

PROJECT HISTORY-2021

INSURANCE HOLDING COMPANY SYSTEM MODEL ACT (#440)

INSURANCE HOLDING COMPANY SYSTEM MODEL REGULATION WITH REPORTING FORMS AND INSTRUCTIONS (\$3450) (Receivership)

1. Description of the Project, Issues Addressed, etc.

In 2020, the NAIC Plenary adopted a new charge for the Receivership Law (E) Working Group. The charge is still active and reads as follows:

“Review and provide recommendations for remedies to ensure the continuity of essential services and functions to an insurer in receivership by affiliated entities, including nonregulated entities. Among other solutions, this will encompass a review of the Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450) to provide proposed revisions to address the continuation of essential services through affiliated intercompany agreements in a receivership.”

Prior to, and prompting the need for, the adoption of this charge, the Receivership and Insolvency (E) Task Force performed a macroprudential analysis of the U.S. system of insurance regulation with respect to receivership laws compared to international standards under the Financial Stability Board (FSB) and under the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). At the 2019 Summer National Meeting, the Receivership and Insolvency (E) Task Force adopted a report including recommendations to address receivership powers that are implicit in state laws, rather than explicit. One such area is the power to ensure the continuity of essential services and functions within a holding company group once an insurer is placed into receivership.

The Task Force identified the following authority and remedies available within the U.S. regime related to these international standards:

- Model #440 requires approval of affiliated transactions, allowing a state insurance regulator to identify agreements that could create obstacles in a receivership. Model #450, Section 19, provides that cost sharing and management agreements specify if the insurer is placed in receivership that an affiliate has no automatic right to terminate the agreement.
- The receiver can take action against a provider that refuses to continue services under a contract or seek an order requiring it to turn over records. If an affiliate providing services is inextricably intertwined with the insurer, the receiver could also seek to place the affiliate into receivership.

However, it was noted that some of these authorities and remedies may not address the immediate need to continue services in some receiverships. Despite these available remedies, receivers continue to be challenged by this issue in receivership, often resulting in significant additional legal and administrative expenses to the receivership estate.

In 2020, the Receivership Law (E) Working Group was given the charge to provide recommendations for remedies to ensure the continuity of essential services and functions to an insurer in receivership by affiliated entities, including nonregulated entities and specifically for agreements with affiliated entities whose sole business purpose is to provide services to the insurance company.

2. Name of Group Responsible for Drafting the Model and States Participating.

The Receivership Law (E) Working Group of the Receivership and Insolvency (E) Task Force drafted the initial revisions to Model #440 and Model #450. The 2020 and 2021 members of the Subgroup were: Illinois (Co-Chair); Pennsylvania (Co-Chair); Arkansas; California; Colorado; Connecticut; Florida; Iowa; Louisiana (2021); Maine; Massachusetts; Michigan; Missouri; Nebraska; Texas; and Washington.

A drafting group was formed to draft the revisions. Members included: Florida; Illinois; Maine; Michigan; Oklahoma; Pennsylvania; and Texas.

3. Project Authorized by What Charge and Date First Given to the Group.

As described in paragraph 1 above, the initial charge prompting a review of Model #440 and Model #450 was given to the Receivership Law (E) Working Group for 2020. The Request for NAIC Model Law Development to open Model #440 and Model #450 for revision was adopted by the Executive (EX) Committee at the 2020 Summer National Meeting.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc.). Include any parties outside the members that participated.

In August 2020, the Receivership Law (E) Working Group began its work to address its charge by conducting a survey of state insurance regulators and interested parties to gather feedback on possible provisions to be addressed and goals of those revisions to Model #440 and Model #450. Survey responses were received from state insurance regulators and interested parties identifying specific sections of the models and topics to be considered.

5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited).

On Dec. 17, 2020, the Receivership Law (E) Working Group met in open session to expose proposed amendments to Section 5A and Section 11 of Model #440 and Section 19 of #450 for a 42-day public comment period ending Jan. 29, 2021. Comments were received from Florida; the American Council of Life Insurers (ACLI); America's Health Insurance Plans (AHIP) and the Blue Cross and Blue Shield Association (BCBSA); Arbor Strategies LLC; Morgan, Lewis & Bockius LLP and the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA); and the National Conference of Insurance Guaranty Funds (NCIGF).

On Feb. 4, 2021, the Receivership Law (E) Working Group met in open session to discuss comments received. Subsequent edits were drafted by the drafting group as discussed during the meeting. The Working Group exposed proposed revised amendments to Section 5A and Section 11 of Model #440 and Section 19 of #450 for a 14-day public comment period ending Feb. 4, 2021. Comments were received from AHIP and the BCBSA; the American Property Casualty Insurance Association (APCIA); Arbor Strategies LLC; and NOLHGA and the NCIGF.

On March 4, 2021, the Receivership Law (E) Working Group met in open session to discuss comments received. Subsequent edits were drafted as discussed during the meeting by the drafting group in coordination with the interested parties that had provided comments. The Working Group co-chairs released proposed revised amendments to Section 5A(1)(g) of Model #440 for a 30-day public comment period ending April 9, 2021. One comment letter was received from the ACLI. The ACLI's proposed edit was accepted.

All exposures were distributed by email to members, interested state insurance regulators and interested parties of both the Receivership Law (E) Working Group and the Receivership and Insolvency (E) Task Force and posted to the NAIC website.

All issues raised by members, interested state insurance regulators and interested parties were explained or addressed in the revisions to the original amendments.

The amendments were adopted by the Receivership Law (E) Working Group on May 4, 2021.

The amendments were adopted by the Receivership and Insolvency (E) Task Force on May 20, 2021.

The amendments were adopted by the Financial Condition (E) Committee on July 8, 2021.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response).

There were no unresolved issues of real significance raised during the exposure periods. However, the following issue was considered and addressed by the Receivership Law (E) Working Group. Interested parties requested and provided draft revisions to the amendments in Section 5.A.(1)(g) regarding the requirement for a bond or deposit that limits the provision to insurers found to be in a condition of hazardous financial condition or a condition that would be grounds for supervision, conservation or a delinquency proceeding. Interested parties also provided revisions to the subsection and the accompanying drafting note that would further define and clarify the circumstances and the agreements to which the subsection could be applied. The Working Group was agreeable to these changes and accepted interested parties' revisions. List the key provisions of the model (sections considered most essential to state adoption).

The amendments to Model #440 are within Section 5, Standards and Management of an Insurer Within an Insurance Holding Company System, and within Model #450 Section 19, Transactions Subject to Prior Notice.

- Section 5A(1) of Model #440
 - Books and records of the insurer are updated to specifically include data of the insurer, being the property of the insurer. The data and records should be identifiable and capable of segregation. Essentially the data and records should be available to the receiver in the event of insolvency, including the systems necessary to access them.
 - If the commissioner deems the insurer to be in a statutorily defined hazardous financial condition, the commissioner may require a bond or deposit, limited in amount, after consideration of whether there are concerns about the affiliated party's ability to fulfill the contract in the event of a liquidation.
 - Premiums are the property of the insurer, with any right of offset subject to receivership law.
- Section 5A(6) of Model #440
 - The affiliated entity is subject to jurisdiction of receivership court, and in certain circumstances the commissioner may require the affiliate to agree to this in writing.
- Section 19 of Model #450
 - Books and records of the insurer are updated to specifically include data of the insurer, being the property of the insurer. The data and records should be identifiable and capable of segregation. Essentially the data and records should be available to the receiver in the event of insolvency, including the systems necessary to access them. The data is specifically defined in Model #450.
 - Model #450 includes a provision relating to indemnification of the insurer in the event of gross negligence or willful misconduct by the affiliate.

- In the event of receivership (now including supervision and conservatorship):
 - The rights of the insurer extend to the receiver or guaranty fund.
 - The affiliate will make available essential personnel.
 - The affiliate will continue the services for a minimum period of time as specified in the agreement with timely payment for post-receivership work.
 - The affiliate will maintain necessary systems, programs or infrastructure and make them available to the receiver or commissioner for as long as the affiliate receives timely post-receivership payment unless released by the receiver, commissioner or receivership court.

7. Any Other Important Information (e.g., amending an accreditation standard).

The Receivership and Insolvency (E) Task Force has not had formal discussions with respect to whether the current Insurance Holding Company Systems accreditation standard under the NAIC Financial Regulation Standards and Accreditation Program should be amended to include the current revisions to Model #440 and Model #450. The Task Force will consider this and make appropriate referrals prior to the 2022 Spring National Meeting.

PROJECT HISTORY - 2020

INSURANCE HOLDING COMPANY SYSTEM MODEL ACT (#440)

INSURANCE HOLDING COMPANY SYSTEM MODEL REGULATION WITH REPORTING FORMS AND INSTRUCTIONS (#450) (Group Capital Calculation (GCC))

1. Description of the Project, Issues Addressed, etc.

In 2015, the NAIC Plenary adopted a charge to the Financial Condition (E) with respect to the construction of a group capital calculation (GCC). The Financial Condition (E) Committee subsequently formed the Group Capital Calculation (E) Working Group to carry out the following charge:

“Construct a U.S. group capital calculation using an RBC aggregation methodology; liaise as necessary with the ComFrame Development and Analysis (G) Working Group on international capital developments and consider group capital developments by the Federal Reserve Board, both of which may help inform the construction of a U.S. group capital calculation.”

The charge was developed primarily as a result of discussions that revealed that developing a GCC was a natural extension of work that state insurance regulators had already begun on group supervision as a result of the lessons learned from the 2008 financial crisis. While state insurance regulators currently have the authority to obtain information regarding the capital positions of non-insurance affiliates, they do not have a consistent analytical framework for evaluating such information. The GCC is designed to address this shortcoming and will serve as an additional financial metric that will assist state insurance regulators in identifying risks that may emanate from a holding company system. More specifically, the GCC and related reporting provides more transparency to state insurance regulators regarding insurance groups and make risks more identifiable and more easily quantified.

It is important to understand that the GCC utilizes an aggregation approach to group capital where existing legal entity capital requirements [e.g., risk-based capital (RBC)] and existing valuation for capital (e.g., statutory accounting) are utilized. In selecting this approach, it was recognized as satisfying state regulatory needs while at the same time having the advantages of being less burdensome and costly to regulators and the industry, in addition to respecting other jurisdictions’ existing capital regimes. To capture the risks associated with the entire insurance group, including the insurance holding company, calculations were developed in those instances where no RBC calculations currently exist (i.e., non-regulated entities) and are part of the GCC. The methods selected were tested in 2019 by more than 30 insurance groups representing 15 lead states. These methods have since been modified to consider the lessons learned from the testing and subsequent comments from the industry and state insurance regulators. The more significant items are discussed in paragraph 6 below.

Also important in finalizing the GCC was the scope of groups that would be required to complete it. Specifically, Model #440 exempts single-state companies, insurers located in reciprocal jurisdictions that have already recognized the U.S. approach to group supervision and group capital, as well as other jurisdictions that agree to recognize the U.S. approach to group capital. Model #450 also provides commissioners with additional discretion to exempt groups that have less than \$1 billion in premium, provided the group has no non-U.S. insurers, has no banks or similar financial institutions, and has non-risky non-regulated entities within the group.

2. Name of Group Responsible for Drafting the Model and States Participating.

The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee drafted the revisions to Model #440 and Model #450. The 2020 members of the Working Group were: Florida (Chair); Connecticut (Vice Chair); California; District of Columbia; Illinois; Indiana; Iowa; Massachusetts; Michigan; Minnesota; Missouri; Nebraska; New Jersey; New York; North Carolina; Ohio; Oregon; Pennsylvania; Tennessee; Texas; Virginia; and Wisconsin.

3. Project Authorized by What Charge and Date First Given to the Group.

At the 2015 Fall National Meeting, the Financial Condition (E) Committee received the following charge:

“Construct a U.S. group capital calculation using an RBC aggregation methodology; liaise as necessary with the ComFrame Development and Analysis (G) Working Group on international capital developments and consider group capital developments by the Federal Reserve Board, both of which may help inform the construction of a U.S. group capital calculation.”

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc.). Include any parties outside the members that participated.

The Group Capital Calculation (E) Working Group began its work on the GCC in 2016 and spent the next two-and-one-half years constructing the calculation. Over the course of that time, the Working Group conducted numerous public conference calls to discuss the proposed construction on a topic-by-topic basis. In 2019, the Working Group set up a voluntary process under which the GCC was tested by more than 30 insurance groups represented by 15 lead states. This testing was completed in early 2020, at which time the Working Group began to make changes to the GCC to reflect the learnings from the testing. Simultaneously with this testing, at the 2019 Fall National Meeting, the Executive (EX) Committee approved the Working Group’s request to open Model #440 and Model #450 to develop the legal authority under which the GCC would be implemented. In addition to requiring the filing of the GCC with the lead state commissioner, the models would also provide information on the types of insurance groups that would be exempt from filing the GCC, as well as provide the necessary language to protect the confidentiality of the tool.

In January 2020, the Working Group exposed for public comment a draft memorandum that set forth possible exemptions, as well as the basic construct for the confidentiality protections, based on previous public comments made by Working Group members. The first draft of amendments to Model #440 and Model #450 were drafted based on decisions made by Working Group members, with previous input from the industry considered by the Working Group members. This continued to be the case with respect to future versions of the model(s), although the Sept. 18 version was drafted with specific input from a small drafting group consisting of California, Nebraska, Missouri, Texas and Wisconsin.

NAIC staff met via conference call with representatives of the U.S. Department of the Treasury (Treasury Department) and the Office of the U.S. Trade Representative (USTR) on Sept. 10 and Oct. 14 to discuss their concerns regarding the consistency of the draft revisions to a covered agreement with the European Union (EU). (Please refer to discussion in paragraph 8.)

5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited).

At the 2019 Fall National Meeting, the Executive (EX) Committee approved the Working Group's request to open Model #440 and Model #450 to develop the legal authority under which the GCC would be implemented. In January 2020, the Working Group exposed for public comment a draft memorandum that set forth possible exemptions, as well as the basic construct for the confidentiality protections. Comments were received Feb. 17, 2020, but due to the COVID-19 pandemic, the first discussion of proposed changes to Model #440 and Model #450 did not occur until June 2, 2020.

During its June 2, 2020, call, the Working Group made several key decisions related to the comments on exemptions and subsequently released its first version of proposed changes to Model #440. Comments were received July 15, 2020, with numerous edits proposed by interested parties that were incorporated into a modified version for discussion by the Working Group on its July 21, 2020, call, including comments on subgroup reporting. Discussion on the subgroup reporting issue was deferred by the Working Group until decisions were made on all other comments, and the Working Group exposed for public comment proposed changes to Model #440, along with proposed changes to Model #450, on July 23, 2020. Comments on this exposure, which were largely focused on subgroup reporting, were discussed by the Working Group on its Sept. 18, 2020, call. The next version of Model #440 and Model #450 were exposed for a public comment period ending Oct. 5, 2020, with most of the changes from the July 23, 2020, version representing proposed revised wording from various interested parties intended to streamline both models. New versions of the models were produced and exposed following the Working Group's Oct. 20, 2020, call based on comments received Oct. 5, 2020, and discussed by the Working Group on its Oct. 20, 2020, call. The final versions of Model #440 and Model #450 were exposed Oct. 21, 2020, for a public comment period, and subsequently adopted by the Working Group on its Nov. 17, 2020, call.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response).

Significant issues which were ultimately addressed include:

1. Ability to exclude immaterial risky affiliates from the calculation.
2. Excluding recasting of XXX/AXXX transactions in the GCC.¹
3. Allowing a proxy level of senior debt to be added to capital that represents the subordinated capital controlled by the commissioner's authority over approving extraordinary dividends.
4. Inclusion of the concept of scalars to recognize U.S. reserve requirements are often much higher than other jurisdictions.
5. The level at which the GCC is calibrated with RBC (200%).
6. A subgroup capital calculation under which a lead state commissioner shall require the group capital calculation for U.S. operations of any non-U.S. based insurance holding company system if it is deemed appropriate by the lead state commissioner for prudential oversight and solvency monitoring purposes or for ensuring the competitiveness of the insurance marketplace. This particular aspect of Model #440 was the most controversial topic and was debated extensively, while other potential options failed to receive a majority vote.

7. List the key provisions of the model (sections considered most essential to state adoption).

The changes to Section 4L(2) of Model #440 are the most important provisions in the proposed changes, as they require the ultimate controlling person of every insurer subject to registration to concurrently file an annual GCC as directed by the lead state commissioner with the registration statement. Immediately following this provision in Section 4L(2)(a) through Section 4L(2)(d) are four types of holding company systems that are exempt from filing, which are also important to many parties. As previously discussed, Section 4L(2)(e) would permit, under certain circumstances, a subgroup capital calculation. Section 4L(2)(f) is also important, as it provides the commissioner the discretion to exempt other groups from filing that meet the criteria in Model #450. Finally, Section 8(A)(1) of Model #440 provides key statutory authority to hold the GCC confidential and actually prevents the group itself from sharing the GCC publicly. Model #450 provides more detailed aspects of the exemptions, including additional discretionary authority for exempting certain groups, as well as additional details of the NAIC process for maintaining a list of jurisdictions whose groups recognize and accept the GCC and are, therefore, exempt from filing the GCC.

8. Any Other Important Information (e.g., amending an accreditation standard).

a. Covered Agreement

Under Title V of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Treasury Department and the USTR are authorized to jointly negotiate covered agreements, defined under the Dodd-Frank Act as written bilateral or multilateral agreements between the U.S. and one or more foreign governments, authorities or regulators regarding prudential measures with respect to insurance or reinsurance, on the condition that the prudential measures subject to a covered agreement achieve a level of protection for insurance or reinsurance consumers that is “substantially equivalent” to the level of protection achieved under U.S. state insurance laws. On Sept. 22, 2017, the Treasury Department and the USTR signed the “Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance” (Covered Agreement). On Dec. 18, 2018, a separate covered agreement was signed between the U.S. and the United Kingdom, which mirrors the language from the agreement with the EU and has the same timing requirements for implementation.

The Covered Agreement includes requirements on reinsurance collateral, group supervision and group capital. Specifically, Article 4(h) provides that the host supervisor (i.e., a supervisory authority from the territory in which an insurance group has operations but which is not the territory where the worldwide parent is domiciled or headquartered) may not impose a group capital assessment or requirement at the level of the worldwide parent, but only if the insurance group is subject to a group capital assessment imposed by the home supervisor. The group capital assessment of the home supervisor must include a worldwide group capital calculation capturing risk at the level of the entire group, and the home supervisor must have the authority to impose preventive, corrective or otherwise responsive measures on the basis of the assessment, including the authority to impose capital measures where appropriate.

¹ “XXX/AXXX transactions” are those transactions required to be valued under Section 6 or Section 7 of the *Valuation of Life Insurance Policies Model Regulation* (#830).

Under Article 10(e) of the Covered Agreement, supervisory authorities in the EU shall not impose a group capital requirement at the level of the worldwide parent undertaking of the insurance or reinsurance group, with regard to a U.S. insurance or reinsurance group with operations in the EU, for 60 months after the date of

provisional application of the Covered Agreement; i.e., Nov. 7, 2022. The GCC is intended to serve as an analytical tool for evaluating an insurer's capital position at the group level but is not intended to be applied as a group-level capital requirement or standard. The *Statement of the United States on the Covered Agreement with the European Union* provides further clarification with respect to this group capital assessment.

The Covered Agreement limits the worldwide application of EU prudential group insurance measures on U.S. insurers operating in the EU. The Covered Agreement also provides that U.S. insurers and reinsurers can operate in the EU without the U.S. parent being subject to the group-level governance, solvency and capital, and reporting requirements of Solvency II, and reinforces that the EU system of prudential insurance supervision is not the system in the U.S. The Covered Agreement does not require development of a group capital standard or group capital requirement in the U.S. Article 4(h) contemplates that the states will develop a group-wide capital assessment. Through the NAIC, the states are in the process of developing a group capital calculation which is intended to serve as an analytical tool for evaluating a firm's capital position at the group level. **The U.S. expects that the NAIC's GCC will satisfy the "group capital assessment" condition of Article 4(h), provided that the work is completed and implemented within five years of the date on which the Agreement is signed.** [Emphasis added].

Any state with U.S. groups operating in either the European Union or the United Kingdom will need to adopt these legislative changes by Nov. 7, 2022, to effectuate compliance with the Covered Agreement.

b. Liquidity Stress Testing

In coordination with the work on the GCC, the Liquidity Assessment (EX) Subgroup of the Financial Stability (EX) Task Force drafted revisions to Model #440 to incorporate a liquidity stress test (LST) and to provide confidentiality requirements with respect to the LST. These revisions to Model #440, while not directly related to the GCC, are also intended to be considered for adoption by the NAIC membership simultaneously with the GCC-related revisions to Model #440. A separate Project History has been prepared with respect to the LST.

c. Accreditation

The Group Capital Calculation (E) Working Group has not had formal discussions with respect to whether the current Insurance Holding Company Systems accreditation standard under the NAIC Financial Regulation Standards and Accreditation Program should be amended to include the current revisions to Model #440 and Model #450. However, it is expected that these revisions will be incorporated into the accreditation standard in order to encourage the states to effectuate compliance with the Covered Agreement.

PROJECT HISTORY – 2011

INSURANCE HOLDING COMPANY SYSTEM MODEL ACT (#440)

INSURANCE HOLDING COMPANY SYSTEM MODEL REGULATION WITH REPORTING FORMS AND INSTRUCTIONS (#450)

1. Description of the Project, Issues Addressed, etc.

In the wake of the recent financial crisis as well as discussions regarding group supervision that have been taking place in the international regulatory community, U.S. state insurance regulators have become aware of the necessity to enhance the Insurance Holding Company System Model Act (Model #440) and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (Model #450) to address group supervision. At the heart of the lessons learned from the recent financial crisis is the ability of regulators to be able to assess the enterprise risk within a holding company system and its impact on an insurer within the group.

As recommended by the Group Solvency Issues (EX) Working Group, the U.S. insurer solvency regime should consider incorporating certain prudential benefits of group supervision, providing a clearer window into group operations, while building upon, the existing walls which provide solvency protection. Ultimately, this enhanced “windows and walls” approach should provide greater and much needed breadth and scope to solvency regulation while retaining the highest level of policyholder protection that exists currently. The concepts addressed in the enhanced “windows and walls” approach include such items, such as: communication between regulators; supervisory colleges; access to and collection of information; and enforcement measures.

The first step to accomplish building better windows is by addressing some of these topics as well as lessons learned during the recent financial crisis through enhancements to the insurance holding company laws and regulations.

2. Name of Group Responsible for Drafting the Model and States Participating

The Group Solvency Issues Working Group of the Executive (EX) Committee was charged by the Financial Condition (E) Committee with drafting revisions to Model #440 and Model #450. The 2010 members of the Working Group that drafted and adopted the revised models on June 14, 2010, were: Nebraska and Texas (co-Chairs), California, Connecticut, Delaware, Florida, Illinois, Iowa, New York, Pennsylvania and Wisconsin.

3. Project Authorized by What Charge and Date First Given to the Group

During the February 11, 2009, conference call, the Financial Condition (E) Committee agreed to revise the holding company models, but suggested the technical work be delegated to a Working Group under the Solvency Modernization Initiative (EX) Task Force that was working on other group related initiatives. Based on this recommendation and referral, the Task Force drafted charges for a new working group that would focus on groups issues, including the NAIC Holding Company Models. The Working Group’s charges related to the models were as follows:

- Study the need to modify the Holding Company Model Act by gathering input from all states regarding the use of the existing model and its effectiveness in addressing the issues that exist within insurer groups, particularly considering issues identified during this most recent economic downturn. At the conclusion of such study, provide a recommendation to the Financial Condition (E) Committee.

- Study the international solvency issues related to groups and the need to modify the Holding Company Model Act for any proposed changes in this area. This study should include consideration of the interaction between federal and state financial regulators and any changes that would be necessary to improve regulatory oversight provided by the Holding Company Model Act. At the conclusion of such study, provide a recommendation to the Financial Condition (E) Committee.

On August 18, 2009, the Financial Condition (E) Committee via electronic vote adopted the model law development form related to models #440 and #450. It was adopted by Executive and Plenary during the 2009 Fall National Meeting.

4. A General Description of the Drafting Process and Due Process

An initial survey of state insurance regulators and industry was conducted in June 2009 to gather ideas for areas of focus in drafting revisions to the Models focusing on area where the Models need improvement based on states' experience and the need for more focus on group issues. Twelve states submitted initial proposed language to address the eleven key topics identified in the initial survey.

Many open meetings were conducted to discuss this project. During these meetings, comment letters were discussed, and language was drafted (with some sections specifically assigned to interested parties or interested regulators to draft). Between May 2009 and June 2010, the Working Group conducted 15 public conference calls, five public meetings at NAIC National Meetings and one public interim hearing in June 2010. Financial Condition (E) Committee conducted three public conference calls.

Exposure drafts were released for public comment at multiple times. Public comment periods included December 2009, January 2010, March 2010, May 2010, June 2010 and July 2010.

All comment letters were considered and discussed by the Working Group in public sessions. In total, 27 comment letters were received from regulators and 36 comment letters were received from interested parties. Additionally, Financial Condition (E) Committee received and considered ten comment letters (one regulator and nine interested parties).

On June 18, 2010 the Working Group unanimously adopted revisions to Model #440 and #450 to be sent to Financial Condition (E) Committee for the Committee's consideration with the caveat that centralization data collection and confidentiality of enterprise risk supplemental filing should be addressed by Executive. E Committee met three times on August 5th adopted the revisions to the Models to be sent to Exec/Plenary.

Subsequent Discussions (Post Adoption by Financial Condition (E) Committee) – Director Ann Frohman and Danny Saenz, Chairs of GSIWG, and NAIC Legal and Executive Staff have engaged in numerous discussions with certain large industry trade organizations regarding the centralized filing of information at the NAIC. During these discussions these industry organizations were given significant time and opportunity to provide a compromise and to discuss these issues.

5. A Discussion of the Significant Issues

The following topics for revisions within the Models were discussed extensively with regulators and interested parties:

- a. Model #440 Section 1—definitions of “enterprise risk”.
 - Purpose of this change is to define a new term used in other revisions within the model.
 - This topic was addressed on GSIWG conference calls and the June 4th hearing. Interested party comments generally suggested replacing the definition of “contagion” with “enterprise

risk', and voiced concerns with the phrase "has the potential" and with the term "contagion" being speculative. Comments were heard and discussed. Definitions of contagion was eliminated enterprise risk was incorporated in the model.

- b. Model #440 Section 3A4—Notification of divestiture of controlling interests.
 - Purpose of this change is to allow for notification to the state of any divestiture of controlling interests. Regulators' have experienced divestitures that were not in the best interest of the policyholders and where regulators were not given prior notice.
 - This topic was introduced on the May 14th call with a separate exposure document released for comment. It was further discussed on the subsequent calls and the June 4th hearing. The GSIWG heard and discussed comments and made certain edits as a result.
- c. Model #440 Sections 3B12, 3B13, 4B8, 11F and Model #450 Form A Item #13 & Form B Item #9—The filing of a report of the ultimate controlling person which identifies material risks within the insurance holding company system that could pose financial and/or reputational contagion to the insurer and potential sanctions.
 - This change is in response to recent economic downturns and worldwide discussions on contagion risk within the financial sector. It is also in response to regulators' experience regarding the financial impact that non-insurance entities within the group can have on an insurance company's financial solvency. The change is intended to provide regulators with more information about potential risks to the insurer.
 - This topic was discussed on multiple calls, revised and new draft language was re-released for public comment. Subsequent edits were also made. Interested party comments primarily focusing on this section being too broad, inconsistent, and creation of the presumption that insurers need to over-comply with the provision in order to cover all foreseeable circumstances in their reporting were heard and discussed on subsequent calls and the June 4th hearing.
- d. Model #440 Section 4B5—Providing insurance holding company system financial statements.
 - This change is intended to provide regulators with access to more insurance holding company system information through the filing of holding company financial statements.
 - This topic was discussed on multiple GSIWG calls. Interested parties were heard and given the opportunity to submit optional draft language regarding SEC filings. Edits to the original draft language were made regarding the acceptance of SEC filings.
- e. Revisions as they relate to corporate governance including 1) Model #440 section 4B7 —Statements of the Board of Directors; and 2) Model #440 Section 5C—Independence of Board of directors and committees no longer being optional language and the section edited so as not to conflict with the Model Audit Rule.
 - Section 4B7 requires the insurer's board of directors to make statements regarding the corporate governance and internal control responsibilities within the registration statement. Section 5C was changed to no longer be an "optional" section of the model by the Working Group but was reversed by the E Committee. The section addresses board of director composition and committee responsibilities (which were edited to be in line with the Model Audit Rule). Additionally, a new paragraph with criteria for waiving the insurer from the requirements of the section was added.
 - These topics were discussed on multiple GSIWG calls and were referred to the Corporate Governance (EX) Working Group (CGWG). It was discussed by CGWG on two public conference calls where interested party comments were considered. Interested party concerns primarily related to suggestions to remove corporate governance language as it was felt is was not appropriate in these models or if not removed to modify the language to

reflect that management was “responsible for” and that boards “oversee” rather than stating boards were “responsible for”. CGWG made some edits, however retaining the “board is responsible for...” language and the no longer optional section 5C, and sent recommendations to GSIWG. GSIWG heard additional discussion at the June 4th hearing and made edits to section 5C waiver language.

- f. Model #440 Section 4K—Disclaimer of affiliation.
 - The change includes language regarding disallowance of a disclaimer of affiliation and request for an administrative hearing.
 - GSIWG discussed this recommended change on the Feb. 26th call and the June 4th hearing. Comments regarding wording changes were heard and edits were made.
- g. Model #440 Section 5A1b and Model #450 Section 19. Requirements of agreements for cost sharing services and management.
 - The intent of these changes is to provide minimum requirements for the agreements for cost sharing and management services in order to eliminate the potential for capital to flow out of the insurer through these types of agreements.
 - This topic was discussed on several GSIWG calls. Interested party comments were heard and considered. Numerous edits were made to the original draft language.
- h. Model #440 Section 5A2—Amendments or modifications of affiliated agreements.
 - The change requires notification of amendments and modifications to affiliated transactions including requirements for the notification. Included in the change is the addition of notification of all reinsurance pooling agreements and agreements that are projected to be material to surplus.
 - This topic was discussed on several GSIWG calls and the June 4th hearing. Numerous edits were made to the original draft language.
- i. Model #440 Section 6—Examination of affiliates, access to books and records and compelling production of information as it relates to examinations.
 - The changes to Section 6 are intended to give regulators power to examine the insurer and its affiliates, to provide better access to books and records of affiliated entities within the insurance holding company system and to compel the insurer to provide that access to those books and records in an effort to better ascertain the financial condition of the insurer and any contagion risk within the insurance holding company system.
 - The GSIWG addressed the topic on multiple conference calls including allowing interested parties to provide optional language. Interested parties expressed concerns about the potential for penalties and that the ability to examine an affiliate was overly broad and exceeded state jurisdictions. Proposed optional language was not accepted by GSIWG.
- j. Model #440 Section 7—Supervisory Colleges.
 - As there is a world-wide push for more group-wide supervision of insurance holding company systems with international operations, this new section provides the regulators the authority to recoup expenses incurred for attending or conducting supervisory colleges from domestic insurers whose group is engaging in international activities.
 - The Supervisory Colleges and Methods of Cross-Border Communication (EX) Subgroup met in open session and drafted the language for this new section of Model #440.
 - This topic was discussed on by the GSIWG and interested party comments were heard and considered. A few edits were made to the section by GSIWG.

6. Any Other Important Information

None