

# THE BARNERT REPORTS™

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## Around the NAIC

These meetings are becoming a little surreal, what with entertainment at the Opening Session in place of topical speakers that used to be the norm and roving reporters interviewing and photographing attendees for publication in the NAIC's daily news releases. One would think, with the serious issues facing state insurance regulation, the NAIC's resources could be put to better use. But perhaps this was just a respite for the upcoming meeting in Washington, DC where efforts are underway to pre-empt state regulation via the creation of an optional federal charter, small business health plans, and other health insurance "reforms."

The March meetings are used to lay out the work for the coming year through adoption of committee charges and creation of working groups to implement them. One of the most important achievements anticipated for 2006 is implementation of the Interstate Compact to facilitate approval of national life, annuity, and long-term care insurance products. This year should also see an end to the SOx war with adoption of a revised Model Audit Rule, and increasing international interactions, in recognition of the probability that international accounting standards would ultimately be incorporated into US GAAP and the need to resolve the long-running debate over credit for reinsurance requirements for non-US unlicensed reinsurers.

## NAIC/Industry Liaison Committee

The industry devoted this meeting to international issues it would like the NAIC to address.

**Reinsurance Collateral:** The industry asserted that the burden of proof should be on the non-US, non-licensed reinsurers that their proposal for an alternative to the current credit for reinsurance rule requiring collateral would be at least as effective in protecting solvency as the current system and would not expose claimants to potentially unpaid claims. Sonia Larkin Thorne (Hartford) pointed out the regulations that non-US reinsurers are exempt from, including financial reporting, RBC, loss certification, and holding company transaction reporting, and

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**Financial Condition (E) Committee**

- Capital Adequacy (E) Task Force
- PROPERTY RISK-BASED CAPITAL (E) WORKING GROUP
- LIFE RISK-BASED CAPITAL (E) WORKING GROUP
- Valuation of Securities (E) Task Force
- Accounting Practices and Procedures (E) Task Force
- INTERNATIONAL ACCOUNTING STANDARDS (E) WG
- EMERGING ACCOUNTING ISSUES (E) WORKING GROUP
- STATUTORY ACCOUNTING PRINCIPLES (E) WORKING GROUP
- BLANKS (E) WORKING GROUP
- Examination Oversight (E) Task Force
- Receivership and Insolvency (E) Task Force
- Reinsurance (E) Task Force
- International Solvency Initiatives (E) Working Group
- Risk Assessment (E) Working Group
- NAIC/AICPA (E) Working Group
- Financial Examination Modernization (E) Working Group

**Financial Regulation Standards and Accreditation (F) Committee**

**International Insurance Relations (G) Committee**

- International Regulatory Cooperation Working Group
- International Holocaust Commission Task Force
- NAFTA Working Group
- NAIC International Insurance Symposium

11 dismissed efforts to characterize this as a  
 11 trade issue, arguing that the collateral rule  
 11 did create an unlevel playing field. Finally  
 11 the industry repeated the argument heard  
 11 many times during this long running dispute  
 12 that the requirement to post collateral could  
 12 be avoided by becoming licensed US  
 12 insurers.  
 13 Kevin Harris (NCIGF) asserted that the  
 15 unavailability of collateral would increase  
 17 the cost of insolvencies that would have to  
 18 be covered by guaranteed funds because the  
 18 receivers would need to start collection  
 19 proceedings overseas. To put a number on  
 19 the problem, Harris noted that the guarantee  
 20 funds had, over the last five years, been  
 21 responsible for claims totaling \$14 billion of  
 which about half remained unpaid.  
 21 Approximately 20% or \$1.4 billion of the  
 22 outstanding claims was reinsured by non-US  
 23 reinsurers.  
 23 Superintendent Alessandro Iuppa (ME)  
 24 agreed that this is not a trade issue and  
 stated the NAIC intended to resolve it before  
 the end of this year. He announced that the

Reinsurance Task Force would be given a charge to this effect. He asked the industry to come to the table ready to discuss alternatives that would continue to protect consumers through solvency. The new charge was later approved at the Executive/Plenary meeting.

Transparency: Dave Synder (AIA) recognized Iuppa for his efforts to open up IAIS meetings but noted that since it was now left to committee chairs to decide, it is mostly committees chaired by US regulators that are opened. He asked the NAIC to continue to work for a rule requiring open meetings.

China has just issued a new reinsurance rule which will go into effect in one month without providing an opportunity to comment. Synder asked the NAIC to push for transparency rules in all countries. Iuppa replied that he had attended a meeting the previous day with European counterparts (the EU-US Dialogue) and had asked for their support for adoption of uniform administrative procedures rules.

International Financial Accounting Standards and Solvency: Synder expressed concern with the direction of this effort in Europe and its impact on the US. Steve Broadie (PCI) noted that the international accounting standards were already in effect in the EU. He is concerned with two ongoing projects, Phase II which is developing standards specific to insurance and an agreement between the IASB and FASB to converge their standards and merge the international standards into US GAAP to the extent possible. These revised GAAP standards will be required for reporting purposes by all publicly traded companies. The NAIC will then need to consider them for incorporation into statutory accounting and Broadie believes there will be strong pressure to adopt them.

There are also two committees at the IAIS that may impact the regulation of insurance. Rob Esson (NAIC) chairs one, the IAIS Insurance Contracts Subcommittee, and the second is the Solvency and Actuarial Subcommittee on which Commissioner Al Gross (VA) is a member. Both are developing best practices and again there may be considerable pressure for the US to adopt.

Broadie stated PCI appreciates the NAIC's commitment to remain involved with the IAIS and that "E" Committee has a group working with the IASB and has just established the International Solvency Issues Working Group to work with the IAIS on development of its solvency standards. However, he emphasized that time is short and the NAIC and individual commissioners need to do more to influence outcomes.

Market Liberalization Development: Synder stated the industry's appreciation of the NAIC's efforts to help promote the creation of competitive insurance markets in developing countries. He pointed out the social benefits of these activities - expanding the availability of insurance, freeing up governments to pursue other important governmental objectives, increasing capital that can be used for infrastructure development, and promoting risk reduction and safety.

NAFTA: Synder urged the NAIC to continue its efforts to fully implement NAFTA with respect to cross-border trucking operations between the US and Mexico.

### **NAIC/Consumer Liaison Committee**

Medicare Part D: Bonnie Burns (California Health Advocates) made a lengthy presentation describing the implementation problems with Medicare Part D. Her main purpose was to try to enlist the commissioners' help in a campaign to convince Congress to extend the enrollment period past the May 15th deadline or at least eliminate or delay the imposition of penalties for late applications and to obtain some limited regulatory powers over the sellers of the plans and their sales forces.

With regard to the May 15th deadline, Burns disputed the Administration's claims that millions have signed up, noting that only five million enrollees were not previously covered by a drug plan and there are millions who have not signed up. Much of the delay can be attributed to the difficulty of selecting a plan. Seniors trying to decide which plan best meets their needs are overwhelmed. In one California County there are 75 plans all with different drugs list and different rules. She emphasized that this is not just a start-up problem. All future retirees will be faced with the same confusing choices.

Concerning regulatory oversight, Burns highlighted the states' very limited powers. They have no authority over the Part D plans or the companies that sell them unless the company happens to be a licensed insurer. Their consumer services divisions can do very little to resolve problems seniors bring to them. The law makes it very difficult to regulate the producers or even to enforce licensing laws. Agents are using Part D to gain entrance into the homes of seniors and pitch other products. On this issue an assistant commissioner from Puerto Rico reported that her department and California have issued orders requiring all producers to be licensed. She urged the NAIC to work through the Senior Issues Task Force to convince CMS to clarify producer licensing requirements and to require that at least one state have jurisdiction over each plan that the other states can go to for help with their residents' complaints.

States' revenues are also impacted. Besides the expenses incurred to fill in the gaps in coverage that have resulted for the dually-eligible, the federal government is reducing its payments to states by the amounts they are supposedly saving as a result of Part D. In addition states may not collect premium taxes on sales of Medicare Part D.

Response to the 2005 Hurricanes: The Consumer Advocates were very complimentary of the response of the insurance departments, especially the Louisiana Department. However, the purpose of this presentation was to draw attention to the problems the hurricanes have exposed in the catastrophe insurance system. In Texas, thousands of people were required by the state to evacuate their homes and were not permitted to return home for several weeks after Rita struck. When they applied to their homeowners insurers for reimbursement for temporary living expenses those whose homes had not been damaged were denied. Texas is now trying to force the insurers to pay but the advocates are calling for all risk policies so that policyholders are not left bare for specific perils they thought they had protection for.

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With respect to health insurance, within weeks after Katrina, displaced people were threatened with the loss of health insurance that had been provided by their employers who had been forced to close down. Others were unable to pay their premiums because they had no incomes. Residency requirements in the states evacuees had ended up in prevented them for qualifying for high-risk pools. At the same time the need for health care greatly increased. Mila Kofman (Georgetown University) characterized the US health insurance system as “like an umbrella that melts in the rain.” Louisiana has mitigated these problems where it could be issuing emergency rules. Among other things, the rule prohibited cancellations for non-payment of premiums, premium increases, late charges, or interest charges and offsetting claims payments with premiums due.

Bill Newton (Florida Consumer Action Network) spoke of some of the insurance problems experienced by Florida homeowners. Insurers refused to pay for fully insured homes based on a probable cause not covered in the policy. This issue is now in the courts. Rates have “gone through the roof,” many policies are being non-renewed and insurers are abandoning markets. Newton charged that insurers have abandoned the basic tenant of insurance - spread the risk. He suggested that continued coastal development is unsustainable unless insurance remains available and building codes alone will not solve the problem. One remedy he suggested was protection of barrier islands and wetlands.

Shyanna Smith (National Fair Housing Alliance) was very critical of the plan Mississippi Governor Haley Barbour has announced to distribute federal block grant money in the form of \$150,000 grants to homeowners who had insurance. Left out are landlords who provided housing to low income people and the uninsured who in many cases had found the cost unaffordable because of insurers' use of credit scores in underwriting. Many of these people are seniors living on fixed incomes who many times have to choose which bills to pay.

Birny Birnbaum (Center for Economic Justice) praised the NAIC's project to develop a national catastrophe response and enumerated the provisions he believed essential:

- o Loss mitigation, including stronger building codes and controls on the causes of climate change;
- o All-risk coverage that would include everything - flood, wind, hail earthquake, terror, etc.;
- o Assistance for low income consumers; and
- o A federal backstop.

Commissioner Kevin McCarty (FL) replied that the plan under development addresses his concerns and attributed much of today's problems on the creation of the National Flood Insurance Program in 1968 and the out-of-date maps it is based on. He believes that all-risk policies should be available but insureds should be free to buy less provided they are not compensated after an uninsured event. He believes it is a bad policy to force insurers to pay where there was no coverage and in his state most insurers acted responsibly.

Birnbaum responded that it is a bad policy to let insureds choose the perils and that all policies should be all-risk.

Association Health Plans: Kofman reported that Senator Mike Enzi's compromise bill, the Health Care Insurance Marketplace Reform Act (S.1955), was scheduled for mark-up on Wednesday. She stated the new version, the Chairman's mark, was just as dangerous for consumers and state regulation as the original. It pre-empts small group reforms in over 30 states (key reforms that protect the most vulnerable populations, such as business with sicker and older workers). In addition, Small Business Health Plans (SBHPs) that the Act would create are permitted to have their own rating pool, meaning their experience would not be combined with other small group experience. The combination of these changes would most probably cause the cost of health insurance for those excluded from SBHPs to become even more unaffordable. It exempts SBHPs from all coverage mandates. It would enable fraud through self-certification. It allows SBHPs to sue states in federal courts and denies consumers the right to sue. It guts state enforcement by exempting SBHPs from form and rate filing requirements and market conduct oversight.

Kofman told the commissioners that if they want to stop S.1955 they need to act now and strongly oppose it. She stated that the NAIC has enumerated seven principles to evaluate federal health insurance reform proposals

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and Enzi's bill fails all seven as it does nothing to address rising health care costs, it deprives consumers of their existing states' rights, it does not support state reforms and assistance programs, and it does not protect the less healthy but rather permits surcharges.

Commissioner Mike Kreidler (WA) asked Kofman if she believed SBHPs would be good news for the young and healthy. Kofman cited New Hampshire's experience when it deregulated part of its market based on the promise of lower rates. Rates went up, it became unaffordable for small businesses and last session the New Hampshire legislature restored its community rating law.

Administrator Joel Ario (OR) defended the NAIC's decision to not oppose the bill in order to retain its seat at the table and acknowledged its many shortcomings although he believed it might not pre-empt all states' small-group reforms and anticipated there would be strong opposition to its rating provisions. In effect he said, yes it's a bad bill but it's not as bad as the original. He believes the NAIC still has an opportunity to improve it.

Rick Baum (CA), however, agreed with Kofman. He stated it's easy to lower rates (using Enzi's approach). In California low cost policies are available to the young and healthy but they do not cover anything. His department believes all-peril coverage is the way to go and that now is the time for regulators to take a stand. He urged the NAIC to take action at this meeting to develop a complete and unified response.

NAIC Databases: Birnbaum stated that he agreed with concerns raised by NAMIC with respect to recent database activity at the NAIC, namely concerns with the lack of transparency, assertions by the NAIC of ownership and control, proposals for databases that duplicate existing private sector databases, representations that NAIC databases are not subject to federal or state freedom of information laws, privacy laws, etc, and expectations that the databases will be paid for by the industry. Birnbaum supports increases in the collection by state regulators of market conduct data. However, he proposed that the states should designate statistical agents and allow the NAIC to compete with other entities so it would be accountable to the states that would be free to designate another entity. Brendon Bridgeland (Center for Insurance Research) agreed and added his concern with the continuous reductions in the portion of annual statement data available to the public.

Market Conduct Model Act: Birnbaum commented on the recent action by NCOIL to abandon the joint market conduct model and begin consideration of the Texas law which he stated had gutted the model. He felt betrayed that this should occur after he had supported efforts to develop the joint model. He urged the NAIC to go back to its original model. Susan Nolan (NCOIL) responded, stating that NCOIL had taken this action because no commissioner has supported passage of the joint model.

## **Joint Executive Committee and Plenary Meeting**

With the exception of the following items which were considered separately, the Joint Executive/Plenary adopted by consent the Committee and Task Force minutes of the 2005 Winter National Meeting held in Chicago.

The Joint Executive/Plenary adopted the following without debate:

- o An amended Modified Guaranteed Annuity Regulation to bring it in line with the recently adopted revisions to the model Standard Non-forfeiture Law and to make it consistent with the model Variable Annuity Regulation.
  - o An amended Risk-Based Capital for Insurers Model Act to incorporate a P/C trend test that would trigger the company action level when the combined ratio is greater than 120% and RBC is between 200 and 300. The test was required beginning with 2005 yearend RBC reports but is currently informational only. Enactment of the amended model would empower a commissioner to act if the test triggers the company action level.
  - o An extension of the sunset date for the Actuarial Guideline XXXIX: Reserves for Variable Annuities with Guaranteed Living Benefits to 1/1/08. The extension is needed to give the NAIC more time to develop new reserve requirements for variable annuities with guaranteed living benefits. The extension keeps the current guidelines in place while work continues on the revisions.
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- o The joint IAIBC/NAIC Workers' Compensation Large Deductible Study. This study was undertaken to identify problems and concerns with the growing practice of marketing workers' compensation coverage with large deductibles.
- o The U.S. Reinsurance Collateral White Paper. This paper was authorized to help the NAIC determine if the current credit for reinsurance rules should be revised as requested by non-US, non-licensed reinsurers. The NAIC has committed to resolving this festering issue by yearend 2006. At this Plenary session a new charge was given to the Reinsurance Task Force requiring it to consider approaches that take into account a reinsurer's financial strength and to consult with international regulators in addition to the usual Interested Parties.
- o The Uninsured Motorists: A Growing Problem for Consumers White Paper. The industry had objected to a recommendation for a "standardized national database system" in an earlier version of this white paper. The one presented at this meeting to Plenary by "C" Committee replaced the objected to recommendation with one calling for a "cost effective uniform approach".
- o The National Flood Insurance Program White Paper. This white paper examines responses of the National Flood Insurance Program for catastrophic floods occurring in 2003 and 2004 and recommends improvements.

Superintendent Iuppa gave the report of the EX 1 Subcommittee. Actions of significance include:

- o The creation of the NAIC Insurance Regulator Designation Program, which provides for three designation levels.
- o A direction to "C" Committee to continue to explore the feasibility of an insured vehicle identification network that is intended to track vehicles nationwide in coordination with police departments and state insurance and motor vehicle departments.
- o It heard a report on the results of an RFP for a Receivership Integrated Technology Application (RITA) intended to make the administration or receiverships more efficient and cost-effective.
- o It provided a grant of \$500,000 to allow the Interstate Compact Commission to set up its operations.

Under "Other Matters," Commissioner Jim Poolman (ND) requested that that "A" Committee be given a new charge to amend the Senior Protection in Annuity Transactions Model Regulation to make it applicable to all annuity transactions. The current model only applies to persons 65 and older.

### **Interstate Compact Implementation (EX) Task Force**

Commissioner Diane Koken (PA) announced that Wyoming was about to become the 21st compacting state; Wyoming's law had passed earlier in the day and was awaiting the Governor's signature. Only five more states are needed to activate the Compact and it has been introduced in 15. The Task Force is confident that the threshold will be passed this year and much needs to be done in order for the Compact Commission to begin operations.

The Task Force was advised that the Commission would need to follow the states' administrative acts which required notice of the proposed by-laws by publishing them, allowance of time for written comments, possibly a hearing, and consultation with state legislators. Among the steps that had to be undertaken include:

- o Create a legislative committee, an industry advisory committee, and a consumer advisory committee;
  - o Determine the make-up of an interim Management Committee in accordance with the rules set out in the enabling legislation;
  - o Develop a job descriptions for an executive director and supporting staff, operating procedures and fee structures;
  - o Create a preliminary budget; and
  - o Finalize and adopt by-laws in accordance with the Model State Administrative Procedures Act.
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Two working groups were created to flesh out these issues and non-compacting states were invited to participate. The Interstate Compact National Standards Working Group suggested that even after the Compact becomes effective it could continue to develop standards and supporting documents such as checklists and product identifiers. SERFF made a presentation describing what needed to be done if the Commission decides to use SERFF to receive filings.

### **Meeting of Compacting States**

Commissioner Diane Koken (PA) was elected to chair the meeting. The States discussed organizational issues. Staff noted that there is a National Center for Interstate Compacts that might be able to assist the Commission to get organized. NIPR could also provide some insight based on its start-up experience ten years ago. They will also reach out to NCSL and NCOIL to create a legislator advisory committee.

As was done for NIPR, the NAIC has made a grant of \$500,000 to allow operations to begin before revenues (filing fees) start coming in. The States considered how the office (to be housed initially at the NAIC Washington DC office) would initially be staffed and agreed job descriptions would need to be developed, especially for an executive director, as this position should be filled before operations began. Staff had developed a draft budget proposal that provided for an executive director and for two rate and form analysts. It assumes the NAIC will provide back office support for such things as accounting, legal, human resources, and technology. The states will consider whether to hire or contract out for actuarial services.

The by-laws will be reviewed to determine the make-up of an interim management committee that will be formed at the June meeting. A timeline for implementation will also be considered in June.

The 2005 annual report has been sent to the Governors of the compacting states.

### **Speed to Market (EX) Task Force**

#### **INTERSTATE COMPACT NATIONAL STANDARDS (EX) WORKING GROUP**

Richard Robleto (FL) chairs this Working Group. He reported that no new standards were developed at this meeting. The Working Group is close to completing work on several riders to life products, including an accelerated death benefit rider. It has begun work on "incidental products" that are not covered by the scope of the Compact. It is also reviewing the Annuity Non-forfeiture Model Regulation to determine if any changes were needed to previously adopted product standards.

The Long-Term Care Subgroup is continuing to work on standards for rating rules and is also considering developing standards for advertisements for disability income products.

#### **PERSONAL LINES MARKET REGULATORY FRAMEWORK (EX) WORKING GROUP**

The Working Group heard comments from the industry and consumer advocates on the direction this project should take. The industry urged the Working Group to allow competition to determine rates. The consumer advocates expressed concern that consumers lacked the knowledge and information that is the basis of competition and suggested file and use for rates and prior approval for rate classifications and forms.

#### **OPERATIONAL EFFICIENCIES (EX) WORKING GROUP**

This Working Group is drafting a Product Filing Examiner's Handbook, the goal of which is to achieve consistency in the states review of product filings. The Working Group's members have been asked to review this draft and provide comments by the end of March. An exposure draft will be released in June.

### **Life Insurance and Annuities (A) Committee**

"A" committee is chaired by Commissioner Jim Poolman of North Dakota. The Committee passed revisions to the Senior Protections in Annuity Transactions Model Regulation. The re-titled model regulation will expand its application to all annuity purchasers.

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There will be a hearing regarding life settlements and premium financing in an interim in New York, tentatively scheduled for the end of May. The Committee will also form a subgroup on the use of travel in life underwriting in order to stay ahead of the regulatory curve on the issue.

The Committee then adjourned to a joint meeting between it and “D” Committee to hear presentations by Advantage Compendium, Ltd. and the State of Iowa on indexed annuities. These products remain a small but important part of the market that has experienced considerable growth in the last two years. The regulators from Iowa related their positive experience contacting the major companies in their state and in Minnesota (who together are home to the top six writers) in order to discuss the need for additional regulation. The regulators recognized that indexed annuities would be important to some investors while at the same time may be unsuited to others. The discussions resulted in agreement between the regulators and companies on suitability, producer training, and other regulatory initiatives that the companies involved have agreed to implement not only in Iowa and Minnesota but in every state.

### **Life and Health Actuarial Task Force**

The Life and Health Actuarial Task Force, under the leadership of Michael Batte (NM) met, as it traditionally does, the two days before the NAIC meeting began. The Task Force approved the minutes of its interim conference calls.

The Task Force began with *C-3 Phase II Work and Variable Annuity Reserves and Actuarial Guidelines*. Bill Carmello (NY) reviewed changes to the Actuarial Guidelines, which New York had presented in January, calling for an optional value floor, standard scenario assumptions, revenue sharing restrictions, and a Conditional Tail Expectation (CTE) of 75. The American Academy of Actuaries (AAA) opposed these changes. Carmello said that if stochastic modeling is done conservatively, the results would be higher than the standard, but he thinks the floor is necessary especially for variable annuities. Tom Campbell (AAA) said he had met with the New York Department to discuss its concerns regarding the pre-tax implications and the shock scenarios. Carolyn Stontz (Life Investors) expressed concerns about the additional costs and extra time such testing would require. There will be an interim conference call in early April to work on the less controversial issues in the draft and a subsequent call in May to look at the key issues raised by the New York Department. The chair said the goal was to have LAHTF consider the Guidelines in June 2006 and the NAIC to act in September 2006.

SOA-AAA Project Oversight Task Force: A proposal for interim reserve changes for certain products, developed by Towers Perrin Tillinghast, was presented by Paul Graham (ACLI) along with a legal opinion regarding the use of such standards. The NAIC legal counsel is currently preparing its own legal opinion. Several members of the Task Force expressed concerns regarding the use of tables which had not been reviewed by an independent body and asked the Society of Actuaries (SOA) to review the proposal. AAA and SOA continue to work on the Interim Table for Preferred and Standard Mortality Classes and expressed concern that any additional work would detract from the longer term project. Larry Gorski (AAA) indicated that 49 companies had submitted data for review and said they expect to have a product by March 2007. The Task Force charged the Society of Actuaries with conducting a peer review of the ACLI data, the specific charge to be approved in a conference call.

SVL 2 Subgroup: Larry Bruning (KS) presented an overview of Standard Value Laws (SLV) in order to allow principles-based valuation. This presentation was the subject of an AAA web cast. The next web cast will be March 22 at 12 noon. Bruning said that under a principles-based system, regulators will have to collect data in order to evaluate individual company submissions. The Task Force also discussed Principles-Based Approach (PBA) Reviews. Donna Claire (AAA) said the Society of Actuaries hopes to have white papers on PBA Review and governance by June 2006.

AAA Life Reserves Working Group: The Task Force heard a presentation by Tom Kalmach and Dave Neve (AAA). The session focused upon considerations for setting assumption margins under a principles-based system. The Life Reserve Working Group of the AAA is exploring the use of a number it is calling “Z” to

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provide for the quantitative comparison of the aggregate impact of all assumptions, where Z represents the amount by which the pre-tax return on capital is expected to exceed the return in invested assets. Kalmach also presented the results of modeling reserves on a 20-year level premium term product. Carmello expressed concerns regarding federal income taxes, reserving, discount rates, aggregation, mandated reporting requirements, fair value disclosure, and overly optimistic estimates. He proposed language to impose a penalty if a regulator believes that the company was overly optimistic in its estimates. The ACLI also raised concerns with the AAA proposal regarding the tax implications and large deterministic reserves.

Accident and Health Working Group: The report of the Working Group was accepted with New York opposing the report. The Working Group adopted changes to long-term care exposure reporting forms, SSAP 59, and the health reserving guidance manual.

CADTF/LHATF Joint Subgroup: Bill Carmello (NY) reported that the Subgroup had examined the peer review process and was developing governance rules for company boards requiring them to establish oversight of the risk management systems, validation, and controls.

The Task Force agreed that “E” committee should look at this issue since corporate governance was not limited to actuarial issues. Carmello agreed with the caveat that if “E” Committee did not act, the Subgroup would push forward with its recommendations since these governance rules were necessary for a principles-based system.

AAA Non-Forfeiture Working Group: Dave Sandberg (AAA) said the Academy was preparing a white paper and would have a report by June. Industry representatives said the AAA was not making progress. Sandberg said that companies must be able to provide a cash option or other vendors would step into fill the gap. The Task Force expressed a desire to resolve this issue quickly.

AP&P Manual: Sheldon Summers (CA) raised concerns that some companies are taking reserve credits that are greater than the direct reserves they establish. He recommended changes to SSAP 51, 61 and the AP&P Manual to correct this. The changes were exposed for a 45-day period at which time they will be discussed on a conference call and submitted to Statutory Accounting Principles Working Group for review.

Actuarial Guidance ABC: The report was adopted.

Charge 11- Actuarial Opinions: Blaine Shepherd (MN) will pull together information on the feasibility of incorporating actuarial opinions into electronically filed statutory annual statements.

## **Property & Casualty (C) Committee**

Commissioner Kevin McCarty (FL), the Committee chair, introduced a representative of the General Insurance Association of Japan who gave a presentation explaining how Japan has addressed the risk of catastrophic loss. For natural catastrophic risks other than earthquake (typhoon, flood, windstorm, etc.) insurers place five percent of their net premiums written into tax deductible reserve accounts until they reach the expected maximum loss from a 1 in 70 year event. For earthquake risk the yearly contribution to a catastrophe reserve is treated as an expense. There is also catastrophe reinsurance, a third of which is covered by the government, a third by direct writers, and a third by reinsurers.

The presenter identified three characteristics of an effective program to address catastrophic risk:

- o It must improve the security of insurer solvency;
- o The government must share in the risk; and
- o It must include a public awareness program on risk mitigation.

To accomplish the last Japanese companies engage in consumer education.

Dave Synder (AIA) made the point that in Japan only the earthquake component of homeowners insurance is subject to prior approval.

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### **Casualty Actuarial (C) Task Force**

The Task Force formed a subgroup to provide comments on a recommendation by the P/C Line of Business Subgroup to add a line to the Blank for warranties and to consider a request by Commissioner Tim Wagner (NE) to modify the actuarial certification of reserves for motor vehicle service contracts.

The Workers' Compensation Large Deductible Subgroup is developing a proposal for presentation in June to respond to recommendations in the Workers' Compensation Large Deductible Study.

The Intercompany Pooling Subgroup is investigating the increased use of pooling arrangements that result in the elimination of schedule P reporting for all but the parent company.

The Task Force will work with the Academy of Actuaries on enhanced risk-focused surveillance and risk transfer measurements for reinsurance contracts.

On the international front, the Task Force considered setting up a subgroup to review and comment on proposals of the IAIS that impact financial reporting.

### **Catastrophe Insurance (C) Working Group**

McCarty also reported on the activities of this Working Group. The Working Group discussed additions and revisions to the NAIC Comprehensive Catastrophe Insurance Plan. He announced that Superintendent Howard Mills (NY) would be holding a meeting of the Terrorism Insurance Implementation Working Group in New York at the end of March and that since the membership was similar to the CAT Working Group he was planning a meeting in conjunction with Mills.

The Working Group heard a report on bills recently introduced in Congress to deal with natural catastrophes, including H.R. 846, the Homeowners Insurance Availability Act of 2005, which would establish a reinsurance mechanism to improve availability and H.R. 2668, the Policyholder Disaster protection Act of 2005 that would permit insurers to establish tax-free catastrophe reserves.

### **Terrorism Insurance Implementation (C) Working Group**

The Working Group heard from David Brummond who is with the US Treasury office of Terrorism Risk Insurance Program (TRIP) to begin discussion of a long-term solution to insurance for acts of terrorism. Brummond reviewed the provisions of the Terrorism Risk Insurance Extension Act of 2005 (TRIEA) that cut back on the types of insurance covered and significantly raised the amount of losses that would have to be absorbed by the insurance industry. Interim guidance has been published and is available on the TRIP web site.

The principle differences between TRIA and TRIEA include:

- o Elimination of several lines of business (commercial auto, farmowners, burglary and theft, surety, and professional liability) and the addition of D&O liability;
- o Raising the trigger from \$5 billion (under TRIA), to \$50 billion in 2006 and \$100 billion in 2007;
- o Increasing the mandatory recoupment of federal payouts from \$15 billion under TRIA, to \$25 billion in 2006 and \$27.5 billion in 2007;
- o Increasing the company deductible from 15% (under TRIA), to 17.5% in 2006 and 20% in 2007; and
- o Above the deductible, maintaining co-payments at 10% in 2006 but increasing them to 15% in 2007.

TRIEA requires the President's Working Group on Financial Markets (PWG) to develop long-term solutions in consultation with the NAIC and the industry. PWG is chaired by Treasury Secretary John Snow, and the others are the SEC chair, Christopher Cox, the Federal Reserve chair, Ben Bernanke, and the Commodity Futures Trading Commission chair, Reuben Jeffery.

Superintendent Howard Mills (NY) announced a hearing to be held in New York City in late march to consider long-term solutions.

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**Uninsured Motorist (C) Working Group**

This Working Group is newly formed and met for the first time. It will be working with the American Association of Motor Vehicle Administrators (AAMVA) to develop a national system to improve the identification of uninsured motorists. It will begin by studying systems already in place in several states.

**Financial Condition (E) Committee**

The Financial Condition Committee chaired by Commissioner Al Gross (VA) heard the reports of the following subgroups.

**Capital Adequacy (E) Task Force**

The Capital Adequacy Task Force (CADTF) meeting was chaired by Lou Felice (NY). The interim conference call minutes were adopted, including the underwriting risk factors for Medicare Part D prescription drug coverage that had previously been released for comment.

**PROPERTY RISK-BASED CAPITAL (E) WORKING GROUP**

The Property Risk Based Capital Working Group met with the Catastrophe (C) Working Group to discuss ways in which the catastrophe models might be incorporated into the RBC formula. Updates on the property/casualty trend test data was distributed to the regulators.

**LIFE RISK-BASED CAPITAL (E) WORKING GROUP**

The Task Force adopted the report of the Life RBC Working Group with clarification to the C-3 Phase I expansion instructions that the Working Group had released for comment. The Working Group received a report from the American Academy of Actuaries (AAA) regarding modified co-insurance dividend liabilities. The AAA will be drafting instructions for that proposal and the changes to the instructions as a result of C-3 Phase II by conference call at the end of March. If the changes are adopted at the Summer NAIC meeting, a yearend 2006 effective date is still possible for C-3 Phase I, C-3 Phase II and modified coinsurance. C-3 Phase III was also discussed and the AAA was requested to provide a description of the expected result of the project.

C-3 Phase II Results Subgroup provided a report to the Working Group summarizing the results of the survey on variable annuities. A sample of companies has been selected for a second survey. In addition, the AAA was asked to provide results on its own survey on C-3 Phase II. The " provided a report on its activities including discussion of a draft of governance procedures for review of reserve models. (*See the report of the Life and Health Actuarial Task Force in the A Committee*)

The Task Force working agenda for 2006 was adopted as modified to add a reference to international solvency issues in charge number 22. A conference call will be held to discuss issues related to international solvency and to consider the formation of a subgroup for review of those issues.

The E Committee approved the Task Force's request that it be made a standing task force.

**Valuation of Securities (E) Task Force**

The Task Force met on Sunday to discuss its agenda. Mike Moriarty (NY) is the Chairman. First on the agenda was the guidance for principal protected notes (SSAP 43). Moriarty summarized the issue by saying that Interested Parties had provided a draft SSAP and issue paper which the Task Force had exposed in December. The issue was discussed on one of the interim conference calls. On that call, Matti Peltonen (NY) gave an example of a circumstance where a security whose cash flow was significantly deteriorated would not trigger an impairment. Industry requested at the time that New York write up the example and it was provided in the materials for this meeting. Moriarty went on to suggest a course of action different from that adopted by the Task Force previously - to add some of the language proposed by Interested Parties regarding principal protected note impairments and to change "undiscounted" to "discounted" and propose the change as an amendment to SSAP 43.

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Ed Stephenson (BAI for the NALC Investment Committee) suggested that the analysis in Peltonen's memo might not be correct, that it took cost, which is theoretically discounted, and compared it to the undiscounted cash flow. As he understood it, the impairment test was a comparison between the undiscounted cash flow at purchase and a recalculation of the undiscounted cash flow at the time of the comparison. (Later, after reviewing the text of SSAP 43, Stephenson conceded that the language was confusing because the book value is cost, but that the impairment test appears to be a comparison of two other values).

Rose Albrizio (AXA Financial) said that the accounting Interested Parties had just received Peltonen's memo and had not gotten a chance to respond, but that what Stephenson was saying made sense. Moriarty referred to the discussion of discounted vs. undiscounted and asked if the Interested Parties could explain why SSAP 43 securities received the different treatment. Wally Giveler (Northwestern Mutual) responded by saying that cash flows and impairments were different and that one of the probable reasons for the undiscounted impairment tests was the effects of write-down and subsequently realized income on the income statement.

Moriarty agreed to give the Interested Parties time to respond to both his question and Peltonen's memo, and tabled the issue.

Three referrals from the Investment Schedule Subgroup of Blanks were discussed. On the question of whether to unify the definition of a foreign investment or to have companies continue to report in accordance with state law, the Chair requested staff to draft language that would use the same definition as was in the Model Investment Law proposal for consideration of the Task Force. The Task Force adopted the memo written by the SVO explaining its view that it was unnecessary to do summary designations of short-term investments. In the last of the investment schedules items the Task Force also passed the staff recommendation to add three new symbols to indicate whether an SCA's value was determined by the SVO or the reporting company.

The Task Force next heard a report from the manager of SVO research on the work plan for the Derivative Model Regulation re-drafting project. He will look to derivative industry practice and to the federal regulators of the banking industry to determine their practices and report back. Moriarty suggested that the starting point be New York's Derivative Use Plan regulations. Stephenson agreed that the New York approach was consistent with Risk Assessment, suggested the SVO also look at the IAIS and EU Commission work on Solvency II to determine if there should be consistency of treatment and expressed his organization's willingness to work with staff and the Task Force on this effort. Chris Anderson (Merrill Lynch) said that staff should keep in mind that the insurance industry's use of derivatives is limited by statute.

Lastly Bob Carcano (SVO) reviewed the agenda items still pending that were not discussed at this meeting, including surplus and capital notes guidance ongoing guidance on new NRSROs, the NASVA P&P Manual changes and SAPWG referral on LIHTC.

### **Accounting Practices and Procedures (E) Task Force**

The Task Force adopted the following reports from its working groups.

#### **INTERNATIONAL ACCOUNTING STANDARDS (E) WORKING GROUP**

Mel Anderson (AR) chairs this Working Group. The minutes of the conference call to discuss and adopt the comment letter on the IASB/FASB Business Combinations exposure draft were approved.

Rob Esson (NAIC) provided an update on the IASB Insurance Contracts Phase II project. He reported that at the October and November 2005 IASB meetings, education sessions were held on the characteristics of contracts, insurance-linked securities and continuation, reinsurance, and cancellation and renewal options of insurance contracts. There have been no decisions yet on these issues. At the December IASB meeting there will be an education session on participation features in insurance contracts presented by the International Actuarial Association.

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**EMERGING ACCOUNTING ISSUES (E) WORKING GROUP**

## Action on Tentative Positions:

- o INT 03-01- *Application of SSAP No. 35 to the Florida Hurricane Catastrophe Fund*. The position was rejected and INT 03-01 was nullified.

## Action on Outstanding Issues:

- o EITF 04-6 - *Accounting for Stripping Costs Incurred during Production in the Mining Industry*. Not applicable to Statutory Accounting. Tentative - EITF position was rejected.
- o EITF 04-13 - *Accounting for Purchases and Sales of Inventory with the Same Counterparty*. Not applicable to Statutory Accounting. Tentative - EITF position was rejected.
- o INT 00-26 - *Amendment resulting from the issuance of FAS 153*. This item was amended with a non-substantive explanatory paragraph that reflects the amendment to APB 29.
- o *Reinsurance of Separable Benefits* - This item was withdrawn.
- o *Accounting for Revenue as a Result of the Sale of Claims Data to a Pharmacy Benefits Manager (PBM)*. This item was exposed with a tentative consensus.
- o *Accounting and Reporting for Investments in a Certified Capital Company*. Rose Albrizio (AXA), commenting for the Interested Parties, said they do not believe that CAPCOs are within the scope of Issue Paper No. 126. This item was exposed with a tentative consensus.
- o *Classification of Litigation Expense*. Keith Bell (St. Paul Travelers), speaking for Interested Parties, commented that this was an accounting interpretation and the expense is included in policy limits. He does not know what the Casualty Actuarial Task Force can add to that. Nevertheless, this issue was referred to the Casualty Actuarial Task Force.

## Action on Outstanding Issues Previously Addressed:

- o APB 29 Subgroup Progress Report was received.

The comment deadline for items exposed is May 1, 2006.

**STATUTORY ACCOUNTING PRINCIPLES (E) WORKING GROUP**

Joe Fritsch of New York chairs the Working Group. The deadline for items exposed for comment is May 15, 2006. The following actions were taken during the hearing.

**Hearing Agenda**

2005-08, *Issue Paper No. 127-Exchanges of Non-monetary Assets, a Replacement of SSAP No. 28-Non-monetary Transaction* was passed without comment.

2005-17, *Move INT 03-17 disclosure to SSAP No. 55* was tabled in recognition that all of the other sources of disclosure had not yet been considered; that perhaps only paid liabilities should be included; and that the effect on health entities may not have been completely discussed.

2005-18, *Clarification of SSAP No. 72 -Surplus and Quasi-reorganizations*, paragraph 14 was passed without comment.

2005-19, *Prepaid Reinsurance* was passed without comment.

**Meeting Agenda**

The Working Group took the following action on their Maintenance Agenda - Pending List:

It exposed the following FASB and AICPA guidance with the recommendation that they be rejected for the purpose of Statutory Accounting:

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- o 2006-01: *FAS 151: Inventory Costs, and amendment of ARB No. 43 (FAS 151), Chapter 4*
- o 2006-02: *FAS 154: Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3 (FAS 154)*
- o 2006-03: *FIN 47: Accounting for Conditional Asset Retirement Obligations (FIN 47)*
- o 2006-06: *Consideration of FSP FAS 141/142-1*
- o 2006-05: *SOP 03-4, Reporting Financial Highlights and Schedule of Investments by Non-registered Investment Partnerships: An Amendment to the Audit and Accounting Guide Audits of Investment Companies and AICPA Statement of Position 95-2, Financial Reporting by Nonpublic Investment Partnerships (SOP 03-4).*

2006-04: *New Model Laws and Revisions to Existing Model Laws* were exposed. This proposal would take the recently deleted Model Law A-588 and add it to the P&P Manual as an appendix, because staff believes references to it in SSAPs 56 and 80 are still relevant. Alternatives, not discussed at the Working Group, would be to reduce the model to its relevant parts and add only those parts as an appendix, or to take the relevant guidance and place it in the SSAPs as an amendment.

2006-07: *Disclosure of Supplemental Information Within the Annual Audit Report* was referred to NAIC/AICPA Working Group in order to sync the proposal with the changes to the Model Audit Rule.

2006-08: *Update and illustration related to Paragraph 7d of SSAP No. 1* was exposed. The chair stated that New York is still concerned with requiring the disclosure in the case of a proscribed practice, which might be the result of direction from the Commissioner or state law.

Consideration of Maintenance Agenda - SUBSTANTIVE ACTIVE LIST:

2005-11: *90-Day Rule for Intercompany Transactions: Issue Paper 128* on the proposed guidance was exposed for comment.

Bail Bond Subgroup, APB Opinion No. 29 Subgroup and SSAP 88 Subgroup all gave updates on their activities.

Consideration of Maintenance Agenda - NON-SUBSTANTIVE ACTIVE LIST:

2004-14 *New Model Laws and Revisions to Existing Model Laws*. The Working Group exposed staff's recommended changes to A-010 and SSAP 59, a proposal to add Model Regulation 818 to the Appendix, and a proposal to delete Model Guideline 825 and change all references to it to the actuarial guidelines in Appendix C

#### **Any Other Matters Brought Before the Working Group:**

The Risk Retention (E) Task Force certified several questions to the Working Group concerning how either the permitted or proscribed practice allowing RRGs to use GAAP reporting fits within in the AP&P framework.

The SVO forwarded comments to Issue Paper 126 - Accounting for Transferable State Tax Credits and their relationship to CAPCOs and Interested Parties provided a letter in response. The regulators had language written by staff that was not provided to the public. The material was exposed and will be posted on the web.

Keith Bell (St. Paul Travelers) presented the results of the Industry Survey on SSAP No. 35-*Guaranty Fund and Other Assessments*, and promised to come back to the Working Group with appropriate proposals based on the conclusions.

The Chair asked everyone to consider whether there were items that could be removed from the agenda. His candidates were the need for a definition of "best estimate" and the application of foreign currency transactions.

*International Statutory Accounting Principles Subgroup*: During update at the SAPWG Steve Johnson (PA) sounded a note of caution to his fellow regulators concerning the drive to convergence. He felt that the codification effort had resulted in a product the state regulators should be proud of, and that he questions the idea of convergence for convergence sake - if there is little demonstration that it results in a better answer.

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Doug Stolte (VA) noted that there is a good deal of codification that is based on US GAAP and that keeping up with changes is a necessary part of the process of maintaining Statutory Accounting. Changes are coming to US GAAP there will be other pressures to converge and US regulators need to be prepared.

Doug Barnert (BGL for GNAIE) said that he had volunteered to the Working Group to give presentations on the recent proposals concerning Fair Value Measurement and Fair Value Option. He stated his belief that the key was for regulators to devote the resources in order to get US policies and practices on the table when international standard-setters consider their direction, and to suggest that international standards adopt the US standards. He stated that the GNAIE remains concerned with the direction the IASB is going in establishing a theoretical market value for liabilities, and the direction the IAIS is going with theoretical ideas.

Lou Felice (NY) echoed Barnert's comments in saying that it will be better for US regulators to participate in the process rather than react, though he acknowledged that it will be a big task. Rob Esson (NAIC) spoke to remind regulators that international standards are concerned with general purpose accounting as opposed statutory, although there are concerns with the relationship to stat. Barnert pointed out that in spite of this the NAIC leadership has seen international accounting to be important and has gotten involved. Very few alien jurisdictions have a statutory accounting; how to use general purpose accounting is being discussed at the same time as it's development, and the time to effect the answer is now. The US industry is also effected now by the accounting requirements for subsidiaries and parents. Felice also pointed out that the NAIC considers principle-based regulation, the consideration and development of like regulation overseas is critical to the movement.

#### BLANKS (E) WORKING GROUP

The Blanks Working Group adopted the revised procedures for dealing with proposals that were not adopted or were rejected. A proposal can be referred to another group removing it from the Blanks agenda or it can be deferred. An item may only be deferred twice.

The report from the Investment Schedules Subgroup was adopted. The reports from the P&C Lines of Business Subgroup and the Schedule T Subgroup were accepted. On March 21st there will be a conference call to discuss Schedule T Subgroup's charge and a memo will be put together regarding these issues. Interested Parties were asked to join the conference call. Blanks Working Group chair, Gloria Glover (AK), said any decisions regarding Electronic Filing Requirements will be made at the next meeting. A memo from NAIC staff regarding changes to procedures was adopted. All the Editorial Changes included with the advance materials were adopted. For the Finite Reinsurance exposure it was decided that all comments should go to the P&C Reinsurance Subgroup instead of the Blanks Working Group.

#### Action on Items Previously Deferred:

- o 2005-38BWG - *Modify the instructions to the Combined Property/Casualty Blanks to require write-ins to be reported in detail as opposed to being reported on one write-in line.* Max McGee (Prudential), speaking for Interested Parties, felt there was no need for this. Connie Jaspar Woodruff (Fiserv Insurance Solutions), also speaking for Interested Parties, said they had tried this approach with companies and the clients did not like it. One of the biggest problems was that it added significantly to printing costs to put in all that detail. After much discussion this item was rejected.
  - o 2005-39BWG - *Add instructions to clarify how paid in surplus should be reported in the capital and surplus account.* With the modifications, Interested Parties had no issue with the proposal. This item was adopted.
  - o 2005-41BWG - *Modify various exhibits of the health blank to combine stop-loss, disability income and long-term care into "Other" health lines.* This item was adopted.
  - o 2005-42BWG - *Modify the Title Actuarial Opinion Instructions to be consistent with the 2005 Property/Casualty Actuarial Opinion Instructions.* This item was adopted.
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- o 2005-43BWG - *Modify the Life quarterly Schedule S - Ceded Reinsurance*, to add a new column for effective date and a new column for type of reinsurance ceded. Although McGee stated this information was already provided on the annual statement and the change was not needed, this item was adopted.
- o 2005-44BWG - *Modify the Notes to Financial Statements for new disclosure requirements of SSAP 90, Accounting for the Impairment or Disposal of Real Estate Investments, Discontinued Operations (2005-44BWG)*. This item was adopted.
- o 2005-45BWG - *Add lines to Schedule BA and AVR to account for the SSAP 93 low-income housing tax credits by categories*. Interested Parties were very supportive of this proposal. This item was adopted.
- o 2005-49BWG - *Add instructions for Schedule T, Part 2 - Interstate Compact Products Exhibit of Premiums Written*. This item was adopted.

Action on Items Previously Exposed for Comment:

- o 2005-50BWG - *Modify the Life Schedule O Part 5 to include Group Annuities*. This item was adopted.
- o 2005-51BWG - *Clarify reporting of unrestricted collateral used for securities lending transactions*. McGee said that this was a good clarification and the Interested Parties were very supportive. This item was adopted.
- o 2005-52BWG - *Add guidance on the reporting of a gain or loss on the disposal of fixed assets*. Interested Parties opposed this proposal because it did not cover all gains and losses. This item was adopted.
- o 2005-53BWG - *Clarify what is expected to be reported under Note 1 of the Financial Statements*. This item was adopted.
- o 2005-54BWG - *Modify Note 12 to incorporate the requirements of FASB Statement No. 132R as adopted by the SAPWG into SSAPs 11, 14 & 89*. This item was adopted.
- o 2005-55BWG - *Modify Schedule P Interrogatories for new disclosure requirements as adopted by the SAPWG and recommended by the Casualty Actuarial Task Force*. Steve Johnson (PA), speaking for Joe Fritsch (NY), said that the Statutory Accounting Principles Working Group and the Casualty Actuarial Task Force should work together on this and he made a motion to defer. There will be conference call between the two groups. This item was deferred.
- o 2005-56BWG - *Expand country of domicile abbreviations to be used for Property/Casualty Schedule F and also included in the Life/Health appendix*. This item was adopted.
- o 2005-57BWG - *Add language to clarify that existing non-restricted asset codes should be used to note all such restricted assets, regardless whether the arrangement meets the requirements of SSAP 91*. This item was adopted.
- o 2005-58BWG - *Clarify that for purposes of the quarterly general interrogatories and the annual Five year Historical page, affiliated investments should be reported based upon the book/adjusted carrying value and not the statement value or fair value*. McGee said that from a technical standpoint the Interested Parties did not want a precedent set by adopting this change retroactively. Johnson explained that although he did agree about not setting a precedent, the retroactive change was needed for trend analysis. This item was adopted.
- o 2005-59BWG - *Direct companies to report money market mutual funds and mutual funds within the Industrial and Miscellaneous category of the Schedule D Summary*. This item was adopted.
- o 2005-60BWG - *Add columns to the Life, Fraternal & Health Schedule T to allow subtotals of certain premium*. A motion was adopted to adjust the Health page as follows: Take out the Guaranty Fund column and add back the Deposit column after Total. This item was adopted.
- o 2005-61BWG - *Change bar codes to include code to identify hardcopy amendments to financial statements*. Dan Daveline (NAIC staff) suggested holding off on rejecting or amending this proposal. McGee said that he would talk with Dan on finding a workable solution. This item was deferred.

- o 2005-62BWG - *Modify the Life, Fraternal and property statements by adding a new row to the state page to identify certain exempt Medicare premium.* McGee suggested deferring this proposal and to have Lou Felice (NY) look at it since Felice will be introducing another proposal in June that deals with Medicare Part D. This item was deferred.
- o 2005-63BWG - *Modify the Schedule Y instructions to provide specific guidance where an entity is 50% owned by two parties.* This item was adopted.

#### Action on New Items:

In order save time, a motion was adopted to expose all new items as a group. All comments are due by May 11, 2006.

- o 2006-01BWG - *Modify the Life Guaranty Assessment Exhibit to allow for data capture of fee income associated with variable contracts with guarantees.*
- o 2006-02BWG - *Clarify Schedule BA & related AVR reporting.* A motion was adopted to modify this proposal per Daveline's March 4, 2006 memo to Blanks. A paragraph was added to the Schedule BA instructions that clarified questions surrounding the valuation of the reporting of capital and surplus notes.
- o 2006-04BWG - *Add two new codes to the existing options for the foreign code column of the Investment Schedules.*
- o 2006-05BWG - *Clarify what shouldn't be reported within the fair value column of the Investment Schedules for loan-backed securities.*
- o 2006-06BWG - *Establish consistent reporting guidance for Medicare Part D coverage including the addition of a new Medicare Part D supplement.*
- o 2006-07BWG - *Add inset to Life & Fraternal Summary of Operations for tax on Unrealized Gains.*
- o 2006-08BWG - *Delete reference to valuation allowance for Bonds.*
- o 2006-09BWG - *Clarify that zero should reported in the PY Value Column on Schedule D Part 4 when the security was not owned by the reporting entity in the prior year.*
- o 2006-10BWG - *Modify the title of Schedule T Part 2 to exclude the word "Products" from the phrase Interstate Compact Products.*

### **Examination Oversight (E) Task Force**

The Examination Oversight Task Force is chaired by Betty Patterson of Texas. The group received reports from its three Working Groups.

The Task Force voted to retain the NAIC Model Law on Examinations in its current form until the completion of the Risk Assessment development process. It was suggested that those working on the issue of confidentiality look at the language in the model to determine if it solves the perceived problems.

*Audit Software Working Group:* The Working Group is in the process of revising the Exhibit C on internal controls in information systems and is working on a project to create a standardized data request form for insurer information requests, intended to help regulators track the response of insurers. In the near future the Working Group will consider proposing revisions to Exhibit K - Sample Letters of Representation with regard to IT representations.

*Analyst Team System Working Group:* The Working Group will look at how the risk assessment CARMEL Prioritization System compares and is related to the ATS validated priority rankings and whether CARMEL should be integrated.

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*Financial Examiner's Handbook Technical Group:* The Technical Group is adopting an information request log to go along with the request form being developed in the Audit Software Working Group. The Handbook Revisions Subgroup of the Risk Assessment (E) Working Group will be holding an interim meeting on March 20th in Chicago to discuss proposed changes to the Handbook.

### **Receivership and Insolvency (E) Task Force**

The Task Force is still considering the need for and operation of possible clauses regarding large deductible policies. The Model Act Revision Working Group will look at the *Insurer Receivership Model Act* to address comments received from mortgage and financial guaranty insurers and rating agencies. The work on the *P/C Insurance Guaranty Association Model Act* will continue. A drafting group will work on paragraph 8C (3). Florida gave extended reports on its receivership related software applications and ideas that could be shared with all states. Finally the Law & Intergovernmental Working Group will review IRMA to make recommendations as to what parts should be included in accreditation Part A.

### **Reinsurance (E) Task Force**

The Reinsurance Task Force is chaired by Commissioner Julie Bowler (MA).

The Task Force received a report from Debra Hall (Swiss Re) on behalf of the Interested Parties which provided an overview of 39 state laws that allow cut-through provisions in contracts other than reinsurance agreements. Hall clarified that this issues was not connected to finite reinsurance. The chair decided to return the referral to "F" Committee for further clarification on the impact of such provisions on the Credit for Reinsurance Regulation.

Superintendent Howard Mills (NY) provided an update on the February meeting of the International Association of Insurance Supervisors (IAIS) triennial meeting in Basel. At the meeting Bryan Fuller (NAIC staff) presented a report on the NAIC white paper on reinsurance collateral adopted in December 2005 and Mills discussed the two proposals released by the US Ad Hoc Committee on Reinsurance Collateral. The Task Force discussed the collateral issue further. Iuppa said that the leadership of the NAIC feels that it must look at alternatives. He then said the NAIC would be considering a charge to the Task Force to examine the issue and this issue would be the dominant work stream of the Task Force for 2006. Bowler said the Task Force would hold a number of conference calls to meet the goal. Iuppa asked the Interested Parties to "discuss this in good faith." That charge was adopted at the Plenary session (see report).

The Task Force adopted amendments to the Reinsurance Intermediary Model Act which were designed to improve the arbitration process associated with disputes between ceding and assuming insurers.

The Task Force received comment letter from the ACLI, Nationwide, and the Life Insurance Council of New York on the proposed attestation for life insurance companies on finite reinsurance. Action was deferred at the request of Mills pending an assessment of the regulatory experience in reviewing life reinsurance contracts for risk transfer.

The Task Force received a report from Interested Parties on placing qualified financial conglomerates on the SVO approved banking list, but deferred action to the Summer meeting pending further research on the regulation of these groups.

The Task Force adopted proposed revisions to Section 10(b)(14) of the Credit for Reinsurance Model Regulation relating to the administration of assets of a single beneficiary trust. These provisions were deemed to be inconsistent with Section 304 of the US Bankruptcy Code.

The Task Force heard a presentation by Brad Kading on the Association of Bermuda Insurers and Reinsurers which represents the Class 4 companies in Bermuda.

The E Committee adopted the report of the Task Force.

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### **International Solvency Initiatives (E) Working Group**

Commissioner Al Gross (VA) chaired the first meeting of the Solvency Working Group, formed in December, to comment on international solvency developments in Europe and at the IAIS. Rob Esson (NAIC staff) presented an overview of the IAIS Solvency activities including the current work on the Structures paper which is scheduled to be completed for adoption at the IAIS annual meeting in October. Esson described these developments as “a tsunami approaching our shore.”

Karel van Hulle, Head of the Insurance unit of the European Commission, described the Solvency II project being undertaken by the European Commission to rewrite solvency regulation in Europe to a risk sensitive system. The goal is by allowing companies to base capital requirements on internal models, to improve policyholder protection and increase the competitiveness of European insurers. He said this also puts pressure on regulators, “who need to learn to talk about the business of insurance.” Van Hulle said that the Solvency II proposal will be released in draft form early next year. A public hearing will be held in Brussels June 21 to which van Hulle invited US companies to participate.

Alberto Corinti, Secretary General of the Committee of European Insurance and Pensions Supervisors (CEIOPS), reviewed the role the supervisors are playing in advising the Commission. In addition to reviewing the questions posed by the Commission, CEIOPS will conduct two and possibly three quantitative impact studies. The first has just been completed and the second will begin in May. Corinti said that CEIOPS hopes “to achieve a harmonized regulatory and supervisory framework in Europe.”

Leslie Deich (Genworth) and Peter Giacone (XL Capital), representing the Group of North American Insurance Enterprises (GNAIE), discussed the importance international developments in solvency have for US insurers. Deich said, “We live in a global economy; we pay attention to global trends; we worry about trends that circumnavigate the globe... We need to ensure that there are consistent underpinnings of regulation.” Several company and trade association representatives from the audience supported the need for the NAIC to increase its involvement on international solvency issues.

Chairman Gross said the Working Group will hold a conference call the second week of April to review a work plan and the IAIS Structure paper. He asked for comments from the Interested Parties on the paper. Rob Esson said that he and Gross were also developing a paper on corporate governance they would like the Working Group to review.

### **Risk Assessment (E) Working Group**

The Risk Assessment Handbook Revisions Subgroup chair, Ramon Calderon (CA), reviewed the key issues that were discussed at the October 2005 interim meeting, which were Confidentiality, Small/Medium Company Approach, Coordination with NAIC/AICPA Working Group, Evaluation of Prospective Risks/Assessment of Procedures Outside Financial Reporting and Utilization, Placement of Management Comment Letters, Training/Risk Assessment Examples/Examiner Mindset, and Deployment. There will be an interim meeting in Chicago on March 20, 2006 to discuss the revisions. All questions or discussion topics are to be submitted by March 14, 2006.

Paula Panik (St. Paul Travelers) said the Interested Parties have had a problem with Confidentiality since the beginning. They have formed a legal team and will have preliminary comments by March 20, 2006. There are concerns with possible conflicts with other confidentiality laws and whether confidentiality can be maintained when the documents are shared by states. Calderon suggested confidentiality issues have always existed. Panik replied that the risk assessment project raises additional confidentiality issues. Julie Gann (NAIC Staff) said that the NAIC Legal Team has reviewed the language.

With regard to the Small/Medium Company Approach, Joe Zolecki (Blue Cross/Blue Shield) said it was not clear if examiners are supposed to use the old book or the new book. Dave DelBiondo (PA), chair of the Risk Assessment Implementation Subgroup, replied that this issue has already been addressed. For implementation of handbook guidance in the interim period, both the SRA Approach and the Revised Risk-Focus Framework

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Approach are okay. 2006 will be the last time that the SRA Approach will be available in hard copy. Thereafter updates will be provided on the web site. Both sets of books will be available until January 1, 2010 when the accreditation standard goes into effect. Zolecki was concerned that this represents a cultural change for examiners and there could potentially be training problems with the SRA to risk approach. DelBiondo was confident that the commissioners would select the right people to train.

Panik said that the Interested Parties were not suggesting postponement until completion of the Sarbanes-Oxley related revisions to the NAIC Model Audit Rule. After additional comments from Interested Parties, Mike Moriarty (NY), the Risk Assessment Working Group chair, replied that their comments “point to a high level of concern of our ability.”

When looking at Evaluation of Prospective Risks, Tom Finnell (Maryland First Financial) said that “if we move down this path there's overlap with other regulation.” He also wanted to know if Exhibit V found on the NAIC web site is an example or not. Gann replied that it was not intended as an inclusive list.

Panik wanted to defer discussion of Utilization because it was not clear and Interested Parties could not respond. Calderon said that the intent was for management letters to be elective. They would be merely examples and not all-inclusive.

Regarding Deployment, the Interested Parties agreed with recommendations 1 and 2 but had serious concerns with recommendation 3 because it could lead to redundant fieldwork. Panik commented that this was like Codification, with some states adopting it as soon as it was approved and others delaying adoption, requiring insurers operating in more than one state to maintain two systems of accounting.

DelBiondo assured the Interested Parties that the examiners are as interested in being trained as they are that the examiners be trained. He stated training would begin later this month and acknowledged it would take time to get examiners up to speed. There will be a 30-day comment period for the Risk-Focused Surveillance Guidance after it is presented to the Working Group shortly after the March interim meeting. The exposure period would end before the Summer National Meeting. All documents are available on the Working Group page ([http://www.naic.org/committees\\_e\\_rawg.htm](http://www.naic.org/committees_e_rawg.htm)).

### **NAIC/AICPA (E) Working Group**

The NAIC/AICPA Working Group is chaired by Doug Stolte (VA). The Working Group heard a report on AICPA activities from Debra Whitmore (E&Y). In March 2006 the Auditing Standards Board (ASB) will issue eight standards on the audit process and the relationship to risk assessment and internal controls, refining and defining the process for auditors to rely on the internal control work of the client in order to modify (one hopes reduce) the reliance on substantive testing. The ASB also released an exposure draft of AT 501, *Reporting on an Entity's Internal Control over Financial Reporting*, in order to sync it up with Public Company Accounting Oversight Board's (PCAOB) Auditing Standard 2. Comments are due May 19th and can be found on the AICPA web site. The replacement for Statement on Auditing Standards (SAS) 60, *Communication of Internal Control Related Matters Noted in an Audit*, was revised and will be up for adoption at the next ASB meeting. Finally Whitmore reported that the ASB is considering replacing SAS 61, *Communication with Audit Committees*, with guidance more like that of the recent International Auditing Standard 260.

The Working Group approved the proposed changes to the *NAIC Model Regulation Requiring Annual Audited Financial Statements* that have been the subject of discussion for approximately two years. The proposal was approved with minor editorial changes with a recommendation that it be exposed at 'E' Committee for a 45-day comment period, to be followed by an interim hearing or conference call to discuss the proposal, given its importance. There was also discussion of the NCOIL resolution that is foursquare against the proposal. Paul Donohue (NCOIL) reported on the resolution and Judy Weaver (MI) reported on her testimony at NCOIL. Neil Aldredge (NAMIC) disagreed with suggestions that the legislators did not understand the issues and pointed out

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that Stolte, Ramon Calderon (CA), and Weaver were all given the opportunity to explain the issues at the last three meetings. Aldredge suggested that the legislators understood the issues but disagreed with the proposal nonetheless.

The Interested Parties will continue work on the accompanying implementation guide, and the Working Group will hold a meeting in the interim.

### **Financial Examination Modernization (E) Working Group**

The minutes of the interim meeting held on February 13, 2006 were adopted.

The Recommended Guidelines on Possible Exceptions to the 18-month Timeliness Exceptions was amended after a brief discussion. The revised draft was exposed for a 45-day comment period.

There was a short discussion on the 2006 Charge Pertaining to Documentation Requirements for Reliance on Another State's Workpapers, regarding relying on the pool and the shared system where the lead state takes responsibility. Julie Gann (NAIC Staff) will draft new language and there will be a conference call at the end of March to discuss this further.

### **Financial Regulation Standards and Accreditation (F) Committee**

Commissioner Susan Cogswell (CT), "F" Committee chair, announced that there were no new models or amendments to existing models adopted in 2005 that were recommended for consideration as additions to the accreditation standards. The Committee did adopt, however, changes to five NAIC publications that are currently included in the standards by reference and the task forces responsible for each have recommended them for addition to the standards and have deemed them "insignificant" and therefore eligible for adoption into the standards. The publications are: the RBC formulas, Blanks instructions, and the Financial Condition, SVO and Accounting Practices handbooks.

Commissioner Al Gross (VA), who chairs "E" Committee, reported that after the Insurer Receivership Model Act (IRMA) was adopted in December, the Receivership Model Act (E) Working Group solicited comments on which of the model's provisions should become accreditation standards. The new standards would replace the current requirement that each insurance department have a scheme for the administration of conservation and liquidation of insurers found to be insolvent. The Working Group will meet again during this national meeting to consider the comments received, some of which opposed any change to the current standard. Gross indicated "E" Committee should have a recommendation to present in June.

The Committee adopted the 2001 changes to the Model Audit Rule. The primary change to the rule would prohibit indemnification clauses in CPA contracts. The rule does permit mediation or arbitration clauses. The revised rule had been exposed for the required period and no comments were received.

In December the Committee had exposed for comment an amended multi-state insurer definition. The only comment was submitted by Mike Motil (OH). Arizona asked for and received confirmation that the revised language would exempt from both Part A and Part B of the standards reinsurers licensed only in their state of domicile who write no direct business. The business ceded to these reinsurers is subject to the credit for reinsurance rules. The Committee agreed to a wording change offered by an industry representative concerning excess lines insurers. He pointed out that these insurers do not operate in the state where the risk is located but rather that they accept business on an export basis from that state. The definition as amended was added to the standards.

The Committee adopted a staff memorandum identifying the elements of the Model Act and Regulation on Custodial Agreements and the Use of Clearing Corporations that would be considered significant if the model were to be added to the accreditation standards.

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## **International Insurance Relations (G) Committee**

Commissioner Diane Koken (PA) chaired the meeting of the International Insurance Relations Committee which received the reports from several task forces and working groups.

*NAIC-EU Dialogue:* Staff reported on the EU-US dialogue held on March 3. The topics discussed included reinsurance, Solvency II, insurance groups, and the IAIS. European Commission Head of the Insurance Unit, Karel van Hulle, attended the meeting as did Alberto Corinti, the Secretary General of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), the European equivalent of the NAIC. The next NAIC-EU dialogue will be held in September in Europe.

At the request of the chair, Rich Gaffin (US State Department) of the US Mission to the European Union addressed the International Insurance Relations Committee. He indicated that European Internal Markets Commissioner Charlie McCreevy has an “ABC” priority list that includes (A) accounting convergence, (B) Basel II, (C) collateral reduction, and (D) deregistration. McCreevy has come to the US twice to promote this agenda. Koken indicated that the NAIC met with McCreevy in February and that there was no mistaking the priority he gave to the removal of collaterals. At that meeting, McCreevy had asked the US to commit to a roadmap for reduction of collaterals. From the US side, Gaffin said, “The President is committed to a regular dialogue with Europe to promote financial growth in Europe, regulatory cooperation, and a level playing field for US companies.”

Dave Snyder (AIA) asked if the NAIC had made a commitment to remove or reduce collateral requirements. Koken said no decision had been made, but the NAIC did want to come to a resolution of the issue. Superintendent Alessandro Iuppa (ME) agreed, saying that the time has come to reach closure on the topic. He said by drafting the charge to examine the issues, the leadership hoped to bring the various parties to the table to discuss the options. He did add that one option on the table is retention of the current collateral system. He urged the industry not to read too much into the charge to the Reinsurance Task Force saying, “If we had a preconceived notion, there would be no need for the charge.”

*Memorandum of Understanding on Data Exchange:* Betty Patterson (TX) presented the Memorandum of Understanding (MOU) on data exchange which has been developed for use between individual US states and European Member States. The Committee of European Insurance and Occupations Pensions Supervisors (CEIOPS) approved the MOU at its February meeting. The MOU was approved by the Committee.

George Brady (NAIC staff) reported that the NAIC is also developing an MOU on data exchange with Mexico.

*US-Japanese Insurance Talks:* Commissioner Walter Bell (AL) reported on recent US-Japanese Insurance Consultations in Tokyo sponsored by the US Trade Office. He indicated that Kampo, the Japan Post entity which is a major provider of financial services, is now being privatized. US officials urged the creation of a level playing field.

*International Association of Insurance Supervisors (IAIS):* Superintendent Alessandro Iuppa (ME) provided an update on the IAIS activities which were detailed in the latest NAIC International Report distributed at the meeting. The report includes a summary of action taken at the IAIS February triennial meeting held in Basel. Iuppa said that the IAIS Executive Committee continues to push for changes in the association's funding to make it less dependent on third party funds which now provide half of the IAIS's budget. He expects a recommendation to be made to the IAIS annual meeting in October.

Commissioner Al Gross (VA) reported on the IAIS Solvency Subcommittee which is working on the Structures and Asset Liability Management papers. The NAIC has formed an International Solvency Initiatives Working Group to review the drafts from this committee and several of the other technical task forces will be looking at the issues.

The NAIC will host the IAIS October 2007 annual meeting in Miami.

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*International Accounting Standards Board (IASB):* Rob Esson provided an update on developments at the IASB. The IAIS Insurance Contracts Subcommittee, which Esson chairs, is preparing a second paper for the IASB on risk margins and long-term premium flows which will be completed by May. Dave Snyder (AIA) urged the NAIC to support the participation of a commissioner to the Insurance Contracts meetings saying that Rob Esson's role as chair of the subcommittee makes it difficult to fully express the NAIC position on the issues. Iuppa said it was an issue of resources and that all statements made to the IAIS were reviewed by the Commissioners.

*Joint Forum Working Group:* Commissioner Kevin McCarty (FL) reported on the Joint Forum Working Group which met in Hong Kong. The Forum has completed a paper on Regulatory and Market Differences which has been sent to the parent organizations for publication. Working groups are continuing to look at credit risk, market risk concentration, customer suitability, management of funding liquidity, and business continuity. McCarty has said he will take some of these issues to the newly formed NAIC International Solvency Initiatives Working Group.

*Capital Hill Outreach:* George Brady (NAIC staff) reported on the increasing contacts the NAIC is making with members of Congress on insurance issues.

### **International Regulatory Cooperation Working Group**

Superintendent Howard Mills (NY) chaired the Working Group and reported that the fall 2005 internship program that hosted interns from China, Korea, Vietnam, and Brazil had been very successful. He reported that plans are now underway for the 2006 and 2007 sessions with interns already scheduled from Russia, India, the British Virgin Islands, and Lebanon. Leo Lui (AR) reported that China has asked to extend the internship program beyond the three-year limit. There was also a discussion of the need to send NAIC representatives to other countries to meet with the departments and conduct on-site training. Although some of this work is being undertaken, language problems make this difficult in some jurisdictions. The International Curriculum Development Technical Group is continuing its work on training materials.

The NAIC has signed new Memorandums of Understanding (MOU) with Russia, Iraq, and Brazil to provide training, exchange data, and assist in the improvement of the regulatory and market climate in those countries. A MOU is also under discussion with the Association of Latin American Insurance Supervisors (ASSAL). The NAIC already has MOUs with China and Vietnam.

A proposal for an international training fund has been exposed for a 30 day period. The fund would provide a vehicle to receive private funding for the internship program.

*Priority Countries:* The Committee reviewed the current list of priority countries for regulatory technical assistance, adding Iraq and dropping Romania, Kazakhstan, Morocco and the ASEAN Regional Group.

### **International Holocaust Commission Task Force**

Lauren Scott (NAIC Staff) reported that the International Commission on Holocaust Era Insurance Claims (ICHEIC) will close by the end of 2006 and is in the process of finalizing claims appeals. Since its inception, \$180 million has been awarded to claimants as a result of the ICHEIC process.

### **NAFTA Working Group**

Commissioner Eric Serna (NM) reported that the Trilateral Insurance Working Group will be held in Santa Fe, New Mexico on April 6-7, 2006. The Working Group will discuss the sale of variable annuities in Mexico, transportation flows between Mexico, the US and Canada, bilateral health insurance, and the security and prosperity work plan.

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### **NAIC International Insurance Symposium**

The NAIC held an International Insurance Symposium on February 23-24, 2006, in Washington, DC. Entitled “Meeting Tomorrow's Global Challenges Today,” the sessions focused on Latin America, China, India, and Europe. Roger Ferguson, Vice-Chairman of the US Federal Reserve Board, was the keynote speaker. A report on the conference is contained in the NAIC's March 2006 International Report which can be found at [www.naic.org](http://www.naic.org).

### **Abbreviations Used in this Report**

ACLI	American Council of Life Insurers
AIA	American Insurance Association
ASB	Auditing Standards Board
ASSAL	Association of Latin American Insurance Supervisors
CARRMEL	Adequacy, Asset Quality, Reinsurance, Reserve Adequacy, Management Assessment, Earnings and Liquidity
CEIOPS	Committee of European Insurance and Occupations Pensions Supervisors
CPA	Certified Public Accountant
EU	European Union
GLBA	Graham-Leach-Bliley Act
GNAIE	Group of North American Insurers Enterprises
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
NAIC	National Association of Insurance Commissioners
NALC	National Alliance of Life Companies
NAMIC	National Association of Mutual Insurance Companies
NCOIL	National Conference of Insurance Legislators
PCI	Property Casualty Insurance Association of America
SERFF	State Electronic Reporting Forms Filing
TRIA	Terrorism Risk Insurance Act
TRIEA	Terrorism Risk Insurance Extension Act of 2005
TRIP	Terrorism Risk Insurance Program (Office of the US Treasury)

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