

NAIC REGULATORY UPDATE

This quarterly issue of the *NAIC Regulatory Update* summarizes the National Association of Insurance Commissioners' financial activities affecting health entities at the 2006 Summer National Meeting. The meeting took place June 10 - 13, 2006 in Washington DC.

NAIC Hot Topics

The Capital Adequacy Task Force reported on the results of the 2005 RBC Data...see [page 1](#)

The Blanks Working Group adopted a new Medicare Part D Supplemental filing for the 2006 Health Annual Statement and exposed a Medicare Part D Supplement for the 2007 quarterly statements.....see [page 1](#)

The Statutory Accounting Principles Working Group adopted IP No. 128, *Settlement Requirements for Intercompany Transactions*.....see [page 2](#)

The Emerging Accounting Issues Working Group exposed for comment new accounting guidance on accounting of revenue from the sale of claims data to a PBM.....see [page 3](#)

The Valuation of Securities Task Force reconstituted the Invested Asset Working Group.....see [page 4](#)

The (EX) Committee and Plenary adopted revisions to the Model Audit Rule.....see [page 4](#)

The Risk Assessment Working Group postponed adoption of the new "risk-focused surveillance guidance" until September.....see [page 5](#)

The Financial Examiners Handbook Technical Group adopted provisions related to the USA PATRIOT Act.....see [page 5](#)

Financial Regulation—Risk-Based Capital

The **Capital Adequacy Task Force** presented a comparative analysis of the RBC filing results for the year ended December 31, 2005. Since the adoption of the Health Risk-Based Capital formula in 1998 the number of health entities triggering a RBC action level has diminished significantly; however the 2005 results show an increase in the number of entities triggering a RBC level over the prior two years. Since the NAIC does not provide specific data on the analysis, no specific explanation can be given at this time for the increase.

The results are summarized in the table below.

Health Entities - Annual Statement Year Ending				
	12/31/05	12/31/04	12/31/03	12/31/02
Companies that have an RBC loaded	747	602	696	698
Companies with action levels:	24	14	22	59
Percentage of total RBC's loaded	3.21%	2.32%	3.16%	8.45%
Company Action Level	10	9	6	25
Regulatory Action Level	5	4	8	20
Authorized Control Level	1	0	2	4
Mandatory Control Level	8	1	6	10

Financial Reporting

The **Blanks Working Group** adopted 12 blank proposals affecting the 2006/2007 Life, Property/Casualty (P&C) and Health Blank form and instructions. In addition, the Working Group exposed for comment 25 items including the addition of a new "Medicare Part D Supplemental" filing for the 2007 Health Quarterly Statement. The Supplement is also applicable to the 2007 Life and P&C quarterly statements. Many of the new items exposed for comment are proposed modifications to the invested asset schedules.

The Working Group created the **Schedule T Subgroup** at the March 2006 meeting to:

- Discuss the current reporting in Schedule T by all types of insurers;
- Address the requirements for premium reported on Schedule T and the state page; and discuss how companies currently apply those requirements to certain issues; and
- Determine if more specifics are needed in the Annual Statement Instructions to increase the consistency in reporting by insurers.

Generally health entities report premiums in Schedule T based on the state in which the policy is written or the state residency for individual and group subscribers.

The Subgroup is proposing the following instructions for adoption:

- That the reporting on Schedule T be based on the residence of the policyowner for life insurance, annuity considerations, deposit-type contract funds and other considerations.
- For group insurance, it is proposed that the reporting on Schedule T be based on the residence or employment location of the covered group member without allocation by dependents.

The Working Group adopted other items affecting the Health and other statements including:

Item	Effective Date
Changed bar codes to include a code to identify hardcopy amendments to financial statements	2006 Annual Statement
Modified the Life, Fraternal and property statements by adding a new row to the state page to identify certain exempt Medicare premium	2007 Annual Statement
Modified the Life Guaranty Assessment Exhibit to allow for data capture of fee income associated with variable contracts with guarantees	2006 Annual Statement
Clarified Schedule BA & related AVR reporting for Life and Fraternal organizations	I st Quarter 2007
Added two new codes to the existing options for the foreign code column of the Investment Schedules	I st Quarter 2007
Clarified what should not be reported in the fair value column of the Investment Schedules for loan-backed securities	I st Quarter 2007
Established consistent reporting guidance for Medicare Part D coverage including the addition of a new Medicare Part D supplement	2006 Annual Statement
Added inset to Life & Fraternal Summary of Operations for tax on unrealized capital gains	I st Quarter 2007
Deleted reference to valuation allowance in the Annual Statement Instructions for bonds on the asset page	I st Quarter 2007
Clarified that zero should be 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	I st Quarter 2007
Modified the title of Schedule T Part 2 to exclude the word "Products" from the phrase Interstate Compact Products	2006 Annual Statement
Clarify that the confidential Actuarial Opinion Summary, a confidential document supporting the Actuarial Opinion, should not be filed with the NAIC	2006 Annual Statement

Financial Regulation—Accounting

During its regular meeting the **Statutory Accounting Principles Working Group** adopted new SSAP No. 94 – *Accounting for Transferable State Tax Credits* and Issue Paper No. 128 - *Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25 - Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*, to require a 90-day admissibility rule for intercompany transactions.

Transferable state tax credits per **SSAP No. 94** are created by states that have enacted laws that create programs by which these tax credits are granted to entities under certain specified conditions (e.g., an entity makes an investment in a particular industry). State tax credit programs share the following four characteristics:

- The tax credit is nonrefundable;

Financial Regulation—Accounting, Continued

- The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise resell or transfer the credit;
- The transferable state tax credit will expire if not used by a predetermined date; and
- The transferable state tax credit can be applied against either state income tax or state premium tax.

Transferable state tax credits held by reporting entities will meet the definition of assets as specified in SSAP No. 4 - Assets and Nonadmitted Assets and will be admissible assets to the extent that they comply with the requirements of SSAP No. 94. SSAP No. 94 is effective for reporting periods ending on or after December 31, 2006. Early adoption is permitted.

With the adoption of **IP No. 128** the NAIC will release a Statement of Statutory Accounting Principle (SSAP) for comment. The initial draft of the SSAP will contain the adopted Summary Conclusion of this issue paper. It is expected that the SSAP will be effective for reporting periods beginning on or after January 1, 2007. Reporting entities must file a Form D under the Holding Company Act to reflect changes to any management agreements that are in place.

Paragraph 7d of SSAP No. 1 was updated to add “prescribed practices” along with “permitted practices” to illustrate the disclosure of differences between NAIC statutory accounting practices and procedures and accounting practices prescribed or permitted by the state of domicile. Appendix-205 was also modified to include an illustration related to the change to paragraph 7d.

The Working Group also adopted other nonsubstantive changes that were previously exposed for comment. Several nonsubstantive changes also were exposed for comment with an August 14, 2006 deadline. Included in these items was a proposed Q&A appendix to SSAP No. 88 - *Investments in Subsidiary, Controlled and Affiliated Entities, a replacement of SSAP No. 46*.

The **Emerging Accounting Issues Working Group** adopted as final several Interpretations that were previously exposed for comment, including **INT 06-01: Accounting for Revenue as a Result of the Sale of Claims Data**. INT 06-01 was tentatively adopted to include guidance to SSAP No. 55 that revenues associated with sales of claims data must be recorded as “other income” and not as a reduction to of claims expense as originally proposed. The item was referred back to the Emerging Accounting Issues Working Group for re-exposure. The comment deadline on INT 06-01 is August 14, 2006.

The Working Group also exposed for comment the tentative positions regarding the Liability for Claim Adjustment Expenses for Managed Care Contracts under **INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses**. The original reached a consensus that the liability for unpaid loss adjustment expenses (LAE) should be established regardless of any payments made to third party administrators, management companies or other liabilities. In addition, the guidance stated the liability for claim adjustment expenses on indemnity accident and health contracts should be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third party administrators and other similar entities.

The revisions to INT 02-21 adopts guidance for certain types of managed care contracts in the managed care contracts which include capitation payments should be excluded from INT 02-21 and non-capitated managed care contracts should be included within the guidance.

The Working Group re-exposed for comment **INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)**, after modifying the proposal to include the guidance for tax credits received by the entity.

Financial Regulation—Investments

The **Valuation of Securities Task Force** failed to take action on many agenda items but did address the following items:

- Reconstituted the Invested Asset Working Group to help with many of the accounting and reporting issues that are presented to the Task Force which may include the review of hybrid securities and the derivatives market study.
- The New York Department of Insurance requested that some of their companies submit their hybrid securities for proper valuation and classification by the SVO. In the past these securities were reported as bonds by the companies. Some of these securities were determined by the SVO to be classified as common stock instead of bonds. The insurers pointed out that it was their assumption when the securities were purchased that they would receive bond treatment in Risk-Based Capital.

The Task Force proposed grandfathering the classification of the hybrid securities purchased prior to June 11, 2006 to remain as bonds for RBC purposes. However, those purchased June 11, 2006 and after would be treated as common stock for RBC. There were many issues brought up with this proposal including the need to make a modification to the RBC formula. The proposal is delayed until the September NAIC National meeting so that the Task Force will have time to address all of the underlying issues in the grandfathering procedures.

- Adopted guidance for reporting foreign country exposure captured in the Summary by Country and Supplemental Investment Risk Interrogatories. The guidance is to help bring uniformity across the states. The proposal adopted by the Task Force modifies the annual statement instructions by adding the definition of foreign investment contained in the Defined Limits Version of the NAIC Investment of Insurers Model Act.

The Task Force decided to address the remaining issues on the agenda in conference calls prior to the September NAIC National Meeting including:

- Consider adoption of proposed amendments to the SVO P&P Manual, the Accounting Practices and Procedures Manual, and the Annual Statement Instructions related to the valuation of surplus notes.
- Consider adoption of an amendment that would add new eligibility criteria for listing on the NAIC NRSRO List and a second amendment that clarifies NAIC objectives in the use of rating.
- Consider adoption of agreed upon amendments to the SVO P&P Manual resulting from continuing NASVA and SVO discussions.

Other Financial Regulatory Issues

The **NAIC/AICPA Working Group** discussed that the Working Group adopted the proposed revisions to the Model Audit Rule and forwarded the revisions to the Financial Condition (E) Committee (E Committee) for its consideration. The E Committee exposed the revisions for comment for a 30-day period and held a public hearing on May 11, 2006. A follow-up conference call by the E Committee was held May 18, 2006. During this call, the E Committee adopted the revisions and forwarded them to the Executive (EX) Committee (EX Committee) and Plenary. The motion to adopt the revisions contained the following items:

- Voted to increase the premium threshold amounts related to audit committee member independence in Section 14. The premium thresholds increased by \$200 million at each level.
- Voted to change the effective date from Jan. 1, 2008 to Jan. 1, 2010 for requirements related to audit committees.
- Voted to change the effective date from Dec. 31, 2009, to Dec. 31, 2010 for the management's assessment of intern control over financial reporting.

Other Financial Regulatory Issues, *Continued*

Consequently the EX Committee and Plenary adopted the revisions to the Model Audit Rule. The adopted Model contained the following revisions:

- The Working Group must draft a new general interrogatory that would prompt the insurer to disclose whether it has been granted any exemptions to the Model Audit Rule as permitted in Sections 7H, 14H and 17A of the model.
- The Working Group must annually review the premium threshold amount included in Section 16 with the general intent that those companies subject to the Section 16 requirements would capture at least approximately 90% of industry premium and/or in response to any future regulatory or market developments.
- The Working Group was also requested to research the feasibility of indexing the Section 16 threshold amount to a publicly available index.

The revised Model Audit Rule is effective for audits of the year beginning January 1, 2010 and thereafter. The revisions will not be incorporated into the Annual Statement Instructions. Each state insurance department must adopt the revised Model Audit Rule by either statute or regulation. The Working Group will try to ensure that there is a uniform effective date for the model amendments by all states.

The Working Group also continues work on an Implementation Guide associated with the adopted amendments to the Model Audit Rule. The Implementation Guide is a supplement intended to provide interpretative guidance and clarification of terms used in the Model Audit Rule. Further amendments to the guide are required and will be addressed at the NAIC Fall National Meeting. The Working Group plans to forward the Implementation Guide to the E Committee at the Fall National Meeting for their approval.

The **Risk Assessment Working Group** deferred adoption of the revisions to the NAIC Financial Condition Examiners Handbook regarding the risk-focused guidance until the NAIC Fall National Meeting to address expressed concerns raised by the industry. The Working Group also discussed accreditation, transition and implementation issues.

The **Financial Examiners Handbook Technical Group** adopted revisions to the NAIC Financial Condition Examiners Handbook (Handbook) that were in response to the U.S. Treasury Department's final implementation rules for the USA PATRIOT Act. The rules require anti-money laundering programs for all insurers who sell or underwrite "covered products" as defined in the final implementation rules.

The Technical Group also adopted revisions to Exhibit K: Sample Letters of Representation included in the Handbook. The revisions incorporate information technology representations within the management representation letter.

2006 NAIC Meeting Schedule

Spring National Meeting:	March 4-7, Orlando, FL
Summer National Meeting:	June 10-13, Washington, DC
Fall National Meeting:	September 9-12, St. Louis, MO
Winter National Meeting:	December 9-12, San Antonio, TX

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2006 Millennium Consulting Group Seminars

Seminar	Seminar Date	Seminar Site
Investment Accounting and Reporting Workshop	June 26-27	Scottsdale, AZ
Introduction to Health Statutory Accounting and Reporting Seminar	July 24-26	Chicago, IL
2006 Health Annual Statement Preparation Seminar	August 28 – 31	Miami, FL
Claims Accounting and Reporting Workshop	September 14-15	Dallas, TX
Regulatory Update for Health Organizations Workshop - Midwest	September 25	Chicago, IL
Regulatory Update for Health Organizations Workshop - West	September 26	Newport Beach, CA
Regulatory Update for Health Organizations Workshop - East	September 27	Atlanta, GA
Regulatory Update for Health Organizations Workshop - Southwest	September 28	Dallas, TX
Introduction to Health Statutory Accounting and Reporting Seminar	November 27–29	Orlando, FL
2006 Health Annual Statement Preparation Seminar	December 4 - 7	Las Vegas, NV
2006 Risk-Based Capital Preparation Workshop	December 7-8	Las Vegas, NV
2006 Risk-Based Capital Preparation Workshop	January 15-16, 2007	Orlando, FL

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