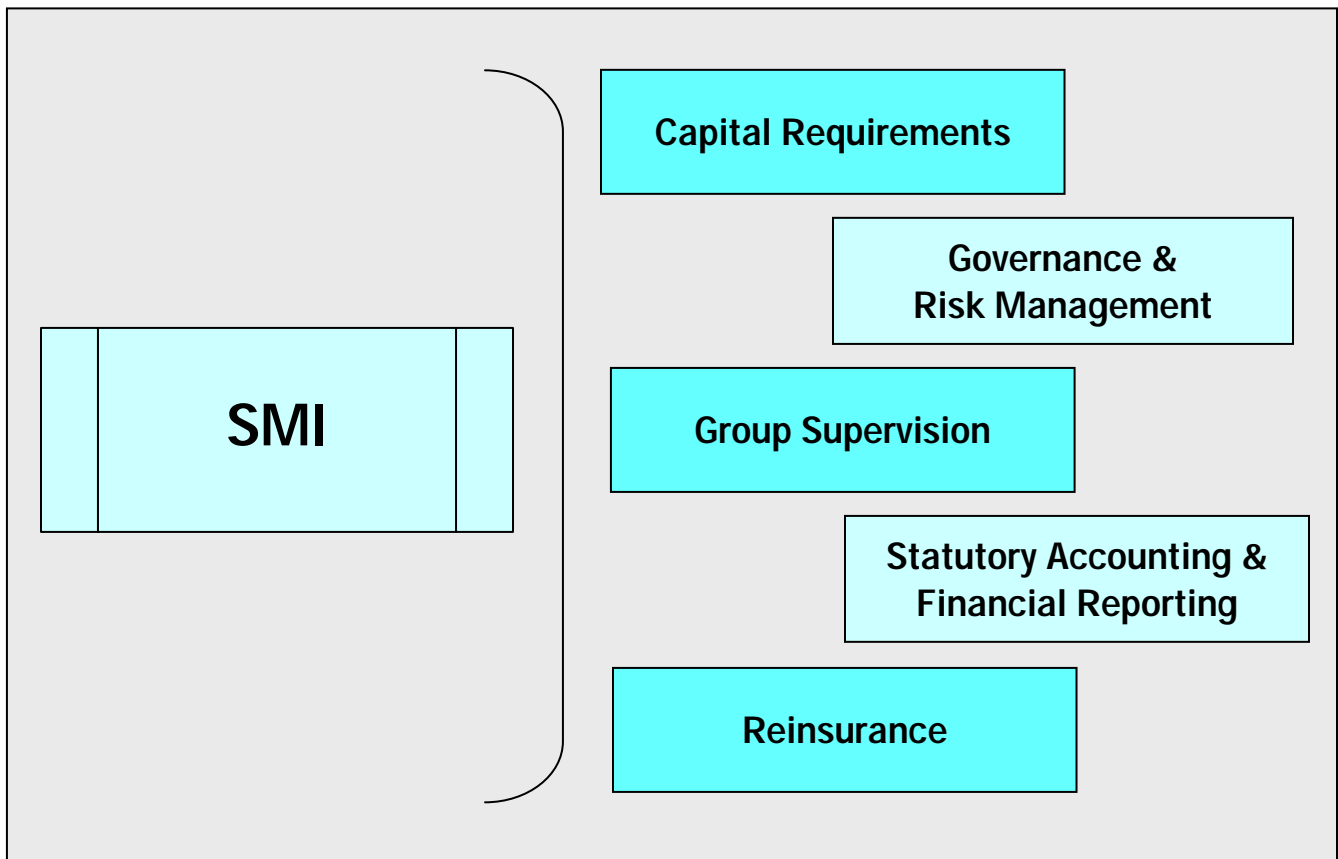


**Solvency Modernization Initiative
ROADMAP**

Solvency Modernization Initiative

1. The Solvency Modernization Initiative (SMI) is a critical self-examination to update the United States' insurance solvency regulation framework and includes a review of international developments regarding insurance supervision, banking supervision, and international accounting standards and their potential use in U.S. insurance regulation.
2. The SMI scope includes the entire U.S. financial regulatory system and all aspects relative to the financial condition of an insurer, and is not limited to the evaluation of solvency related areas. The SMI focuses on key issues such as capital requirements, governance and risk management, group supervision, statutory accounting & financial reporting, and reinsurance.





SMI Roadmap

3. This Roadmap sets out the policy direction and priorities for SMI activities and seeks to clarify the role and scope of various task forces' and working groups' SMI activities through year-end 2012.¹ We anticipate that all major policy decisions will be completed by the end of 2012; at which time the NAIC, through the various appropriate committees, can then choose to proceed as may be appropriate.
4. Initial activities within the SMI that are already completed include the following:
 - Documentation of the current U.S. Insurance Financial Solvency Framework and Core Principles.
 - Initial study of international solvency systems to formulate new ideas for consideration in the U.S.
5. The SMI (EX) Task Force coordinates all NAIC efforts to successfully accomplish the SMI, utilizing the technical expertise of numerous NAIC groups. The Task Force recognizes the interplay of SMI issues and the interrelationships of activities in different NAIC groups. The Task Force will monitor the evolving proposals to ensure that work is coordinated and does not overlap.
6. The following describes the remaining projects to be completed in the SMI, establishes some expected timelines for deliverables, and identifies the committees involved.

Capital Requirements

7. Capital requirements in the U.S. have been risk-based for more than a decade, with the initial life insurance risk-based capital (RBC) formula implemented in 1993. Numerous improvements have been implemented in the RBC formulas over time, with most recent changes including development of scenario modeling for life insurance interest and market risk ("C-3") risk.
8. Four ladders of intervention currently exist, two as "action" levels and two as "control" levels. The amount of capital required for each level is based upon the application of industry-wide risk charges applied to each company's investment portfolio and risk profile. The RBC is calibrated to identify "weakly capitalized companies" and does not represent the economic target levels of capital that a company should hold.
9. RBC will continue to be a component in the legal framework of U.S. solvency regulation in order to maintain a floor for triggering regulatory intervention. Regulators are conducting a holistic evaluation of the RBC formulas, factors, and methodology.
10. Some additional capital assessments are under consideration in risk management and group supervision.
11. The following identifies the timeline of activities for RBC capital requirements:
 - Identification of calibration and correlation policy: December 2010
 - Development of a plan for the modification to the formulas to implement missing risk charges and make other significant improvements: December 2010
 - Industry Impact Study: 2012
 - Determination of changes to RBC: December 2012
12. Modifications to RBC capital requirements are considered by the Capital Adequacy (E) Task Force and its working groups.

¹ The SMI also includes development of comments regarding the International Association of Insurance Supervisors (IAIS)' papers; that aspect of the SMI is not included in this Roadmap.

Governance and Risk Management

13. Today's corporate governance requirements for insurers exist in state corporate governance law, including case law. Regulators will evaluate the existing U.S. laws, study international corporate governance principles and standards, document high-level corporate governance principles, and determine whether such principles should be supported through a model law or other means.
14. Certain elements of risk management evaluation are currently performed in the enhanced risk-focused surveillance process. The existing process includes the assessment of risk and the management or mitigation of risks. Regulators will draft a consultation paper which discusses risk management reporting and quantification requirements (e.g. ERM/ORSA²-type tool) in light of risk management supervisory tools being developed around the world that incorporate periodic risk reporting, stress tests, and prospective solvency assessment.
15. The following identifies the timeline of activities for governance and risk management activities:
 - Legal Framework Summary: July 2010
 - International Corporate Governance Principles Study: September 2010
 - Outline high-level governance Principles: December 2011
 - Development of ERM/ORSA-type tool: December 2011
 - Development of model law or other implementation tool: December 2012
16. Governance and Risk Management issues are currently under consideration in the Corporate Governance (EX) Working Group. The International Solvency (EX) Working Group is developing an ERM/ORSA-type tool.

Group Supervision

17. Group supervision is currently performed under the Insurance Holding Company System Regulatory Act (Model #440) and the Insurance Holding company System Model Regulation with Reporting Forms and Instructions (Model #450). These models apply to groups of two or more affiliated persons/organizations, at least one of which is an insurer. Amongst others, the requirements include steps to acquire an insurer, commissioner approval of certain material transactions (e.g. large investment or reinsurance transactions) and extraordinary dividends, examination authority (of insurer and affiliates), and receivership authority.
18. Regulators want to be able to look at any entity within an insurance holding company system that may or may not affect the holding company system, but could pose reputational risk or financial risk to the insurer. Therefore, regulators will consider incorporating certain prudential features of group supervision, providing a window into group operations, while building upon, rather than rejecting, the existing walls which provide solvency protection. The concepts addressed in the "windows and walls" approach include 1) communication between regulators, 2) supervisory colleges, 3) access to and collection of information, 4) enforcement measures, 5) group capital assessment, and 6) accreditation.
19. Models #440 and #450 will be expanded to maintain the walls established for the insurers within a group, and to open up some "windows" into the holding company system. Enterprise risk, governance, and internal controls will require reporting. In addition, regulators will be able to ask the insurer for holding company information and will have the power to participate in supervisory colleges.
20. Additional "windows" will be investigated through discussions on enhanced group-wide supervision through the development of holding company best practices.

²ERM stands for "Enterprise Risk Management"; ORSA stands for "Own Risk and Solvency Assessment"

21. The following identifies the timeline of activities for improved group supervision:

- Supervisory college tracking documentation: August 2010
- Updated Models #440 and #450 adopted: October 2010
- Accreditation Part B Guidelines regarding review and documentation of the Holding Company: December 2010
- Holding Company Best Practices: December 2010
- Study of Holding Company financial reporting requirements: December 2011
- Study need for group-wide supervision best practices: December 2012
- Determine approach to group-wide capital assessment: December 2012

22. Group supervision is under consideration in the Group Solvency Issues (EX) Working Group and the Financial Condition (E) Committee. Accreditation issues are considered by the Financial Regulation Standards and Accreditation (F) Committee.

Statutory Accounting & Financial Reporting (including Valuation)

Valuation (Principles-Based Reserving)

23. Statutory accounting for life insurance reserves (“valuation”) is not yet principles-based, as it is for other lines of business. The NAIC adopted the Standard Valuation Law (Model #820) in late 2009. Regulatory actuaries are charged to draft an initial Valuation Manual upon which an industry study can be performed. After study of the impact, the Valuation Manual will be finalized.

24. To utilize principles-based reserving, there will need to be some industry statistics collected. A statistical agent(s) will need to provide regulators and the industry with statistical information once principle-based reserving is effective.

25. The following identifies the timeline of activities for life insurance principles-based reserving:

- Industry Study Completed: March 2011
- Statistical Agent Policy Decisions: March 2011
- Valuation Manual (VM-20) – Initial: October 2010, Final: Summer 2011

26. The Life and Health Actuarial Task Force is charged with the development of the Valuation Manual, with material issues coordinated with the SMI’s Principles-Based Reserving (EX) Working Group.

Future of Statutory Accounting & Financial Reporting

27. Regulators will make significant policy decisions about the future of statutory accounting and the financial reporting system.

28. The current statutory accounting system already includes consideration of any new Generally Accepted Accounting Principles (GAAP) pronouncements, whereby GAAP changes are rejected, adopted, or modified for implementation into statutory accounting. Some GAAP pronouncements have already been issued as a result of agreed convergence between the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). Even with this process in place, commissioners have decided they need to formulate a policy decision about whether this approach continues in the future. The policy decisions should include the impact of international accounting and the extent of public disclosure versus regulatory reporting.

29. In the meantime, regulators continue to analyze IASB and FASB pronouncements and International Financial Reporting Standards (IFRS), especially regarding insurance contracts, financial instruments, revenue recognition, and reporting. Regulators provide input to the IAIS and sometimes to the IASB directly.

30. The following identifies the timeline of activities for statutory accounting:
- Comments on IASB Exposure Draft - Insurance Contracts by November 30, 2010
 - Policy positions regarding IFRS and its inclusion/exclusion from the framework of insurance solvency regulation and on the regulatory impacts of non-regulatory uses of statutory financial statements:
 - a. Documentation of considerations: August 2010
 - b. Policy Positions Adopted by Subgroup: March 2011 and by Executive/Plenary: October 2011
31. The initial policy decisions are contemplated by the Statutory Accounting and Financial Reporting (EX) Subgroup. The chairs of numerous technical groups are providing input into these decisions: International Accounting Standards (EX) Working Group, Statutory Accounting Principles (E) Working Group, and Emerging Accounting Issues (E) Working Group. Input into the IASB and FASB pronouncements are made by the International Accounting Standards (EX) Working Group and the Statutory Accounting Principles (E) Working Group.

Reinsurance

32. The Reinsurance Regulatory Modernization Framework proposal (Reinsurance Framework), adopted by the NAIC during its Winter 2008 National Meeting, is a conceptual framework that was developed by the Reinsurance (E) Task Force in response to its charges to consider the current collateralization requirements regarding unauthorized reinsurers, and to consider the design of a revised U.S. reinsurance regulatory framework. The modernization framework is intended to facilitate cross-border reinsurance transactions and enhance competition within the U.S. market, while ensuring that U.S. insurers and policyholders are adequately protected against the risk of insolvency.
33. The Framework recommended implementation through federal legislation in order to best preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation of this legislation throughout all NAIC member jurisdictions, and as a more comprehensive alternative to related federal legislation. Throughout 2009, the Reinsurance Task Force developed federal legislation intended to implement the Reinsurance Framework. In September of 2009, the NAIC Government Relations Leadership Council approved the Reinsurance Regulatory Modernization Act, and agreed to submit the draft federal legislation to Congress for its further action. Unfortunately, the NAIC has been unable to procure congressional sponsorship for this proposed legislation.
34. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was signed into law on July 21st. This Act includes the Nonadmitted and Reinsurance Reform Act (NRRRA), as well as creates the Federal Insurance Office (FIO) within the U.S. Department of the Treasury. With respect to reinsurance, the NRRRA prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes such credit and is 1) an NAIC-accredited state; or 2) has financial solvency requirements substantially similar to NAIC accreditation requirements. It also preempts the extraterritorial application of a non-domiciliary state's laws, regulations, or other actions (with certain limitations), and it reserves to a reinsurer's domiciliary state sole responsibility for regulating the reinsurer's financial solvency. Finally, it prohibits any other state from requiring a reinsurer to provide financial information in addition to that required by its NAIC-compliant domiciliary state.
35. In light of these developments, some states are now expressing an interest in moving forward with individual state-based reinsurance collateral reduction reforms. The NAIC has been advised that the changes being considered are generally intended to conform to key elements of the Reinsurance Framework. The Financial Regulation Standards and Accreditation (F) Committee requested that the Reinsurance Task Force consider which key elements of the Reinsurance Framework should be considered in reviewing any individual state initiatives, and whether these key elements should be incorporated into the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786). On Aug. 16th, the Financial Condition (E) Committee approved a request from the Reinsurance Task Force to begin the process of considering amendments to Model #785 and #786 to make them consistent with key elements of the Reinsurance Framework.
36. In addition, the Reinsurance Task Force will provide guidance to the F Committee with respect to its evaluation and possible revision of the accreditation requirements. On Aug. 16th, a draft of "Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation Purposes" was exposed for a public comment period ending on Sept. 16th. The Reinsurance Task Force will consider any comments received, and expose a draft with any revisions prior to the 2010 Fall National Meeting.

37. Regulators may also consider whether modernization of risk transfer requirements applicable to life reinsurance is appropriate. Any consideration of this issue by the Reinsurance Task Force should be coordinated with the Life and Health Actuarial Task Force.

38. The following identifies the timeline for reinsurance modernization activities:

- Reinsurance Task Force adoption of Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation Purposes: October 2010
- Reinsurance Task Force adoption of amendments to Model #785 and #786 to make them consistent with the Reinsurance Framework: by October 2011

39. Reinsurance modernization issues are currently under consideration in the Reinsurance (E) Task Force.

Future U.S. Insurance Financial Solvency Framework and Core Principles

40. Regulators will be making changes in the SMI that will modify the U.S. solvency framework, both in the implementation of new tools and processes, as well as the elimination of aspects no longer needed. Therefore, at the end of the SMI, regulators will review the documentation of the U.S. Insurance Financial Solvency Framework and Core Principles to determine whether changes should be made.

41. The Solvency Modernization Initiative (EX) Task Force will revise the *U.S. Insurance Financial Solvency Framework and Core Principles* to reflect changes made through the SMI.

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