



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Sean Dillweg, Commissioner

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: ociinformation@wisconsin.gov
Web Address: oci.wi.gov

DATE: June 5, 2009
TO: David Vacca, NAIC
FROM: Roger A. Peterson
SUBJECT: Group Solvency Issues WG Questionnaire – Holding Company Act Changes

Overall Context: It is critical to remember that that holding company act is built on and consistent with the U.S. statutory construction in which solvency is measured at the legal entity level. Potential changes that are inconsistent with or detract from this construction will weaken not strengthen our solvency protections. Changes that enhance our ability to evaluate risks to the individual insurance companies as well as potential benefits from the holding company system should be emphasized. The Financial Analysis Handbook already contains general questions intended to identify strengths and weaknesses in the holding company system and how they affect the insurer. We can expand on that concept by considering the following points:

- The scope of our analysis should vary based on a number of factors including but not limited to the size of the insurance entities compared to the overall holding company system and the relative degree of interdependence.
- The scope of our analysis should be generally more limited for non-regulated entities versus regulated ones.
- Consideration should be given to requiring (based on materiality) documentation and reporting enterprise-wide risk management processes.
- Problems that have developed with affiliated relationships have been more due to lack of disclosure than rather insufficient authority within the holding company act.
- A codified requirement, at least in federal law, for regular communication, information-sharing and collaboration between the functional regulators within a holding company system should be advocated.

Observations or lessons learned: The experience with securities lending has disclosed a reporting weakness within our regulatory system. The risks associated with the re-investment of securities lending collateral was not adequately disclosed. Regulators are addressing this reporting weakness, but the larger question is how can these undisclosed affiliated transactions that add risk to the insurance company be avoided or discovered earlier. In that regard, we believe that an expansion of the collateral examination authority to specifically include broader risk categories such as liquidity, reputation, and ratings risks in the definition of "impact on the financial condition". As noted above, to successfully address this situation, the required regular communications, information-sharing and collaboration between the functional regulators is necessary.

Significant Statutory Enhancements: Wisconsin law contains a risk-based capital requirement known as Compulsory and Security Surplus. Compulsory and Security Surplus predates the NAIC Risk-Based Capital laws. Compulsory and Security Surplus is largely based on premium to surplus ratios with the authority to adjust the relevant factors as determined necessary by the commissioner. The normal

operation of the Compulsory and Security Surplus regulation does not allow credit for unauthorized reinsurance. By order, Wisconsin has allowed credit for unauthorized affiliated reinsurance in cases where recoverables are held in approved trusts and where necessary reporting requirements on the unauthorized reinsurer have been agreed to. We believe that material unauthorized affiliated reinsurance poses significant additional risks to U.S. regulated insurers due to different capital and reporting standards and the lack of arms-length negotiation of the non-US regulated affiliated insurers. Our application of the Compulsory and Security Surplus regulation attempts to deal with these risks while allowing the capital flexibility being sought.

Recommendations to enhance the Model Act: In addition to the points made above, Wisconsin recommends that the "fair and reasonable" standard for transactions between affiliates be strengthened by requiring that all services provided to the insurer be at actual cost.