



AMERICAN ACADEMY *of* ACTUARIES

April 30, 2012

Director Christina Urias
Solvency Modernization Initiative (EX) Task Force
National Association of Insurance Commissioners
Via email: c/o kdefrain@naic.org

Re: NAIC White Paper *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative*

On behalf of the American Academy of Actuaries¹ public policy practice groups² examining the National Association of Insurance Commissioners (NAIC) Solvency Modernization Initiative, we are pleased to submit comments on The draft *U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative*.

Our comments were developed to reflect the perspective of practicing actuaries in the United States, as well as with an intent of educating readers not fully familiar with the U.S. regulatory system. This report includes both technical and non-technical comments. Finally we offer our observations to augment your efforts to ensure the effectiveness and accuracy of the information presented in the paper.

¹ The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

² For the current white paper exposure, this includes the Risk Management and Financial Reporting Council Solvency Committee, the Life Practice Council, the Property and Casualty Risk-Based Capital Committee, and the Health Practice Solvency Work Group.

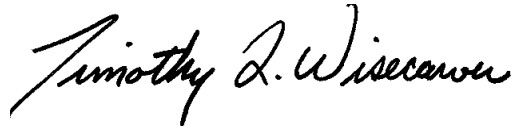
Sincerely,



R. Thomas Herget, FSA, MAAA, CERA
Chair, Solvency Committee



Alex Krutov, ASA, MAAA, FCAS, CERA
Chair, Property/Casualty RBC Committee



Tim Wisecarver, FCA, MAAA, FCAS
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Donna Novak, ASA, MAAA, FCA
Chair, Health Solvency Work Group



Cande Olsen, FSA, MAAA
Life Practice Council

Item	Observation	Suggestion
Overall	The paper does not stress the extensive use of standardized public disclosures in the U.S. system. This bolsters both the regulatory efforts (pillar 2) and the market discipline (pillar 3), and is currently unique in the world.	This needs to be stressed so that its importance can be understood by the outside reader unfamiliar with the U.S regulatory environment.
Overall	The paper does not stress the extensive nature of the financial examination process. Those outside the current U.S. insurance regulatory process might not appreciate the effectiveness of that regulatory tool in the U.S. without more discussion of the robustness of the current exam process.	The extensive nature of the financial examination process needs to be stressed so that its importance can be understood by the outside reader.
Overall	While the paper explains why at this point a standard formula rather than internal models is the best way to determine minimum regulatory capital, it should avoid negative statements about internal models.	Insert a statement that the use of internal models for solvency and capital management is encouraged (but not as a substitute for the standard formula).
Overall	It would help the reader to know what the intended purpose of this paper is as well as who the intended audience is.	Add such a statement at the beginning of the paper.
Overall	The flow of the paper could be improved. There are sections that are repetitive. These sections do not necessarily relate to each other. How they all come together to make their points could be clearer.	Perhaps reorganization along the lines of history of regulation, outcomes to date, evolving practices and future considerations could be a starting point.

Item	Observation	Suggestion
Page 3, Exec Summary – general	If this is written (primarily) for a non-US audience, the reader may not have an understanding of the US state- based regulatory system.	There should be a short overview of the state regulatory system and how it relates to the NAIC in the beginning of the paper.
Pages 3 and 4	The Executive Summary sets forth a series of comments under the heading “Regulatory Success”. These comments are either not clearly or not further developed elsewhere in the paper. It is also not clear why the concept of success is the first item discussed.	Include language demonstrating accomplishment of policyholder protection, maintaining available and affordable coverage, fostering successful insurance markets, and financial stability and reliability of insurers.
Page 3, par 5: The third sentence says “... regulators will liquidate an insurer, if necessary, to ensure ... successful rehabilitation outcomes.”	It seems incongruous to state that liquidation is part of rehabilitation. Rehabilitation implies survival, while liquidation is anything but survival.	This should to be reworded or eliminated.
Pages 3, 7, 8, 12 and 45	The U.S. Insurance Regulatory Mission is recited 5 times in the paper, including 4 times in the first 12 pages of text.	Review/organize the paper to eliminate unintended redundancy.
Page 4, par 7, first sentence: “The US ... regulatory system has a strong track record of protecting consumers and overseeing solvency...”	It is a statement that does not have supporting corroboration included with it.	Add examples or statistics, similar to what appears in the paragraph’s second sentence.
Page 4, par 7: “few (if any) SIFIs and limited connectivity between insurers and banks...”	This statement may be too strong. The acronym “SIFI” has not yet been defined in this paper. Even if there are few Systemically Important Financial Institutions and limited connectivity today, the situation could change in the future.	Consider modifying the sentence to reflect present-day nature.
Page 4, par 8	Regarding market regulation, U.S. publicly-traded insurers are subject to certain federal oversight of the markets (Securities and Exchange Commission (SEC)).	If market <i>conduct</i> is the intended subject, so indicate.

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Page 4, par 10 (and an overall comment)	There are inconsistencies among states, not only in terms of regulations, but in the level of expertise and resources.	Add a statement more clearly recognizing that state oversight varies. We recognize this may be contrary to what the NAIC sees as the purpose of this paper.
Page 4, par 11, “These financial oversight activities also allow regulators to look for new risk concentrations and/or optimistically-valued risks in order to prioritize companies and catch issues long before they become apparent in the marketplace.”	This statement should be substantiated.	Add examples.
Page 4, par 11: “Notably, the system maintains confidentiality...”	While the confidentiality of certain aspects of the NAIC's regulatory processes is understandable (e.g., not disclosing the name of the companies under regulatory review), this confidentiality can prevent regulators from demonstrating and quantifying the effectiveness of the regulatory process. As an example, the Financial Analysis Working Group (FAWG) process has been touted as an effective means for regulators from different states to review individual companies operating in their jurisdictions and industry trends in aggregate.	The NAIC might consider ways to demonstrate the effectiveness of its regulatory oversight process such as publishing a summary of the number of companies reviewed, how many reviews detected the looming insolvency, or led to a successful improvement in an insurer's financial condition. Also consider publishing redacted case studies where regulatory intervention prevented insolvencies.
Page 4, par 11: “... uniform financial reporting system...” and “Uniform and detailed reporting...”	There is uniformity in regulations emanating from the NAIC but they are not uniformly enacted by the states. While the blue blank itself may be uniform, the regulations and guidelines underlying the reporting of financial values for life and health companies vary by state and thus are not uniform. States codify model laws effective at different times. Actuarial Guidelines have relevancy that varies by state. States authorize differing permitted practices. Only 35 of 55 states have enacted Health	Either remove the word “uniform” in both sentences or describe the potential for state variations.

Item	Observation	Suggestion
	Risk-Based Capital (RBC). Actuaries must sign “state of filing” opinions.	
Page 4-5, par 11: “regulators try not to place too much reliance on the “over-optimism” that will exist in a company’s own measurement of regulatory capital needs.”	<ol style="list-style-type: none"> 1. This introduces an overstated comment, implying that companies always try to understate their capital needs. 2. Where does “optimism” affect capital requirements? Capital requirements are based on formula. 	<ol style="list-style-type: none"> 1. Change “will exist” to “may exist”. 2. Address this in the sentence.
Page 5, par 12: “In the U.S., regulators do not use RBC as an insolvency predictor in isolation, but rather, they rely upon other significant financial indicators and analysis.”	While RBC can be a significant indicator in life and health insurance insolvencies, it is not so for property & casualty insurers. Many P&C impairments are related to catastrophes, but catastrophe risk is not part of RBC. Combined and claims ratios are better predictors.	Consider adding this commentary.
Page 5, par 13: “... not all claims are covered in full but to the limits of coverage and types of policies specified in state law”.	This could be misread because the phrase “ <i>the limits of coverage</i> ” could be confused with contractual policy limits at first, rather than caps on recoveries from state law.	Suggest reword, perhaps by removing the word “the” so it reads “to limits of coverage and types of policies specified in state law”.
Page 6, par 15: “...uniform statutory accounting practices and procedures...”	See aforementioned comment on Page 4, par 11 on uniformity.	See aforementioned comment on Page 4, par 11 on uniformity.
Page 8, subtitle at top of page	The subtitle “Executive Summary” is confusing, as this appears to be only a summary of the Framework and Core Principles and not the entire paper.	Change to “Section 2 summary” or something similar, or delete.
Page 8, par 3: “The U.S. meets preconditions required for effective regulation.”	It is unclear on what is meant by this statement in the executive summary. It is later explained in the more detailed discussion (pg. 12, par 17), but someone only reading the executive summary could be confused.	Add a clarifying phrase at the end of the sentence, such as, “... in that it has the requisite authority to achieve its mission”, or “as defined in ICP #...”, or “as outlined by the IAIS in ...”

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Page 8, par 4	This paragraph omits any mention of the extensive disclosure requirements that exist today.	Suggest adding a third item to the list in the first sentence, such as “(3) extensive standardized public disclosures”.
Page 8, par 4	The on-site examinations of some countries can be very short, similar to what we would call a “visit” from a rating agency.	The NAIC should highlight the robustness of each state’s examination process. Add “extensive” before “on-site examinations” in the last sentence.
Page 8, par 5, second sentence	It is unclear how a “principle” can be an “action.”	The paper should reword its “principles” so that they are all principles. Alternatively, it could use a different term other than “principles.”
Page 8, par 6: “...the states’ adoption of model laws and model regulations...”	While accreditation is discussed on the next pages, the concept of states not necessarily adopting or enforcing these laws and regulations in their entirety is not addressed.	Consider forthrightly addressing this subject.
Page 9, par 7, first sentence	The first sentence implies that all states need to adopt model laws verbatim; this is not the requirement for accreditation. Internationally, there is a debate on several fronts between verbatim adoption of, versus substantial compliance with, model insurance laws. This paper should clarify how the U.S. views this concept.	Suggest a change, such as by saying “requires states to show substantial compliance with model laws and regulations ...” or something similar. (The same issue arises later in the paragraph where it says “laws, regulations and rules that must be adopted ...”.)
Page 9, par 8	Principles vs. the Implementation of Principles.	If in the paper it is desired to use the word principles, these 7 items should be reworded so that they are principles and not implementations of principles. For example, the first one could be “Insurers should report financial information on a regular, timely, transparent and consistent basis to allow for timely financial analysis of their condition and comparisons to other insurers.” (As worded they are more “pillars” of the U.S.

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		regulatory foundation than “principles”.)
Page 9, par 8, item (3)	The current wording does not stress the extensiveness of the exam process, such that these “examinations” may be viewed as no more than “visits” by some readers.	This should stress the extensiveness of the exam process.
Page 10, item (6): the last sentence.	The last sentence implies that some regulatory actions are not “enforced”. This may suggest an ineffective regulatory regime.	Delete this last sentence.
Pages 11 & 12, par 12: “A hallmark of the state regulatory system is its dynamic efforts to constantly improve the regulatory solvency system and adjust the system as needed, especially regarding inputs into the model used to determine asset, liability and capital requirements.”	While this is true, the U.S. solvency framework relies heavily on contributions by professional groups. This support is integral to the entire process.	Extend this paragraph to discuss and acknowledge role professional groups.
Pages 11 & 12, par 12	While there have been changes to the solvency system, the current regulatory process has not provided for timely or robust analysis of recent complex risks, such as the risks associated with variable annuity contracts or the more complex life insurance product designs.	Please address this observation.
Page 12, par 13: The last sentence “It is through the NAIC that insurers are provided ...”	Is it supposed to be “insurers” or “state insurance regulators”?	Change if it should be state insurance regulators.
Page 12, par 17: the wording under the subheading “... (Regulatory Authority)”		Consider adding a comment regarding the testing of resourcing and independence, for example, “State resources and maintenance of independence can be tested periodically.
Page 13, par 18: the phrase “adoption of these model laws”.	The phrase “adoption of these model laws” can imply adoption of the verbatim NAIC model by all states.	Reword to reflect “substantially similar” language

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Page 13, par 19, first sentence		Replace “leads” with “can lead”.
Page 13, par 19: missing item	Extensive standardized public disclosure is also a unique feature of the U.S. system that many outside the U.S. do not fully appreciate.	Add an item (3) – extensive standardized public disclosure.
Page 13, par 20: “To effectively regulate in such a large market, a risk-focused approach is utilized by state regulators.”	Have risk-focused examinations been in place long enough in all the states to make this statement?	Please evaluate and modify if appropriate.
Page 13, par 20: “Under a risk-focused approach, attention is focused on the greatest risks faced by insurers...”	A reader may find useful information on how the ORSA will dovetail with the risk-focused exam.	Suggest commenting on how the two may align. Perhaps state that the risk-based focus was the forerunner of ORSA if that is the case.
Page 14, par 23	This paragraph understates the extent of NAIC exams and implies verbatim adoption of model laws	Add the word “extensive” before “on-site examinations”. It is also recommended that the word “enactment” be qualified with regard to model laws, so as not to imply verbatim enactment.
Page 14, par 25: “Fifty states and the District of Columbia are currently accredited.”	Would it be clear to a non-US reader that this is all the states? Are the territories (mentioned earlier in the document) also supposed to be seeking accreditation?	It might be helpful to say “All of the fifty states, the District of Columbia and the territory of Puerto Rico are currently accredited.” This also impacts page 9, paragraph 6.
Page 15, par 26	Current wording implies verbatim adoption of model laws.	Reword the phrase “must adopt certain laws ...” so as not to suggest verbatim adoption.
Page 15, par 27	The current wording is awkward as “necessary” may be interpreted as an adjective of “management letter”.	In the last sentence of this paragraph, add a comma after “If necessary”.
Page 15, par 28	The wording implies verbatim adoption of model laws. The NAIC requirement is for “substantial similarity”, not verbatim adoption.	Reword the phrase “requires state adoption of model laws ...” so as not to suggest verbatim adoption.
Page 16, par 28 (7): “Each state has statutes requiring insurers to invest in a diversified portfolio...”	Are there not maximum investment limits?	If so, state.

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Page 16, par 28 (10): “For life and A&H insurers, reserve requirements must adhere to... actuarial standards”	For the fast reader, the omission of P&C makes it seem that they are exempt from actuarial standards.	Consider adding to the end of page 16, paragraph 28 (10) the following: “(Property/casualty reserves are principle-based, with reasonability control provided by the combination of an actuarial reserve opinion (subject to actuarial standards) and external audit requirements. In addition, required public disclosure of how prior estimates have moved help provide continual additional feedback regarding the reasonableness of reserve estimates.)”
Page 16, par 28	One component of solvency is reserve adequacy. For the past 25 years, life companies have had to perform cash flow testing to assert that reported reserves are adequate. This is missing from paragraph 28. This cash flow testing is really an internal model; the NAIC pioneered its use.	Add another bullet stating so.
Page 16: paragraph under “U.S Insurance Financial Solvency Regulatory Monitoring Requirements”	Current wording implies verbatim adoption of model laws.	Reword the phrase “laws, regulations and rules that must be adopted ...” so as not to suggest verbatim adoption.
Page 16: paragraph under “U.S Insurance Financial Solvency Regulatory Monitoring Requirements”	This paragraph should stress the importance of the extensive standardized financial reporting and disclosure requirements that are part of statutory accounting. This is a very strong part of the U.S. system that is not fully understood by others. This is an important difference from other systems throughout the world, and the Financial Analysis Solvency Tools (FAST) and FAWG system rely heavily on these disclosures.	Consider addressing.

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Page 16: first bullet labeled "(1)"	The phrase that says "Regulators are required to examine an insurer ..." provides no insight as to how extensive such an examination must be.	This needs more clarification, otherwise it is somewhat misleading. This is because for some countries' regulators, such an examination may be only a brief visit.
Page 16: bullet labeled "(2)"	The current order overemphasizes the importance of RBC. RBC is not a front-line defense; it is a back-line defense.	Reference RBC action levels after the discussion of FAST and FAWG, to be consistent with how these are used and relied upon in the U.S. insurance regulatory system.
Page 17, par 28 (2): "... those... performing poorly are prioritized for more detailed review by... FAWG"	It is unclear whether action by FAWG is mandatory.	FAWG details do appear on page 21 par 37 and on page 41 par 26. Reference to these upcoming paragraphs will let the reader know there will be elaboration.
Page 20, par 29	This paragraph does not address the transparency issue of the "principle".	Some mention of the transparency, i.e., the public nature of the information, should be added.
Page 20, par 30, last sentence	This sentence may be overlooked.	Can it be highlighted? Adding a sentence at the end such as "This uniformity of accounting is a major component of the calibration of company oversight and interventions "would help highlight the sentence that could be under-emphasized.
Page 20, par 31	The reader may not be familiar with an actuarial opinion.	The words "an actuarial opinion" could be footnoted to say: The formal actuarial opinion for life and health companies is supported by an actuarial memorandum and an actuarial report for P&C companies. The opining actuary is also subject to qualification and practice standards).

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Page 21, par 34	This paragraph understates the availability of substantial insurer data, such as via on-line services in standardized format or through Excel Add-ins.	This write-up should further discuss the extensive annual and quarterly financial statement information filed electronically with the states and the NAIC. (It is mentioned already, but almost in passing. It is key to the off-site monitoring.)
Page 21, par 34 & 35	No mention is made of special data calls and queries to insurers.	One of these paragraphs should mention special data calls and written queries to insurers that are triggered by this off-site monitoring.
Page 21, par 35: sentence starting with “When insurers with anomalous results...”	This sentence may be under-emphasized.	Can it be highlighted?
Page 22, par 37: last sentence	This sentence may be under-emphasized.	Can it be highlighted?
Page 22, par 38-43	This section understates the U.S. exam system.	There should be some mention of the Financial Examiners Handbook. There should also be mention of the various disciplines on the examination team and the length of time such exams take.
Page 22, par 41: “... practices and processes... to identify and mitigate risk are reviewed and assessed...”	The actual effectiveness of the risk mitigation (and internal controls) should be reviewed and assessed.	Add a sentence to state this.
Page 23, par 45	The mention of “state-specific minimum capital requirements” acknowledges the issue of state variations but is in contrast to the white paper’s contention of uniformity.	The issue of uniformity needs to be addressed throughout the paper.

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Page 23, par 45	This paragraph excludes several key items.	This paragraph, or elsewhere in principle 4, should mention actuarial reports, opinions, memorandums, asset adequacy testing for life companies, model audit rules and hazardous financial condition rules. It should also further stress the actuarial opinions and external audit requirements.
Page 23, par 46	The statement about the RBC amount explicitly considering the size and risk profile of the insurer, while technically correct, creates the impression of a level of precision not present in the RBC formula. The following sentence (higher charges for riskier lines/assets result in higher capital needed) is also too strong.	Reword sentences 4 and 5 the following way: "The RBC amount considers the size and risk profile of the insurer. The risk-based capital calculation is intended to provide for higher RBC charges for riskier assets or for riskier lines of business/products so that more capital is required as a result."
Page 23, par 48	These minimum reserve requirements do not apply to P&C companies and much of health insurance.	Qualify the term "insurers".
Page 24, par 50.(3)	There is not enough detail on dividend limitations.	It might help to state that the dividend limitation is based on recent earnings, retained earnings and surplus.
Page 24, par 51, last sentence	The last sentence implies that some regulatory actions are not "enforced" which seems counterintuitive and implies an ineffective regulatory regime.	Alternatively, state that "These regulatory <i>measures</i> are enforced as necessary."
Page 25, par 53	As currently worded, it may imply that the hazardous financial condition rules are a subset of the RBC system.	Remove the tie between the hazardous financial condition and RBC in the last sentence, perhaps by deleting that sentence entirely.
Page 26, principles 1-4	Some items are missing.	Add "Actuarial Opinion Model Law (Property & Casualty)" to these lists.
Page 28, par 1: the list	Lists can become outdated.	Add an "as-of" date to the text. There are other lists in this document that could benefit

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		from an “as-of” date.
Page 30, item (10)	This is now out of date due to recent developments.	Change to reflect the model law that provides for a certified reinsurer and the model regulation that addresses the reduction of collateral.
Page 33, item a “Sufficient Qualified Staff and Resources”	How are these qualifications defined? On what basis are insurance department staff and resources deemed qualified? What are the qualifications for regulatory actuaries?	This section could be expanded to inform the reader how sufficiency is measured and maintained.
Page 37, Section 3	While overall this reads very well, parts come across as an advocacy document.	For example, a word such as “ensuring” may be too strong.
Page 37, par 1, second sentence: “First, regulators eliminate or limit some risks...”		Add “and regulations” after “regulators”.
Page 37, par 2: the word “uniform”	The system is not uniform by state; laws are adopted with different wording; actuarial guidelines have varying effectiveness; permitted practices exist.	Rewrite and remove reference to uniform.
Page 37, par 2: “Within minutes, regulators can perform stress tests...”	We are not aware of this capability.	Suggest elaboration.
Page 37, par 4: “... high risk investment strategies led regulators <i>to consider...</i> imposing either defined limits or defined standards.”	This is unclear.	Make it clear as to whether or not either the Defined Limits or Defined Standards were actually imposed.
Page 37, par 4: “Upon establishing eligibility for filing in the annual statement ...”	What is being evaluated for eligibility? An asset? Also, isn’t the issue the admission or non-admission of the asset, not the “eligibility for filing”? The problem may be the use of in-house terminology that is less common to the outside world.	Reword the sentence.

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Page 38, par 6	The first sentence addresses assets in general while the other two sentences address a specific liability, reinsurance.	This paragraph could be clarified. Separate into two paragraphs.
Page 38, par 6: “authorized reinsurer	The meaning of the term “authorized reinsurer” may not be clear to some readers.	Define in a footnote.
Page 38, par 7: “The RBC capital requirement calculation varies based on the type of asset and while RBC does not tend to drive investments (because companies’ target capital levels are much higher than RBC), the RBC formula could have some influence on management decisions”	RBC does drive the choice of investments for life insurers. While the statement is true that life insurers hold capital in excess of minimum capital requirements, the required capital for certain investments is a deterrent. The statement that the RBC formula could have some influence on management decisions is also true, but presumably this is an unintended use of RBC. RBC was designed to identify weakly capitalized companies and not designed to influence management decisions.	The statement should be expanded upon to more fully explain in this paragraph RBC’s current applications.
Page 39, par 14: “... the specific RBC calculation for each company reflects the particular risks unique to that specific company.”	This is true to a degree, but the RBC does not reflect differences in all risks by company.	Recommend amplification
Page 39, par 16	We call to your attention the description of Total Adjusted Capital (TAC) which does not appear accurate to. TAC is based on a company’s surplus, with adjustment for specified items. What is described in this paragraph sounds more like the calculation of the ACL RBC.	State that: “TAC is generally the excess of assets (only those admitted for statutory purposes) over the reserves (calculated on the statutory basis) with some generally minor differences.”
Page 40, par 19	Schedule F for P&C companies is comparable to Schedule S for life and health companies.	The reference to Schedule F needs to be clarified or qualified.

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Page 40, par 19	The reader may not be familiar with “asset adequacy analysis” is.	Explain in a footnote: asset adequacy analysis is a model-based determination of various product groups under current and realistic scenarios that determine the initial amount of assets on the valuation date needed to fund prospective benefits and related expenses.
Page 41, par 22.1	This paragraph says that the IRIS ratios are confidential. The formulas are public and are calculated from public information. Thus it is misleading to say that the result of the ratio calculation is confidential, given that they can be freely calculated by the public.	Delete the word “confidential”.
Page 42, par 26: the FAWG	The FAWG can play a very important role. Their role and significance should be elaborated.	Adding a sentence that describes the qualifications of the individuals who comprise the FAWG. Perhaps repeating, if not slightly expanding, the “experienced, seasoned” description from page 17, par 28 (2) would suffice.
Page 42, par 27	This statement would benefit from being substantiated by providing additional details.	It would be good to add some relevant. For example, how many FAWG recommendations have been made?
Page 43, Financial Examination section	This section understates the examination process.	Recommend highlighting the different disciplines brought in for these examinations. Some mention should also be made of the independent actuarial analysis done as part of these examinations. This latter item adds a third actuarial review to the process (i.e., the appointed actuary, the external auditing actuary, and the financial examination actuary).

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Pages 46 through 57	Not all of the data presented here is critical to the regulatory process. What is needed is data related to the performance of the solvency regulation, including warning systems, etc.	Add data pertaining to how well the regulatory system has performed.
Pages 46 and 47: charts	The charts are interesting and informative, but they are only presented for P&C companies. The reader could think these metrics would be used for non-P&C companies.	Add comparable charts for life companies or just reference them and use the P&C as an example]
Page 47, Table 2	The number of groups in this table looks low, and is much lower than the number of groups reported to exist in Bests Aggregates & Averages (1,036 P&C organizations according to the 2011 edition – based on year-end 2010 filings). An extract of 2011 NAIC data (via SNL) showed over 1,100 groups plus unaffiliated companies (including RRGs) with over \$1M in 2011 direct written premium. The Table 2 group totals are also surprising due to the number reported to be selling just Commercial Auto (115, according to Table 1) versus the overall total selling any product (117, according to Table 2).	The data should be updated from its 2009 source to 2011 data.
Page 48, par 10, last sentence	The last sentence says that the data show that residual markets are quite small and points to Table 2. Table 2 does not appear to show residual market shares. If included, it would be better to show this data by line, where residual market lines is/can be significant. Is there an error in the table?	Either delete reference to residual markets or provide supporting data and/or reference.
Pages 48 & 49, Table 4	The table omits life and health.	Can columns be added for life and health?

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Page 51, table 6	This table shows comparative information between countries and U.S. states. While it might be factually accurate, it does little to suggest that the U.S. has a uniform regulatory focus. It seems to be suggesting that states are more different than alike. Also, it seems to be saying that many U.S. states have more weight (capacity) than most countries.	Some suggest this table be eliminated. Others think its value could be enhanced by including the U.S. in total. Could this table be used to somehow emphasize that it is more challenging to develop regulation in the diverse U.S. environment than in much smaller, more homogeneous countries?
Pages 51 & 52	It is unclear in both the chart (2) and the table (6) what lines of business have been aggregated in "Premium" and "Premium Volume."	Clarify
Page 53 & 54, table 7	Is it correct that there are zero health insurers licensed in California? We understand that California's health insurers are licensed by its Department of Managed Health Care (DMHC), a non-NAIC organization.	Copy a footnote similar to the footnote in Table 6. Or, since this is a paper about insurance regulation in the U.S., include either census data or DMHC data in the table.
Page 54-57, par 17-23: the 7 reasons why insurers should be regulated by states.	The section could be improved by addressing life and health issues, mentioning federal anti-trust laws and aligning the rationale with the assertion that state regulation is appropriate.	Incorporate these items into the text.
Page 56, par 20	On whether you intend to raise racial makeup as impacting regulatory structure.	Consider whether the statement is correct and whether differences in racial makeup lead to changes in regulatory structure.
Page 58, title	This section will become out of date as the SMI project moves along.	Add an "as-of" date to this section.
Page 58, par 4a and par 4d	These two bullets refer to actions started in 2007/2008.	Describe the current development of the two endeavors.
Page 59, par 6	The wording suggests that the current system began with the codification project. This would imply that nothing major existed prior to that date. In fact, statutory accounting began many decades previously. It was just not as formally codified until 2001.	Reword to acknowledge long history of statutory reporting.

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Page 59, par 9, last sentence: "SAP expenses acquisition costs ... yet GAAP capitalizes acquisition costs and expenses them over time."	While technically a correct statement, it is a misleading one. Statutory Accounting Practices (SAP) use the Commissioners' Reserve Valuation Method (CRVM), which mandates minimal funding in year one so that acquisition costs may be paid. The reserve then catches up over the lifetime of the policy. This is the same concept as used by Generally Accepted Accounting Principles (GAAP). GAAP uses a net level reserve; GAAP explicitly identifies the acquisition cost and capitalizes it, while SAP deducts it from a liability.	Provide a fuller example of differences.
Page 59-60, par 10	The reference to the IASB in 1997 is technically incorrect. It was the IASB's predecessor organization, the IASC that started this effort in 1997.	Correct via clarification or footnote.
Pages 60, 61 and 62: "Looking Forward"	These paragraphs go into detail about various accounting models. It is fundamental that a metric used to evaluate solvency depends intrinsically on the accounting basis used to measure assets and liabilities. However, there seems to be an overemphasis on the accounting basis. Insolvency is not caused by any accounting basis. It is usually caused by investment deterioration, policy design, underestimated claim reserves or management actions/inactions.	Add a paragraph stating that due to the risk-focused nature of the regulatory process, the choice of an accounting model to measure solvency is not the most critical item in assessing insurer viability. This aligns with the Pillar II / Pillar III preference of the NAIC. Naturally, a lot of work would need to be done if a new statutory accounting basis were introduced.
Page 63, par 23	Corporate governance also includes senior management, not just the board of directors.	The definition of corporate governance should include mention of senior management as well as the board of directors. Note that these terms are interpreted differently in different countries.
Page 64, par 30, the third charge	The third charge given to the Corporate Governance Working Group is buried in the bottom of this paragraph (as the last sentence of this paragraph).	The last sentence should be a stand-alone paragraph so that each of the three charges are emphasized.

Item	Observation	Suggestion
Page 64, par 31: "... existing laws... do not seem to recognize a board of directors' legal duties to policyholders."	Presumably the white paper on Governance will have a recommendation to this effect.	If so, consider adding
Page 66, par 36, last sentence	If the reader of this document is from outside the U.S., he or she may not know how to interpret the term "unauthorized" in the last sentence.	A footnote explanation may be necessary. The term is also used in paragraph 40.
Page 66, par 38: "Unrecoverable reinsurance balances have played a critical role in some of the largest insurance company insolvencies in recent years. Due to this high risk, ..."	While this is accurate for P&C business, it is not so for life insurers.	Insert the word "P&C" between "largest insurance" in the quoted sentence.
Pages 67-68, par 46 describes the new Credit for Reinsurance Model Law and Model Regulation in some detail.	This paragraph does not fully capture model Regulation section 8.A. (5) which addresses whether reductions in collateral may or may not apply to inforce reinsurance.	Edit fourth bullet in paragraph 46 to read as follows: "A certified reinsurer will be eligible for collateral reduction with respect to contracts entered into or renewed subsequent to certification, <i>provided that collateral was not previously provided for the risk.</i> "
Page 69, par 49	There is no mention of the fact that ORSA will provide a total company assessment of the risks (insurance and non-insurance) of the corporate group.	If agree, add sentence
Page 70, par 51, first sentence	The first sentence says that indirect approaches are more common, but does not clarify what the comparison is to. Is it more common than direct approaches? Or are indirect approaches more common for insurance regulators than non-insurance regulators?	Clarify

Item	Observation	Suggestion
Pages 71 & 72, par 60-65: “looking forward”	These paragraphs address group supervision. However, there is no mention of how the NAIC will address the IAIS’s ComFrame or the Joint Forum’s comparable initiative on financial conglomerates.	Add text that discusses this
Page 72, par 65	The phrase that the ORSA manual “states the expectation to require a report” is stronger than what is worded in the manual. The ORSA manual allows a regulator to require an ORSA report, but several regulators have stated that they do not anticipate utilizing that authority.	Reword the first sentence to acknowledge that while a regulator will have the authority to require an annual ORSA report, it will not be required if the regulator does not wish to request it.
Page 73, par 67: ORSA in general	This single paragraph does not discuss the scope and purpose of the ORSA. Significant work on this tool, both nationally and globally, is underway. While the ORSA may yet evolve, the discussion of the ORSA seems short.	Add text that discusses this without deemphasizing RBC.
Page 74, par 68	The statement would benefit from minor changes that avoid deemphasizing the role of RBC, the unnecessary/questionable reference to company size, and the somewhat unclear mention of “elastic means.”	The following edits are suggested (words to be deleted are underlined): “Risk-based capital (RBC) is an important <u>one of the methods</u> used to monitor the capital adequacy of insurers. The RBC calculation is a standardized approach to measuring a minimum amount of capital for an individual insurance company in consideration of its <u>size and risk profile</u> . The RBC provides an <u>elastic</u> means of setting the minimum regulatory capital requirement which reflects the degree of risk taken by the insurer as the primary determinant. The standardized RBC formulas specified by the NAIC are utilized by all of the states for life and P&C insurers.”
Page 74, par 68: “RBC is one of the methods used to monitor the capital	The purpose of RBC is to identify weakly-capitalized companies as well as trigger points for regulatory	Please reference the purpose of RBC.

Item	Observation	Suggestion
adequacy of insurers.”	action.	
Page 74, par 71, last sentence: “RBC was developed as a capital adequacy standard...”	<ol style="list-style-type: none"> 1. It is unclear from this statement that RBC is a minimum standard. 2. RBC was developed as a tool for regulators to identify weakly capitalized companies and to establish legal, objective means for regulatory action 	<ol style="list-style-type: none"> 1. Insert “minimum” before “capital adequacy”. 2. Please state accordingly
Page 74, par 71	The language may create the impression that RBC fully reflects all risk factors.”	<p>Replace the text with the following (a number of mostly minor changes): “RBC work began in the early 1990s to address the deficiencies inherent in simplistic minimum capital and surplus requirements (e.g., a fixed dollar amount such as \$1M). These deficiencies did not reflect differences that exist from one company to another, such as the riskiness of one line of business (e.g., auto insurance) compared to another (e.g., workers compensation insurance), the amount of premium volume, the riskiness of the investment portfolio, and many others. RBC was developed with the goal of establishing a minimum capital adequacy standard that considers the risks and characteristics of a specific insurer.</p>
Page 74, par 72	The description of RBC could benefit by reordering and additional description.	<p>Rewrite the entire paragraph.</p> <p>Do not mention the various action levels until after the RBC ratio is defined.</p> <p>Discuss adjustments for concentration and diversification.</p> <p>Each of the four action levels should then be described briefly.</p>

Item	Observation	Suggestion
Page 74, par 73	Could be bolstered by adding one more sentence:	“If a company is identified as a potentially weakly capitalized company, substantial individual company analysis and modeling of its risks and capital may be required.”
Page 75, par 76, third sentence	The sentence states “This annual financial statement filing must be audited...” The entire annual statement is not audited. The financial statements are audited, but not at the detail which also appears in the annual statement.	Modify the statement.
Page 75, par 78, “SMI regulators”	There are no SMI-only regulators.	Remove “SMI”
Page 75, par 78	The last sentence may be seen to imply that the choice between a standard formula and internal models is based only on the cost/benefit analysis, which is different from the logic elsewhere. It’s unnecessary and not necessarily appropriate to make a comparison between winding up and operating as a going concern in this context.	Rephrase the last sentence as follows: “The regulators believe that at this point a uniform approach to establishing minimum capital requirements creates a more reliable solvency monitoring tool than the use of internal models.”
Page 75, par 78, all	This paragraph could be strengthened.	A suggestion: “The mostly formulaic structure of RBC minimizes cost and efforts for most of the industry. Only potentially weakly capitalized companies have to do extensive modeling and individual company analysis if required to identify corrective action(s). Replacing current RBC with all or mostly internal models could also lead to a lack of a precisely-defined takeover point due to disagreements over model assumptions used (regulator vs. company).”

Item	Observation	Suggestion
Page 76, par 79, all	This paragraph could be strengthened.	A suggestion: "For life insurance, RBC assumes formula reserves are established to meet valuation standards such as one standard deviation or 70 CTE. RBC measures the additional risks in excess of reported reserves."
Page 76, par 80: "(and removing the current charges out of other risk calculations)"		Please clarify what "other risk" refers to.
Page 76, par 80: "We are also reviewing the credit risk calculation to improve the accuracy."	This can be strengthened to address the specific charge.	Append the end of the sentence with "by updating the formula for assets that were not prevalent at the time the formula was developed."
Page 76, par 81	In the P&C and health RBC formulas, the growth charge is a limited reflection of operational risk. In the life formula, operations risk may be viewed as a component of the C4 business risk.	Consider mentioning growth risk charges in this paragraph.
Page 76, par 82, second sentence	The wording of second sentence is unclear.	Rewrite the second sentence. "At least one required capital formula being proposed outside the U.S. relies on correlation matrices that allow for partial correlations between risk components, as opposed to the current U.S. approach that assumes either full or no correlation." The following sentence would then change "risk matrices" to "correlation matrices".
Page 76, par 83	<p>The statement can perhaps be viewed from an overly broad perspective in describing what is captured by the formula.</p> <p>The mention of both correlation and diversification may be unnecessary since one helps to measure the other.</p>	<p>Rephrase the last sentence as follows: "Additional elements in the RBC formula aim to address risk concentrations, correlations, and diversification. Examples include the bond concentration risk formula and the property/casualty business line diversification adjustment."</p> <p>Also consider not mentioning</p>

Item	Observation	Suggestion
		both correlation and diversification.
Page 76, par 84	The statement, regardless of whether it's factually correct, may create an impression that there is international consensus on this issue.	Consider rephrasing
Page 76, par 84: "The U.S. [regulators" ... verify that the overall capital level is appropriate..."	This is not precisely true. The regulators establish the trigger points for action based on judgment and knowledge of troubled companies.	Clarify
Page 76, par 86	The whole section (pages 74-77) may create an overly confident view of the current RBC system. In the future, this can also make it harder to introduce any improvements not listed in this section.	Change the language to: "In the continuous work on improving the RBC calculation methodology, the emphasis will always be on those advances in risk analysis that can be implemented in a credible fashion. Currently, numerous changes to RBC are being contemplated, ranging from public disclosure of company-specific RBC calculations to re-evaluation of the thresholds for the action and control levels. The SMI Roadmap will continue to be updated as we investigate these and other potential changes."