely revised to align Handbook guidance with current coordinated examination realities. These revisions include expanded definitions of the roles and responsibilities for each state within a holding company group and modifications to how the coordinated effort should be documented within the examination file. This change also impacted Exhibit Z, Part Two – Examination Coordination.

As a result of these revisions, FEHTG would advise accreditation to consider revising the guidelines pertaining to Accreditation Standard E: Use of Appropriate Guidelines and Procedures regarding reliance on the work of other states in a coordinated examination and Accreditation Standard G: Scheduling of Examinations regarding documentation of attempts to coordinate examinations as well as the selection criteria included in the Work Plan for the On-Site Accreditation Review. FEHTG would suggest the following language be utilized to reflect this change in the accreditation manual:

Accreditation Standard E: Use of Appropriate Guidelines and Procedures, Guideline 4:

Companies that are part of a holding company group that includes more than one insurer are subject to varying responsibilities and requirements based on the extent of participation in the coordinated group exam.

An Exam Facilitator conducting a fully coordinated group examination is responsible for the overall quality of the work performed in support of the coordinated exam conclusions and is therefore...
responsible for compliance with the accreditation guidelines for this work. Exhibit Z, Part Two, Section B (or a similar document) should be completed by the Exam Facilitator to demonstrate its role in the coordinated examination. Any state-specific work performed that is solely related to an individual domestic insurer in another state is excluded from the Exam Facilitator’s responsibility. The accreditation team members are encouraged to consider coordinated group examinations in selecting which examinations to review.

- A participating state in a fully coordinated group examination is responsible for demonstrating active participation throughout the coordinated examination, as defined in the Examiners Handbook, and any work performed specific to its domestic company(ies) in the group. Section C of Exhibit Z, Part Two (or a similar document), should be used to document participation. Participating states meeting these requirements are not responsible for the overall quality of the work performed in support of coordinated exam conclusions. Documentation of active participation in a coordinated group examination is subject to accreditation review.

- A state that does not participate in a coordinated group examination or utilizes existing work outside of a fully coordinated group examination (i.e., a state not directly involved in the planning, oversight and review of examination work) does not qualify as a participating state in a fully coordinated group examination. This state is responsible for the overall quality of the work performed in support of examination conclusions for the company(ies) examined and is therefore responsible for compliance with the accreditation guidelines for this work. Section D of Exhibit Z, Part Two (or a similar document) should be completed to demonstrate the role of this state as it relates to the holding company group examination.

States electing to rely on examination work completed by another state should review the planning memorandum of the testing state related to the area of planned reliance, review the related examination program prepared by the testing state, and communicate any concerns with the testing state about the examination approach. Additionally, the relying state should review the testing state’s conclusions after the examination work and a detailed review has been completed by the testing state. The relying state may also review additional working papers at the sole discretion of the relying state. For example, the relying state may choose to review working papers related to significant findings and material adjustments. A memorandum shall be included within the workpapers of the relying state describing the communication between the testing state and the relying state, information on the relying state’s actual review of the workpapers and how this review and reliance will impact the relying state’s examination. The relying state should also have a copy of the pertinent workpapers completed by the testing state within their examination file.

a) If relying on the work of a state that was accredited at the time of the review/reliance, the accreditation review team will not review the examination workpapers completed by the accredited testing state, but will review the memorandum documenting the review and reliance to determine compliance with this accreditation guideline. If a significant portion of the examination work was completed through reliance on another state’s workpapers, the accreditation review team may choose to select another examination to supplement the overall accreditation score on examinations.

b) If relying on the work of a state that was not accredited at the time of review/reliance, the relying state must assume ownership of the work completed by the non-accredited testing state. This requires the relying state to conduct a review of the examination work performed by the non-accredited testing state. The relying state should use professional judgment in determining the extent of the review to be performed. However, since the relying state assumes ownership of the work, the accreditation review team will review the examination workpapers completed by the non-accredited testing state as if they had been completed by the relying state. If the relying state does not have the workpapers from the non-accredited testing state, this will result in an interpretation that the examination procedures were not completed. The accreditation review team
is encouraged not to select other examination files to review if the documentation within a file in which reliance on a non-accredited testing state was lacking.

Additionally, FEHTG would advise accreditation to consider revising the guidance related to the selection of files to be reviewed within the Work Plan for the Full On-Site Accreditation Review as follows:

If the selected state is involved in a significant number of coordinated examinations as a participating state, the review team should consider reviewing Exhibit Z, Part Two, Section C (or a similar document), for a sample of coordinated examinations in which the state participated. If, upon review of Exhibit Z, Part Two, Section C (or a similar document), it is determined that the selected state did not meet the criteria to be classified as a fully participating state, it will be responsible for compliance with the accreditation guidelines for this work.

Accreditation Standard G: Scheduling of Examinations, Guideline 4:
“The department should document the attempt to coordinate examination efforts with the departments of other states consistent with the coordinated exam approach prescribed in the Examiners Handbook. Each company that is part of a holding company group that includes more than one insurer should include a copy of the coordination plan, documented in Section A of Exhibit Z, Part Two (or a similar document), in its examination file. In connection with this guideline, the team is not to evaluate the level of coordination between departments, but rather to confirm that an attempt at coordination was made.”

- Exhibit H – Insurer Profile Summary (IPS) was revised to incorporate branded risk classifications as a common language for communicating findings between the financial examiner and financial analyst functions and maintaining ongoing oversight and monitoring of the financial solvency of an insurer. Since it is anticipated that revisions related to this Handbook change will impact the Review Team Guidelines for both Financial Analysis and Financial Examinations, the Risk-Focused Surveillance (E) Working Group will provide a separate recommendation to the F Committee in order to maintain consistency between the two functions.

Non-Significant Changes to the Handbook Impacting Accreditation Standards and/or Review Team Guidelines:

- Exhibit J – Risk Assessment Worksheets was eliminated from the Handbook. FEHTG would suggest the following language be utilized to reflect this change in the accreditation manual:

Accreditation Standard E: Use of Appropriate Guidelines and Procedures, Guideline 1:

1) A risk-based approach should be utilized in establishing priority of accounts or operational areas. The risk-based approach should include the following seven phases:

- Phase 1 – Understand the company and identify key functional activities to be reviewed
- Phase 2 – Identify and assess inherent risk in activities
- Phase 3 – Identify and evaluate risk mitigation strategies
- Phase 4 – Determine residual risk
- Phase 5 – Establish/conduct exam procedures
- Phase 6 – Update prioritization and supervisory plan
- Phase 7 – Draft examination report and management letter based on findings

The examination approach may be documented in a variety of ways; however, the examiner should prepare a Risk Assessment Matrix, or substantially similar document including each of the seven phases listed above, as the central location for the documentation of risk assessment. The Risk Assessment Worksheets included within the Examiners Handbook are optional tools available to supplement the Risk Assessment Matrix.
For companies without extensive risk mitigation strategies/controls or for situations in which the examiner determines that it would not be cost-effective or efficient to perform control testing, control testing may not be required prior to the examiner’s ultimate determination of residual risk. However, even in those instances, the examiner should still follow the seven-phase examination process, including documenting an understanding of controls. Rather than testing controls, the examiner may assess an overall control rating of “weak” for the identified risks.

Other Changes to the Handbook:

- Revisions to focus the examination objective on the review and evaluation of an insurer’s business processes and controls to assist in assessing and monitoring current financial condition and prospective solvency.
- Revisions to emphasize customization of Exhibit M – Understanding the Corporate Governance Structure based on the nature and extent of operations for the insurer(s) under examination.
- Revisions to clarify which elements of an examination are required to be performed as part of each full-scope examination and which elements are considered optional tools or for informational purposes only.
- Revisions to the Handbook Preamble to reflect current examination guidance.
- Revisions to incorporate guidance related to the Own Risk and Solvency Assessment (ORSA). This includes narrative guidance and a template for completing a review of an ORSA in section one of the Handbook, as well as references to the ORSA assessment in Phase 1 guidance in section two and applicable examination exhibits in section four.
- Revisions modifying exam report requirements, including enhanced scope language, reduction in required elements to be reported, and clarification regarding the inclusion of financial statements and presentation of exam adjustments.
- Revision to Exhibit V – Prospective Risk Assessment to incorporate succession planning as a possible area of prospective concern.
- Revisions to examination repositories to align the content with the concept of critical risk categories.
- Revisions to Exhibit A – Examination Planning Procedures Checklist to ensure consistency with recent changes to Handbook guidance. These revisions include emphasizing collaboration with the financial analyst to reduce duplication of efforts during planning, focusing the review of documents in planning to the most recent years covered by the examination period, incorporating references to Exhibit CC – Issue/Risk Tracker and Exhibit DD – Critical Risk Categories, and other minor changes related to implementation of critical risk categories.

The FEHTG requests that the FRSAC consider the items listed above when updating the Accreditation Program Manual. We will continue to notify the FRSAC of any changes to the Handbook and also advise if, in our opinion, those changes are “significant” by accreditation expectations.
To: John Huff, Chair of the Financial Standards and Accreditation (F) Committee  

From: Doug Slape and Justin Schrader, Co-Chairs of the Risk-Focused Surveillance (E) Working Group  

Date: March 10, 2015  

Re: Recommended Part B Revisions to Incorporate IPS Changes

In 2014, the Risk-Focused Surveillance (E) Working Group (RFSWG) took on a project to improve communications between financial analysts and examiners through developing modifications to the format of the Insurer Profile Summary tool. As a result of this project, new guidance was developed and adopted for inclusion in the NAIC’s *Financial Analysis Handbook* and the *Financial Condition Examiners Handbook*. The new guidance requires incorporation of branded risk assessments into the Insurer Profile Summary to provide a common language for use in communicating risks facing the insurer across functions and states.

As the updated Insurer Profile Summary and related guidance significantly impacts existing Part B Accreditation Standards, the RFSWG has developed proposed revisions to the related guidelines to enforce the new guidance. These proposed revisions are attached to this memorandum for consideration by the Committee.

If there are any questions regarding the proposed revisions, please feel free to contact either of us or supporting NAIC staff (Dan Daveline and Bruce Jenson) for clarification. Thanks for your consideration of this referral.
b. Communication of Relevant Information to/from Financial Analysis Staff

*Standard:* The department should provide relevant information and data received by the department which may assist in the financial analysis process to the financial analysis staff and ensure that findings of the financial analysis staff are communicated to the appropriate person(s).

**Guidelines**

1) Procedures should be established such that information material to the financial analysis process is communicated to the analysts. Examples would include significant complaint data, legal actions taken against the company, material rate changes, results of market conduct and financial condition examinations, significant changes in the company's agents, MGAs or reinsurance intermediaries, and regulatory actions taken by other states. Some information may be effectively analyzed in a summary fashion (e.g., summary analysis of a complaint register including all domestic insurers). To accomplish this, the analyst or another department representative should inquire of individuals in other areas of the department on at least an annual basis regarding information that may be significant to the upcoming analysis. If responses are not received from some or all of the individuals, this may be discussed in the management comment letter but should not affect the scoring on this standard.

Because of the organizational structure of some state insurance departments, other sections within the department may not receive or have significant information related to captive insurers as all business related to the captive occurs within the captive unit. To the extent that sections outside of the captive unit have information relevant to the financial analysis process of a captive, such information should be communicated to the captive financial analyst. To the extent that upper management in the captive unit has significant information relevant to the financial analysis process of a captive, such information should be communicated to the captive financial analyst.

2) Analysts should comment in the analysis file with respect to significant information obtained from other units or other individuals within the captive unit, if applicable.

3) Evidence of communication (e.g., minutes of meetings, memos or notes to the file, printouts, etc.) when problems or concerns are identified should be included in the department’s analysis files or binders. To a lesser extent, oral verification may provide such evidence.

4) Financial solvency information, particularly adverse findings or significant unresolved issues, obtained as a result of the financial analysis procedures performed should be communicated to examiners, management and other department staff as needed.

5) Results of ongoing analysis procedures should be shared with the financial examiners to assist in examination planning. At the beginning of each examination, the analyst should communicate areas of concern and specific issues to address during the examination. To assist in communication, the
analyst should provide a current copy of the Insurer Profile Summary as well as any other supporting documentation necessary to communicate concerns and suggested procedures.

6) Analysts should obtain and utilize information from financial examiners in conducting ongoing analysis procedures. At the conclusion of an examination, the analyst should collaborate with the examiner to consider and discuss the examination results and/or findings in developing and updating the insurer’s prioritization level, ongoing supervisory plan and assessment of branded risks contained in the Insurer Profile Summary. In addition, the analyst should follow-up with the insurer to address concerns/issues identified as a result of examination activities, which may include examination report findings, management letter comments or prospective risks. Information to be obtained and reviewed as a result of each full-scope examination should include the report of examination, management letter (if used) and summary review memorandum (or substantially similar document).

f. Documented Analysis Procedures

Standard: The department should have documented financial analysis procedures and/or guidelines to provide for consistency and continuity in the process and to ensure that appropriate analysis procedures are being performed on each domestic insurer.

General Guidance: The department should develop an analysis manual or otherwise document its analysis process to provide a reference guide and training tool for the analysts. The use of the NAIC Financial Analysis Handbook or sections thereof is considered acceptable.

Guidelines

1) All analysis work performed should include initials of the preparer and the dates of completion. This is not applicable for companies that passed the automated quarterly review process for non-troubled companies.

2) Worksheets designed to document the analysis process should be properly completed as set forth by the department’s procedures.

3) Any unusual item, fluctuation from established norms, or other issue raised during the analysis of a company, should be properly addressed and documented in the analysis file. For example, if the department establishes a premiums to surplus ratio of 3 to 1 and the company being analyzed is writing 6 to 1, the issue should be addressed in the analysis file as to why it is acceptable, or if not, what action the department will require the company to take to remedy it. Also, if an analyst indicates that a fluctuation or ratio result is unusual, there should be evidence of follow-up and a conclusion as to whether the analyst considers the unusual fluctuation or ratio result to be a concern and why. Some ratios or fluctuations from established norms may not be appropriate for captive RRGs primarily because of the accounting method utilized. If this is the case, the analyst should explain why the ratio or fluctuation is not applicable.

4) Any follow-up (e.g., memo to the file, letter to the company, etc.) should be properly documented. Any letter received from a company should show proper analysis by the department, signing off and concluding that the response is adequate. For example, if the department discovers that a company is not filing its securities with the Capital Markets and Investment Analysis Office and sends a letter to
the company requesting that such filings be made, a copy of the department’s letter and a copy of the company’s response, including evidence that the analyst has determined that the company’s final response is adequate, should be in the analysis file. The analyst should also consider follow-up with an insurer on comments included in the management letter of a financial examination.

5) The financial analysis process should include a summary discussion of the analysis findings including a general discussion of the company’s strengths and weaknesses and a discussion of its exposure to prospective risks. The analyst may use the Insurer Profile Summary to document this summary or should use provide a separate summary this discussion within the file to and update the Insurer Profile Summary (and Supervisory Plan, if maintained separately from the Profile) with relevant information, if applicable. Note: The summary discussion is ultimately the work product summary of the results of the financial analysis process, while the Insurer Profile Summary is a forward-looking, high-level living document that should be influenced by all units or areas of the department.

6) The Insurer Profile Summary should be updated annually through the financial analysis process, after the conclusion of on-site examination activities at the insurer (full-scope or limited scope) and as significant information impacting the insurer is identified throughout the year. The Insurer Profile Summary should provide an assessment of the insurer’s prospective exposure to each of the nine branded risk classifications, with supporting detail provided as necessary to accurately describe the analyst’s view of risks in that area. The Insurer Profile Summary should also contain information from each of the five elements of the regulatory Risk-Focused Surveillance Cycle: 1) Financial Analysis; 2) Financial Examination; 3) Internal/External Changes; 4) Priority System; and 5) Supervisory Plan.

7) Conclusions should be reached as to whether any action should be considered as a result of the analysis. For example, the worksheets could have a write-in section at the end that would enable the analyst and supervisor to comment and make recommendations for action, monitoring and plans for follow-up. The analyst may use the Insurer Profile Summary (and Supervisory Plan, if maintained separately from the Profile) to document these conclusions.

8) The analysis work performed by the lead state (or the domestic state for those groups with only one multi-state insurer or with multi-state insurers domiciled in only one state) should document sufficient evidence of a review of the holding company system. The lead state may choose to rely on the analysis work performed by an international insurance supervisor (e.g., work products from a supervisory college) or another functional regulator. If such reliance takes place, the lead state is still responsible for documenting and distributing to other domestic states an analysis of the overall financial condition of the group, significant events and any material strengths and weaknesses of the holding company group. Additionally, if the lead state has material concerns with respect to the overall financial condition of the holding company group, they are responsible for notifying all other domestic states.

If the department is a non-lead state, the department should receive the holding company system analysis performed by the lead state and utilize this information to document the impact of the holding company system on the multi-state domestic insurer.
Part B2: Financial Examinations

b. Communication of Relevant Information to/from Examination Staff

Standard: The department should provide relevant information and data received by the department, which may assist in the examination process to the examination staff and ensure that findings of the examination staff are communicated to the appropriate person(s).

Guidelines

1) Procedures should be established such that information material to the financial examination process is communicated to the examiner-in-charge (EIC). Examples would include results of the financial analysis process, significant complaints data, legal actions taken against the company, material rate and form changes, results of market conduct examinations, significant changes in the company’s agents, MGAs or reinsurance intermediaries, and regulatory actions taken by other states. To accomplish this, the EIC or another department representative should inquire of individuals in other areas of the Department during Phase 1 of the examination. If responses are not received from some or all of the individuals, this may be discussed in the management comment letter but should not affect the scoring on this standard.

Because of the organizational structure of some state insurance departments, other sections within the department may not receive or have significant information related to captive insurers as all business related to the captive occurs within the captive unit. To the extent that sections outside of the captive unit have information relevant to the financial examination of a captive, such information should be communicated to the captive financial examiner. To the extent that upper management in the captive unit has significant information relevant to the financial examination of a captive, such information should be communicated to the captive financial examiner.

2) The EIC, or other appropriate examination staff member, should comment in the examination file with respect to significant information obtained from other units or other individuals within the Captive unit, if applicable.

3) Evidence of communication (e.g., bi-weekly reports, memos or notes to the examination files, examination reports, etc.) when problems or concerns are identified as part of the examination process should be included in the examination files. To a lesser extent, oral verification may provide such evidence.

4) Financial solvency information, particularly adverse findings, obtained as a result of the financial examination procedures performed should be communicated to the EIC, chief examiner, department management and other department staff as needed.

5) Examiners should obtain and utilize information from financial analysts to assist in planning examination activities. At the beginning of each examination, the examiner should obtain input from the financial analyst regarding areas of concern and specific issues to address during the examination. To assist in gathering this information, the examiner should obtain a current Insurer Profile Summary from the financial analyst as well as any other supporting documentation necessary to understand the analyst’s concerns and suggested procedures.
The risk-focused surveillance approach requires fully coordinated efforts between the financial examination function and other financial solvency functions. There should be a documented exchange of relevant information between the field examination function and financial analysis function.

Examples of the types of information that may be contained in the examination files include, but are not limited to:

- Updates to company prioritization levels
- Material adverse findings made by department personnel
- Changes to corporate structure
- Results of meetings with company officials
- Changes to the forward-looking plans of formal or informal monitoring or surveillance efforts of the company’s activities including recommendations for changes to the supervisory plan
- Emerging issues that have the potential to impact the company

6) Results of examination activities should be shared with the financial analyst to assist in conducting ongoing analysis procedures. At the conclusion of an examination, the examiner should collaborate with the analyst to discuss the examination results and/or findings and their impact on the insurer’s prioritization level, ongoing supervisory plan and assessment of branded risks contained in the Insurer Profile Summary. In addition, the examiner should recommend follow-up for the analyst to perform in addressing concerns/issues identified as a result of examination activities. In so doing, the examiner should adequately communicate examination report recommendations, management letter comments and/or prospective risks. Information to be provided as a result of each full-scope examination should include the report of examination, management letter (if used) and summary review memorandum (or substantially similar document).

Key issues and results of the on-site risk-focused examination of an insurer or insurance group shall be summarized in a document or documents and shared with the assigned analyst. The document or documents should be tailored to each examination and may include, but are not limited to, the following: a high-level overview of the insurer’s holding company structure, a discussion of potential ongoing or future solvency concerns, a discussion and assessment of the insurer’s corporate governance and risk management function, a summary of the examination adjustments and management letter comments, and a discussion of residual risk concerns (significant internal control weaknesses, risks that were not adequately mitigated, or risks that should be monitored during the period between examinations). At the conclusion of an examination, the examiner should collaborate with the analyst to consider and discuss the examination results and/or findings when developing or updating the insurer’s prioritization level and/or Supervisory Plan.
Attachment Six

Risk Management and Own Risk
Solvency Assessment Model Act (#505)
Executive Summary

On September 12, 2012, the NAIC Executive Committee and Plenary adopted the Risk Management and Own Risk and Solvency Assessment (ORSA) Model Act (Model #505). This new Model provides for a requirement for insurers/insurance groups to maintain a risk management framework; regularly perform an own risk and solvency assessment (ORSA); and, annually file an ORSA Summary Report to the commissioner upon request and notwithstanding that request, if the insurer is part of a group file an ORSA Summary Report to the lead state commissioner of the group. The Model also includes provisions for exemptions, confidentiality, and outlines other filing requirements.

A statement and explanation of how the potential standard is directly related to solvency surveillance and why the proposal should be included in the standards:

The current solvency surveillance framework includes examination and analysis of enterprise risk management (ERM) of insurers as outlined in the Financial Condition Examiners Handbook and the Financial Analysis Handbook. In 2010 and 2011, the International Association of Insurance Supervisors adopted two Insurance Core Principles related to risk management that heighten the need for standards and guidance on ERM, including ORSA. Generally, the ORSA is an internal assessment appropriate to the nature, scale and complexity of an insurer/insurance group conducted by that insurer/insurance group of the material and relevant risks associated with the current business plan and the sufficiency of capital resources to support those risks.

The IAIS Insurance Core Principle 16-Enterprise Risk Management for Solvency Purposes (ICP 16) was adopted by the IAIS in October 2010. Within ICP 16 is the following requirement: “16.11: The solvency regime requires the insurer regularly to perform its own risk and solvency assessment (ORSA) to assess the adequacy of its risk management and current, and likely future, solvency position.” Additionally, ICP 8 –Risk Management and Internal Controls (ICP 8) was adopted by the IAIS in October 2011 and requires “8.3: The supervisor requires the insurer to have an effective Risk management function capable of assisting the insurer to identify, assess, monitor, manage and report on its key risks in a timely way.” These requirements in risk management were not included in the 2009 Financial Sector Assessment Program (FSAP) as they were adopted subsequent. However risk management and ORSA will be included in the 2014 FSAP review.
During 2011, the Working Group reviewed these ICPs and determined that the enterprise risk management and ORSA requirements were appropriate and beneficial for inclusion in the U.S. solvency framework. The ORSA will allow state insurance regulators access to information that will improve their understanding of the insurer/insurance group and the material risks to which the insurer/insurance group is exposed, directly benefiting solvency regulation. It will provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view. In 2011, the Working Group developed an ORSA Guidance Manual that serves as guidance for insurers for reporting on its ORSA. The ORSA Guidance Manual was adopted by the NAIC at the 2012 Spring National Meeting.

While the Working Group gave consideration to various legal framework options to require an insurer to perform an ORSA and submit an ORSA Summary Report, ultimately regulators agreed to develop a new Model Act to serve as the legal authority for such a requirement.

A statement as to why ultimate adoption by every jurisdiction may be desirable:

Per Model #505, the ORSA Summary Report will be filed to the commissioner upon request and not withstanding such a request, if the insurer is part of a group it will file the report to the lead state insurance regulator. It is anticipated that the majority of insurance groups filing the ORSA Summary Report will file the report on a group basis. It is expected that states will coordinate the regulatory review of the ORSA Summary Report during coordinated examinations and holding company analysis. Uniform adoption of this Model will provide that the legal framework exists in all states to require the ORSA so that this coordinated regulatory effort can be effective.

A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date:

As Model #505 was adopted in September 2012, some states are in the process of preparing legislative proposals but no states have adopted the Model to-date.

A statement as to the provisions needed to meet the minimum requirements of the standard. That is, whether a state would be required to have “substantially similar” language or rather a regulatory framework. If it is being proposed that “substantially similar” language be required, the referring committee, task force or working group shall recommend those items that should be considered significant elements:

The Working Group recommends that states’ law should contain Model #505 or an act that is substantially similar. The sections of Model #505 that would be considered significant elements are as follows:

- **Section 2 – Definitions**
  - Include similar definitions defined in subsections 2A, 2B, 2C, 2D and 2E for consistent use and understanding of terminology between states.

- **Section 3 – Risk Management Framework**
  - Include substantially similar requirements to “…maintain a risk management framework…”

- **Section 4 – ORSA Requirement**
  - Include substantially similar requirements to “…regularly conduct an ORSA consistent with a process comparable to the ORSA Guidance Manual…”

- **Section 5 – ORSA Summary Report**
  - Include a requirement to file an ORSA Summary Report substantially similar to subsections 5A, 5B and 5C.

- **Section 6 – Exemptions**
  - Include provision for exemptions to the Act substantially similar to subsections 6A, 6B 6C, 6D, and 6E.

- **Section 7 – Contents of the ORSA Summary Report**
  - Include a provision for contents of the report similar to subsections 7A and 7B.
Section 8 – Confidentiality
  
  Include substantially similar provisions for protecting confidential information submitted to the commissioner, including provisions maintaining confidentiality for information shared with state, federal and international regulators. If sharing confidential information with the NAIC and third-party consultants is permitted, appropriate confidentiality protections should be included.

Section 11 – Effective Date
  
  Include an effective date no earlier than Jan. 1, 2015.

An estimate of the cost for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it, if reasonably quantifiable:

The ORSA (E) Subgroup submitted a report to the Financial Condition (E) Committee on November 5, 2012 containing referrals to the Financial Analysis Handbook (E) Working Group and the Financial Condition Examiners Handbook (E) Technical Group to include in their development of regulatory guidance considerations for state insurance department resources necessary to perform the regulatory review of ORSA Summary Reports. The Working Group is currently unable to estimate or reasonably quantify the cost for insurers to comply with the Model or for state insurance departments to enforce this Model and perform the regulatory review of an ORSA Summary Report. While some states may use existing in-house expertise or hire consultants, it should be noted that the ORSA (E) Subgroup will be considering a proposal in 2013 for the NAIC to hire an Enterprise Risk Management expert to assist in the review process for states that need such assistance.

Additional information:
None
December 19, 2014

Director John Huff, Chair
Financial Regulation Standards and Accreditation (F) Committee
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108

Attn: Julie Garber, CPA, Senior Accreditation Manager
Via e-mail: jgarber@naic.org

Re: Accreditation Recommendations – Risk Management and Own Risk and Solvency Assessment Model Act

Dear Director Huff,

We want to thank you and the (F) Committee members for this opportunity to comment on the recommended addition of the Risk Management and Own Risk Solvency Assessment Model Act (RMORSA, or ORSA) as a new Part A: Laws and Regulations Accreditation Standard, and the related April 7, 2013 referral memo containing the suggested significant elements. We recognize the importance of ORSA and support its uniform adoption by the states. At the same time, for the reasons explained below, we urge that if ORSA is included as an accreditation standard, it be made clear that the states are required to provide confidentiality protections that provide the same level of protection as Section 8 of ORSA.

Our good faith collaboration with regulators produced ORSA, the 2010 revisions to the Insurance Holding Company System Model Act (HCA), and most recently the Corporate Governance Annual Disclosure Model Act (CGAD), referred to collectively herein as “the Models”. Each of these Models includes strong protections for the highly sensitive and proprietary insurance company information that is required to be submitted for regulatory review. However, since the adoption of these Models by the NAIC, we have been disappointed that the agreed-upon confidentiality provisions have been weakened or compromised in legislation that has been enacted in several states, unnecessarily exposing the industry to legal risk. Notwithstanding our support for ORSA, described above, we cannot support state laws or regulations that jeopardize the confidentiality of our member companies’ most sensitive and proprietary information.

The insurance industry is willing to provide regulators meaningful information to evaluate insurers’ solvency risk. We understand the need for the ORSA and support state-based regulatory tools designed to protect consumers and insurers from insolvencies. However, the insurance industry must be confident that the states will adopt
ORSA without modifying its strict confidentiality protections for the highly proprietary, strategic, organizational and financial data likely to be submitted to regulators under this law. Otherwise, the public release of this information could be very damaging to companies and policyholders.

For this reason, it is particularly troubling that the “substantially similar” accreditation standard has been diluted in ORSA and HCA legislation that has been enacted in some states over the last few years. We recognize that some states may need to make certain language changes to satisfy their specific legislative drafting rules. However, in some states, substantive modifications to the confidentiality protections, not just formatting or stylistic amendments, have been made.

In view of the above, it is critical that states adhere to the Models’ confidentiality provisions. It is similarly critical that the accreditation program remain robust and true to its original purpose.

In order for ORSA to remain a robust assessment of insurance company solvency, we urge the NAIC to make it clear that the accreditation requirements for Section 8 of ORSA require the states to adopt language that provides the same level of protection as provided in Section 8, through language that is either identical or “functionally equivalent” to the language of Section 8.

Accordingly, we urge that the current language of “Section 8 – Confidentiality” on page 2 of the April 7, 2013 referral memo be substituted with the following:

**“Section 8 – Confidentiality.”** Include provisions that provide confidentiality protection for documents, materials, or other information, including the ORSA Summary Report, that are in the possession or control of the Department, or shared with state, federal or international regulators, the NAIC or third party consultants or gathered, created or assembled for such sharing (collectively or separately, “the Materials”). The provisions should provide the same level of confidentiality protection as Section 8 of Model #505, through language that is either identical or functionally equivalent to the language of Section 8 of Model #505. Provisions providing the following protections are considered significant elements:

1. The Materials are proprietary, trade secrets, confidential by law, and privileged;
2. The Materials are not subject to the state’s Open Records, Sunshine, Freedom of Information, or other similar laws;
3. The Materials are not subject to subpoena nor are they subject to discovery or admissible in any private civil action;
4. The Commissioner may use the Materials in furtherance of any regulatory or legal action brought as part of the Commissioner’s official duties, but shall not otherwise make the Materials public without the prior written consent of the insurer;
5. Neither the Commissioner nor any other person who has received any of the Materials while acting under the authority of the Commissioner, nor any other person...
with whom the Materials have been shared, shall be permitted or required to testify in any private civil action concerning the Materials.;

6. The Commissioner may share the Materials with other state, federal and international regulators, including members of a supervisory college as defined in [insert appropriate reference to state’s HCA, as amended], with the NAIC, and with third-party consultants, only if the recipient agrees in writing to preserve the confidentiality of the Materials, and has verified it has the legal authority to do so;

7. The Commissioner may receive Materials from regulatory officials of other jurisdictions including members of supervisory colleges, and from the NAIC, only if the Commissioner maintains confidentiality protections equal to or greater than those applicable under the laws of the jurisdiction which is the source of the Materials;

8. No waiver of any claim of privilege, confidentiality, proprietary nature or trade secret status of the Materials shall occur as a result of any disclosure or sharing under this Act.

9. Materials in the possession of the NAIC or any third-party consultants retain their confidentiality under the confidentiality protections of this Act.

10. The Commissioner shall enter into a written agreement with the NAIC or third party consultant governing sharing and use of information, which agreements shall meet the requirements of Section 8.C (3) of the Model.

11. Any written agreement between the NAIC and any other state regulators governing the sharing and use of the Materials shall meet the requirement of Sec. 8.C.(3)(i).

The above language will give insurance commissioners the flexibility to adopt ORSA in a functionally equivalent form that provides the same level of confidentiality protections as contained in Section 8. It will also provide insurers with the security and confidence they need to prepare and submit their most sensitive and proprietary information to regulators and allow them to support ORSA legislation when it is introduced in the states.

We thank you for your consideration and look forward to discussing these issues with you further.

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<tr>
<th>Organization</th>
<th>Name</th>
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<th>E-mail Address</th>
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</thead>
<tbody>
<tr>
<td>American Council of Life Insurers</td>
<td>Robbie Meyer</td>
<td>202-624-2184</td>
<td><a href="mailto:robbiemeyer@acli.com">robbiemeyer@acli.com</a></td>
</tr>
<tr>
<td>American Insurance Association</td>
<td>Adam E. Kerns</td>
<td>202-828-7163</td>
<td><a href="mailto:akerns@aiadc.org">akerns@aiadc.org</a></td>
</tr>
<tr>
<td>America's Health Insurance Plans</td>
<td>Bob Ridgeway</td>
<td>501-333-2621</td>
<td><a href="mailto:bridgeway@ahip.org">bridgeway@ahip.org</a></td>
</tr>
<tr>
<td>Blue Cross Blue Shield Association</td>
<td>Kim Holland</td>
<td>202-626-4810</td>
<td><a href="mailto:Kim.Holland@bcbsa.com">Kim.Holland@bcbsa.com</a></td>
</tr>
<tr>
<td>National Association of Mutual Insurance</td>
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<td>317-875-5250 x1070</td>
<td><a href="mailto:mrogers@namic.org">mrogers@namic.org</a></td>
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<tr>
<td>Property Casualty Insurers Association of America (PCI)</td>
<td>Stephen W. Broadie</td>
<td>847-553-3606</td>
<td><a href="mailto:Steve.Broadie@pciaa.net">Steve.Broadie@pciaa.net</a></td>
</tr>
<tr>
<td>Reinsurance Association of America</td>
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<td>202-783-8380</td>
<td><a href="mailto:morell@reinsurance.org">morell@reinsurance.org</a></td>
</tr>
</tbody>
</table>
Attachment Seven

Referral from the Valuation of Securities (E) Task Force
MEMORANDUM

To: Hon. John M. Huff, Chair, Financial Regulation Standards and Accreditation (F) Committee and Director of Insurance for the State of Missouri
From: Stewart Guerin, Chair of the Valuation of Securities (E) Task Force
Bob Carcano, Senior Counsel, NAIC Investment Analysis Office
Cc: Julie Garber, NAIC Senior Accreditation Manager
Sara Franson, NAIC Accreditation Program Manager
Charles Therriault, Director, NAIC Securities Valuation Office
Gail Sciacchetano, NAIC Deputy General Counsel
Re: Referral – Managing the Impact of the Recalibration Project on State Investment Laws
Date: November 19, 2014

1. **Background** – The Valuation of Securities (E) Task Force received an SVO proposal, referred to as “Recalibration,” recommending that the NAIC: 1) replace the current single credit risk assessment framework (NAIC 1 - 6 credit quality grades applied to all insurer-owned securities) with three: one for corporate securities, one for municipal securities and one for asset-backed securities; 2) expand the number of NAIC Designation categories within each asset specific framework; and 3) revise the statistical value assigned to NAIC Designations in each framework. Recalibration was referred to the Investment Risk-Based Capital (E) Working Group, (reporting to the Capital Adequacy (E) Task Force), which is engaged in a comprehensive review of the RBC framework. Working Group reports indicate its final proposal will include a recommendation for additional RBC factors. This Task Force, therefore, expects that it will take up the Recalibration proposal at some point in the future. In the interim, the SVO was asked to assess the impact of Recalibration on NAIC operations and on state investment laws. In part, the SVO concluded that a decision to change the number of NAIC designations would require changes in state laws because state laws typically refer to the current 6 Designation framework. The SVO also concluded that until the Task Force actually identifies what frameworks it wishes to adopt, the SVO is not in a position to advise the states on how they should rephrase statutory references to NAIC Designations and related processes. However, in its initial report, the SVO also identified inaccuracies and inconsistencies in how state investment laws refer to NAIC Designations and had made recommendations in nomenclature to correct these inaccuracies and further uniformity of expression in state laws.

2. **Referral** – This Task Force considers that the objective of minimizing the impact of Recalibration on state laws would be furthered if states had an opportunity to align references to NAIC Designations in state investment laws to NAIC current and planned usage before Recalibration is adopted. We believe that aligning state laws as discussed in the attached memorandum (Attachment One) would also further uniformity objectives entrusted to this Committee. Although we do not believe that the issue warrants an accreditation standard, we nevertheless believe that the Committee is in the best position to advise this Task Force on how the issue could be presented to the States within the context and consistent with established NAIC processes.
1. **Introduction** – We were asked to evaluate the impact on state laws if the NAIC adopted the use of plus (+) and minus (-) symbols for NAIC Designation Categories under the proposed “Recalibration” project. During an assessment of state laws for this purpose, the SVO identified inaccurate and inconsistent references to NAIC Designations and related processes in state statutes. Although Recalibration is yet in the future, the SVO considered that correcting existing inaccuracies and inconsistencies in state law references to NAIC Designations could help prepare the states for Recalibration and in any event would align state statutes with current NAIC practices. This memorandum would provide guidance to the state on how they might correct the inaccuracies and inconsistencies we found in state laws.

2. **Concepts** – This section discusses core credit analysis concepts and provides benchmarks to orient the user of this memorandum as they consider the comments contained below.

a. **Credit Risk** – Credit risk refers to the relative ability of a borrower to repay a financial obligation in accordance with the terms of an agreement. Credit risk is expressed as a continuum or range between a high ability and willingness to pay and payment default. This continuum or range of risk is divided into a given number of risk bands, in accordance with the needs of the person creating this “credit scale.” Each segment of the resulting division is a band of risk, and each band of risk is assigned a specific statistical meaning (i.e., historical frequency of default) and a symbol in the risk continuum or range. Each symbol in the continuum or range expresses an inverse relationship between quality and risk: i.e., the higher the quality (ability to pay), the lower the risk (of non-payment), and the lower the quality, the higher the risk. Each successive symbol articulates a shift in this relationship until the (next to) last symbol, which conveys that likelihood of payment is at its lowest and credit risk at its highest, and the last symbol, which conveys that payments are not being made or are unlikely to be made. There are times when an analyst wishes to express a distinction in credit quality/risk of less than a full band or grade. The practice is to use other symbols, most typically plus (+), a minus (-) with an intermediate half grade between them. These half grades are collectively called notches and are individually called a notch. The NAIC credit risk scale is described in Part One, Section 3 of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

b. **Relative Priority of Claim and of Payment** – The contract between the lender and borrower will specify the type of claim on the assets of the borrower that the lender has. For example, the obligation may be described as being “senior secured,” meaning that the lender has the highest possible priority to payment as well as a security interest in borrower property. On the other hand, an obligation described as junior subordinated is significantly lower in the borrower’s capital structure and entitled to payment only after all senior obligations have been paid. These terms place a specific borrower obligation in the space they occupy relative to other obligations of the borrower. Because the agreement specifies the lender’s priority of claim on borrower assets, it also specifies a priority of payment for the specific obligation. This means that a credit opinion is specific to a liability and reflects the likelihood of payment associated with that specific obligation. The risk of a senior secured obligation holder not being paid would always be less than the risk of a subordinated obligation holder issued by the same borrower. Please refer to Part One, Section 3 (c) (iii) (B) of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for an illustration of differing levels of claims and priority of payments in a hypothetical capital structure and for a description of the methodology used to make distinctions between securities of the same issuer.
3. NAIC Definitional and Usage Practices

a. Current Practice – The NAIC has adopted the symbols 1, 2, 3, 4, 5 and 6 to express the credit scale it wants to use to segment credit risk. Each of these symbols expresses the quality and credit risk of a given borrower liability. It is, therefore, appropriate to refer to the symbols as “NAIC designations for quality” or “NAIC quality designations” in conversation. But the aggregate of the symbols; 1, 2, 3, 4, 5 and 6 are referred to as NAIC Designations Categories, and each symbol is referred to as an NAIC Designation Category to ensure consistency in more formal communication.

b. Usage under Recalibration – If the NAIC chooses to adopt plus (+) and minus (-) symbols as part of its formal continuum (range) of credit risk, the SVO would refer to these new symbols collectively as NAIC Designation Notches and to each individually as an NAIC Designation Notch. To illustrate, using the NAIC Designation Category 1, a formal reference to a given NAIC Designation Notch would be expressed as: NAIC Designation Notch 1 (+) or NAIC 1 or NAIC 1 (-). The Investment Analysis Office would view each NAIC Designation Category as incorporating the related NAIC Designation Notches—for example, NAIC Designation Category 2 means and incorporates the credit risk gradation between NAIC 2 (+), NAIC 2 and NAIC 2 (-). That is the high mid and low point of the Category. This means that a state that wishes to refer to an NAIC Designation Category can do so in two ways. If the state refers to the “Category,” it communicates that any of the three intermediate credit notches are acceptable for purposes of that statute. Conversely, the state can specify a more granular “Notch” within the Category and thereby set and communicate a definite statutory tolerance associated with a given quality/risk grade. The following illustrates these points. NOTE: The NAIC has not adopted notches, so what follows is hypothetical:

<table>
<thead>
<tr>
<th>NAIC Designation Notches</th>
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<tbody>
<tr>
<td>1 (+)</td>
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<td>6</td>
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</tbody>
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4. Evaluation of State Law References to NAIC Designations

A. Issues Posed

Item A1: References to NAIC quality designation.
NY – Ins Sect 1404 – “(iv) have been given the highest quality designation by the Securities Valuation Office of the National Association of Insurance Commissioners ...” (bold and underlined text was added for purposes of this discussion).

- We would recommend that States use the following text pattern for this statute: “… have been assigned the highest NAIC Designation Category by the Investment Analysis Office of the National Association of Insurance Commissioners …”
If the NAIC expands NAIC Designation Categories by adopting plus and minus symbols (hereafter referred to as "Recalibration"), the new symbols would be referred to as “NAIC Designation Notches,” and each individual symbol would be an “NAIC Designation Notch.” A state legislature might want to consider whether the statutory objective is better served by a reference to the NAIC Designation Category 1, which would permit any of the NAIC Designation Notches or if it wished to restrict the reference to one of the more granular NAIC Designation Notches, i.e., NAIC 1 (-).

**Item A2: References to SVO**

NY – Ins Sect 1404 – (iv) have been given the highest quality designation by the Securities Valuation Office of the National Association of Insurance Commissioners.

- The reference should be to the Investment Analysis Office of the National Association of Insurance Commissioners.
- This text would not require modification if Recalibration is adopted.

**Item A3: References to “highest” or “second highest,” and etc. or similar language**

NY Ins Sec 4526 “… given at least the second highest quality designation by the Securities Valuation Office of the National Association of Insurance Commissioners…”

NY – Ins Sect 1404 – (iv) have been given the highest quality designation by the Securities Valuation Office of the National Association of Insurance Commissioners.

11 NYCRR § 97.3 (2013) … determined to be in one of the top two designations by the Securities Valuation Office of the National Association of Insurance Commissioners.

- We would recommend that States use the following text pattern “the highest NAIC Designation Category” in this statute.
- If Recalibration is adopted the State legislature may consider whether to continue to refer to the NAIC Designation Category or to one of the NAIC Designation Notches. Today “highest” would refer to the NAIC Designation Category 1 but refer and thereby permit NAIC 1+, NAIC 1 and NAIC 1(-).

**Item A4: Use of the word “category” to refer to an NAIC Designation.**

NY Ins 6902 – “... a rating in category 1 or 2 by the Securities Valuation Office of the National Association of Insurance Commissioners …”

- We would recommend that states use the text pattern in this statute: “an NAIC Designation Category 1 or 2 by the Investment Analysis Office of the National Association of Insurance Commissioners…”
- If Recalibration is adopted, the state legislature may want to reconsider whether to refer to a specific NAIC Designation Notch in the named NAIC Designation Categories.

**Item A5: Grouping of NAIC Designations into Lower Grade, Medium Grade or High Grade or similar language**

11 NYCRR § 176.3 (2013) – “… (b) "Lower grade" ...means obligations rated four, five or six by the Securities Valuation Office of the National Association of Insurance Commissioners; …”

- No textual concern is presented by the grouping reference (i.e., lower grade). However, we would recommend that in this statute, states replace the word “rated” and the words “four,” “five” and “six” with text that follows this pattern: “Lower grade … means obligations assigned NAIC Designation Category 4, 5 or 6 by the Investment Analysis Office of the National Association of Insurance Commissioners.”
- If Recalibration is adopted, the state legislature would want to consider whether to modify the grouping to refer to the NAIC Designation Notches that correspond to the identified NAIC Designation Categories.
Item A6: References to Investment Grade Linked to NAIC Designations

CA CICS 12100(o) – “… obligation of the same issuer has been determined to be investment grade (as indicated by a
category 1 or 2 rating) by the Securities Valuation Office of the National Association of Insurance Commissioners.”

- No textual concern is presented by the grouping “investment grade or “non-investment grade.” However, we would
recommend that in this statute, states use the pattern: “… as indicated by the assignment of an NAIC Designation
Category 1 or 2 by the Investment Analysis Office of the National Association of Insurance Commissioners…”
- If Recalibration is adopted, the state legislature would want to consider whether to modify the grouping to also
refer to the NAIC Designation Notches that correspond to the identified NAIC Designation Categories.

B. Inaccuracies in State Laws and Suggested Modifications

Item 1B: The word “one” is used instead of the number “1” when referring to NAIC designation symbols.

Example: NY – Ins Sect 1404 – “… a designation of one from the Securities Valuation Office of the National
Association of Insurance Commissioners, or any successor office established…”

- We would recommend that states use the following text pattern in this statute: “… NAIC Designation Category 1
assigned by the Investment Analysis Office of the National Association of Insurance Commissioners…”
- If Recalibration is adopted, the state legislature would want to consider whether the references should be to a
specific NAIC Designation Notch.

Item 2B: Use of the word “rating” to refer to an NAIC quality designation.

Example: NY Ins 6902 – “… a rating in category 1 or 2 by the Securities Valuation Office of the National Association of
Insurance Commissioners…”

Example: 215 ILCS 5/53 – The bond, note, or debt of the issuing country must be rated in one of the 4 highest
classifications by an established, nationally recognized investment rating service or must have been given a rating of 1
by the Securities Valuation Office of the National Association of Insurance Commissioners.

Example: 215 ILCS 5/126.11 – The aggregate amount of preferred stocks then held by the insurer under this subsection
which are not sinking fund stocks or rated P1 or P2 by the SVO does not exceed 15% of its admitted assets.

Example: (c) The aggregate amount of investments rated 5 or 6 by the SVO then held by the insurer would exceed 3%
of its admitted assets.

Example: 215 ILCS 5/126.2 – “High grade investment” means a rated credit instrument; rated 1, 2, P1, P2, PSF1 or
PSF2 by the SVO. … ZZ. "Lower grade investment" means a rated credit instrument rated 4, 5, 6, P4, P5, P6, PSF4,
PSF5, or PSF6 by the SVO.

Example: TN 56-3-302 – (42) "SVO Rating" means the numerical ranking designation of one (1) through six (6)
assigned to securities as determined by the NAIC-SVO.

- We would recommend that states use the following text pattern: “… an NAIC Designation Category 1 assigned by
the Investment Analysis Office of the National Association of Insurance Commissioners” in any statute that uses
the word “rating” or “rated by.” Despite surface similarities, NAIC Designations Categories are different from
NRSRO credit ratings. The fact that the NAIC permits some NRSRO credit ratings to be converted into an
equivalent NAIC Designation Category reflects a desire to preserve regulatory resources and not a decision that the
two products are identical in purpose or nature.
The second example shown above (215 ILCS 5/53) presents a mixture of textual issues. 1) It is accurate to use the word “rated” when referring to Nationally Recognized Statistical Rating Organizations (NRSROs), but in this formulation: “… must be rated in one of the 4 highest classifications),” it would more effective to use this text: “must have received one of the four highest credit ratings …” (assuming the intent is to refer to AAA, AA, BBB and BB. If the intent is otherwise, the state should identify the specific graded (i.e., notches) it wishes to refer to.)
2) In this same statute, the phrase (an established, nationally recognized investment rating service probably intended to say Nationally Recognized Statistical Rating Organization (i.e., NRSRO) if the intent is to refer to one of 10 credit rating agencies registered with the U.S. Securities and Exchange Commission (SEC) as NRSROs; or something like “an established credit rating agency,” could be used instead if the state has a tolerance to any such agency without specifying federal registration and regulation. 3) Because the statute is referring to a sovereign rating, this text “The bond, note, or debt of the issuing country must … or must have been given a rating of 1 by the Securities Valuation Office …” should be deleted because neither the SVO nor the Structured Securities Group of the Investment Analysis Office assigns sovereign ratings.

Please see the further discussion on sovereign ratings in Item 7B below.

Item 3B: The use of the words “Yes” and “No” to refer to NAIC Designations

Example: 11 NYCRR Sec 43.2 (2013) “... grade (as indicated by a "yes" rating) by the Securities Valuation Office of the National Association of Insurance Commissioners ...

“Yes” and “No” are symbols in use prior to 1990 and were replaced by the NAIC Designation Category 1, 2, 3, 4, 5 and 6. Accordingly, any statute or regulation that references Yes No symbols should be amended to refer to one or more NAIC Designation categories. As discussed above, the word “rating” should be replaced. We would, therefore, recommend the following text pattern for this statute: “... grade (as indicated by assignment of an NAIC Designation Category X by the Investment Analysis Office of the National Association of Insurance Commissioners ...

Item 4B: Use of the phrase “a rating agency recognized by the SVO” or by the NAIC.

Example: “… equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC; (b) obligations issued, assumed or guaranteed by … ... equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC; (c) an investment made pursuant to the provisions of clauses (...... equivalent by a rating agency recognized by the Securities Valuation Office of the NAIC; and (2) the equity interests of the institution are registered on a ... ... equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC. (ii) no more than 20 percent of the total of the "...

Example: 215 ILCS 5/107a.11 (8) Mutual funds: (A) government money market mutual funds that meet the conditions of paragraphs (c)(2), (c)(3), and (c)(4) of 17 C.F.R. 270.2a-7, revised as of April 1, 1992, that have been rated in one of the 2 highest rating categories by an independent rating agency recognized by the National Association of Insurance Commissioners, and that invest in obligations issued, guaranteed, or insured by the United States or Canada or any agency or instrumentality of the United States or Canada.

The use of the word “recognition” in reference either to the NAIC or to the SVO implies the exercise of legal or regulatory authority with respect to the rating agency, which the NAIC does not claim to have. The credit rating industry was unregulated until 2006, when Congress modified the law to give credit rating agencies that met specified criteria the right to register with the U.S. SEC as NRSROs. Over the years, the NAIC has used a variety of ways to identify rating agencies whose ratings could be used in its regulatory process as a way to preserve SVO resources for unrated transactions. Typically, the NAIC has sought to utilize the services of entities deemed to be NRSROs by the U.S. SEC. However, the Purposes and Procedures Manual of the NAIC Investment Analysis Office correctly identifies the NAIC relationship to NRSROs as that of a customer and user of credit ratings to a vendor of credit rating products. We would recommend that state laws reflect this NAIC perspective or identify a different mechanism to select a rating agency for purposes of its regulatory processes.
Item 5B: Use of phrase SVO designation.

Example: 215 ILCS 5/126.15 – A tenant or its affiliated entity, whose rated credit instruments have a SVO 1 or 2 designation or a comparable rating from a nationally recognized statistical rating organization recognized by the SVO, has a full faith and credit obligation to make the lease payments;”

- We would recommend the following text pattern for this statute: “… whose rated credit instruments have been assigned an NAIC Designation Category 1 or 2 or a credit rating issued by a nationally recognized statistical rating organization that is equivalent to the NAIC Designation Category 1 or 2 as indicated in the Purposes and Procedures Manual of the NAIC Investment Analysis Office. “(Please see the discussion in Item 4B above with respect to the reference to SVO recognition of the NRSRO.)

Item 6B: Use of the phrase “have been awarded” (a designation).

Example: 215 ILCS 5/107a.11 – (B) the corporation has a tangible net worth of not less than $500,000 and the obligations have been awarded a "1" or "2" rating by the Securities Valuation Office of the National Association of Insurance Commissioners;

- We would recommend the following text pattern for this statute: “ … and the obligations have been assigned an NAIC Designation Category 1 or 2 by Investment Analysis Office of the National Association of Insurance Commissioners ...”

Item 7B – References to “SVO Sovereign Debt Ratings.”

Example: (2) the aggregate amount of foreign investments then held by the insurer under this subsection in a single foreign jurisdiction does not exceed 10% of its admitted assets as to a foreign jurisdiction that has a sovereign debt rating of SVO 1 or 5% of its admitted assets as to any other foreign jurisdiction.

Example: 215 ILCS 5/126.2 – "Acceptable collateral" means:… and as to lending foreign securities, sovereign debt rated 1 by the SVO;

- The SVO does not have the technical capability (and has never been given a mission to) assign credit ratings to sovereign entities (i.e., nations or supranational entities). The SVO does, however, use credit ratings assigned by NRSROs to sovereigns and supranational entities to derive NAIC Designation equivalents in part for internal analytical purposes and in part to support insurance company reporting under Appendix A-001 (Investments of Reporting Entities) of the Accounting Practices and Procedures Manual. We would recommend that states refer to NRSROs in statutes of this kind.

Item 8B: Use of the word “Class” to refer to an NAIC Designation

Example: CT § 38a-86; Reg. §§ 38a-88-4 & 38a-88-6 “ (C) Have been designated as Class One or Class Two by the Securities Valuation Office of the NAIC;”

Example: IN 760 IAC 1-57-4 – “(10) “Noninvestment grade bonds” means bonds designated as Class 3, 4, 5, or 6 by the NAIC securities valuation office.”

- We would recommend that states use the following text in the above statutes: “Have been assigned NAIC Designation Category 1 or 2 by Investment Analysis Office of the National Association of Insurance Commissioners ...”
**Item 9B:** References to the Filing exempt Rule and its relationship to SVO.

Example: CA – CICS 922.5(c) – “For purposes of this section, the phrase "deemed exempt from filing as defined by the Purposes and Procedures Manual of the National Association of Insurance Commissioners Securities Valuation Office" shall mean all United States government securities, and all other securities or bonds with a rating of SVO 1 or FE 1 listed by the National Association of Insurance Commissioners Securities Valuation Office as exempt.”

- We would recommend the following text pattern for this statute: “… and all other securities or bonds that have been assigned an NAIC Designation Category 1 by the Investment Analysis Office of the NAIC or that are filing exempt and have an equivalent credit rating pursuant to the procedures specified in the Purposes and procedures of the NAIC Investment Analysis Office … “
To: Director John Huff, Chair, Financial Regulation Standards and Accreditation (F) Committee

From: Judy Weaver, Chair, Financial Analysis Handbook (E) Working Group (FAHWG)

Date: November 5, 2014

Re: Proposed Accreditation Standard to Address Charge Given to the FAHWG

On June 30 conference call, the FAHWG received the following charge from the Principle-Based Reserving Implementation (EX) Task Force:

“Develop for year-end 2014, a new section for the Financial Analysis Handbook that specifies procedures for domestic/lead/captive states’ review of XXX/AXXX reinsurance transactions with captives/SPVs to be performed initially and on an ongoing basis, consistent with recommendations from the Financial Analysis (E) Working Group (FAWG). These procedures should be modified in the future as the detailed proposals from other work streams for the XXX/AXXX Reinsurance Framework are adopted by the NAIC.”—Essential

In addition, we were also requested to develop a recommendation to the Financial Regulation Standards and Accreditation (F) Committee regarding Part B standards related to the above procedures. The FAHWG has considered this request, and proposes the following new Part B standard:

**Part B1: Financial Analysis**

e. Appropriate Depth of Review

**Guidelines**

6) For those domestic insurers that cede XXX/AXXX business to affiliated or unaffiliated captives or special purposes vehicles, complete those procedures contained within the NAIC *Financial Analysis Handbook* that pertain to XXX/AXXX transactions 1) as included on the Supplemental Procedures-Form D section for any new proposed transactions; and 2) as included in the Level 2-Reinsurance section for any existing transactions that have previously been approved.

If there are any questions regarding the proposed recommendation, please feel free to contact myself or NAIC staff (Dan Daveline) for clarification. Thanks for your consideration of this suggestion.