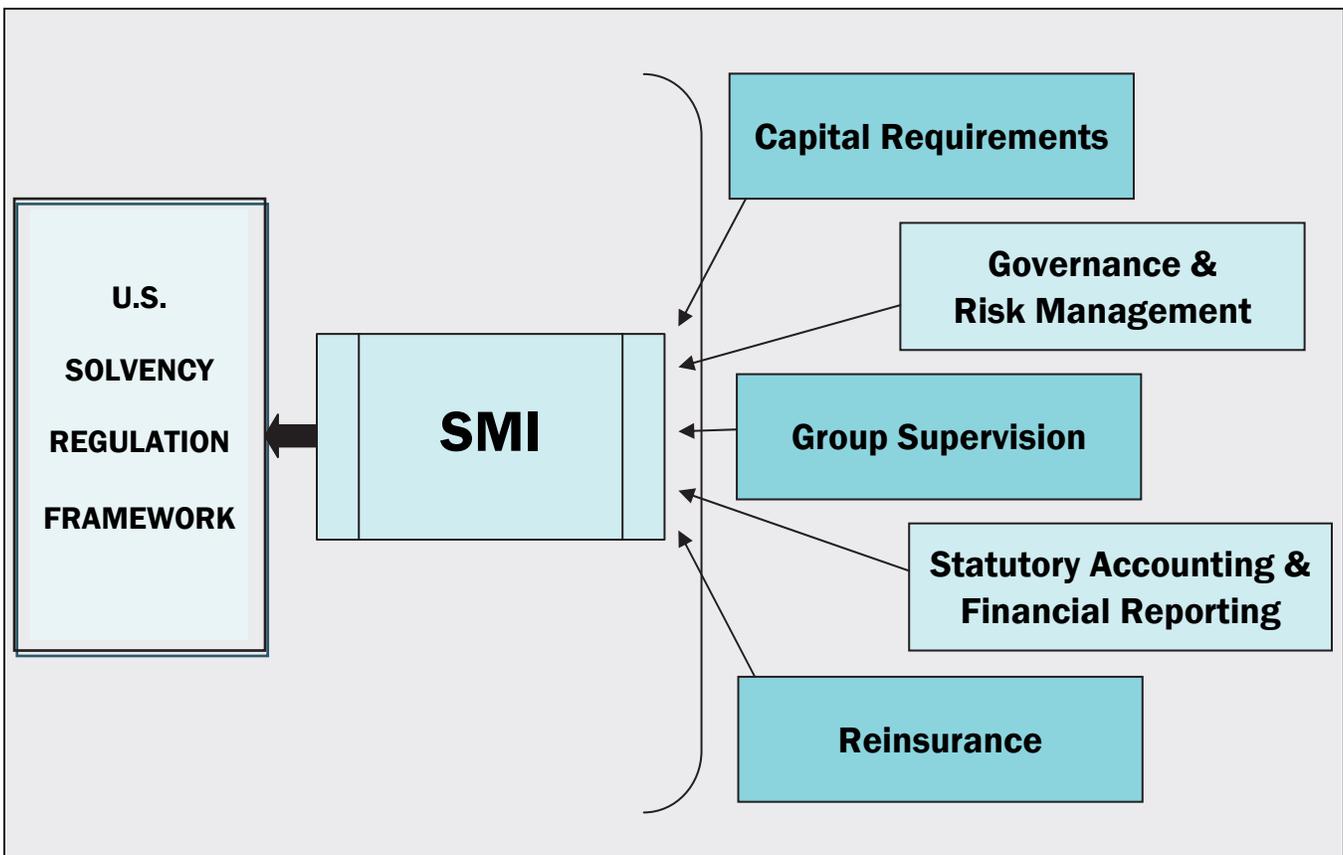


**Solvency Modernization Initiative  
ROADMAP**

**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 2013.<sup>1</sup>
4. Key completed activities within the SMI include the following:
  - NAIC adoption of revised group supervision: Insurance Holding Company System Regulatory Act (Model #440) and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (Model #450).
  - NAIC adoption of the *Risk Management and Own Risk and Solvency Assessment Model Act (#505)* and the *Own Risk and Solvency Assessment (ORSA) Guidance Manual*.
  - Increased scheduling of supervisory colleges and implementation of supervisory colleges' tracking documentation.
  - NAIC adoption of the *Existing U.S. Corporate Governance Requirements*.
  - NAIC adoption of updates to the *Standard Valuation Law* (Model #820) and the *Standard Nonforfeiture law for Life Insurance* (Model 808), completion of the industry impact study for life insurance principles-based reserving, and adoption of the *Valuation Manual*.
  - NAIC adoption of revised reinsurance supervision: *Credit for Reinsurance Model Law* (Model #785) and the *Credit for Reinsurance Model Regulation* (Model #786).
  - 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 following describes the remaining issues and projects to be completed in the SMI, establishes some expected timelines for deliverables, and identifies the committees involved.

### Capital Requirements

6. 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 and introduction of and changes to trend tests.
7. 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.
8. 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.
9. Because the NAIC made many of the RBC formula, factors and methodology decisions over a twenty-year period, we need to maintain institutional knowledge and ensure consistency in the formulas and calibrations. Therefore, we will compile historical information to explain why we developed each RBC formula, how we calculated individual factors, why/how we calibrated the formulas and factors, and why regulators subsequently made modifications to the formulas. This documentation will be required as part of future revisions to the formulas and will be added to the historical documents.
10. Since we knowingly excluded some risks in the RBC calculation, regulators have re-evaluated "missing risks" to determine if we should now include them in the RBC calculation, or whether we appropriately handle those risks utilizing other regulatory methods. Regulators will continue to evaluate RBC formulas, factors, and methodology, concentrating first on material existing or emerging risks and the method to combine risk charges (the "square root formula") and making adjustments to reflect other SMI changes, such as statutory accounting (e.g. principles-based

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

reserving) or reinsurance modifications. The Capital Adequacy (E) Task Force has identified four priority areas for implementation: introduction of an explicit property/casualty catastrophe risk charge; increased granularity in the asset and investment risk charges (called the “C1 factor review”); refinement to the credit risk charge for reinsurance recoverables; and development of an explicit operation risk charge in all formulas. Work is currently under way for the first two items, the third item is on the agenda of the P&C RBC (E) Working Group for 2013, and the last item is being discussed by the SMI/RBC (E) Subgroup of the Capital Adequacy (E) Task Force. Modifications to the current methodology for deriving credits for risk diversification (i.e. “covariance”) are being studied.

11. As factors and methodology are updated, we will (1) aim for a specified safety level and time horizon unless such calculation is not appropriate for a particular measurement (e.g. sufficient statistical data is not available or a different time horizon is more appropriate) and (2) aim for consistency between the RBC formulas (by line of business). At this time there is not an aim to calibrate the final result of RBC to one safety level and time horizon, but to continue with the approach to calibrate to a level of regulatory capital that defines a poorly capitalized company, while limiting the potential for false positives and continuing to integrate with other elements of the regulatory framework as enhanced by SMI. A top-down approach to calibration is not feasible for a variety of reasons, including (1) safety levels and time horizons should vary by the underlying types of risk and (2) there is a lack of credible loss distributions and risk profiles needed to produce statistically valid aggregate safety levels for every factor.
12. The Capital Adequacy (E) Task Force reviewed the public reporting of final RBC calculations, investigating whether to continue to release those numbers publicly. The Task Force decided to maintain the status quo due to the market discipline that results from making that information public.
13. Beyond RBC, capital assessments are included in the adopted guidance for the Own Risk and Solvency Assessment – ORSA. These additional capital assessments complement RBC which is our final financial regulatory safeguard to (1) guarantee regulator action and (2) provide the legal authority to intervene without extensive litigation. The ORSA capital assessment will aid review of the financial stability of a company, group, or industry and disclosure of capital sufficiency in the group (to potentially aid a failing entity in the group).
14. The following identifies the timeline of activities for RBC capital requirements:
  - Development of a plan for the modification to the formulas to implement missing significant risk charges: Plan completed December 2012; Implementation by 2015.
  - Prioritization of risks in the RBC formula for evaluation: Ongoing
  - Historical RBC documentation, including determination of the average calibration of the current RBC: Life RBC Jan. 2013; P&C RBC June 2013
  - Proposal for improvement to the methodology to combine risk charges: Draft proposal: August 2013
  - Plan of action for changes to RBC including definition of the standard safety level(s) and time horizon(s): April 2013
  - Debate on the public nature of some company-specific RBC calculations: Completed Dec. 2012 (No change)
15. Modifications to RBC capital requirements are considered by the Capital Adequacy (E) Task Force, its SMI RBC Subgroup, and its working groups. The Task Force is addressing modification to asset categories jointly with the Valuation of Securities (E) Task Force through the C1 Factor Review Subgroup.

**Governance and Risk Management**

16. Historically, U.S. insurance regulators have reviewed the corporate governance of prospective insurers before granting a certificate of authority to write insurance business. On an ongoing basis, a review of an insurer's corporate governance practices is performed during on-site financial examinations. The review of corporate governance during a financial examination has increased significantly as the U.S. has moved to a risk-focused examination process, and the increased review has highlighted the need for additional standards in this area. Examiners have identified concerns related to Board oversight, succession planning, lack of formal risk management and a failure to establish independent internal audit functions. These issues are typically dealt with indirectly, as there is not a set of uniform corporate governance standards for insurers within insurance regulation. Consequently, this is an area of solvency regulation where regulators believe some improvements may be necessary.
17. The most recent financial crisis also led to continued discussions by regulators and international supervisors regarding the importance of corporate governance and risk management. Although most insurers weathered the crisis, regulators have recognized a need to learn from the governance problems identified in other industries and act before a crisis in corporate governance or risk management directly impacts insurers. Many of the financial supervisors around the world have taken measures to clarify standards and expectations relating to corporate governance for regulated entities in their respective areas, and U.S. regulators have identified a need to make improvements consistent with what is being done around the world.
18. In addition, comments received from the recent U.S. participation in the Financial Sector Assessment Program (FSAP) found that the U.S. largely observed many of the international supervisory principles related to corporate governance and risk management. However, specific deficiencies in the U.S. regulatory process were identified and recommendations were made for improvements in certain areas. These recommendations included establishing: (1) specific suitability criteria (e.g. background, experience, etc.) for key persons; (2) requirements in relation to ongoing notifications regarding suitability; (3) additional requirements or guidance for insurers related to good corporate governance practices; (4) requirements for insurers in maintaining an internal audit function; and (5) explicit requirements for insurers in maintaining risk management systems capable of identifying, measuring, assessing, reporting and controlling risks.
19. Many of the existing corporate governance requirements for insurers are contained in state corporate governance statutes and case law. Therefore, to get a better understanding of existing laws and regulations, the Corporate Governance (EX) Working Group performed a review of existing legislation and case law relating to corporate governance requirements for insurers and summarized corporate governance laws in California, Delaware, Georgia, Illinois, Iowa, Nevada, New York and Texas. In addition, the Working Group studied Rhode Island's recent adoption of corporate governance provisions into its insurance code. The Working Group also performed a study of corporate governance principles and standards placed upon insurers worldwide by the International Association of Insurance Supervisors (IAIS), Australia, Canada, Switzerland, and the United Kingdom. The study sought input from the supervisors in each of these countries on the summarized principles. As a result of this study, Working Group members noted that many of the standards and principles adopted in other countries, and included in the IAIS core principles, are not necessarily fully addressed within the current U.S. insurance regulatory system.
20. After extended consultation with interested parties, the Working Group agreed to compile a summary of existing corporate governance requirements found within NAIC/insurance-specific sources and non-NAIC/insurance-specific sources, to assist in identifying potential changes in the existing insurance regulatory structure that could be addressed through the SMI. This summary identifies existing corporate governance requirements, standards and regulatory monitoring practices that are applied to insurance entities in the United States within the structure of *The United States Insurance Financial Solvency Framework*, which was adopted by the NAIC in 2010. Financial solvency core principles underlie the active regulation that exists today and make up the Framework. Seven core principles are identified for the U.S. insurance regulatory system and these principles were utilized to illustrate the corporate governance requirements, standards and regulatory monitoring practices that are currently in place within the U.S. system. The summary *Existing U.S. Corporate Governance Requirements* was adopted by the Working Group on December 22, 2011.

21. After summarizing the existing corporate governance requirements, the Working Group performed a comparative analysis between the existing U.S. requirements and regulatory needs, best practices and principles outlined within the IAIS' Insurance Core Principles. The results of this comparative analysis, along with proposed enhancements to the U.S. system resulting from this study, have been presented in a document entitled *Proposed Response to a Comparative Analysis of Existing U.S. Corporate Governance Requirements*. This document was exposed for public comment through Sep. 28, 2012. After receiving a number of comments during the exposure period, the Working Group held several conference calls to discuss the comments received and to modify the existing draft. These modifications resulted in the Working Group agreeing to re-expose Exhibits A, B and E of the document for an additional 45-day period ending January 18, 2013. Upon receiving comments at the conclusion of this exposure period, the Working Group plans to review and discuss the additional comments received and make necessary modifications to the proposed enhancements, before making policy decisions and completing its primary charges by the 2013 Spring National Meeting.
22. The projected timeline for corporate governance related activities is as follows:
- Re-expose changes to the proposed enhancements to existing U.S. corporate governance requirements (including referrals to other NAIC groups): Dec. – Jan. 2013
  - Receive and address comments: Jan. – Mar. 2013
  - Finalize and adopt enhancements to existing corporate governance requirements: Apr. 2013
23. Regulators currently perform certain elements of risk management evaluation in the enhanced risk-focused surveillance process, which includes an assessment of risk and the insurer's ability to manage or mitigate risks. To formalize regulatory considerations in this area, regulators drafted a consultation paper to discuss risk management reporting and quantification requirements (e.g. ERM/ORSA-type tool) in light of the global development of risk management supervisory tools that incorporate periodic risk reporting, stress tests, and provide a group capital and prospective solvency assessment. The Group Solvency Issues (E) Working Group scheduled several meetings to discuss the implementation and utilization of the ORSA tool within the U.S. solvency system. The NAIC adopted the NAIC *Own Risk and Solvency Assessment Manual* in March 2012.
24. Implementation of the ORSA was referred to the Financial Condition (E) Committee for implementation. The ORSA (E) Subgroup was formed to address implementation initiatives including ERM education for state insurance regulators and an ORSA Feedback Pilot Project. Implementation initiatives including ERM education will be ongoing. The ORSA Feedback Pilot Project was completed in July 2012 and recommendations from the Project are expected to be referred to Financial Condition (E) Committee in November 2012.
25. The following identifies the timeline for risk management activities:
- Development of an ERM/ORSA-type tool: Adopted the NAIC *Own Risk and Solvency Assessment Manual*, March 2012
  - Create a model law to require insurers have a risk management framework, perform an Own Risk and Solvency Assessment (ORSA) and file an ORSA Summary Report to the lead state insurance regulator: Adopted the Risk Management and Own Risk and Solvency Assessment Model Act (#505), September 2012
  - ORSA Feedback Pilot Project: First pilot completed in 2012; second pilot to be completed in the Fall 2013.
  - ERM education, including development of a glossary: ERM education completed May-August 2012. Adopted Glossary for the ORSA Guidance Manual August 2012.
  - Evaluate needs for additional NAIC resources and/or staffing for ORSA implementation: 2013
26. Governance issues are under consideration by the Corporate Governance (E) Working Group. Risk management issues are under consideration by the Group Solvency Issues (E) Working Group.

## Group Supervision

27. Group supervision is currently performed under authority of the *Insurance Holding Company System Regulatory Act* (Model #440) and the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (Model #450) and applied under practices described in the NAIC *Financial Analysis Handbook*.
28. At the heart of the lessons learned from the recent financial crisis was the need for regulators to be able to assess the enterprise risk within a holding company system and its impact or contagion upon the insurers within that group. Therefore, regulators want to enhance certain prudential features of group supervision within the models and monitoring practices, providing clearer windows into group operations, while building upon the existing walls which provide solvency protection for insurers. The concepts addressed in the enhanced “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.
29. Models #440 and #450, as modified and adopted in December 2010, apply to groups of two or more affiliated persons/organizations, at least one of which is an insurer. The revised models still contain the previous windows and walls concepts, including requirements 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. The models now also include enhancements such as the following:
- Expansion on the ability to look at any entity within an insurance holding company system that may or may not directly affect the holding company system, but could pose reputational risk or financial risk to the insurer through a new Form F – Enterprise Risk Report.
  - Enhancements to regulators’ rights to access information, especially regarding the examinations of affiliates and access to books and records to better ascertain the financial condition of the insurer, as well as language to require notification of divestiture of controlling interest.
  - Introduction of and funding for supervisory colleges. While regulators are able to participate in supervisory colleges today, the amended models and forthcoming documented best practices will enhance the US regulators ability to participate in supervisory colleges and provide guidance on how to conduct, effectively contribute to, and learn from colleges.
  - Enhancements in corporate governance, Board of Director and Senior Management responsibilities – in line with the current NAIC Model Audit Rule, state laws and legal practices.
  - Guidance on the disclaimer of affiliation filings that includes disallowance of a disclaimer of affiliation language and an opportunity for an administrative hearing on those matters.
  - Additional standards for reviewing affiliated agreements to enhance minimum requirements.
30. Additionally, the following timeline identifies activities related to group supervision:
- Supervisory college tracking documentation: Completed initially in August 2010 and maintained annually;
  - International Supervisory College On-line Request Form: Completed October 2010;
  - Accreditation Part B Guidelines regarding depth of review and documentation of the holding company analysis: December 2010;
  - Holding Company and Supervisory Best Practices document and a referral accepted by the Financial Analysis Handbook Working Group to include in the *Annual 2011/Quarter 2012 NAIC Financial Analysis Handbook* publication: Adopted November 2011;
  - Study of the need to create a standard template for the holding company financial reporting requirements required by the Form B: 2013.
  - Draft additional guidance for roles and responsibilities of the U.S. Lead State for inclusion in the *Annual 2013/Quarterly 2014 NAIC Financial Analysis Handbook*: 2013
31. Group solvency issues are under consideration by the Group Solvency Issues (E) Working Group. The ORSA (E) Subgroup was formed to implement the ORSA.

## Statutory Accounting & Financial Reporting (including Valuation)

### Valuation (Principles-Based Reserving)

32. Statutory accounting for life insurance reserves (“valuation”) is not yet principle-based, as it is for other lines of business. The NAIC adopted the amended Standard Valuation Law (Model #820) in late 2009, studied the impacts of changes to valuation methodologies, and adopted the Valuation Manual in late 2012. As with other handbooks and manuals at the NAIC, additional refinements to the Valuation Manual will be adopted over time, as needed.
33. According to provision in the Standard Valuation model law, the principle-based reserve (PBR) requirements will become effective after at least 42 states (comprising greater than 75% of US life and A&H/health/fraternal insurance direct premiums written) have adopted the amended law and Valuation Manual. Once those thresholds are met, the PBR requirements become effective on Jan. 1<sup>2</sup> in all states that have adopted the amended law and Valuation Manual, applicable to prospective business.
34. To utilize principle-based reserving, statistical data will need to be collected to provide regulators and the industry with statistical experience information. We expect to determine how to collect such information in 2013.
35. The following identifies the timeline of activities for life insurance principle-based reserving:
  - NAIC adoption of updates to the Standard Valuation Law (#820): 2009
  - NAIC adoption of updates to the Standard Nonforfeiture Law for Life Insurance (#808): Summer 2012
  - Industry Impact Study Completed: February 2012.
  - Valuation Manual: NAIC adoption: Dec. 2012.
  - PBR Implementation Plans (including statistical data and coordinated review): 2013-2014  
(Note: State law changes must be implemented and premium thresholds met before PBR becomes effective.)
36. Principle-based reserving activities have mostly been concentrated at the Life Actuarial (E) Task Force and the Principle-based Reserving (E) Working Group, with other groups awaiting policy decisions before beginning their implementation assignments. PBR implementation activities will ramp up in 2013.

### Future of Statutory Accounting & Financial Reporting

37. Regulators analyze Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) pronouncements and International Financial Reporting Standards (IFRS), especially regarding insurance contracts and financial instruments, and provide input to the IAIS, the FASB, and occasionally to the IASB directly.
38. Our current statutory accounting system already includes a process to consider any new Generally Accepted Accounting Principles (GAAP) pronouncements, whereby we reject, adopt, or modify GAAP changes for implementation into our statutory accounting system. Agreed convergence between FASB and IASB have already produced some GAAP pronouncements, but even with this process in place, commissioners are contemplating (1) future policy decisions on this approach; (2) the impact of international accounting activities; (3) the extent of public disclosure versus regulatory reporting; (4) compliance with IAIS ICPs related to accounting and reporting, and (5) the need to communicate with international regulators.
39. Given the current state of play, we expect to address those policy decisions after completion of the IASB/FASB Insurance Contracts project and U.S. Securities and Exchange Commission (SEC) decision regarding IFRS. Awaiting these decisions has potential to delay the 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 passed 2012. The International Solvency and Accounting Standards (E) Working Group and Statutory Accounting Principles (E) Working Group will provide technical recommendations at the appropriate time.

<sup>2</sup> Effective the first Jan. 1 where there is at least a 6-month lag from adoption to implementation.

40. The following identifies the prospective timeline of activities for statutory accounting:
- 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: on hold
41. SMI-related accounting work is considered by the International Solvency and Accounting (E) Working Group and the Statutory Accounting Principles (E) Working Group.

### Reinsurance

42. The Reinsurance Regulatory Modernization Framework proposal (Reinsurance Framework), adopted by the NAIC during its Winter 2008 National Meeting, is a conceptual framework that the Reinsurance (E) Task Force developed in response to its charges to consider (1) the current collateralization requirements regarding unauthorized reinsurers and (2) the design of a revised U.S. reinsurance regulatory framework. The Reinsurance 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.
43. The Reinsurance 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 Task Force developed federal legislation intended to implement the Reinsurance Framework and in September 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.
44. The federal Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law on July 21, 2010. While the Dodd-Frank Act contains provisions that impact reinsurance regulation, the NAIC's proposed federal legislation was not included. The Dodd-Frank Act does include the Nonadmitted and Reinsurance Reform Act (NRRA) and establishes the Federal Insurance Office (FIO) within the U.S. Department of the Treasury. With respect to reinsurance, the NRRA 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 sole responsibility for regulating the reinsurer's financial solvency to a reinsurer's domiciliary state. 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.
45. In light of these developments, states began to express an interest in moving forward with state-based reinsurance collateral reforms. In December 2010, the NAIC charged the Reinsurance (E) Task Force to consider amendments to the *Credit for Reinsurance Model Law (#785)* and *Credit for Reinsurance Model Regulation (#786)* to incorporate key elements of the Reinsurance Framework. In November 2011 the NAIC full membership adopted revisions to the models, serving to reduce reinsurance collateral requirements for non-U.S. licensed reinsurers that are licensed and domiciled in qualified jurisdictions.
46. In order to assist the states in implementing the revised models, during 2012 the Task Force worked to put into place certain elements with respect to 1) accreditation standards; 2) the review and approval of qualified jurisdictions, and 3) the creation of an NAIC group to provide advisory support and assistance to the states in the review of reinsurance collateral reduction applications.
47. On November 29, 2012, the Financial Regulation Standards and Accreditation (F) Committee adopted revisions to the accreditation standard for reinsurance ceded reflecting key elements from revised Models #785 and #786. The provisions within the accreditation standard pertaining to certified reinsurers do not require adoption by every NAIC jurisdiction; rather, these provisions are considered an optional standard (i.e., a state is not required to adopt the revisions to the credit for reinsurance models, but if it chooses to reduce reinsurance collateral requirements the state law must be substantially similar to the key elements of these revisions). Similarly, the notification provisions with respect to reinsurance concentration risk are only required to be adopted by those states which adopt reinsurance collateral reduction. The revised standard was considered and adopted on an expedited basis and became effective immediately. The Task Force will consider developing revised standards for Part B: Practices and Procedures during 2013 for recommendation to the Financial Regulation Standards and Accreditation (F) Committee.

48. The revised models require that an NAIC process will be developed to evaluate the reinsurance supervisory systems of non-U.S. jurisdictions, for the purposes of developing and maintaining a list that includes any such jurisdiction that is recommended by the NAIC for recognition by the states as a qualified jurisdiction in accordance with the revised credit for reinsurance models. Under the revised models, states are required to consider this list and must provide thoroughly documented justification if approving a jurisdiction not on the NAIC list.
49. On April 4, 2012, the Reinsurance Task Force established the Qualified Jurisdiction Drafting Group to develop a process to 1) review non-U.S. jurisdictions, including consideration of budgetary and resource requirements; 2) determine which jurisdictions will be reviewed initially; and 3) develop an implementation timeline. During the 2012 Fall National Meeting, the Task Force released an initial draft NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions for a 45-day public comment period ending January 16, 2013. Interim discussion will be planned to consider any comments received. The evaluation of non-U.S. jurisdictions under the draft process is intended as an outcomes-based comparison to financial solvency regulation under the NAIC Accreditation Program, adherence to international supervisory standards, and relevant international guidance for recognition of reinsurance supervision. It is not intended as a prescriptive comparison to the NAIC Accreditation Standards, although the Accreditation Standards figure prominently in the assessment methodology. It is intended that process for developing and maintaining the NAIC List of Qualified Jurisdictions will be implemented in 2013.
50. The *Preface to the Credit for Reinsurance Models* provides that the NAIC will form a new group to provide advisory support and assistance to states in the review of reinsurance collateral reduction applications. This process is intended to strengthen state regulation and prevent regulatory arbitrage. On April 4, 2012, the Task Force established Reinsurance Financial Analysis Working Group (FAWG) Drafting Group to develop the processes applicable to the new Reinsurance-FAWG. The drafting group established a mission statement and charges for the Reinsurance-FAWG, and developed a Procedures Manual to document the processes necessary to enable the working group to best fulfill its charges and assist states in this area. Consistent with other NAIC FAWG groups, the Reinsurance-FAWG will operate in Executive Session in accordance with the *NAIC Policy Statement on Open Meetings*, and its Procedures Manual will be maintained as a regulator-only document. The Reinsurance-FAWG process is designed to facilitate communication of relevant information between the states with respect to individual reinsurers or reinsurance-related issues, as well as multi-state recognition of a certification. It is important to note that it is not within the authority of the Reinsurance-FAWG to assign ratings or collateral requirements for individual reinsurers. The authority to issue individual ratings of certified reinsurers is reserved to the NAIC member jurisdictions under their respective statutes and regulations. The Reinsurance-FAWG procedures will be implemented in 2013.
51. To date, 11 states have adopted reduced reinsurance collateral provisions—these include Florida, New York, New Jersey, Indiana, Virginia, Connecticut, California, Delaware, Georgia, Louisiana and Pennsylvania. It is important to note that insurers domiciled in these 11 states wrote approximately 40% of the direct premium in the U.S. in 2011, so adoption in these 11 states represents a significant portion of the U.S. market. Several additional states have indicated they plan to adopt the models, and it is understood that several of these intend to include proposed revisions within their 2013 legislative packages. Florida and New York are currently the only states that have approved any reinsurers for collateral reduction. The NAIC will continue to monitor implementation of these models and provide updates on a periodic basis.
52. It should be noted that credit for reinsurance requirements, including collateral, within the U.S. and EU insurance supervisory systems continue to be the subject of discussion within the ongoing U.S./EU Dialogue. This dialogue includes representatives from the NAIC, FIO and the EU. Further updates with respect to this dialogue will be provided as information becomes available.
53. Regulators may also consider whether modernization of risk transfer requirements applicable to life reinsurance is appropriate. The Reinsurance (E) Task Force will coordinate these considerations with the Life Actuarial (A) Task Force and Health (B) Actuarial Task Force.
54. The following identifies the timeline for reinsurance modernization activities:
- Provide guidance to the Financial Regulation Standards and Accreditation (F) Committee with respect to key elements of the revised Models #785 and #786 for the purposes of the Financial Regulation Standards and Accreditation Program: Completed 2012

- Develop recommendations for standards under Part B: Regulatory Practices and Procedures within the NAIC Financial Regulation Standards and Accreditation Program with respect to revised Models #785 and #786: 2013
- Finalize and implement an NAIC process to evaluate the reinsurance supervisory systems of non-U.S. jurisdictions for the purposes of developing and maintaining the NAIC List of Qualified Jurisdictions: 2013
- Implement the Reinsurance-FAWG procedures in order to enable the working group to provide advisory support and assistance to the states in the review of reinsurance collateral reduction applications: 2013
- Begin re-examination of the collateral amounts included in the revised Model #785 and #786: November 2013

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

#### **SMI Task Force**

56. The SMI (E) 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.

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

57. 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.

58. The Solvency Modernization Initiative (E) Task Force is drafting a white paper to explain the U.S. financial regulatory framework and how and why it works successfully. The draft SMI white paper, *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative* provides an overview of the current U.S. Framework; an evaluation of U.S. market competitiveness, considering the U.S. regulatory mission; a more detailed description of financial regulation and regulatory tools used in the Framework; and an elaboration on expected SMI changes to the Framework. In light of comments received from interested parties, the Task Force redrafted the first four sections of the white paper, leaving the final SMI section for last, awaiting additional consideration of some SMI policy decisions.

59. At the end of the SMI process, regulators will determine whether the Solvency Modernization Initiative (E) Task Force should make changes or revisions to the *U.S. Insurance Financial Solvency Framework and Core Principles* to reflect the work of the SMI.

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