

Investment Management & Oversight

Portfolio Accounting

October 6, 2011

Dallas/Fort Worth

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Reporting Standards

- ◆ GASB
- ◆ FASB
- ◆ Statutory (Other Comprehensive Basis of Accounting)

The Changing Statutory Landscape

- ◆ Investment accounting and reporting markedly changed since 2007
- ◆ Changes spurred on by capital markets seizure in late 2007
- ◆ Initial response to seizure was volatile at best
- ◆ Some semblance of calm returns in 2009 as hysteria abates
- ◆ While no end to changes is in sight, at least some recent stability is evident

Areas of Audit Focus

- ◆ Investments
- ◆ Loss and loss adjustment reserves and expenses
- ◆ Reinsurance Ceded
- ◆ Risk-based capital calculation

SSAP's Impacting Investments

- ◆ SSAP 43R establishes accounting and reporting principles for investments in loan-backed and structured securities
- ◆ SSAP 100, Fair Value Measurement defines fair value, establishes a framework for measuring fair value, and establishes fair value disclosure requirements
- ◆ Impact of adoption to NLC Mutual resulted in capital charges of \$4.8 ml over 2 years
- ◆ No additional charges since the end of 2010

Other Than Temporarily Impaired

- ◆ Indicated price represents $<80\%$ of cost for 6 consecutive months
- ◆ Drill down to structured security cashflows that meet this criteria
- ◆ If expected cashflows are confirmed, presents a stronger defense for no OTTI
- ◆ No defense for traditional debt as they are not structured with cashflows
- ◆ In every instance, get agreement with independent accountant where management defends amortized cost basis

Company Declarations

- ◆ Determination of fair value requires significant judgment
- ◆ Determining a forced or disorderly transaction requires judgment
- ◆ Defining whether a market is active or not requires judgment
- ◆ Determining whether impairment is OTTI often requires reasonable judgment

Fair Value Hierarchy

- ◆ Level 1 - Quoted prices in active markets for identical assets
- ◆ Level 2 - Inputs may be less observable than 1...pricing service may be utilized
- ◆ Level 3 - Modeled pricing may be utilized...a severe test based on underlying cash flows

Latest Statutory Guidance

- ◆ Investment-grade debt securities reported at amortized cost
- ◆ Practice provides greater stability than GAAP iro investment-grade debt
- ◆ Lower rated securities carried at lesser of cost or market
- ◆ OTTI securities carried at identifiable market value
- ◆ Market values may be determined by an office of the NAIC
- ◆ Stocks carried at fair/market value

Footnote Disclosures

- ◆ Have become more expansive since market seizure
- ◆ Attempts to quantify investment risk within portfolio
- ◆ Portfolio is now presented at the credit level within the notes
- ◆ Speaks to all recently adopted statutory pronouncements
- ◆ More extensive subsequent events testing
- ◆ Provides extensive tabled data on unrealized gains and losses

Footnote Disclosures (cont)

- ◆ FY 2007 statutory investment footnotes totaled 2 1/2 pages
- ◆ FY 2008 statutory investment footnotes total 5 pages
- ◆ FY 2010 statutory investment footnotes total 10 pages
- ◆ Guidance for disclosures provided by either FASB, GASB or SSAP