The NAIC and state regulators have recently received requests to identify the impact on risk-based capital requirements from the NAIC's new method of assessing residential mortgage backed securities ("RMBS"). The NAIC does not currently have sufficient information to assess the impact with an acceptable degree of accuracy.

The NAIC retained PIMCO Advisors to undertake the modeling of expected losses for the more than 20,000 RMBS held by the insurance industry. Regulators' goal in adopting the new RMBS process was to increase the accuracy in assessing expected losses, and to use the improved assessment to determine a more appropriate capital requirement for RMBS. The new approach reduces regulatory reliance on rating agencies, and allows for greater regulatory input into the modeling process and the assumptions used. In addition, it links the capital requirement to the carrying values for each specific insurer, instead of treating every investment the same. This new process thus allows for a more precise assessment of expected loss and capital need for individual insurers, benefiting consumers and the insurance market.

Under the NAIC's new methodology, the valuation of an asset and its risk-based capital charge are intricately intertwined. An insurer that has written down an asset has a lower capital charge than an insurer that has not taken a writedown. Thus, the valuation of the assets is a critical component of the results. Given the changes that have taken place normally during the course of a year, and undoubtedly in 2009, both in the industry's holdings of RMBS and in their statutory valuation, the change in the required capital cannot be accurately estimated until the 2009 financial statements become available in March.

Some recent published estimates of the impact have relied on 2008 financial statement data, thus failing to account for the change in holdings and the valuation issues. These estimates have also failed to account for the covariance element of the NAIC's Risk-Based Capital ("RBC") formula. (Covariance tends to reduce the RBC requirement below one determined with a simple factor-based model.) Thus, the NAIC does not view these as a reliable estimate of the impact on 2008 RBC requirements.

The NAIC believes the impact of the revised RMBS assessment methodology will generally be to create (1) higher capital requirements for year-end 2009 than for year-end 2008 and (2) lower capital requirements for year-end 2009 under the current methodology than would have been required under the prior methodology. We are unable, however, to provide any indications of magnitude at this time.

The lower capital requirements must be considered in conjunction with a new requirement that insurers recognize the credit-related portion of other than temporary impairments (OTTI) on structured securities, including RMBS. This requirement became effective the third quarter of 2009. Increased recognition of credit-related impairments will reduce capital through the recognition of loss, as well as reduce the capital required to be held against potential further losses. The net effect on RBC ratios is ambiguous.

We will continue to study the impact and provide additional information as it becomes available.