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NAIC Report: 2013 Summer National Meeting

September 3, 2013

The National Association of Insurance Commissioners (NAIC) met in Indianapolis, Indiana, from August 24-27, 2013. Typical for the mid-year meeting, activity largely consisted of reports by various task forces and working groups on the progress of ongoing projects. The only notable new initiative is work on obtaining NAIC support for Congressional reauthorization of the federal Terrorism Risk Insurance Act (TRIA). Indiana Insurance Commissioner Stephen Robertson, as host for the Indianapolis venue, presented the Commissioners with bats made by Indiana's Hoosier Bat Company. Continuing with the baseball theme, the Summer National Meeting was the baseball equivalent of a 1-1 game at the bottom of the 7th – not much excitement for the casual observer, but aspects to appreciate if you follow the game closely.

The following are notable highlights of the meeting.

A. Issues of General Interest

B. Issues of Particular Interest to Life Insurers

C. Issues of Particular Interest to Property and Casualty Insurers

A. Issues of General Interest

1. Corporate Governance – Working Group "Loaded for Bear" to Develop Model Law by Year-End

The Corporate Governance (E) Working Group of the SMI (E) Task Force plans to develop a model law by year-end that will require licensed insurers to file an annual report describing their corporate governance practices, and significant developments are expected by year-end. During the National Meeting, the Working Group heard a presentation from interested parties on concepts that should be included in a corporate governance model law and was presented with a draft model law prepared by industry representatives.

The industry draft, "Corporate Governance Annual Filing Model Act," would require each insurer (or its insurance group) to file an annual report describing its corporate governance practices *for informational purposes only* – the industry model would not create any substantive duties for insurers or their boards. The annual filing would include information on the insurer's (or its insurance group's) corporate governance framework, the policies and practices of its board of directors and its committees, and management's policies and practices. The industry draft would provide insurers with significant flexibility to provide information regarding corporate governance at the ultimate controlling parent level, an intermediate holding company level, or the legal entity level. The annual filing would be kept confidential.

Commissioner Susan Donegan (Vermont), Chair of the Working Group, described the industry draft as a "good attempt" and described herself and the Working Group as "loaded for bear" to get a final draft corporate governance model law ready for the winter meeting in Washington, D.C. The Working Group has formed two subgroups, the Internal Audit (E) Subgroup and the Drafting (E) Subgroup, that are tasked with developing model laws and reporting back to the Working Group. One issue that the Working Group (and its subgroups) will be wrestling with is to what extent the reporting requirements under the corporate governance model would be duplicative of the requirements under the Risk Management and Own Risk and Solvency Assessment Model Act (ORSA Model Act) or the 2010 amendments to the Model Insurance Holding Company System Act and Regulation (Holding Company Act Amendments). The Working Group's goal is to have the corporate governance model law effective in 2016, following the enterprise risk reporting requirement in 2014 and ORSA in 2015.

2. Reinsurance – NAIC Finalizes Procedures for Evaluating Foreign Jurisdictions

On the last day of the Summer Meeting, the Executive (EX) Committee and Plenary adopted the so-called "Process Document" that sets out procedures to be employed for designating "Qualified Jurisdictions" under the new provisions of the NAIC Credit for Reinsurance Model Law and Regulation (Reinsurance Models) that allow highly rated non-U.S. reinsurers to reinsure U.S. domestic cedents subject to reduced collateral requirements. Under the Reinsurance Models, the insurance department in the state of domicile of a ceding insurer may certify an unauthorized reinsurer for collateral reduction if the reinsurer is licensed and domiciled in a "qualified jurisdiction." The Process Document provides a process for the NAIC to evaluate the reinsurance supervisory systems of non-U.S. jurisdictions for the purpose of developing and maintaining a list of jurisdictions that are recommended for recognition as "qualified jurisdictions." Ultimately, approval of a qualified jurisdiction is left to individual states. However, a list of qualified jurisdictions will be created through the NAIC committee process, and individual states must consider the list when approving jurisdictions.

The Process Document provides that the NAIC's review of qualified jurisdictions will be an "outcomes-based comparison to financial solvency regulation under the NAIC Accreditation Program, adherence to international supervisory standards and relevant international guidance for recognition of reinsurance supervision." It further provides that "the NAIC must reasonably conclude the jurisdiction's reinsurance supervisory system achieves a level of effectiveness in financial solvency regulation that is deemed acceptable for purposes of reinsurance collateral reduction, that the jurisdiction's demonstrated practices and procedures with respect to reinsurance supervision are consistent with its reinsurance supervisory system, and that the jurisdiction's laws and practices satisfy the criteria required of qualified jurisdictions as set forth in [the Reinsurance Models]." An earlier draft of the Process Document was released for public comment during the NAIC's 2012 Fall National Meeting and again during the spring of this year.

During the Reinsurance (E) Task Force meeting, Director John Huff (Missouri), Vice Chair of the Task Force, reported on the next steps for the NAIC's determination of "qualified jurisdictions." Director Huff reported that the first order of business will be to establish a Qualified Jurisdiction Working Group that will be tasked with determining which non-U.S. jurisdictions are "qualified jurisdictions," in accordance with the Process Document. Director Huff recommended John Finston (California) to lead the Qualified Jurisdiction Working Group. The new Working Group will first review those jurisdictions that have been designated for "expedited review" under the Process Document (Bermuda, Germany, Switzerland and the U.K.). However, the Process Document does provide that the NAIC may consider extending the expedited review procedure to other jurisdictions that have been approved by a state as a "qualified jurisdiction," provided that certain additional requirements are met.

Jurisdictions designated for expedited review are eligible for a conditional designation as "qualified" based on an initial review of publicly available information, as supplemented by information necessary to update the public information. Conditionally qualified jurisdictions may be subsequently upgraded to fully qualified status. The conditional qualification lasts for one year, but can be extended. Director Huff reported that the Working Group will conduct a concurrent review of the jurisdictions designated for "expedited review," and will issue its approval for each jurisdiction on the same date so as to avoid any competitive disadvantage between jurisdictions. The Task Force is targeting year-end 2013 for these approvals. Thereafter, the Working Group will review additional jurisdictions, which will be prioritized by "objective" factors such as ceded premium volume and reinsurance capacity, but the NAIC will also act upon individual state requests.

The Reinsurance (E) Task Force also received a report on the inaugural meeting of the Reinsurance Financial Analysis Working Group (R-FAWG), which met in a closed session in Indianapolis. R-FAWG is tasked with providing advisory support and assistance to states in their review of reinsurance collateral reduction applications, determinations of "qualified jurisdiction" and "certified reinsurer" status, and coordinating multistate recognition of "certified reinsurers." Steve Johnson (Pennsylvania), Chair of R-FAWG, reported that this fall R-FAWG will be conducting a peer review of those reinsurers that have been designated as "certified reinsurers" by states to determine whether the Working Group agrees with the states' determinations. The hope is that this peer review process will make it easier for states to accept the "certified reinsurer" designations of other states (the Reinsurance Models permit a state to defer to the "certified reinsurer" designations of other states). R-FAWG plans on completing the peer review process for current certified reinsurers (and those certified this fall) by year-end so that states can "go live" with their reduced collateral requirements on January 1, 2014. To date, only Connecticut, Florida and New York have designated reinsurers as "certified" for purposes of reduced collateral, with a total of 29 reinsurers certified nationwide.

According to NAIC staff, changes to allow reduced reinsurance collateral have now been adopted by 18 states, representing approximately 53% of the total U.S. domestic insurance premium (the states are Alabama, California, Connecticut, Delaware, Florida, Georgia, Indiana, Iowa, Louisiana, Maine, Maryland, Missouri, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Virginia). The Staff also reports that, based on pending legislation, reduced collateral legislation is expected to be enacted in states representing 70% to 75% of total U.S. domestic insurance premium by year-end 2014.

3. The Solvency Modernization Initiative – Job Nearly Done, but Are There Redundancies?

The NAIC's Solvency Modernization Initiative (SMI) reached some milestones in Indianapolis, inviting the questions now of whether the individual states will do their part to implement SMI's reforms and also whether the reforms have simply created overlapping, redundant requirements.

SMI is a critical self-examination of the U.S. insurance solvency regulation framework that began in 2008. SMI includes a review of international developments regarding insurance supervision, banking supervision, and international accounting standards and their potential use in U.S. insurance regulation. While U.S. insurance solvency regulation is updated on a continuous basis, SMI's focus is on five key solvency areas: capital requirements, international accounting, insurance valuation, reinsurance, and group regulatory issues. In Indianapolis, significant milestones were reached when (i) the NAIC adopted the SMI White Paper: *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative*, (ii) the Holding Company Act Amendments were adopted as a state accreditation standard (effective January 1, 2016), and (iii) the ORSA Model Act was released for a one-year comment period (beginning January 1, 2014) for consideration as a state accreditation standard. See the sections of this Legal Alert addressing reduced collateral requirements (Section A(2)), corporate governance (Section A(1)), and PBR (Section B(1)) for updates on additional SMI initiatives.

<u>Holding Company Act Amendments</u>. The Financial Regulation Standards and Accreditation (F) Committee adopted a list of significant elements of the Holding Company Act Amendments that states will need to adopt in order to maintain their NAIC accreditation. The NAIC adopted the Holding Company Act Amendments in 2010 to address certain weaknesses in the regulation of insurance holding company systems (particularly with respect to enterprise risk) that were highlighted during the 2008 economic crisis. Most notably, the Holding Company Act Amendments include the following key changes: (i) the ultimate controlling person of every insurer subject to registration must file an "enterprise risk report" (Form F) annually, which must identify, to the best of the ultimate controlling person's knowledge and belief, the material risks within the insurance holding company system that could pose enterprise risk to the insurer, and (ii) any person seeking to divest its controlling interest in a domestic insurer must provide 30 days' prior notice to the state insurance department (which will then determine if prior approval is required). The requirements identified as "significant elements" of the Holding Company Act Amendments for state accreditation purposes include these key changes and others (including changes to reporting requirements for affiliate transactions). Now, the onus is on the states to ensure that their laws meet the NAIC's updated accreditation standards. The new standards become effective January 1, 2016. NAIC Staff reports that, to date, the Holding Company Act Amendments have been adopted in some form in 23 states (California, Connecticut, Georgia, Idaho, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Mississippi, Nebraska, Nevada, New Hampshire, New York, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, Vermont, West Virginia, and Wyoming).

<u>ORSA Model Act</u>. The Financial Regulation Standards and Accreditation (F) Committee released the ORSA Model Act for a one-year comment period (beginning January 1, 2014) for consideration as a state accreditation standard. Broadly speaking, the ORSA Model Act applies to domestic insurers that have annual direct written and unaffiliated assumed premium of more than $500 million or are part of an insurance group that has annual direct written and unaffiliated assumed premium of more than $1 billion. Insurers subject to the Act must "maintain a risk management framework to assist the insurer with identifying, assessing, monitoring, managing and reporting on its material and relevant risks." They must also perform an ORSA at least annually and at any time "there are significant changes to the risk profile

of the insurer" or its insurance group. Insurers must also file an ORSA Summary Report with their insurance commissioner if requested (but not more often than annually). The one-year comment period for the ORSA Model Act is consistent with the NAIC's standard procedures for adoption of a new accreditation standard and, if adoption of the ORSA Model Act for state accreditation purposes proceeds as planned, the ORSA Model Act will be adopted as a state accreditation standard two years following the end of the comment period (2017). Notwithstanding the 2017 target for state accreditation, during the Financial Regulation Standards and Accreditation (F) Committee's meeting in Indianapolis, Steve Johnson (Pennsylvania) reminded states that they have committed to adopting the ORSA Model Act by January 1, 2015, and that they should be striving towards that goal.

SMI White Paper. The Financial Condition (E) Committee adopted the SMI White Paper: *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative.* The White Paper, which has been a work in progress since SMI began, explains the U.S. solvency regulatory framework, and how and why it works successfully. It also discusses the SMI evaluation process, the strengths of the "national state-based system of insurance regulation," and the improvements made over the last several years through SMI.

The significant progress that the NAIC has made to modernize the regulation of insurance in the U.S. is commendable, but interested parties have voiced concerns that some of the new reporting requirements may be redundant. For example, the Holding Company Act Amendments require the annual filing of an enterprise risk report (Form F) that identifies all of the material risks within the insurance holding company system that could pose enterprise risk to the insurer, and the ORSA Model Act requires the filing of an ORSA Summary Report, which is a summary of an insurer's self-assessment of the material and relevant risks associated with its business plan and the sufficiency of capital to support those risks. Presumably, there will be significant overlap between the enterprise risk filing and the ORSA Summary Report. In response to these concerns, the Financial Condition (E) Committee has asked the Risk Focused Surveillance (E) Working Group to review any possible redundancies that may exist under the new SMI reporting requirements. However, Commissioner Joseph Torti III (Rhode Island), Chair of the Financial Condition (E) Committee, noted that he is concerned about a delay in state implementation of the various SMI requirements that may result. The Corporate Governance (E) Working Group will also be considering this redundancy issue as it develops the new corporate governance reporting requirements (See Section A(1) for more details).

4. International Regulatory Standards – U.S. Regulators are Wary

Although not at center stage as at recent NAIC meetings, the undercurrent of international regulatory issues was certainly palpable in Indianapolis. A number of regulators expressed concerns about the possible prescriptive effect that the International Association of Insurance Supervisors (IAIS) Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) might have on U.S. insurance regulation. The stated objectives of the IAIS ComFrame initiative include: (i) developing methods of operating group-wide supervision of internationally active insurance groups, and (ii) establishing a comprehensive framework for supervisors to address group-wide activities and risks. However, some regulators and industry representatives have voiced concerns that ComFrame will go beyond these objectives and add an additional unnecessary layer of regulation and costs for the insurance industry.

The International Insurance Relations (G) Committee met in Indianapolis and heard extended discussion on the Financial Stability Board's (FSB) direction to the IAIS to develop an international insurance supervisory system that includes group capital standards, as well as the progress of the IAIS ComFrame project. Industry groups and individual insurers pointed out that the FSB's directive further increases the danger of international banking regulators, without transparency or accountability, imposing bank-centric regulation on insurance regulatory systems. Industry uniformly urged U.S. regulators to coordinate with U.S. members of the FSB and reject the push toward global capital standards at the IAIS. As the IAIS ComFrame project moves toward release of a final "consultation" draft in October and prepares for field testing, the Property Casualty Insurers Association of America (PCI) strongly urged that the additional layer of unnecessary regulatory requirements imposed on global insurers by the current draft be removed, and that the preparatory work for the field testing process be made significantly more transparent. The Committee approved a draft of high-level NAIC principles on ComFrame, reiterating the NAIC's long-held position that ComFrame should remain as flexible and non-prescriptive as possible and not become a de facto additional layer of regulation.

On August 27, the FSB issued its "Peer Review of the United States" report, which observes shortcomings in the U.S. insurance regulatory system. The release of the FSB report coincided with the end of the Summer National Meeting, so release of the findings could not be discussed in Indianapolis. Stay tuned for our upcoming Sutherland Legal Alert discussing the FSB report and industry's reaction.

B. Issues of Particular Interest to Life Insurers

1. PBR Implementation Task Force Considers Captive and SPV Issues

In Indianapolis, the Principle-Based Reserving (PBR) Implementation (EX) Task Force received a referral from the Financial Condition (E) Committee regarding insurers' use of captives and special purpose vehicles (SPVs). Specifically, the referral requires the Task Force to consider several recommendations relating to the regulation of captives and SPVs that were made by the Captive and SPV Use Subgroup in its White Paper, *Captives and Special Purpose Vehicles: An NAIC White Paper.* The recommendations referred to the Task Force include recommendations relating to accounting considerations (to address perceived reserve redundancies that result from the NAIC's Regulation XXX and Actuarial Guideline 38 (AG 38, more commonly known as AXXX)), confidentiality, disclosure and transparency, and the need for related guidance in the Financial Analysis Handbook.

At the meeting, the heated discussion about captives between Steve Kinion, the Director of the Bureau of Captive and Financial Insurance Products in the Delaware Insurance Department, and Commissioner Joseph Torti III (Rhode Island), Co-Chair of the Task Force, ran out the clock. The captives and SPV agenda item was described by Commissioner Torti as "critical," so it was taken out of turn and pushed other items on the agenda to an interim meeting. Director Kinion argued that the Task Force's charge to "address any remaining XXX and AXXX problems without encouraging formation of significant legal structures utilizing captives to cede business" conflicts with Delaware law, and requested that the conflicting language be reconsidered or removed. Commissioner Torti responded that it would be inappropriate to change the charge after its adoption, and that the language is not necessarily in conflict insofar as the point is that captives and SPVs should be used only where necessary. Jumping into the fray, Robert Easton, Executive Deputy Superintendent of the Insurance Division of the New York Department of Financial Services, urged Delaware and other states to end all XXX and AXXX transactions. Director Kinion responded that this was "unacceptable."

The referral to the PBR Implementation Task Force fits nicely into the Task Force's mandate, which is two-fold: (i) to serve as the coordinating body for all NAIC technical groups involved with projects related to the PBR initiative for life and health policies, and (ii) to further assess the solvency implications of life insurer-owned captive insurers and alternative mechanisms. At the Spring National Meeting, Commissioner Torti had made clear that the Task Force's primary mission is to implement PBR, which has been meandering down a long and uncertain path for several years. The goal of PBR is to "right size" reserves for specific products with the hope of also addressing the issue of reserves, widely viewed as redundant, that result from the NAIC's Regulation XXX and AXXX. In 2009, the NAIC adopted a revised Model Standard Valuation Law, which authorizes PBR, and a Valuation Manual that sets forth the minimum reserve and related requirements for certain products under PBR. In 2012, the NAIC adopted the Valuation Manual, despite strong opposition from several key states (including New York and California). More recently, the NAIC has been considering whether states have the resources necessary to implement PBR. PBR will not be implemented until the amended Standard Valuation Law is adopted by 42 states and state adoption reflects 75% of total life insurance premium written in the U.S. This means that New York and California, two of the most vehement objectors to PBR, which have large volumes of life insurance premium written in their states, could, with one other state, derail the process.

The Captive and Special Purpose Vehicle (SPV) Use Subgroup did not meet in Indianapolis since its recommendations are now being considered by the PBR Task Force and Reinsurance (E) Task Force.

C. Issues of Particular Interest to Property and Casualty Insurers

1. NAIC Begins Work on TRIA Reauthorization

The NAIC's Government Relations (EX) Leadership Council (GRLC) approved a concise, strongly worded general resolution supporting federal reauthorization of the Terrorism Risk Insurance Act (TRIA). The resolution conspicuously avoided any specific details regarding reauthorization.

In an earlier meeting of the Terrorism Insurance Implementation Working Group, NAIC Staff reported that the NAIC's GRLC, not the Working Group, would consider a TRIA resolution. In the past, this Working Group has been the primary NAIC committee dealing with TRIA issues, but policymaking power on that issue has now been transferred to the GRLC. Thus, the Working Group will function in more of an advisory capacity, while also continuing to address implementation issues.

The Working Group heard a presentation from Dr. Gordon Woo of Risk Management Solutions (RMS) on modeling for terrorism risks, with a particular focus on the Boston Marathon bombing. Dr. Woo made the case that the risk of terrorism is uninsurable and that TRIA is needed.

In a presentation to the Working Group, Sutherland Of Counsel Tom Glassic and Bob Woody of the Property Casualty Insurers Association of America (PCI) discussed the practical issues regulators will likely confront as the expiration of the current TRIA program approaches in year-end 2014, including the use of conditional exclusions that cut off terrorism coverage after 2014 if TRIA is not reauthorized or is reauthorized with significant changes.

The Working Group later decided by conference call that the NAIC will comment formally, rather than informally, on the request of the President's Working Group on Financial Markets for comments on the current state of the terrorism insurance market and on TRIA reauthorization. The Working Group has scheduled subsequent calls in September to consider the substance of the NAIC's formal comments.

2. Mortgage Insurance – Work Continues on Overhaul of Existing Regulation

The Mortgage Guaranty Insurance (E) Working Group and industry representatives reported on their continued efforts to determine what changes, if any, are necessary for the solvency regulation of Private Mortgage Guaranty Insurance (PMI), including changes to the NAIC Mortgage Guaranty Insurers Model Act. Following the open session, Working Group members met in a closed session with representatives from the Federal Housing Finance Agency (FHFA), the federal agency tasked with regulating Fannie Mae and Freddie Mac.

The Working Group has made significant progress since the last national meeting, where interested parties discussed a list of proposed changes to the regulation of PMI insurers (known as the "Concepts List of Potential Regulatory Changes") that are intended to address significant issues facing the PMI market. The proposed changes reflected in the Concepts List are intended to address the following issues: (i) the overconcentration of mortgage origination activity, (ii) the market's tendency for long periods of profitability, punctuated by periods of varying duration of catastrophic loss, and (iii) the disincentive for attentive underwriting of PMI created by the market's tendency to provide long periods of great profitability. The Concepts List (which is being updated to reflect public comments provided during an exposure period) initially included the following potential changes:

- Require minimum underwriting standards.
- Change minimum capital requirements.
- Update and modify contingency reserve requirements.
- Abolish reinsurance requirements to concentrate resources and cut unnecessary overhead expenses.
- Prohibit captive reinsurance arrangements with originating banks.
- Create limitations on dividends beyond those required within the Holding Company Act that force insurers to retain capital in long profitable time periods for availability during periods of severe losses.
- Create a mutual reinsurance company that all insurers are required to use to house additional reserves for the bad times.
- Create some type of FDIC-like government entity as a backstop where premiums are paid in over the entire business cycle.
- Require new reporting requirements that break out types of risks/exposures (similar to the Financial Guaranty Exhibit) and are used to help determine/assess leverage and perhaps even be used for capital requirements.
- Re-establish the Home Owners' Loan Corporation to facilitate greater uniformity in the workout process for borrowers that meet criteria indicating viable prospects for retaining home ownership.
- Modify investment limitations to strengthen enforcement of prohibition of investment by mortgage guaranty insurers in mortgages and real estate that are not directly related to the ordinary conduct of their business in good faith.
- Establish rights and responsibilities for PMI insurers concerning rescissions of insurance policies and certificates.

Since the Spring National Meeting, the Working Group has obtained the approval of the Financial Condition (E) Committee and the Executive (EX) Committee for a Request for Model Law Development that would amend the Mortgage Guaranty Insurers Model Act to address the changes identified on the Concepts List (as updated to reflect public comments). Working Group members reported that they expect their work to speed up now that approval has been received and that an initial draft of the Model Act amendment should be released for public comment following their closed session meeting. The Working Group has assigned specific topics, which are expected to be addressed in the Model Act amendment, to member states for their review and consideration. Wisconsin, which chairs the Working Group, has been tasked with addressing investment limitations and issues relating to underwriting and quality assurance. Arizona has been tasked with addressing dividend limitations, contingency reserve requirements, capital maintenance requirements, and loss reserve estimates. The topic of rescission rights and responsibilities has been assigned to North Carolina. Pennsylvania, in turn, has been tasked with considering mandatory reinsurance requirements and lengthened periods for contingency reserves. Finally, New York has been tasked with considering potential restrictions relating to geographic concentration. Whether some or all of these changes are reflected in the Model Act amendment is an issue to watch for.

Birny Birnbaum, on behalf of the Center for Economic Justice, thanked the Working Group for its openness in the review process, but noted that the Working Group would be "missing the boat" if the amendments to the Model Act do not address two key issues: (i) the current market structure that permits mortgage originators and servicers (and their affiliates) to receive consideration in the sale of PMI (often to the detriment of insureds), and (ii) coordination between state regulatory requirements and the requirements that FHFA will impose on Fannie Mae and Freddie Mac for the purchase of mortgages. Steve Johnson (Pennsylvania) responded on behalf of the Working Group that these issues are being considered as part of the review process, and that the Working Group's goal is to establish a single regulatory model for PMI insurers that works for the FHFA and the states. Coordination between the FHFA and the states was expected to be a key issue during the closed session.

The Private Mortgage Guaranty Insurance Industry Group also reported on its work to develop a new risk-based capital (RBC) model for PMI insurers, which would be similar to the RBC requirements applicable to general insurers but specifically tailored for PMI. Currently, the Mortgage Guaranty Insurers Model Act requires that a mortgage guaranty insurer maintain a ratio of outstanding total liability (net of reinsurance) under its aggregate mortgage guaranty insurance policies to capital, surplus and contingency reserves of 25:1 or less. Regulators and interested parties have been actively discussing a move from a fixed solvency ratio requirement to a RBC regime for PMI insurers. The Industry Group has commissioned the consulting firm of Oliver Wyman to recommend a modeling approach that would be appropriate for PMI. During the Working Group meeting, representatives from the Industry Group reported that Oliver Wyman recently completed Phase I of the project and issued its report, which proposes a framework and methodology for the new model. The next steps for the Industry Group will include finalizing the capital model recommendation, soliciting feedback from the Working Group and other interested stakeholders, and commissioning the actual development of the model. The Industry Group has identified the following as key design principles for the model: (i) increased risk and premium sensitivity (the impact of macroeconomic factors should be incorporated), (ii) forward looking (capital should be assessed at multiple points in the future), (iii) comprehensive (stresses on both assets and liabilities should be included), and (iv) adaptable (flexibility to accommodate new product features and periodic review and back testing of the methodology). The Industry Group is scheduled to provide its next update on the model development at the NAIC's Fall National Meeting in Washington, D.C.

3. Risk Retention Groups – State Accreditation Standards May Be Expanded to Require Increased Regulation

The Risk Retention Group (E) Task Force is charged with monitoring and evaluating the work of other NAIC committees, task forces and working groups related to risk retention groups (RRGs). If any changes affect the NAIC state accreditation standards, this Task Force assesses whether (and how) those changes should apply to RRGs and their affiliates. As noted in Section A(3) above, the Financial Regulation Standards and Accreditation (F) Committee has adopted a list of significant elements of the 2010 Holding Company Act Amendments that states will need to adopt in order to maintain their NAIC accreditation, effective January 1, 2016. The RRG Task Force is currently considering which of those significant elements states will also be required to apply to RRGs in order to maintain their NAIC accreditation. It is expected that the Task Force will recommend that most of the significant elements applicable to general insurers also be applicable to RRGs. Most notably, this would include a requirement to file an enterprise risk report (Form F) annually and meet reporting requirements for any proposed divestment of "control" in an RRG. Next up, the RRG Task Force will be considering whether the requirements of the ORSA Model Act, discussed in Section A(3) above, should be applicable to RRGs.

Separately, the Financial Regulation Standards and Accreditation (F) Committee adopted an amendment to the Business Transacted with Producer Controlled Property/Casualty Insurer Model Act to remove the exemption provided for RRGs. The Model Act provides additional reporting and disclosure requirements for "licensed insurers" (previously defined to exclude RRGs) that are "controlled" by a producer for which they write a significant amount of business in any given year (gross written premium equal to 5% or more of admitted assets). Producer-controlled insurers are also subject to an audit committee requirement and substantive requirements governing the contract between the insurer and its controlling producer. While this amendment is noteworthy, it is only expected to impact a small number of RRGs because it is unlikely that most RRGs would meet the model's criteria for producer-controlled insurer, given that RRGs are owned by their member insureds.

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If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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