



**BlueCross BlueShield
Association**

An Association of Independent
Blue Cross and Blue Shield Plans

A Blue Cross and Blue Shield Association Presentation

NAIC, FASB, Tax and Actuarial Issues Update

WESTERN CONFERENCE IOC FINANCE CAUCUS
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Agenda

- Actuarial and Solvency Issues
- FASB Issues
- Statutory Accounting and Reporting Issues
- Tax Issues
- Annual Financial Reporting Model Regulation
- Risk-Focused Surveillance
- Open Q&A

Actuarial & Solvency Issues

- ❑ Revised Health Actuarial Opinion Instructions
- ❑ Cost Containment Expenses versus Medical Benefits
- ❑ Health RBC Trend Test
- ❑ Revised Medicare Part D RBC Factors
- ❑ Solvency Modernization Initiative

2009 Health Actuarial Opinion

Major Revisions

Appointed Actuary	Table of Key Indicators	Actuarial Memorandum
<ul style="list-style-type: none">- Appointed by the Board of Directors by December 31- Commissioner notified within five business days- Report to the Board each year on the opinion items	<ul style="list-style-type: none">- Table of checkboxes at top of opinion- Opinion type (unqualified, qualified, adverse, or inconclusive)- Prescribed wording was used, added to, or modified	<ul style="list-style-type: none">- Confidential and is not intended for public inspection- Prepared to formally convey actuary's conclusions- Documents the data, assumptions, and analysis

Cost Containment Expenses

- ❑ Disease Management Association Proposal
 - Interpretation of SSAP 85, *Claim Adjustment Expenses*
 - Clarify when case management and disease management expenses classified as cost containment expenses versus medical claims expense
 - DMAA cited inconsistency among insurers and states
 - DMAA suggested that chronic care management programs be treated as medical claims expense when more than educational
 - The Accident & Health Working will discuss and make a recommendation to the Emerging Accounting Issues Working Group

Health RBC Trend Test

- ❑ Trend Test triggers Company Action Level
 - HRBC Ratio between 200% and 300%
 - Combine (claims and expenses) ratio of 105% or more
 - 2009 HRBC worksheets have this calculation added
- ❑ RBC for Health Organizations Model Act
 - Updated to include trend test as trigger
 - Must be re-adopted in a state to authorize the trigger
 - NAIC will consider making adoption an accreditation standard to encourage states to adopt it

Medicare Part D RBC Factors

Revised 2009 RBC Factors

Medicare Part D Business	Current Factor	Revised Factor
With risk corridors & reinsurance (up to \$25M)	0.0494	0.0585
With risk corridors & reinsurance (over \$25M)	0.0382	0.0352
With risk corridors only (up to \$25M)	0.0705	0.0836
With risk corridors only (over \$25M)	0.0545	0.0503
Supplemental Benefits (phased in over 2 years)	0.1200	0.2100 (2009) 0.3500 (2010)

Solvency Modernization Initiative

- ❑ International influence
 - Involved with solvency work of International Association of Insurance Supervisors
 - Considering implications of international accounting standards from International Accounting Standards Board
 - Considering other solvency systems (e.g., EU Solvency II)
- ❑ SMI Task Force formed with focus on:
 - Capital requirements
 - International accounting
 - Group supervision
 - Valuation issues in insurance
 - Reinsurance

Solvency Initiative Activities

❑ Capital Requirements

- “Total balance sheet” methodology - the total of reserve liabilities and required capital to absorb significant unforeseen losses
- Studying the use of internal models to replace the current factor-based approach

❑ International Accounting

- Considering the effects of International Financial Reporting Standards for US GAAP on statutory accounting
- Considering the effects of IASB/FASB joint projects on insurance contracts and financial instruments standards

Solvency Initiative Activities *(cont'd)*

□ Group Supervision

- Possible changes to the Holding Company Model Act
- Studying capital requirements defined on a group-of-insurers basis rather than on a legal entity basis

□ Valuation Issues in Insurance

- Developing principle-based reserving for life and annuity
- IASB/FASB insurance contracts project could have significant valuation effects

FSP FAS 115-2 and FAS 124-2

- ❖ FSP FAS 115-2 and FAS 124-2 - *Recognition and Presentation of Other Than Temporary Impairments*
 - Changes OTTI model for debt securities from intent and ability to hold to recovery to does not intend to sell the debt security or will not be required to sell the debt security
 - Even if no intent or requirement to sell an OTTI will still need to be recorded if a credit loss exists (the expected present value of cash flows is less than cost basis)
 - The loss is bifurcated - credit loss is recorded in earnings and the non-credit loss which is recognized in accumulated other comprehensive income in a separate category
 - Total OTTI is presented in statement with the separate components for OTTI recorded in earnings and amount in OCI

FSP FAS 157-4

- ❖ *FSP FAS 157-4- Determining Fair Value when the volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions that are not Orderly*
 - Provides factors to consider in determining whether a market is active or not or has experienced a significant decrease in volume
 - When determined the markets are not active security valuations can be derived from other sources and sufficient collaborative evidence is needed to support the valuation

Disclosures - FSP 157-4, FSP 107-1 and APB 28-1 and FAS 132(R)-1

- FAS 157-4 requires annual and interim disclosures of valuation techniques used to measure fair value or changes in valuation techniques by investment type
- FSP 107-1 and APB 28-1 increases the frequency of fair value disclosures from annual only to annual and quarterly
 - Also requires disclosure of significant assumptions for FV and assumption changes in the period
- FSP 132(R)-1 requires more detailed disclosures regarding pension plan assets including investment strategies, risk strategies and FV levels

FAS 165 Subsequent Events

- Defines subsequent events as “events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued”
 - “Available to be issued” relates to non-public companies
 - Subsequent events should be considered through the issued date
 - Events are categorized as “recognized” did it exist at BS date or “nonrecognized” subsequent events
 - Requires disclosure as to the date up to which subsequent events were considered.

Other Items

- Loss Contingencies - disclosure of highly speculative and highly confidential information
- Preliminary Views on Insurance Contracts - ED expected in late 2009
- Financial Instruments
- Revenue Recognition
- Codification
- Financial Statement Presentation
- Leases

Statutory Accounting and Reporting Issues Update

- SSAP 92: Postretirement Benefits Other Than Pensions; SSAP 100: Accounting for Pensions
- SSAP 10 and Deferred Tax Assets
- FAS 115-2 and 124-2: Recognition of Other-Than-Temporary Impairments
- INT 09-04: Application of the Fair Value Definition
- Issue Paper 138 - Fair Value Measurements

Statutory Accounting and Reporting Issues Update *(cont'd)*

- SSAP No. 98 (Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments)
- FIN 45: Guarantor's Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of Others
- Securities Lending
- Premium Tax Survey
- Investment of Insurers Model Act Revision (E) Working Group

AFRMR - State Adoption

- Model laws and regulations require action by states to become effective
 - Statute, if there is no existing statutory authority for regulator to act
 - Regulation, if there is existing authority to act
- F Committee adopted MAR as accreditation required during recent Summer National Meeting
- Currently, 23 States adopted MAR; 9 States publicly exposed guidance for comment and 19 States to complete by 2009 Y/E
- As of 2008 Y/E, 91% of total direct U.S. premium was subject to SEC SOX or NAIC AFRMR requirements; \$500M threshold unchanged

BCBSA AFRMR Implementation Survey

- 92% of Plans participated in Y/E 2008 survey
- Implementation status
- Departments responsible for implementation
- Plan Complexity
- Auditor attestation?
- Account groupings and total key controls identified
- SAS 70 report usage
- Compliance cost estimates - \$\$\$\$ and time
- 2010 fee based group

Challenges/Lessons Learned - AFRMR

- Define who is in charge: IA? Finance? SOX Coordinator? Business Owners? Consultants?
- Ensure that controls identified as “key” are sound
- Can external auditors rely on documentation and testing?
- Plan definition of material weakness/significant deficiency consistent with external auditors definition
- Perform only necessary documentation and testing; can always add more later if necessary
- End-User Controls – Identification of significant spreadsheets and end-user databases, development of classification scheme, and management review processes
- Entity Level Controls – Determining what testable information exists to demonstrate the “tone at the top”
- Information Technology – CobiT implementation
- Use risk-based approach to drive testing efficiency, not all processes will require the same amount of detailed testing

AFRMR Questions???

- How should controls be documented and tested by the insurer?
- How should Senior Management/BOD/Audit Committee be involved in reviewing the AFRMR documentation and testing?
- How will AFRMR control documentation and testing be reviewed by regulators?
- What actions can be taken against an insurer that does not comply with the AFRMR requirements?
- How will review of corporate governance be performed?

What is Risk-Focused Surveillance?

- Adopted by NAIC in 2006; accreditation standard for states in 2010
- Designed to assist regulators with identifying, assessing and monitoring solvency risks inherent in an insurer's operations on an organization-wide basis
- Detects insurers with potential financial trouble and provides clearer methodology for assessing residual risk and translating into examination procedures
- Assists regulators to be proactive and better positioned to identify and respond to serious threats to the financial stability of the insurer from current or emerging risks
- Expands beyond financial reporting risk and requires a continual and coordinated exchange of information between the financial examination and analysis functions
- Surveillance is flexible and based on the risk assessment of the insurer of any size – “will meet the company wherever they are”

Risk Focused Surveillance

- Regulatory risk-focused surveillance cycle involves five elements in developing an insurer profile
 - Examination (on-site)
 - Financial Analysis (off-site)
 - Internal/External Changes
 - Priority System
 - Supervisory Plan

Phases of Risk Focused Examination

➤ Planning Phases

- Phase 1: Understand the Company and Identify Key Functional Activities to be Reviewed
- Phase 2: Identify and Assess Inherent Risks in Activities
- Phase 3: Identify and Evaluate Risk Mitigation Strategies/Controls
- Phase 4: Determine Residual Risk

➤ Testing and Wrap-up Phases

- Phase 5: Establish/Conduct Exam Procedures
- Phase 6: Update Prioritization and Supervisory Plan
- Phase 7: Draft Examination Report and Management Letter Based on Findings

Risk Focused Exam Lessons Learned

- Start before the Examiners arrive on-site!
- If regulators don't request a "kick-off" meeting prior to arrival request one with the Chief Examiner and Chief Analyst participating
- For 2009, understand which examination approach will be used; 2010 risk-focused only
- Key challenge is matching your controls/risk activities with the Examiner's objectives - Never a perfect match
- Conclusion on risk/controls drives testing procedures in Phase 5 - too late if wait until in writing
- Request regular (weekly) meetings on status of requests
- Stay close to the Examiners progress and reconfirm examiners timetable for completion

Questions?

