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NAIC Reserve and Capital Relief Proposal

State insurance commissioners are engaged in a long-term effort to reform reserve and required capital standards for life insurance companies. In light of current economic conditions, regulators are reviewing more immediate steps that can be taken to reform these standards, ensuring they are at appropriate levels while protecting consumers' interests.

About Reserves

State laws require life insurers to set aside enough assets to pay all claims on policies the company has issued. The amount of reserves and capital that a company is required to hold is based on inflexible formulas that, in certain situations and for certain products, produce requirements that are more conservative than necessary for prudent financial regulation. As a result, companies must commit capital to meet these overly conservative requirements—capital that could be used to develop new business or invest in the economy.

In recent years, the National Association of Insurance Commissioners (NAIC) has been working on a long-term reserve reform proposal known as Principles-based Reserves (PBR), which is supported by the life insurance industry. PBR would allow insurers to set reserves that more accurately reflect the actual risks inherent in the policies that they sell.

While the NAIC has been working with all due haste, implementation of PBR is still a few years away. Understanding that the current inflexible formulas coupled with the nation's financial turmoil may create undue stress on insurance companies' ability to carry on normal business operations, the NAIC began a project in Spring 2008 to identify reserve changes that could be made to provide a bridge between now and the time that PBR becomes effective.

Suggested Reserve and Required Capital Changes

Currently, life insurers have significantly more reserves and capital necessary to pay their future obligations. As a matter of fact, most insurers, as part of their normal business operations, hold some multiple of the level of capital than what is required by regulators. However, if today's market deterioration continues, insurers may be required to hold additional reserves and capital in order to meet state requirements. This would reduce the amount of capital that insurers have freely available for carrying on normal business operations, which includes investing in our economy and growing their businesses.

In response to the NAIC's project, the American Council of Life Insurers (ACLI) has suggested some changes to current standards that are overly conservative or don't work properly in periods when the economy is subject to unusual levels of stress. The changes would allow companies to set a more appropriate level of reserves to meet their obligations to policyholders while freeing up capital.

The suggested changes would not require immediate amendments to state laws or regulations and could be implemented by the NAIC and states in short order, taking effect December 31, 2008.

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The suggested changes impact four general areas of concern:

- Reserves for certain life insurance products;
- Reserve and capital requirements for variable annuities with guarantees;
- Capital requirements for commercial mortgages held by insurance companies; and
- Accounting for deferred taxes.

Because of differences in the product mixes of life insurance companies, the individual changes will have varying impacts upon companies. But, taken as a whole, most insurers would see a positive impact on their reserve and capital requirements.

None of these changes could be considered to "fix" long-standing concerns with the reserve methodologies contained in current regulations and actuarial guidelines, but they do provide some reserve and capital relief, while maintaining prudent standards that are necessary in the regulation of financial services companies.

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