Capital & Surplus Relief (EX) Working Group
GRID of Information Relative to Each ACLI Request

Item #	Description	Authority*				Products Covered									Technical Response:
		NAIC Group	State Statute	State Reg/Rule	NAIC Pub	Life Insurance			Annuities			Other PC/H	Temp	Perm	
						Term	Whole	UL	Fixed	Var	Eq Ind				
Life Insurance															
1a	2001 Preferred Tables for any 2001 Product	LHATF		X		X	X	X						X	Yes#
1b	Section 8C of AG 38 Retroactive	LHATF		X	AG			X						X	No
1c	Allow 2001 Non-Preferred for Segments within AG 38	LHATF		X	AG	X	X	X						X	Yes
2	Eliminate constraints in XXX for X Factors	LHATF		X		X	X	X						X	Yes
3	Facilitate Commissioners discretion for allowable collateral for reinsurance	RE TF	CD	CD	AP&P	X	X	X	X	X	X	X		X	Yes##
Variable Annuities															
1	Eliminate stand-alone asset adequacy for AG 39	LHATF			AG					X			X		Alternate
2	Waive standard scenario floor in C-3 Phase 2	CADTF		X	RBC					X			X		No
Investment															
1	Fix calculation of Mortgage Experience Factor	LRBC		X	RBC								X		No
Accounting															
1	Follow GAAP rules for DTAs	SAPWG			AP&P	X	X	X	X	X	X	X		^	Alternate

***Legend**

AG=Actuarial Guideline
CD=Commissioner Discretion
RBC=Risk-Based Capital
AP&P=Accounting Practices & Procedures Manual

Alternate = if Members support change, technical group suggests alternative to ACLI

^ If counter is adopted, revisit this after the 2009 reporting period
# Restrictions suggested on certain reinsurance accounting practices
Additional requests made, some not supported by Reinsurance TF

Response to request from the Capital & Surplus Relief Working Group
Life 1a, Preferred Mortality Regulation

Respondent: Life & Health Actuarial Task Force

Date: December 5, 2008

1. Review each of the items that pertains to your group;

Life 1a: Allow the 2001 CSO preferred mortality tables to be used with contracts based on the 2001 CSO and issued prior to January 1, 2007 with domestic Commissioner consent. In addition, encourage adoption of the Model Regulation Permitting the Recognition of Preferred Mortality Tables for use in Determining Minimum Reserve Liabilities in the remaining states that have not adopted this Model Regulation. Also, per #5, companies should not be allowed to continue to overstate surplus resulting from reporting an asset, on reporting a negative reserve, that exceeds the income that can be derived from the policies or portions of policies reinsured that are the basis for the asset or negative reserve (SAPWG is considering this accounting in agenda item 2008-15: Deferred Premium Asset and the Unearned Premium Reserve).

2. Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

The Standard Valuation Law specifies a reserve for life insurance policies equal to the present value of future guaranteed benefits less the present value of future valuation premiums, where assumptions for mortality and interest are prescribed in the law. The current "one-size-fits all" approach may result in reserves that are overly conservative for some products and underwriting classifications and inadequate for others. Asset adequacy requirements serve to ensure that reserves are adequate. However, such analysis may not be used to reduce overly conservative reserves.

As described more fully in the project history, the 2001 CSO preferred mortality tables were adopted as part of an "interim solution" proposed by the American Council of Life Insurers (ACLI) to address concerns with overly conservative reserves produced by the 2001 CSO mortality table for some product types and some underwriting classes while the Life and Health Actuarial Task Force completed its work on a principles based valuation methodology to replace the current formulaic approach.

The preferred class structure mortality table may be used in place of the 2001 CSO mortality table under certain conditions, as specified in the regulation, for valuing the minimum standards for certain life insurance products. The split of the 2001 CSO mortality table into super preferred, preferred, and residual standard classes will allow for reserves to better match the risks associated with different underwriting classifications.

The regulation requires insurers to submit certain data because experience information is necessary in order to help the regulators monitor the ongoing adequacy of the reserve established pursuant to this regulation.

The proposed effective date of the 2001 CSO preferred mortality tables was January 1, 2007. However, many states adopted the 2001 CSO aggregate tables prior to this date. Proposal 1a would allow the 2001 CSO preferred mortality tables to be used with contracts based on the 2001 CSO and issued prior to January 1, 2007, with domestic commissioner consent.

The anticipated impact of this proposal will vary by company and by product. For example, companies that did not elect to use the 2001 CSO for policies issued prior to 2007 will not experience any impact from the implementation of this proposal. However, companies electing to use the 2001 CSO prior to 2007 may experience a material reduction in reserves for policies issued on a preferred basis. It is important to note that the impact of this change will likely increase over time.

A survey sent through the ACLI showed an estimated impact of $1 to $2 Billion of reserve relief.

3. Provide a brief history of any activity previously undertaken by your group related to the item being requested;

See above. No further activity has been undertaken by LHATF specifically related to the 2001 CSO preferred mortality tables.

4. Provide a summary of any conclusions related to the item being requested;

The methodology that would be used to calculate reserves for policies issued on or after the initial adoption of the 2001 CSO is already in place for policies issued on or after January 1, 2007, and the required actuarial certification and experience reporting requirements would provide comfort as to the adequacy of the reserves.

5. Explain whether the item provides relief without compromising regulatory objectives;

LHATF believes reserves for certain policies issued on a preferred basis may be overly conservative and that the reserves calculated under the 2001 CSO preferred mortality tables are adequate (assuming appropriate use of the tables) and therefore that this action may not compromise regulatory objectives. However, it is important to note that some companies may already be addressing the overly conservative reserves through a questionable reinsurance accounting practice. For these companies, it would be ill-advised to allow them to further reduce reserves.

6. Explain if the proposed change can be accomplished in the time period requested and if so by what means.

This proposal requires a regulation change in most, if not all, states. It is possible that some states could adopt regulatory changes on an emergency basis by 12/31/08. However, it is highly unlikely that uniform adoption by states can be achieved by 12/31/08. If the proposal is not uniformly adopted by the states then companies in states that can not adopt the change in time would be at a competitive disadvantage relative to companies in states that do adopt the change.

In addition, it is worth considering the likelihood that companies will be able to make the required systems changes in order to implement revised preferred class structure by 12/31/08, even if states did adopt the necessary amendments.

Project History

Date: 8/29/06

Model Regulation Permitting the Recognition of Preferred Mortality Tables For the Use in Determining Minimum Reserve Liabilities

Project Description

The proposed model regulation is connected with amendments to Actuarial Guideline XXXVIII (AG 38). The proposed changes in AG 38 benefited companies that wrote certain types of whole life policies. The proposed model regulation was intended to maintain the balance between whole life and term life insurance.

AG 38 was adopted by the NAIC in 2002 to address questions that arose regarding the appropriate application of the Valuation of Life Insurance Policies Model Regulation (often referred to as "XXX"). Section 8B was a temporary interpretation applicable to certain universal life policies issued between July 1, 2005 and March 31, 2007. These policies contained guarantees that the coverage would remain in force

as long as the accumulation of premiums paid satisfies the secondary guarantee requirement. The drafting note of this section states:

The "sunset" on April 1, 2007 creates a sense of urgency that will drive all concerned to work towards the quick development of a "principles-based" valuation methodology or, as an interim step while continuing to work on such methodology, to adopt a more readily achievable solution that provides relief from overly conservative reserve levels such as a change to valuation mortality requirements.

Although the Life and Health Actuarial Task Force (LHATF) has continued to work towards the quick development of a "principles-based" valuation methodology, such a methodology could not be developed and effective prior to the sunset. There was a need for an interim solution. On November 11, 2005, the American Council of Life Insurers (ACLI) submitted a letter to LHATF proposing an interim solution, which included amendments to AG 38 and a model regulation that would permit the use of preferred mortality tables based on a split of the 2001 Commissioners Standard Ordinary Mortality Table (2001 CSO). On December 1, 2005, the ACLI formally presented its proposal to LHATF at the National Meeting.

Group Responsible for Drafting Model and States Participating

The ACLI prepared and presented the draft of the revision to the Actuarial Guideline.

The 2006 members of the Task Force are: New Mexico (Chair), Kansas (Vice-Chair), Alaska, Alabama, Arkansas, California, Connecticut, Florida, Kentucky, Minnesota, Nebraska, New York, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, Texas, and Utah.

General Description of Drafting Process

The Task Force discussed the matter at public hearings during the National Meetings in December 2005, March 2006 and June 2006. In addition, the Task Force held public conference calls on this topic on the following dates: February 3, 2006; April 27, 2006; July 10, 2006; August 2, 2006; August 4, 2006; and August 29, 2006. Notice of each of these conference calls was posted on the NAIC's home page on the Internet and e-mailed to approximately 300 interested parties, including representatives of the ACLI. Several dozen memos and letters were submitted to the Task Force relative to this project.

Significant Issues Raised

The following issues were raised relative to the proposed model regulation.

Question #1: Should the NAIC adoption a mortality table not produced by the Society of Actuaries?

Historically, the Society of Actuaries (SOA) has produced mortality tables and these tables were reviewed and modified by the American Academy of Actuaries (AAA), which provided public policy recommendations on the use of the tables. Industry had developed a split in the 1980 CSO Mortality table between smokers and non-smokers. This split was reviewed and adopted by the SOA and the AAA.

LHATF charged the SOA with reviewing the methodology used in developing the proposed split of the 2001 CSO. The SOA reviewed the method of construction of the split tables and reported that the method used was appropriate.

Question #2: Does the proposed model regulation provide sufficient guidance on the use of preferred and residual tables?

Some members and interested parties expressed concern that the proposed regulation allows the company's actuary to assign the table based on expected future experience without any guidance on how underwriting classes would be established. Some of the concerns included the use (possibly inadvertent) of proxies for race, economic status, or other inappropriate underwriting criteria. LHATF charged the AAA with reviewing the split for the appropriateness of its intended use as stated in the proposed model regulation.

The AAA reviewed the split of the table for appropriateness for use as preferred and residual classes and determined that the tables could be appropriately used for these classes if proper guidance was provided on determining the appropriate table to use. The ACLI prepared a proposed actuarial guideline to provide guidance on the use of the preferred and residual tables. This actuarial guideline is being considered by LHATF, and a version of it is expected to be adopted by LHATF within a few months.

Question #3: Is it appropriate to adopt a new mortality table when the AAA is expected to present a new table within a year?

The AAA is expected to produce a new set of mortality tables in March, 2007. The new tables are intended to be the starting tables for principles-based reserves. Industry expressed concerns that the effective date of principles-based reserves is unknown and the use of a new table will present tax problems and require the filing of new policy forms.

Question #4: Should the adoption of the proposed amendments to AG 38 and the proposed model regulation be considered together or separately?

The ACLI had presented the two proposed documents together as a compromise between whole life and term life insurers, which would maintain balance. They stated that if only one of the documents were to be adopted, it would create an imbalance in the industry and requested that the two documents be considered as one packaged proposal. Some members wanted to vote on the two proposals separately. By a vote of 11 to 4, with 3 abstentions, LHATF decided to consider the two proposals as an integrated package.

Question #5: Should regulators monitor the experience from the use of the split of the 2001 CSO?

The proposed regulation is a movement towards principles-based reserves. It allows the company some discretion on which mortality table to use in establishing reserves. New York requested that a provision be added to the proposed model regulation, which would require companies to report their emerging experience to a statistical agent for regulatory review. The Task Force amended the model regulation to include this requirement.

Question #6: Are the minimum reserves established by the proposed model regulation sufficient?

The ACLI provided a number of examples compiled by a major consulting firm to help address the issue of sufficiency of reserves. The Task Force determined that with an actuarial guideline to provide direction on the appropriate use of the split of the 2001 CSO, the provisions of the model regulation addressing the use of overly optimistic assumptions, and an ability to monitor emerging experience, the reserves under the model regulation would be sufficient and could be monitored to verify future sufficiency.

Other Pertinent Information Relative to the Proposed Model Regulation Adopted on August 29, 2006

The Task Force's voted on August 29, 2006, to adopt the revisions to AG 38 by a vote of 12 "Yes," and 3 "No" with 4 members abstaining or not voting. The differing opinions among the Task Force members are described in the previous section.

Voting for the motion were Alabama, Arkansas, Connecticut, Kentucky, Nebraska, New York, North Dakota, Ohio, Oklahoma, Oregon, Texas and Utah.

Opposing the motion were California, Florida and Minnesota

Abstaining were Alaska, Kansas and South Carolina. New Mexico, in its position as chair, did not vote.

Draft: 12/5/08

Response to request from the Capital & Surplus Relief Working Group
Life 1b, AG 38

Respondent: Life & Health Actuarial Task Force

Date: December 5, 2008

1) Review each of the items that pertains to your group;

Life 1b: Make section 8C of Actuarial Guideline 38 retroactive to July 1, 2005, with domestic commissioner consent.

2) Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

The Standard Valuation Law specifies a reserve for life insurance policies equal to the present value of future guaranteed benefits less the present value of future valuation premiums. Thus the reserve is the amount that is needed, together with future policyholder premiums, to pay future claims.

Certain policy forms were designed to provide guaranteed benefits for the same required premiums as more traditional policy forms, but for which comparable reserves were not being established. As a result the NAIC adopted the Valuation of Life Insurance Policies Model Regulation, commonly known as Regulation Triple-X, in 1999 and Actuarial Guideline 38 in 2004 to properly value those relatively new policy forms. The guideline was amended in 2005 to add a Section 8B to close a loophole that resulted in lower reserves for certain policy designs. However, due to a sunset date on this new calculation the guideline was once again amended in 2006. This time a new calculation based on a CEO Compromise was added as Section 8C. Section 8B of the guideline applies to policies issued on or after July 1, 2005 and before January 1, 2007 and to policies issued on or after January 1, 2011 while Section 8C applies to policies issued on or after January 1, 2007 and before January 1, 2011.

3) Provide a brief history of any activity previously undertaken by your group related to the item being requested;

See response to # 2 above regarding Actuarial Guideline 38.

4) Provide a summary of any conclusions related to the item being requested;

There is no convincing evidence that reserves in the aggregate for these types of policies are redundant. Furthermore, the Task Force is not convinced that the calculation prescribed in section 8c of Actuarial Guideline 38, which includes a lapse assumption that may not be conservative, will produce adequate reserves.

5) Explain whether the item provides relief without compromising regulatory objectives;

LHATF believes this action is not sufficiently justified and cannot conclude that it would not compromise regulatory objectives.

6) Explain if the proposed change can be accomplished in the time period requested and if so by what means.

The proposal would be simple to implement by a change to Actuarial Guideline 38. In some states the change would take place immediately upon the adoption by the NAIC while in other states a change in law or regulation may be required.

Response to request from the Capital & Surplus Relief Working Group
Life 1.c, Segment Calculation

Respondent: Life Health Actuarial Task Force (LHATF)

Date: Dec. 5, 2008

1. Review each of the items that pertains to your group;

Life Insurance 1.c: "Clarify by means of an Actuarial Guideline that when using the Preferred Structure Tables of the 2001 CSO for basic reserves, the original smoker or non smoker tables, respectively, may be used for determining segments when complying with the Valuation of Life Insurance Policies Model Regulation."

2. Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

This item is one of a package of three proposals relating to the "Interim Solution," originally effective 1/1/07. The first two of these three proposals (Item 1.a and Item 1.b) provide that the Interim Solution be made retroactive.

- The use of the 2001 Preferred Mortality Tables be allowed for any 2001 CSO product, and
- Section 8C of AG-38 be made retroactive to 7/1/05.

Item 1.c (the last of the three related to the Interim Solution), is a clarification of the Triple-X calculations to prevent the technical requirements of the calculation from taking away the relief envisioned by the first two proposals.

In response to Triple-X, products are normally designed with a long 1st segment to maximize the effects of the X-factors in reducing the deficiency reserves. So most term plans are designed to have a 1st segment equal to the full level premium period and UL plans are often designed to have a 1st segment equal to the full life of the policy (i.e., 1st segment extends to the maximum duration).

Section 4 of Triple-X describes the "Contract Segmentation Method" specifying that the segments are to be calculated using "…**valuation mortality rates…** ". So, switching the valuation mortality table retroactively for an in force policy could change the 1st segment length from that in the original design. If the new 1st segment length is shortened then it could reduce the effect of the X-factors and maybe even increase the reserves even though more favorable valuation mortality rates are used. So 1.c clarifies that the 2001 CSO non smoker/smoker Table could continue to be used to define the segments even though the 2001 Preferred non smoker/smoker Table is used for valuation. This prevents the relief granted by allowing the use of the Preferred table for valuation from being diminished by the technical calculation requirements of the segments.

3. Provide a brief history of any activity previously undertaken by your group related to the item being requested;

N/A. Permitting the use of a new mortality table retroactively for in force policies has not been done before in the context of policies with segment calculations, thus this issue has not previously been addressed.

4. Provide a summary of any conclusions related to the item being requested;

The merits of this proposal rest on whether it is desired to implement either Item 1.a or Item 1.b. If yes to either, then Item 1.c should be implemented to successfully achieve the results expected. Otherwise, the benefits of Item 1.a or Item 1.b may not be realized.

Items 1.a, b, and c should all be limited to policies on plans already filled for approval. For new plans designed and filled post implementation of these items, the 1st segment can be designed using the chosen valuation table and the use of a different valuation table will not be an issue. Thus use of the different table would be allowed on future issues as long as the plan was filed before the implementation date of 1.a, b, and c. Policies issued on any plan for which the filing was made after this date, should require the old rule (i.e., the mortality used for segment calculation be valuation mortality).

5. Explain whether the item provides relief without compromising regulatory objectives;

N/A. Item 1.c provides no relief on its own but only facilitates realization of the relief from Item 1.a and Item 1.b.

6. Explain if the proposed change can be accomplished in the time period requested and if so by what means.

The clarification of the segment calculation in the Triple-X regulation could be accomplished via an actuarial guideline "interpreting" the calculation as described in this Item 1.c. Adoption by the NAIC of such an actuarial guideline could probably be accomplished in the time period requested. For those states that recognize actuarial guidelines immediately upon adoption by the NAIC, this item would be immediately effective. Some states require a further step to recognize new actuarial guidelines, and for these the implementation could take longer.

Response to request from the Capital & Surplus Relief Working Group
LIFE 2, X FACTOR

Respondent: Life & Health Actuarial Task Force

Date: December 3, 2008

1) Review each of the items that pertains to your group;

Life 2: Eliminate artificial constraints in Regulation XXX (Model Regulation 830) for the calculation of X factors with consent of domestic Commissioner.

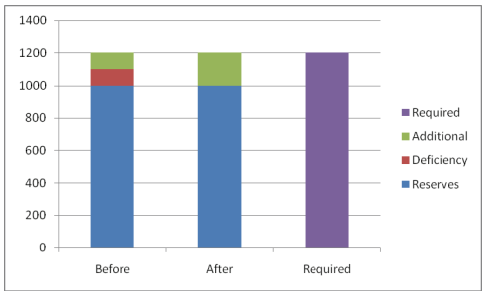
2) Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

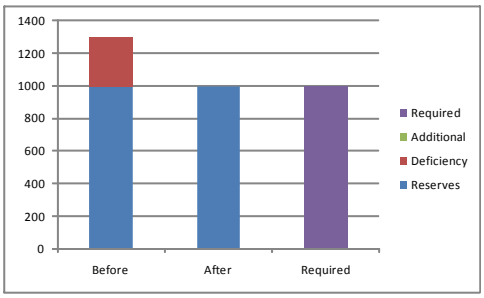
A life policy reserve is equal to future benefits minus future income. Future benefits and future premium are determined using the Commissioners Standard Ordinary Mortality Tables (CSO). The difference between actual premiums and premiums anticipated using the CSO is set up as a deficiency reserve to fund reserves when actual premiums are lower.

In the late 90's, the effect of this difference was significant, as companies valued policies on the 1980 CSO while the experience underlying the actual premiums improved. Since future mortality was unlikely to be at CSO levels, the concept of X factors was developed. An X factor is an experience factor that allows companies to reflect their actual anticipated mortality experience in developing the anticipated valuation premiums while still maintaining regulatory conservatism.

Two developments have affected the need for X factors and constraints upon X factors. The first development is the product development activities of the industry. Directly affecting the need for constraints has been the development of super preferred life pricing. The segmentation of underwriting classes and market specialization within the industry has created the scenario where it is possible factors lower than 20% are appropriate for some product groupings. In addition underwriting technology has progressed making underwriting more effective, also lowering some mortality rates. Relative to the reducing X factor restriction, the industry sees a significant increase in mortality in the third policy year upon expiration of the incontestability clause. This results in a higher X factor as valuation mortality does not exhibit as much increase. This increased X factor is continued unnecessarily in subsequent years, when it should be reduced.

The second development is the asset adequacy analysis required of every company. This analysis is intended to assure sufficient future income is available to fund the future benefits. Eliminating the deficiency reserve requirement would result in asset adequacy testing assuming lower income. If the testing indicates additional reserves may be needed, then the company may be required to establish the additional reserves. In the situation where additional reserves are already required, eliminating deficiency reserves would result in a dollar for dollar increase in additional reserves. In the situation where no additional reserves are required and the excess assets exceed the deficiency reserve, eliminating the deficiency reserve increases surplus. This is the situation many companies are in today. The following two charts illustrate, first where the reserve is effectively transferred and second, where the reserve is released.





We anticipate eliminating the constraints on X factor calculation would release about $3 Billion of the $10 Billion held in deficiency reserves.

3) Provide a brief history of any activity previously undertaken by your group related to the item being requested;

Prior to the ACLI request a subgroup of LHATF had begun exploring possible ways to help the insurance industry address excessive reserve requirements during the current economic crisis. The subgroup determined, before any LHATF consideration, deficiency reserves were redundant. The role of the deficiency reserve has been supplanted by Asset Adequacy Analysis. Therefore eliminating deficiency reserves would still result in appropriately conservative aggregate reserves. These efforts terminated when LHATF was informed the industry was going to suggest changes and LHATF should evaluate their proposals. The ACLI proposal does not suggest eliminating all deficiency reserves but rather eliminating the constraints on the X factors used in determining the deficiency reserves.

In addition it is worth noting the Principle-based reserving approach LHATF has been working to develop would appropriately develop reserves for any deficiency in actual premiums.

4) Provide a summary of any conclusions related to the item being requested;

From an actuarial perspective LHATF concludes the ACLI proposal to eliminate X factor constraints is sound given the asset adequacy analysis requirements. However, if the NAIC supports this proposal, LHATF believes the appointed actuary should make a statement in the actuarial opinion relative to the X factor development process and the resulting changes in X factors. In addition LHATF believes the resulting reduction in deficiency reserves should be reported as a change in valuation method and reported in Exhibit 5A, thus reflecting a release into surplus rather than an increment to the operating statement.

The reduction in deficiency reserve requirements that originally took place with the adoption of Model Rule 830 (Triple-X) and the further reduction that would result from the changes to the limitations on the use of X factors could result in reserves not being sufficient to provide for the payment of benefits and expenses and the establishment of statutory reserves during interim periods prior to the end of the projection period used in the asset adequacy analysis. Therefore, as part of the Regulatory Asset Adequacy Issues Summaries required of life insured companies each year, the appointed actuary should make a statement as to the impact of the insufficiency of assets to support the payment of benefits and expenses and the establishment of statutory reserves during one or more interim periods.

5) Explain whether the item provides relief without compromising regulatory objectives;

Because the deficiency reserve requirements may result in redundant reserves due to aspects of premium deficiencies being handled through asset adequacy analysis, LHATF concludes this action would not compromise regulatory objectives.

6) Explain if the proposed change can be accomplished in the time period requested and if so by what means.

This proposal requires a regulation change in most, if not all, states. It is possible some states could adopt regulatory changes on an emergency basis by 12/31/08. However, it is highly unlikely uniform adoption by states can be achieved by 12/31/08. If the proposal is not uniformly adopted by the states then companies domiciled in states that cannot adopt the change by 12/31/2008 would be forced to hold higher reserves relative to companies in states that do adopt the change.

In addition, it is worth considering the likelihood companies will be able to make the required systems changes in time to implement revised X factors by 12/31/08, even if states did adopt the necessary amendments.

National Association of Insurance Commissioners

TO: The Honorable Thomas Hampton (DC), Chair-Capital & Surplus Relief (EX) Working Group

FROM: Commissioner Steven Goldman (NJ), Chair-Reinsurance (E) Task Force

DATE: December 9, 2008

SUBJECT: Capital & Surplus Relief (EX) Working Group Request for Review

Per the request in your November 21, 2008 memorandum, the Reinsurance Task Force has reviewed the discussion items provided by the ACLI in its November 11, 2008 letter to the NAIC regarding "Commissioners' Discretionary Authority on Collateral." The ACLI requested that the NAIC consider the following suggestions specifically related to reinsurance:

1. The Commissioners' authority in existing law and regulation…could be applied immediately, under Section 3 and 4 of the Law and Section 9 of the Regulation, to expand available collateral;
    a. Consider accepting LOCs issued by the Federal Reserve or issued by US banks and confirmed by the Federal Reserve;
    b. Consider accepting funds provided by the Federal Reserve in US trusts;
    c. Consider accepting LOCs issued by non-bank US institutions (such as Microsoft or an insurance holding company);
    d. Consider expanding the interpretation of the phrase "any other form of security acceptable to the commissioner" (such as assets not owned by the reinsurer in a complying US trust, or such as a guarantee of reinsurance payments by a US parent or affiliate);
2. The Commissioners' authority in existing law and regulation…could be used to establish criteria for expediting accreditation of assuming insurers before year-end 2008 under Section 2.b. of the Model Law.

The Task Force notes that the regulatory objective for requiring collateral is to secure amounts recoverable from assuming insurers who are not authorized to transact insurance or reinsurance business in the ceding company's domiciliary jurisdiction. A review of statutory financial statement data reveals the following types and amounts of collateral reported by U.S. ceding companies as of year end 2007:

Collateral Held by U.S. Ceding Companies as of Year End 2007
(In Millions of $U.S.)

Company Type	Total Recoverable	Total Collateral	LOC	Ceded Balances	Funds Held	Miscellaneous	Other
Property	111,536	146,181	49,823 34%	8,564 6%	17,602 12%	2,974 2%	67,218 46%
	Total Recoverable	Total Collateral	LOC	Trust Agreements	Funds Withheld	Miscellaneous	Other
Life/A&H	833,216	892,952	169,638 19%	274,219 31%	421,000 47%	26,996 3%	1,099 < 1%
	Total Recoverable	Total Collateral	LOC	Trust Agreements	Funds Withheld	Miscellaneous	Other
Health	3,866	4,171	64 2%	247 6%	2,515 60%	1,226 29%	119 3%

Following are the Reinsurance Task Force responses to the suggestions submitted by the ACLI:

1. **The Commissioners' authority in existing law and regulation…could be applied immediately, under Section 3 and 4 of the Law and Section 9 of the Regulation, to expand available collateral**

Reinsurance Task Force Response:
The Model Credit for Reinsurance Law (Model Law) currently grants commissioners discretionary authority under Section 3 to allow "any other form of security acceptable to the commissioner", and under Section 4 to determine that a financial institution meets the criteria to be considered a "Qualified U.S. Financial Institution" for the purposes of issuing or confirming letters of credit (LOC), or for holding assets in trust on behalf of a U.S. ceding company. We note that it is difficult to assess the extent to which commissioners currently exercise this discretionary authority. We also note that not all "credit for reinsurance" statutes grant discretion to the extent provided in the Model Law.

The components of the Model Law were thoroughly contemplated through a well-thought-out, conservative and deliberate process and caution should be used when considering broad expansion of the provisions within the Model Law as a response to current circumstances. So long as the credit for reinsurance law in a respective jurisdiction provides the discretionary authority granted to commissioners under the Model Law, it is the opinion of the Task Force that commissioners should utilize this discretion on a case-by-case basis after careful evaluation of each situation. We do believe that it would be beneficial to issue general guidance to commissioners regarding the types and sources of security that would appear to be generally acceptable within this discretionary authority.

1a. **Consider accepting LOCs issued by the Federal Reserve or issued by US banks and confirmed by the Federal Reserve**

1b. **Consider accepting funds provided by the Federal Reserve in US trusts**

Reinsurance Task Force Response:
It is our understanding that issuance or confirmation of LOCs would be outside of the current operations of the Federal Reserve. If available, however, it is the opinion of the Task Force that forms of security which are issued, explicitly confirmed or explicitly guaranteed by the Federal Reserve would be considered acceptable under the Model Law. It is also our opinion that Federal Reserve Banks would be appropriately considered "Qualified U.S. Financial Institutions." No amendment would be required in order to apply this guidance, as it would seem to be consistent with regulatory objectives for such collateral to be acceptable under the discretion currently provided. In the event that such collateral sources were to become available, they could be immediately accepted without compromising regulatory objectives.

1c. **Consider accepting LOCs issued by non-bank US institutions (such as Microsoft or an insurance holding company)**

Reinsurance Task Force Response
It is the opinion of the Task Force that accepting LOCs from non-bank institutions in general would not be consistent with regulatory objectives, as these institutions are not subject to the same capital requirements and solvency focused regulatory standards as U.S. banks. Therefore they are not evaluated on their long-term ability to fulfill LOC obligations.

We do recommend that the NAIC coordinate with the NAIC Securities Valuation Office (SVO) in an effort to determine the feasibility of reviewing and recommending additional financial institutions to be listed or accepted as "Qualified US Financial Institutions." This would expand the list of financial institutions generally considered acceptable to provide or confirm LOCs, and would provide relief from a possible reduced supply.

Previous Activity on Related Issue – Consolidated Supervised Entities Proposal
In 2006 the Reinsurance Task Force received a proposal from Morgan Stanley (represented by LeBoeuf, Lamb, Greene & MacRae LLP) to amend the Model Credit for Reinsurance Law, in coordination with a recommendation to the SVO to amend Part Ten of the SVO Purposes and Procedures Manual. The proposal was to add a second eligibility standard applicable to highly capitalized financial conglomerates which were subject to supervision and examination by the U.S. Securities and Exchange Commission (SEC) through the Consolidated Supervised Entities program. The proposal would expand the acceptable sources for LOCs.

In September 2008, the SEC ended the Consolidated Supervised Entities program due to substantial changes within the five participating entities, prior to any official action by the Task Force on this issue. Each of the entities remaining has been reconstituted within a federally regulated bank holding company, and would now appear to be eligible for consideration under the current Model Law.

1d. Consider expanding the interpretation of the phrase "any other form of security acceptable to the commissioner" (such as assets not owned by the reinsurer in a complying US trust, or such as a guarantee of reinsurance payments by a US parent or affiliate)

Reinsurance Task Force Response:
Some jurisdictions will currently accept an LOC from a non-insurance U.S. parent when backed by a bank LOC. As LOC pricing and availability is a basis for the ACLI's request, it is the opinion of the Task Force that it is unnecessary to issue general guidance suggesting the acceptance of parental LOCs that are backed by bank LOCs. We do believe, however, that cash or SVO approved securities provided by a parent company in a complying U.S. trust for the sole benefit and under the exclusive control of the ceding company would be considered an acceptable form of collateral under the discretionary authority.

2. The Commissioners' authority in existing law and regulation…could be used to establish criteria for expediting accreditation of assuming insurers before year-end 2008 under Section 2.b. of the Model Law

At the request of the Task Force, the ACLI further clarified this suggestion as follows: "**Our specific concern is waiting periods that might otherwise be imposed for accrediting existing SPVs. We are suggesting that the NAIC endorse prompt accreditation of SPVs in these special circumstances**."

Reinsurance Task Force Response:
It is the opinion of the Task Force that it would not be consistent with regulatory objectives to expand accreditation to Special Purpose Vehicles (SPV). SPVs are not currently accredited or otherwise approved to provide credit for reinsurance, and are not subject to the same regulatory standards as insurance entities. Furthermore, we do not believe that such expansion would fall within the commissioners' discretionary authority under existing law and regulation. If the NAIC wishes to consider accreditation of SPVs, we believe it would be necessary to follow the process for amending the Model Law.

Summary
In response to the request of the Capital and Surplus (EX) Working Group, the Reinsurance Task Force recommends that the NAIC:

1. Issue guidance to commissioners regarding the use of the discretionary authority granted in the Model Credit for Reinsurance Law. This would be general guidance only and would not be binding regulatory interpretation. The guidance would not recommend any changes to existing laws, nor would it expand the commissioners' discretionary authority beyond what we would currently consider acceptable. It would note that commissioners may use this discretion as deemed

appropriate on a case-by-case basis and would include sources of collateral that should generally be acceptable under the discretionary authority currently provided as discussed above.

2. Include guidance regarding effective dates for LOCs. Currently, an LOC is required to be effective no later than December 31 of the reporting year in order for a ceding company to receive credit for reinsurance in its year-end financial statements. It is the opinion of the Task Force that, so long as the law in a respective jurisdiction allows, it should be considered acceptable for a commissioner to grant a permitted practice extending this effective date to February 1, 2009. An extension could provide relief to companies looking to replace LOCs that have recently been non-renewed.

3. Coordinate with the SVO in an effort to determine the feasibility of reviewing and recommending additional financial institutions to be listed or accepted as "Qualified US Financial Institutions," either through inclusion on the SVO Bank List or other supplemental list. This will provide commissioners with guidance when considering entities not currently on the SVO Bank List. Along with this process, the Task Force notes that an LOC issued or confirmed by the Federal Reserve would be considered an acceptable form of collateral for credit for reinsurance purposes; however, this appears to be outside of the current operations of the Federal Reserve.

The Task Force would be happy to discuss these issues and recommendations in greater detail, as well as consider any other specific requests.

Response to request from the Capital & Surplus Relief Working Group

Respondent: Life & Health Actuarial Task Force (LHATF)

Date: December 5, 2008

1) Review each of the items that pertains to your group;

Item: Variable annuities 1: Eliminate use of stand-alone asset adequacy analysis required by Actuarial Guideline 39, which covers only variable annuity living benefit guarantees (VAGLB's) and associated revenue under the contract.

2) Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

The product in question is a variable annuity with a guaranteed living benefit rider.

AG 39 requires a stand-alone asset adequacy analysis reflecting only benefits, expenses, and charges that are associated with the VAGLB. Benefits, expenses, and charges associated with the base contract or guaranteed minimum death benefit (GMDB) are excluded. In previous years, because these guarantees were generally out of the money, this asset adequacy analysis did not lead to a requirement off additional reserves. For this year end, the analysis would likely lead to substantial additional reserves in the current market environment because it would reflect the fact that many VAGLB's are "in the money", i.e., the value of the guarantees exceeds the account value.

AG 34 requires a stand-alone asset adequacy analysis reflecting all benefits, expenses, and charges associated with the variable annuity contract.

The key difference between AG 39 and AG 34 asset adequacy analysis in the current market environment is that AG 34's modeling allows the base contract's future mortality and expense charges to support the payment of VAGLB claims.

There is actuarial merit to relying on the AG 34 method of projecting all cash flows related to the base contract and rider. However, as noted below, there are economic concerns with the ACLI proposal.

A survey sent through the ACLI showed an estimated impact of $2 to $3 Billion of reserve relief.

3) Provide a brief history of any activity previously undertaken by your group related to the item being requested;

The variable annuity guarantee reserve standard has been a highly contentious issue at the NAIC for around ten years. During 3rd quarter 2008, Actuarial Guideline VACARVM was adopted by LHATF and the NAIC following a great deal of compromise by all parties, with an effective date of year-end 2009.

VACARVM incorporates two aspects key to this issue: (1) calculates the reserve recognizing all cash flows (similar to AG 34) and (2) contains constraints on assumptions and economic scenarios (not contained in AG 34).

There is concern that elimination of the AG 39 stand-alone asset adequacy would, in many cases, lead to a reserve level lower than a reserve calculated using VACARVM due to AG 34 not

containing the constraints mentioned above. This would mean that the proposal would provide one year of relief before insurers would need to post the required level of reserves.

4) **Provide a summary of any conclusions related to the item being requested;**

There is actuarial basis to the base contract's mortality and expense charges supporting the payment of VAGLB claims. However, this proposal would substantially lower VAGLB reserves at a time when the drivers of the value of VAGLB's are in turmoil. Lower reserves on this product means a higher degree of vulnerability to efficient policyholder behavior and continuation of the bear market.

Note that the entire group agrees that if this relief is granted, it is absolutely critical that the scope of AG 34 be clarified such that it includes all contracts and guarantees that are within the scope of AG 39. One product that could fall through the cracks if clarification is not made in AG 34 is a VAGLB that is reinsurance assumed by an insurer without the base annuity contract or GMDB. An alternative approach would be to expand the scope of AG 39 to include all cash inflows and outflows related to variable annuities.

Proposed amendments to AG39 to address the economic concerns expressed above are included at the end of this document in the event the Capital and Surplus Relief (EX) Working Group and/or the full membership decide to grant this relief request.

5) **Explain whether the item provides relief without compromising regulatory objectives;**

A main concern was that this relief measure could be seen as a step backwards from the approach agreed upon with the adoption of VACARVM, which places some focus on the "fat tail" aspect of equity market guarantees and constrains some assumptions such as policyholder behavior assumptions (while AG 34 is silent on these aspects). Also, some of the insurers who would be aided by this relief continue to actively sell benefit rich VAGLB's. Blanket relief would lessen regulators' leverage for taking corrective action, such as encouraging the VAGLB writers to improve their hedging programs or encouraging VAGLB writers to increase their VAGLB pricing or lessen the guarantees in new sales to reflect market volatility.

6) **Explain if the proposed change can be accomplished in the time period requested and if so by what means.**

AG 39 could be changed in the time period requested. It is likely that several states have hard-coded the AG 39 requirements into the law. In these instances, there would be a major hurdle for implementation by year-end.

Proposed Amendments to AG39:

Summary of Response:

The amendment clarifies the scope of the asset adequacy analysis and notes the blocks of business to which it should be applied. It then provides a guide to the investment volatility to be tested, and guidance on policyholder behavior assumptions to be used because AG 34 is silent on these factors. Both note that AG VACARVM may be used as a guide for assumptions, as well as RBC C3 Phase II. Finally, guidance is provided on topics to be included in the Actuarial Memorandum supporting the company's annual statement of actuarial opinion.

Impact of Response:

The response to the ACLI proposal moves our previous response from a conditional "no" to an unconditional "yes" on the basis of actuarial logic and consistency with the trend toward principles-based

standards. It needs to be noted that with this type of business, regardless of the reserve standard in place, the amount of reserves held will be highly sensitivity to market fluctuations.

Note that the modifications proposed in this amendment clarify the assumptions which companies must use to implement the ACLI proposal. It does not affect either the quantity of reserves released, or the goal of the ACLI proposal, as we understand it. The clarification of the assumptions for asset adequacy analysis not only is what we would expect under AG 39, but also reflects our expectations under AG 34, even if the ACLI had not made a proposal. Essentially, this amendment says "yes" to the ACLI proposal and merely defines our expectation for such implementation.

Amendment proposed for Actuarial Guideline 39 for year end 2008:

Alternatively, instead of performing asset adequacy analysis for living benefits on a standalone basis [in Actuarial Guideline 39], a company may incorporate such asset adequacy analysis in Actuarial Guideline 34, provided that the following conditions are met:

1. Actuarial Guideline 34 asset adequacy analysis scope: Testing should be performed on all blocks of variable annuity business containing a variable annuity guarantee, issued on and after January 1, 1981, including blocks of business that contain variable annuity guarantees that are assumed by the company via reinsurance or other mechanism.

2. Testing of investment volatility: Asset adequacy testing assumptions for investment returns should include, but not be limited to setting volatility assumptions for stocks, bonds, mortgages, government securities, synthetic assets (CMO's, CDO's), and derivatives that incorporate both historical and recent patterns. (In particular, a company should not use a level set of returns over time for stocks, or any other investment, as its primary test.) A company, at its discretion, may use AG VACARVM or RBC C3 Phase II for guidance.

3. Policyholder behavior assumptions: Such assumptions should reflect both recent history and potential future use of policyholder exercise of any variable annuity contract options. Setting of such assumptions should generally be consistent with AG VACARVM "Appendix 9" modeling constraints and disclosures (i.e., more conservative to extent there is absence of experience and preparation of a separate lapse and utilization memorandum).

4. The Actuarial Memorandum supporting the company's annual statement of actuarial opinion should be expanded to include a detailed analysis of the assumptions and conclusions of the effects of variable annuity living benefits both on reserve adequacy and potential losses under adversity, including but not limited to a description of the policies tested and excluded, the investment volatility tested, and the policyholder behavior assumptions used.

5. To the extent this change in asset adequacy analysis and scope is a change in valuation basis for the company, the Accounting Practices and Procedures Manual and annual statement instructions should be followed as appropriate to reflect this as a change in valuation basis in Exhibit 5A of the life annual statement blank.

Response to request from the Capital & Surplus Relief Working Group

Respondent: Life Risk Based Capital Working Group (LRBCWG)

Date: December 1, 2008

1) Review each of the items that pertains to your group;

Variable Annuities, Item 2: Waive the Standard Scenario as the floor in the C-3 Phase II calculation of risk-based capital for year ends 2008 and 2009.

2) Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

The C-3 Phase II instructions for variable annuities and similar products were first incorporated in the RBC requirements for the year 2005. The requirements for interest risk use many interest rate scenarios in the stochastic calculation which produces a total asset requirement (TAR). The resulting RBC amount is the excess of TAR over the reserve. The Standard Scenario is the floor for the TAR which was argued by industry to be too conservative and not in line with the principle-based type of approach envisioned by the stochastic calculation. Regulators erred on the side of caution by including the Standard Scenario floor but made plans to study the C-3 Phase II results, including the Standard Scenario, for any recommendations. A subgroup was formed for this purpose and began work by reviewing a number of individual company C-3 Phase II results. Documentation was an issue which affected the work of this subgroup. This subgroup will continue their review for any recommendation which could include a phase out of the Standard Scenario if appropriate.

Results to date are mixed with respect to the Standard Scenario. A number of companies use the "Alternative Method" which does not use the Standard Scenario so those companies do not have Standard Scenario results to compare. A $10 billion decrease in TAR across companies was a rough estimate produced by the Market Disruption subgroup of LHATF if the Standard Scenario is removed. The corresponding decrease to RBC likely would be less but was not estimated.

The Standard Scenario may cause TAR to increase over the prior year given the current credit crisis. At the implementation of C3 Phase II, companies had the option to smooth the results by taking a weighted average of the current and prior years' results. Companies that have chosen to smooth use a TAR based on 40% of the prior year's TAR and 60% of the current year's TAR. Companies that did not previously smooth their results may do so with domestic commissioner approval. This is covered in the 2008 RBC instructions in LR025.

3) Provide a brief history of any activity previously undertaken by your group related to the item being requested;

As mentioned in 2) above, the Capital Adequacy Task Force is reviewing the C-3 Phase II results using a subgroup which will make recommendations which could include eventual phase out of the Standard Scenario if appropriate.

4) Provide a summary of any conclusions related to the item being requested;

Given current RBC instructions in LR025 a company has some ability to smooth or ameliorate an RBC increase due to the Standard Scenario.

It is not recommended at this time to provide further relief from the Standard Scenario.

5) Explain whether the item provides relief without compromising regulatory objectives;

This is an unknown. What is known is compelling arguments could not be made to say regulatory objectives would not be compromised. This is due to the relatively short time the C-3 Phase II requirements have been in effect and the complexity of modeling the guarantees and assets involved in these products.

6) Explain if the proposed change can be accomplished in the time period requested and if so by what means.

The ACLI proposal could be put in place for 2009 with normal NAIC adoption procedures and subsequent state implementation. Efforts would still need to move quickly to have NAIC adopt revised instructions by June 2009 for purposes of RBC reporting for 2009.

It is not known if states could put the proposed change in place for 2008. This would first assume the NAIC could alter their process requiring instructions to be adopted by June of the year of implementation. Implementation issues may vary among states if the NAIC is able to adopt the proposed change effective for 2008. State considerations include whether a law is in place to automatically go with the NAIC RBC requirements or whether a state has to adopt by rule. If a state adopts by rule then it depends where that state is in their rulemaking process by the time the NAIC is able to adopt this proposed change for 2008.

Response to request from the Capital & Surplus Relief Working Group

Respondent: Life Risk Based Capital Working Group (LRBCWG)

Date: November 25, 2008

1) Review each of the items that pertains to your group;

Investments 1: Temporarily fix the calculation of the Mortgage Experience Adjustment Factor in the risk-based capital calculation.

2) Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

The relevant component of the Mortgage Experience Adjustment Factor (MEAF) calculation is the ratio of individual insurer commercial mortgage default experience to industry average commercial mortgage default experience. There is a cap of 350% and floor of 50% on the ratio. The values are calculated as 8 quarter averages with a one quarter lag which means that both the 2008 industry average and individual insurer values are calculated through 3rd quarter 2008. Default experience in the 4th quarter will have no impact on the ratio. The ACLI proposal is to create a temporary floor in the industry average commercial default experience value.

NAIC staff has calculated the industry average and has reasonably estimated the individual insurer default values for 2008 and applied the results to 3rd quarter commercial mortgage amounts for individual insurers. The industry average factor declined from .004 to .002, but since the corresponding individual insurers values also declined, the overall impact is a significant decrease in the aggregate amount of commercial mortgage RBC for 2008 (from $8.6 billion to $7.2 billion). It is also relevant to note that the last two quarters of the 8 quarter industry average reversed what had been a trend of decreasing default values and each showed increases over the previous quarter in commercial mortgage defaults.

3) Provide a brief history of any activity previously undertaken by your group related to the item being requested;

The issue of an adjustment to the MEAF calculation was brought to the LRBCWG in 2007 and added to our Working Agenda. A proposal was brought to the CADTF that allowed the optional use of third party software to calculate the RBC amount. The LRBCWG declined to pursue that option as not practical. In 2008, the ACLI brought the proposal requested here to the LRBCWG as a short term solution pending a longer term solution to be developed by the ACLI. The LRBCWG agreed that consideration of a permanent replacement of the MEAF calculation was warranted, but had concerns about the impact of the short term solution proposed by the ACLI. The LRBCWG suggested some alternatives for a short term solution to the ACLI which was evaluating them and was expected to bring a revised proposal to the LRBCWG.

4) Provide a summary of any conclusions related to the item being requested;

Based on the information above, there should be no temporary floor in the industry average commercial mortgage default experience value for year end 2008. The LRBCWG continues to pursue the consideration of a permanent modification for the commercial mortgage component of the Life RBC calculation.

5) Explain whether the item provides relief without compromising regulatory objectives;

Adding a temporary floor to the industry average commercial mortgage default experience value for year end 2008 would reduce the commercial mortgage aggregate RBC amount by $3.0 billion to $4.2 billion, less than half the $8.6 billion held at year end 2007. These amounts are based on

substituting the floor value into the calculation described in number 2 above. No analysis has been provided to support the reduced aggregate RBC amount and particularly given the recent increase in commercial mortgage defaults and press reports indicating future problems with commercial mortgages, it may be compromising regulatory objectives to make this change.

6) Explain if the proposed change can be accomplished in the time period requested and if so by what means.

Since the industry average commercial mortgage default experience value is calculated late in the year, it is put on the NAIC web site for the insurers to input into their RBC calculation. Therefore if it is decided to use a value different than the calculated industry average value, the alternative value can be substituted for the calculated value.

National Association of Insurance Commissioners

To: Commissioner Hampton (DC) – Chair, Capital and Surplus Relief (EX) WG

From: Joseph Fritsch (NY) – Chair, Statutory Accounting Principles Working Group of the Accounting Practices and Procedures (E) Task Force.

Date: December 4, 2008

Re: ACLI Request for Admission of Deferred Tax Assets under *SSAP No. 10—Income Taxes*

This memo is in response to the November 21, 2008 Request for Review memo regarding the ACLI request for admission of deferred tax assets under *SSAP No. 10—Income Taxes* (SSAP No. 10). The following requests per your memo and the Statutory Accounting Principles Working Group response, is outlined below.

1. Review each of the items that pertains to your group;

   The Statutory Accounting Principles Working Group will address the *Accounting Item* noted on the Grid as "Follow GAAP rules for DTAs."

2. Develop a brief overview and analysis of the item including any information that would help quantify the potential impact;

   Based on GAAP guidance for recognition and measurement contained in *FAS 109: Accounting for Income Taxes* (FAS 109), SSAP No. 10 calculates deferred tax assets and deferred tax liabilities in a consistent manner. To ensure that a reporting entity's surplus is conservatively measured, accounting requirements for income tax recoverables and admission criteria for deferred tax assets are applied as follows:

   > 8. Current income tax recoverables shall include all current income taxes, including interest, reasonably expected to be recovered in a subsequent accounting period, whether or not a return or claim has been filed with the taxing authorities. Current income tax recoverables are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, as defined in paragraph 289 of FAS 109, or items for which the reporting entity has substantial authority, as that term is defined in Federal Income Tax Regulations.
   >
   > 9. Current income tax recoverables meet the definition of assets as specified in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.
   >
   > 10. Gross DTAs shall be admitted in an amount equal to the sum of:
   >
   > a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year;
   >
   > b. The lesser of:
   >
   > i. The amount of gross DTAs, after the application of paragraph 10 a., expected to be realized within one year of the balance sheet date; or
   >
   > ii. Ten percent of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill; and

c. The amount of gross DTAs, after application of paragraphs 10 a. and 10 b., that can be offset against existing gross DTLs.

The following information was obtained from 2007 annual statutory financial statements and footnotes. In addition, the impact of valuation allowances could not be reflected in the table, as these are developed at the individual DTA level and require management judgment. As noted in the ACLI request, DTAs will likely increase significantly in 2008 from the amounts presented in this table.

Industry	Current DTA	% of C&S	Period Increase to 5 years*	% of C&S	25% Limit of Capital**, ***	% of C&S
Life	$15.5B	4.7%	$35.1B	10.7%	$21.1B	6.4%
Property & Casualty	$18.5B	2.8%	$22.5B	3.4%	$16.1B	2.4%
Health	$1.7B	2.1%	$5.1B	6.3%	$3.4B	4.2%

* Assumes nonadmitted DTA due entirely to 1-year realization and increase to 5 years would result in admission as proposed.

** Assumes nonadmitted DTA due entirely to 10% limit and calculates the amount of increase resulting from an increase to of the limit to 25% of C&S

*** Does not reflect adjustment to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill as required by SSAP No. 10. These adjustments would reduce the amount and percentage shown

Given the above assumptions:

Life

- An increase in the realization period from 1 to 5 years could have an increase in admitted DTAs of over $35 billion or a 10.7% increase in capital and surplus, OR
- An increase in the percentage threshold from 10% to 25% could have an increase in admitted DTAs of over $21B or a 6.4% increase in capital and surplus.

Property and Casualty

- An increase in the realization period from 1 to 5 years could have an increase in admitted DTAs of approximately $23 billion or a 3.4% increase in capital and surplus, OR
- An increase in the percentage threshold from 10% to 25% could have an increase in admitted DTAs of over $16B or a 2.4% increase in capital and surplus.

Health

- An increase in the realization period from 1 to 5 years could have an increase in admitted DTAs of over $5 billion or a 6.3% increase in capital and surplus, OR
- An increase in the percentage threshold from 10% to 25% could have an increase in admitted DTAs of over $3B or a 4.2% increase in capital and surplus.

3. Provide a brief history of any activity previously undertaken by your group related to the item being requested;

The guidance noted in SSAP No. 10 above was developed to be consistent with the *NAIC Accounting Practices and Procedures Manual's* (AP&P Manual) Statement of Concepts, which states the following (**emphasis added**):

> 27. The primary responsibility of each state insurance department is to regulate insurance companies in accordance with state laws **with an emphasis on solvency for the protection of policyholders. The ultimate objective of solvency regulation is to ensure that policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide an adequate margin of safety. The cornerstone of solvency measurement is financial reporting. Therefore, the regulator's ability to effectively determine relative financial condition using financial statements is of paramount importance to the protection of policyholders.** An accounting model based on the concepts of conservatism, consistency, and recognition is essential to useful statutory financial reporting.

In addition, *SSAP No. 87—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82* (SSAP No. 87) defines nonadmitted assets and relates the concept of nonadmission as follows (**emphasis added**):

3. This statement amends paragraph 3 of SSAP No. 4 to the following:
As stated in the Statement of Concepts, "**The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted.** For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which is accorded limited or no value in statutory reporting, and is one which is:

a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or
b. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

Prior to Codification, deferred tax assets were not admitted assets for statutory financial statements. As part of the goal for a surplus neutral impact for the adoption of Codification and at the request of industry, the above admission criteria were included in SSAP No. 10, even though it was inconsistent with the Concept reference in SSAP No. 87 above. It should also be noted that adoption of Codification of SAP resulted in an increase in surplus, primarily due to admission of deferred tax assets.

GAAP and SAP accounting for income taxes can result in material temporary taxable/deductible temporary differences. Under GAAP, realization of deferred tax assets is addressed by the use of a valuation allowance (reserve). A GAAP entity is to reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. The admission standards outlined above is a replacement of the valuation allowance criteria.

4. Provide a summary of any conclusions related to the item being requested;

The Statutory Accounting Principles (E) Working Group has serious concerns admitting additional deferred tax assets as requested by the ACLI for the following reasons:

- As noted above, surplus must be conservatively measured to ensure that policyholder, contract holder and other legal obligations are met when they come due and that insurers maintain capital and surplus at all times, and in such forms, to provide an adequate margin of safety. Deferred tax assets are not liquid or in a form that provides a margin of safety for policyholder protection.
- These uncertain economic times do not support a conclusion to reduce the margin of safety provided by current capital and surplus impacts related to accounting for income taxes. The Working Group believes this puts policyholders at undue risk, especially in this current economic environment.
- Current statutory accounting allows for admitting gross deferred tax assets in an amount equal to the sum of three elements. The ACLI's proposal to expand the realization period beyond one year of the balance sheet date and to increase the limitation of statutory capital and surplus in excess of 10% only affects one of those elements (the element outlined in SSAP No. 10; Paragraph 10.b). The other two elements are not affected by the limitation of statutory surplus. Dialogue that implies that the total amount of admitted deferred tax assets is capped at 10% of surplus, or will be capped at a different percentage of surplus under the ACLI's proposal, is inaccurate and misleading. Since the admission criteria is a summation of three elements, the total amount of admitted deferred tax assets under current requirements, can and does provide for an insurer to admit amounts greater than 10% of capital and surplus. For example, Paragraph 10.c. allows insurers to admit gross deferred tax assets

that can be offset against existing gross deferred tax liabilities in accordance with existing tax regulation and these amounts can be quite significant.

- In addition, current requirements do not address investments in insurance reporting entities that may also have admitted deferred tax assets. As current SAP does not consolidate, the value admitted by the downstream insurer is added to or "stacked" on top of the amount admitted by the parent insurer. As an example, if a parent insurance company has net deferred tax assets that are equal to 10% of their capital and surplus and the parent company owns downstream insurance companies that also have net deferred tax assets, then the parent company's true admitted value of net deferred tax assets can and does exceed 10% of capital and surplus.
- An increase in the period of realization could impact the financial examiners ability to validate admitted deferred tax assets. Currently, exams are performed in a subsequent period that provides greater assurance of realization of the admitted deferred tax asset within the year the exam is conducted. However, extending the realization period increases the utilization of projections and management judgment, which increases examination detection risk.
- Although materiality of the impact of the proposed guidance is relevant information, statutory accounting principles should be based on the statement of concepts.
- The realization of deferred tax assets is predicated on future taxable income on the transaction that created the future deductible tax difference, meaning the reporting entity must have actual (realized) earnings on the related transaction. While tax-sharing agreements exist within the corporate structure, these agreements cannot be construed to be a sale or assignment whereby an insurer can consider the item liquid.
- The valuation allowance proposed by the ACLI is an *estimate* based on a more-likely-than-not threshold and future taxable income, not a guaranty. Assets that are encumbered or unavailable due to other third party interests, are not liquid and are not available to pay policyholder claims.
- The valuation allowance threshold of more likely than not, is currently incorporated within the SSAP No. 10, Appendix A, Implementation Questions and Answers. As such, deferred tax assets are evaluated against this threshold prior to application of the admission criteria; this results in the intended conservative treatment providing for the admission of deferred tax assets, which by definition are considered a nonadmitted asset.
- Also noted above, the existing admission guidance was adopted with the goal of surplus neutrality in adoption of Codification. The result was an actual increase to surplus, primarily due to admission of deferred tax assets. The Working Group believes capital and surplus relief has already been granted on this item.
- We understand the reasons for the request for relief from certain reserving requirements, but disagree with the request to increase admissibility of deferred tax assets. Having said that, the Statutory Accounting Principles (E) Working Group understands the extraordinary times that insurers are facing related to current market and economic conditions. Therefore, if it is determined that action should be taken regarding the admission of deferred tax assets; we suggest an alternative that is more consistent with regulatory objectives. As such, the Statutory Accounting Principles (E) Working Group would consider relief as follows:
    - An increase in the realization period in paragraph 10.b.i. from 1 to 3 years.
    - An increase in the percentage limitation in paragraph 10.b.ii from 10% to no more than 15%.
    - The Working Group also strongly believes this relief should be revisited after the 2009 reporting period.

5. Explain whether the item provides relief without compromising regulatory objectives;

   The Statutory Accounting Principles (E) Working Group believes that increasing the admission of deferred tax assets, which already is inconsistent with the basis that underlies Statutory Accounting Principles, *would* compromise regulatory objectives.

6. Explain if the proposed change can be accomplished in the time period requested and if so by what means.

Due process is explicitly outlined in Appendix F of the *Accounting Practices and Procedures Manual*. A summarization of the applicable due process for this item is as follows:

- An amendment to existing SSAP No. 10 is at the discretion of the Statutory Accounting Principles Working Group (SAPWG) subject to approval by the Accounting Practices and Procedures Task Force.
- Draft an Issue Paper that contains the summary conclusion, discussion and relevant literature sections.
- Public comment will be solicited on the issue paper, and at least one public hearing will be held on an issue paper before it is converted to a SSAP.
- Accounting and disclosure guidance contained in the issue paper is converted to a SSAP.
- Upon approval by the SAPWG, all proposed SSAPs will be exposed for public comment for a period commensurate with the length of the draft and the complexities of the issue.
- Adoption of SSAPs by the SAPWG, after hearing and any further amendments, may be by simple majority.
- All SSAPs must be on the agenda for at least one public hearing before presentation to the Task Force for consideration.
- Adoption by the Task Force, its parent and the NAIC membership shall be governed by the NAIC Bylaws.

The Statutory Accounting Principles Working Group does not believe that adherence to the above noted due process could be achieved within the time period requested. Having said that, if executive leadership determines that action is to be taken on this item, the Working Group would undertake necessary measures to ensure adherence to this directive is accomplished. The Statutory Accounting Principles (E) Working Group believes that these are extraordinary times that may require extraordinary measures, but notes that the established due process will be adhered to on normal maintenance items.

cc: Ramon Calderon (CA), Chair, Accounting Practices and Procedures Task Force